CHARLOTTE RUSSE HOLDING INC
Form 10-Q
April 16, 2004
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UNITED STATES SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

FOR THE QUARTERLY PERIOD ENDED MARCH 27, 2004

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

COMMISSION FILE NUMBER 0-27677

CHARLOTTE RUSSE HOLDING, INC.

(Exact Name of Registrant as Specified in Its Charter)

DELAWARE	**33-0724325**
(State or Other Jurisdiction of Incorporation)	**(I.R.S. Employer Identification No.)**

4645 MORENA BOULEVARD

SAN DIEGO, CA 92117

(Address, including Zip Code, of Registrant s Principal Executive Offices)

(858) 587-1500

(Registrant s Telephone Number, Including Area Code)

SECURITIES REGISTERED PURSUANT TO SECTION 12 (b) OF THE ACT: NONE

SECURITIES REGISTERED PURSUANT TO SECTION 12 (g) OF THE ACT:

COMMON STOCK, PAR VALUE $0.01 PER SHARE

(Title of Each Class)

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 ¨

Indicate by check mark if the Registrant is an accelerated filer (as defined in Rule 12b-2 of the Act): Yes x No ¨

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date:

The number of shares of common stock outstanding as of April 9, 2004 was approximately 21,524,000.

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PART I. FINANCIAL INFORMATION

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CHARLOTTE RUSSE HOLDING, INC.

CONSOLIDATED BALANCE SHEETS

	March 27, 2004	September 27, 2003
	(Unaudited)	
ASSETS		
Current assets:		
Cash and cash equivalents	$ 40,980,029	$ 22,967,317
Inventories	37,644,811	34,506,912
Other current assets	2,894,129	5,410,123
Deferred tax assets	5,800,000	5,300,000
Total current assets	87,318,969	68,184,352
Fixed assets, net	100,316,252	100,018,536
Goodwill	28,790,000	28,790,000
Other assets	1,872,398	1,371,894
Total assets	$ 218,297,619	$ 198,364,782
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable, trade	$ 30,788,406	$ 20,928,264
Accounts payable, other	2,615,371	6,457,132
Accrued payroll and related expense	4,465,854	2,526,756
Income and sales taxes payable	3,620,315	2,320,337
Other current liabilities	10,622,221	9,886,267
Total current liabilities	52,112,167	42,118,756
Deferred rent	10,933,875	9,946,860
Other liabilities	317,777	312,777
Deferred tax liabilities	6,300,000	5,600,000
Total liabilities	69,663,819	57,978,393
Commitments and contingencies		
Stockholders equity:		
Preferred Stock $0.01 par value, 3,000,000 shares authorized, none issued and outstanding		
Common Stock $0.01 par value, 100,000,000 shares authorized, issued and outstanding shares 21,524,220 and 21,290,182 at March 27, 2004 and September 27, 2003, respectively	215,242	212,902
Additional paid-in capital	46,108,154	44,498,540
Deferred compensation	(9,000)	(63,000)
Retained earnings	102,319,404	95,737,947
Total stockholders equity	148,633,800	140,386,389
Total liabilities and stockholders equity	$ 218,297,619	$ 198,364,782

See accompanying notes.

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CHARLOTTE RUSSE HOLDING, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

	Three Months Ended		Six Months Ended	
	March 27, 2004	**March 29, 2003**	**March 27, 2004**	**March 29, 2003**
Net sales	$ 118,776,591	$ 93,098,703	$ 268,067,229	$ 226,427,339
Cost of goods sold, including buying, distribution and occupancy costs	93,767,147	74,841,538	203,883,718	171,578,511
Gross profit	25,009,444	18,257,165	64,183,511	54,848,828
Selling, general and administrative expenses	25,321,803	20,752,893	53,687,643	45,085,200
Store closing costs	(325,000)	5,500,000	(325,000)	5,500,000
Operating income (loss)	12,641	(7,995,728)	10,820,868	4,263,628
Other income (expense):				
Interest income, net	80,852	22,598	118,309	31,405
Other charges, net	(74,268)	(72,649)	(149,904)	(135,148)
Total other expense	6,584	(50,051)	(31,595)	(103,743)
Income (loss) before income taxes	19,225	(8,045,779)	10,789,273	4,159,885
Income taxes (benefit)	7,497	(3,137,854)	4,207,816	1,622,355
Net income (loss)	$ 11,728	$ (4,907,925)	$ 6,581,457	$ 2,537,530
Earnings (loss) per share:				
Basic	$ 0.00	$ (0.23)	$ 0.31	$ 0.12
Diluted	$ 0.00	$ (0.23)	$ 0.28	$ 0.11
Weighted average shares outstanding:				
Basic	21,510,966	21,236,375	21,437,504	21,225,797
Diluted	23,899,664	21,236,375	23,827,491	23,494,120

See accompanying notes.

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CHARLOTTE RUSSE HOLDING, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

	Three Months Ended		Six Months Ended	
	March 27, 2004	March 29, 2003	March 27, 2004	March 29, 2003
ities				
)	$ 11,728	$ (4,907,925)	$ 6,581,457	$ 2,537,530
econcile net income provided by (used in) es:				
l amortization	4,651,556	3,909,443	9,329,811	7,810,163
	595,271	179,560	987,015	689,305
deferred compensation	27,000	27,000	54,000	54,000
ent and disposal of	14,842	3,072,136	93,375	3,235,796
taxes	200,000	3,100,000	200,000	3,100,000
ting assets and				
	(3,434,563)	(9,505,060)	(3,137,899)	(1,364,363)
ets	1,809,050	(3,683,531)	2,515,994	(5,541,561)
e, trade	10,811,409	6,702,297	9,860,142	1,654,695
e, other	(2,767,946)	189,766	(3,841,761)	(1,395,284)
and related expense	(1,457,093)	(2,040,109)	1,939,098	(52,595)
taxes payable	(3,446,928)	(5,874,529)	1,692,783	341,633
bilities	(3,593,558)	(324,832)	735,954	3,491,436
		58,894	5,000	73,894
d by (used in) es	3,420,768	(9,096,890)	27,014,969	14,634,649
ties				
d assets	(2,010,411)	(6,203,399)	(9,676,641)	(10,672,081)
	(578,697)	(45,781)	(544,765)	13,457
investing activities	(2,589,108)	(6,249,180)	(10,221,406)	(10,658,624)
ities				
suance of common	241,982	131,570	1,219,149	164,070

				44,646	446	92,017
f common stock rcises	(6,295)	(63)	(13,470)			(13,533)
ommon stock for es	64,650	647	63,949			64,596

ommon stock for npensation	35,914	455	24,731			25,186	
ommon stock for tors compensation	10,000	5	2,154			2,159	
ity compensation	281,431	2,814	121,277			124,091	
compensation			186,128			186,128	
					1,359,639	1,359,639	$ 1,359,639
ncy translation				7,480		7,480	7,480
ve Income							$ 1,367,119
T JUNE 30, 2009	10,077,750	$ 100,778	$ 28,740,589	$ (76,355)	$ 1,066,322	$ 29,831,334	

Stock Options We maintain a stock option plan for the benefit of certain eligible employees and our directors. We have authorized 2,000,000 shares for grant under our Amended and Restated 2005 Stock Option Plan, and a total of 253,825 shares of common stock are reserved for additional grants of options at June 30, 2009. Generally, the options outstanding are granted at prices equal to the market value of our stock on the date of grant, generally vest over four years and expire over a period of six or ten years from the date of grant.

For the three and six months ended June 30, 2009, we recorded stock option compensation expense of $168,700 and $186,100, respectively, compared to $159,800 and $237,600, respectively, for the three and six months ended June 30, 2008. The compensation expense, net of tax effects, reduced diluted earnings per share by approximately $0.01 for the six months ended June 30, 2009 and 2008.

As of June 30, 2009, approximately $525,000 of total unrecognized compensation costs related to non-vested awards is expected to be recognized over a weighted average period of approximately 2.28 years.

The following table summarizes information about stock options at June 30, 2009:

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Range of Exercise Prices	Number Outstanding	Options Outstanding Weighted Average Remaining Contractual Life In Years	Weighted Average Exercise Price	Options Exercisable Number Exercisable	Weighted Average Exercise Price
$0.94 - $1.77	76,000	5.29	$0.28	17,500	$1.20
1.90 - 2.50	83,850	2.35	3.67	58,850	2.41
2.52 - 4.54	308,050	4.06	3.91	295,550	3.91
4.56 - 6.10	645,250	3.76	5.37	368,188	5.41
	1,113,150	3.84	$4.49	740,088	$4.47

We use the Black-Scholes option pricing model using weighted average assumptions for options granted to determine the fair value of options. The fair value of options at date of grant and the assumptions utilized to determine such values are indicated in the following table:

	Three Months Ended June 30, 2009	2008
Risk-free interest rate	1.49%	2.92%
Expected volatility	47.5%	37.4%
Expected life (in years)	3.0	3.0
Dividend yield		
Forfeitures	13.0%	0.0%

Option transactions under the 2005 Stock Option Plan during the second quarter ended June 30, 2009 are summarized as follows:

	Options	Weighted Average Exercise Price	Aggregate Intrinsic Value	Weighted Average Remaining Term
Outstanding at December 31, 2008	1,055,550	$ 4.43		
Granted	126,000	3.09		
Exercised	(64,650)	1.90		
Canceled/Forfeited	(3,750)	1.00		
Outstanding at June 30, 2009	1,113,150	$ 4.49	$ 1,904,445	3.59
Exercisable at June 30, 2009	740,088	$ 4.47	$ 1,277,764	3.19

Restricted Stock - In connection with our employment agreement dated as of December 1, 2006 with Gregg O. Lehman, Ph.D., our President and Chief Executive Officer, on January 1, 2007 we granted an award of 25,000 shares of restricted common stock to Mr. Lehman, which was valued at a price of $5.30 per share on the date of grant. This restricted common stock vested in three equal installments on the first of the year for each of 2007, 2008 and 2009. This restricted common stock has the same voting rights as common shares. For both the three and six months ended June 30, 2009, we recorded stock-based compensation related to this grant of $0 compared to $5,500 and $11,000, respectively, for the three and six months ended June 30, 2008.

On April 7, 2008, we granted an award of 10,000 shares of restricted stock to Wesley W. Winnekins, our Chief Financial Officer, under the Equity Incentive Plan (as defined below). This restricted common stock vests in two equal installments on December 31, 2008 and 2009. This restricted common stock has the same voting rights as common shares. For the three and six months ended June 30, 2009, we recorded stock-based compensation related to this grant of $3,300 and $6,600, respectively, compared to $0 and $11,000, respectively, for the three and six months ended June 30, 2008. This grant was valued using a price of $2.30 per share, which was the market value of our common stock on the date of the grant. As of June 30, 2009, $6,600 of unrecognized compensation costs related to the non-vested portion of this award will be recognized through December 31, 2009.

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On December 8, 2008, we granted an award of 10,000 shares of restricted stock to J. Mark McConnell, our Senior Vice President of Business Development under the Equity Incentive Plan (as defined below). This restricted common stock vests in three equal installments on December 8 for each of 2009, 2010 and 2011. This restricted common stock has the same voting rights as common shares. For the three and six months ended June 30, 2009, we recorded stock-based compensation related to this grant of $3,800 and $7,600, respectively. This grant was valued using a price of $2.48 per share, which was the market value of our common stock on the date of grant. As of June 30, 2009, $15,900 of unrecognized compensation costs related to the non-vested portion of this award will be recognized through November 30, 2011.

On February 26, 2009, we granted 35,914 shares of restricted stock to our executives under the Equity Incentive Plan (as defined below). This restricted common stock vests in four equal installments on February 26 of 2010, 2011, 2012, and 2013. This restricted common stock has the same voting rights as common shares. For the three and six months ended June 30, 2009, we recorded stock-based compensation related to this grant of $8,300 and $11,000, respectively. This grant was valued using a price of $1.77 per share, which was the market value of our common stock on the date of the grant. As of June 30, 2009, $52,500 of unrecognized compensation costs related to the non-vested portion of this award will be recognized through February 26, 2013.

On May 27, 2009, we granted 10,000 shares of restricted stock to Wendy D. Lynch, a board director. This restricted common stock vests in three equal installments on May 27 for each of 2010, 2011 and 2012. This restricted common stock has the same voting rights as common shares. For the three and six months ended June 30, 2009, we recorded stock-based compensation related to this grant of $2,200. This grant was valued using a price of $4.24 per share, which was the market value of our common stock on the date of grant. As of June 30, 2009, $41,200 of unrecognized compensation costs related to the non-vested portion of this award will be recognized through May 30, 2012.

Employee Stock Purchase Plan We maintain an Employee Stock Purchase Plan, which allows employees to purchase shares of our common stock at 95% of the fair market value. On May 27, 2009 we increased the total number of shares reserved for issuance under the Employee Stock Purchase Plan by 200,000 shares, thus increasing our total shares of common stock reserved for issuance to 700,000 of which 275,498 shares are unissued and remain available for issuance at June 30, 2009.

Equity Incentive Plan At our Annual Meeting of Shareholders on May 21, 2007, our shareholders approved the implementation of our 2007 Equity Incentive Plan (the Equity Plan). The Equity Plan was developed to provide our executives with restricted stock incentives if certain financial targets are achieved for calendar years 2007 through 2009. In lieu of selecting restricted stock, and at the discretion of our Board of Directors, executives can choose to receive a cash bonus under our 2007 Cash Incentive Plan (the Cash Plan). The performance objectives, and monetary potential of grants under the Cash Plan would be the same as those under the Equity Plan and participants would receive their cash bonuses at the same time as the restricted stock vests under the Equity Plan. Restricted stock granted under the Equity Plan through June 30, 2009, other than the restricted stock granted to our Chief Financial Officer in April 2008 and our Senior Vice President of Business Development in December 2008 as described previously, is earned on an annual basis upon achievement of certain financial objectives for each of 2007, 2008 and 2009. All such shares earned during these years will vest upon completion of our 2009 annual audit. For the three and six months ended June 30, 2009, we recorded $62,000 and $124,000, respectively, of stock-based compensation related to elections under the Equity Plan, which was valued using a price of $5.56 per share, the market value of our common stock on the grant date. We also accrued $7,100 of bonus expense related to elections under the Cash Plan for both the three and six months ended June 30, 2009. As of June 30, 2009, $215,000 of unrecognized compensation costs related to the non-vested portion of this program will be recognized through March 2010.

Common Stock Repurchase Plan During 2008, we repurchased 570,680 common shares at an aggregate cost of $2.3 million, including commissions of $34,000. All repurchased shares have been retired. These purchases concluded the common stock repurchase plan, announced on March 24, 2008, authorizing the Company to repurchase up to $2.5 million of its outstanding common stock.

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Reverse Stock Split On October 6, 2008 we completed a one-for-two reverse stock split in order to qualify for listing on the American Stock Exchange, now known as the NYSE AMEX. Except where specifically indicated, all common share information (including information related to stock options and other equity awards) and all per share information related to our common stock in this report has been restated to reflect the one-for-two reverse split. Pursuant to provisions in our stock options agreements and equity plans, the number of common shares available for purchase and issuance under these agreements and plans, and the exercise prices, were automatically adjusted to give proportionate effect to this reverse split.

NOTE 7**.** CONTINGENCIES

Legal Proceedings We are involved in various claims and lawsuits incidental to the operation of our business. We believe that the outcome of such claims will not have a material adverse effect on our financial condition, results of operation, or cash flows.

Automotive Bankruptcies On April 30, 2009, an automotive customer in our fitness management segment filed for bankruptcy protection under Chapter 11. Our outstanding receivable from this customer was approximately $34,000. The customer has paid the outstanding balance and continues to make timely payments on the continued monthly service billings. In addition, we collected receivable payments of approximately $137,000 from the customer during the 90 days before the bankruptcy filing. Such payments may constitute preferential payments recoverable under the Bankruptcy Code. We believe we have valid defenses to any potential claim for these payments and will not be required to repay the full amount. This customer has assumed our contract as of May 22, 2009. On June 1, 2009, another automotive customer in our fitness management segment filed for bankruptcy protection under Chapter 11. Our outstanding receivable from this customer was approximately $283,000. The customer has paid the outstanding balance and continues to make timely payments on the continued monthly service billings. In addition, we collected receivable payments of approximately $110,000 from the customer during the 90 days before bankruptcy. Such payments may constitute preferential payments recoverable under the Bankruptcy Code. We believe we also have valid defenses to any potential claim for these payments. This customer has assumed our contracts as of July 10, 2009. Our revenue from these customers was approximately $2,909,000 and $746,000 for the year ended December 31, 2008 and the six months ended June 30, 2009, respectively.

ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

You should read the following discussion and analysis of our financial condition and results of operations together with our financial statements and the related notes appearing under Item 1 of Part 1. Some of the information contained in this discussion and analysis or set forth elsewhere in this quarterly report, including information with respect to our plans and strategy for our business and expected financial results, includes forward-looking statements that involve risks and uncertainties. You should review the Risk Factors under Item 1A of the Company s Annual Report on Form 10-K for the fiscal year ended December 31, 2008 for a discussion of important factors that could cause actual results to differ materially from the results described in or implied by the forward-looking statements contained in the following discussion and analysis.

CRITICAL ACCOUNTING POLICIES

Our most critical accounting policies, which are those that require significant judgment, include: revenue recognition, trade and other accounts receivable, goodwill and stock-based compensation. A more in-depth description of these can be found in Note 3 to the interim consolidated financial statements included in this Quarterly Report and Note 1 of our Annual Report on Form 10-K for the fiscal year ended December 31, 2008.

BUSINESS DESCRIPTION

As a leading provider of population health improvement services and programs to corporations, hospitals, communities and universities located in the United States and Canada, we currently manage 204 corporate fitness center sites, 171 corporate health management sites and 87 unstaffed health management programs.

We provide staffing services as well as a comprehensive menu of programs, products and consulting services within our Health Management and Fitness Management business segments. Our broad suite of services enables our clients employees to live healthier lives, and our clients to control rising healthcare costs, through participation in our assessment, education, coaching, physical activity, weight management and wellness program services, which can be offered as follows: (i) through on-site fitness centers we manage; (ii) remotely via the web; and (iii) through telephonic health coaching.

RESULTS OF OPERATIONS

The following table sets forth our statement of operations data as a percentage of total revenues for the quarter ended June 30, 2009 and 2008:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
REVENUE	100.0%	100.0%	100.0%	100.0%
COSTS OF REVENUE	70.1%	70.6%	68.7%	71.0%
GROSS PROFIT	29.9%	29.4%	31.3%	29.0%
OPERATING EXPENSES				
Salaries	16.9%	16.1%	16.1%	16.0%
Other selling, general and administrative	9.5%	9.8%	9.0%	9.6%
Amortization of acquired intangible assets	0.1%	0.2%	0.1%	0.2%
Total operating expenses	26.5%	26.1%	25.2%	25.8%
OPERATING INCOME	3.4%	3.3%	6.1%	3.2%
OTHER INCOME (EXPENSE)	0.0%	0.0%	0.0%	0.0%
EARNINGS BEFORE INCOME TAXES	3.4%	3.3%	6.1%	3.2%
INCOME TAX EXPENSE	1.5%	1.4%	2.6%	1.4%
NET EARNINGS	1.9%	1.9%	3.5%	1.8%

Results of Operations for the quarter ended June 30, 2009 compared to the quarter ended June 30, 2008.

Revenue. Revenue decreased $34,000 or 0.2%, to $18,781,000 for the three months ended June 30, 2009, from $18,815,000 for the three months ended June 30, 2008.

Fitness Management

Our Fitness Management segment declined 5.1%, or $542,000, which included a decline in staffing services of $565,000 or 5.7%, and a slight increase in program services of $23,000, or 3.5%**.** This overall revenue decline is primarily due to contract terminations we experienced in 2008 and 2009 related to customer reaction to the

recessionary business climate. The increase in program services, as compared to last year, was primarily due to increased participation in walking programs and eHealth platform participation.

Health Management

Our Health Management segment contributed total revenue growth of 6.1%, or $507,000, which included overall growth from staffing services of $81,000, or 1.8%, and growth from program services of $426,000, or 11.3%. Overall, the growth in staffing revenue is attributable to new customers and the expansion of sales to existing customers. The increase in program services, compared to last year, was primarily driven by an increase in health coaching and advising services.

2009 Customer Commitments and Cancellations

For the three months ended June 30, 2009, the Company received a total of three health management commitments, three expansions of health management services to existing clients, and four fitness management commitments. This commitment activity for 2009 may realize annualized revenue of $4.4 million, to be partially offset by a potential annualized revenue loss of $1.3 million from fitness and health management contract cancellations. These cancellations reflect the continuing weakness in the economy and the challenges companies expect to face during 2009.

Gross Profit. Gross profit increased $76,000 or 1.4%, to $5,612,000 for the three months ended June 30, 2009, from $5,536,000 for the three months ended June 30, 2008. Total gross margin increased to 29.9%, from 29.4% for the same period last year, which is primarily due to Health Management revenue representing a larger percentage of our total revenue and improved margins for Health Management program services.

Fitness Management

Fitness Management gross profit decreased $183,000, which includes a decrease of $235,000 from staffing services, partially offset by an increase of $52,000 from program services. Gross margin for our Fitness Management segment decreased in the three months ended June 30, 2009 to 24.2%, from 24.7% for the same period of 2008. This result is primarily due to a gross margin decrease in staffing services, which decreased from 23.9% for the same period last year, to 22.8%, partially offset by a gross margin increase in program services, which increased from 36.3% for the same period last year, to 42.8%. The margin decrease for staffing services is primarily due to higher costs for employee medical benefits and workers compensation costs. The margin increase for program services is primarily due to the mix of programs delivered during the quarter as compared to the same period last year and labor efficiencies for personal training and massage services.

Health Management

Health Management gross profit increased $259,000, which includes an increase of $474,000 from program services, reduced by a decrease of $215,000 from staffing services. Gross margin for our Health Management segment increased in the three months ended June 30, 2009 to 36.3%, from 35.4% for the same period of 2008. This result is primarily due to a gross margin increase in program services, which increased from 45.6% for the same period last year, to 52.2%, reduced by a gross margin decrease in staffing services, which decreased from 27.1% for the same period last year, to 22.0%. The margin decrease for staffing services is primarily due to higher costs for employee paid time off, medical benefits, workers compensation costs and increased wage costs. The margin increase in program services is primarily due to increased margins on health coaching and advising services and biometric screening services.

Operating Expenses and Operating Income. Operating expenses increased $78,000, or 1.6%, to $4,979,000 for the three months ended June 30, 2009, from $4,901,000 for the three months ended June 30, 2008.

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The increase is primarily due to higher costs for management incentive programs and employee benefits, reduced by operating cost savings. For the three months ended June 30, 2009, operating expenses, as a percent of revenue, were 26.5%, compared to 26.0% for the same period last year.

Operating margin remained flat to last year for the second quarter 2009, at 3.4%. This result reflects the sales growth in our Health Management segment and cost efficiencies related to Health Management segment program services, offset by the decrease in Fitness Management segment sales, higher staffing costs, and a higher ratio of operating expenses to revenue as discussed above

Other Income and Expense. Interest expense was inconsequential during the quarters ended June 30, 2009 and 2008.

Income Taxes. Income tax expense increased $10,000 to $278,000 for the three months ended June 30, 2009, from $268,000 for the three months ended June 30, 2008. The increase is primarily due to a true-up adjustment for the quarter ended June 30, 2009, compared to the same period of 2008.

Our effective tax rate was 43.8% of earnings before income taxes for the second quarter of 2009, compared to 42.5% for the same period last year. Compared to our normal effective tax rate of 38.5%, our current effective tax rate is higher due primarily to the non-deductibility of compensation expense for incentive stock options.

Net Earnings. Net earnings decreased $6,000 to $357,000 for the three months ended June 30, 2009, from $363,000 for the three months ended June 30, 2008. This decrease is primarily due to the decrease in Fitness Management segment sales, higher staffing costs, and a higher ratio of operating expenses to revenue as discussed above, mostly offset by sales growth in our Health Management segment and cost efficiencies related to Health Management segment program services.

Results of Operations for the six months ended June 30, 2009 compared to the six months ended June 30, 2008.

Revenue. Revenue increased $470,000, or 1.3%, to $37,988,000 for the six months ended June 30, 2009, from $37,518,000 for the six months ended June 30, 2008.

Fitness Management

Our Fitness Management segment declined $1,102,000, which included a decline in staffing services of $1,069,000 and a decline in program services of $33,000**.** This revenue decline is primarily due to the termination of large automotive contracts in 2008 and 2009.

If the economic recession continues for the remainder of 2009, it is possible we could continue to experience a higher level of staffing services revenue loss in our Fitness Management segment. Our most at risk contracts include those in the automotive industry, although we believe the current recession may have an adverse impact on many industries, which could affect our other customers and lead to further revenue loss from contract termination or service reduction. With respect to the automotive industry, we have lost approximately $1.7 million in revenue over the past twelve to eighteen months. During 2009, we expect to realize approximately $2.5 million in revenue from our at risk automotive contracts, and if their financial difficulties continue, we may see similar revenue losses during 2009.

It is also possible we could experience further declines in Fitness Management program service revenue during 2009. Program service revenue is derived from fees we charge to members of our managed fitness centers for services such as personal training, massage therapy, weight loss programs and special fitness classes. The revenue decline we experienced in the first half of 2009 is attributed to the effects of the recessionary economy, employment reductions and our members decreasing their spending on discretionary services. We believe this trend will continue during 2009.

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Because we are the largest provider of fitness management services in the United States, we believe the number of opportunities to bid on new business during 2009 should be consistent with past years. In order to increase our chances of winning new business in 2009 and reverse the historical decline of our fitness management revenue, we also believe that we will need to lower our pricing to be competitive in this market, which may result in lower profitability.

Health Management

Our Health Management segment contributed total growth of $1,572,000, which includes growth of $327,000 from staffing services and growth of $1,245,000 from program services. Overall, the growth in staffing revenue is attributable to new customers and the expansion of sales to existing customers. The increase in program services revenue is primarily due to an increase in our core health programs, including biometric screening services, health coaching and advising services and eHealth platform revenue.

For 2009, we anticipate that the economic recession may have a negative impact on revenue from existing customers. It is possible that many of our health management customers may reduce the scope of their programs during 2009 as a measure to conserve cash and improve profitability. Our health management revenue may also be negatively affected by lower participation rates at some customers due to employee layoffs. At the same time, the recessionary economy has also lengthened the sales cycle for new opportunities. The combination of these events, if they materialize, may challenge our ability to increase 2009 revenue on a basis consistent with past growth.

2009 Customer Commitments and Cancellations

For the six months ended June 30, 2009, the Company received a total of seven health management commitments, three expansions of health management services to existing clients, and five fitness management commitments. This commitment activity for 2009 may realize annualized revenue of $6.0 million, to be partially offset by a potential annualized revenue loss of $1.8 million from fitness and health management contract cancellations. These cancellations reflect the continuing weakness in the economy and the challenges companies expect to face during 2009.

Gross Profit. Gross profit increased $1,025,000, or 9.4%, to $11,904,000 for the six months ended June 30, 2009, from $10,879,000 for the six months ended June 30, 2008. Total gross margin in the six months ended June 30, 2009 increased to 31.3% from 29.0% for the same period last year, which is primarily due to Health Management revenue representing a larger percentage of our total revenue and improved margins for Health Management program services.

Fitness Management

Fitness Management gross profit decreased $173,000, which includes a decrease of $211,000 from staffing services, partially offset by an increase of $38,000 from program services. Gross margin for our Fitness Management segment increased in the six months ended June 30, 2009 to 24.2%, from 23.7% for the same period of 2008. This result is primarily due to a gross margin increase in program services, which increased from 37.2% for the same period last year, to 41.3%, and a slight gross margin increase in staffing services, which increased from 22.9% for the same period last year, to 23.0%. The margin increase for program services is primarily due to the mix of programs delivered during the quarter as compared to the same period last year and labor efficiencies for personal training and massage services.

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Health Management

Our Health Management segment contributed gross profit growth of $1,197,000, which includes growth of $1,211,000 from program services and a decline of $14,000 from staffing services. Gross margin for our Health Management segment increased in the six months ended June 30, 2009 to 39.1%, from 35.6% for the same period of 2008. This result is primarily due to a gross margin increase in program services, which increased from 48.0% for the same period last year, to 54.7%, reduced by a gross margin decrease in staffing services, which decreased from 24.6% for the same period last year, to 23.5%. The margin decrease for staffing services is primarily due to higher costs for employee paid time off, medical benefits and workers compensation costs. The gross increase in program services is primarily due to increased margins on health coaching and advising services and biometric screening services.

The anticipated negative impact of the economic recession discussed above may challenge our ability to improve gross profit and margins in 2009 on a basis consistent with past growth.

Operating Expenses and Operating Income. Operating expenses decreased $109,000, or 1.1%, to $9,571,000 for the six months ended June 30, 2009, from $9,680,000 for the six months ended June 30, 2008.

The decrease is primarily due to general operating cost savings. For the three months ended June 30, 2009, operating expenses, as a percent of revenue, were 25.2%, compared to 25.8% for the same period last year.

Operating margin increased to 3.6% for the six months ended June 30, 2009, from 1.8% for the same period 2008. This result reflects the sales growth in our Health Management segment, cost efficiencies related to Health Management segment program services and operating expense savings, reduced by the decrease in Fitness Management segment sales. Since 2009 revenue growth may be challenged by recessionary pressures, our strategies to maximize our operating profitability will focus on closely managing operating expenses and improving business processes.

Other Income and Expense. Interest expense was inconsequential for the six months ended June 30, 2009 and 2008.

Income Taxes. Income tax expense increased $467,000 to $975,000 for the six months ended June 30, 2009, from $508,000 for the six months ended June 30, 2008. The increase is due to a higher operating income for the first six months of 2009 as compared to the same period last year.

Our effective tax rate was 41.8% of earnings before income taxes for the second quarter of 2009, compared to 42.5% for the same period last year. Compared to our normal effective tax rate of 38.5%, our current effective tax rate is higher due primarily to the non-deductibility of compensation expense for incentive stock options.

Net Earnings. Net earnings applicable to common shareholders increased $673,000 to $1,360,000 for the six months ended June 30, 2009, from $687,000 for the six months ended June 30, 2008. This increase is primarily due to sales growth in our Health Management segment, cost efficiencies related to Health Management segment program services and operating expense savings, reduced by the decrease in Fitness Management segment sales.

LIQUIDITY AND CAPITAL RESOURCES

Our working capital increased $1,800,000 to $12,500,000 for the six months ended June 30, 2009, from $10,700,000 at December 31, 2008. This increase is largely attributable to our improved operating results and cash accumulation strategy given current economic conditions.

In addition to cash flows generated from operating activities, our other primary source of liquidity and working capital is provided by a $3,500,000 Credit Agreement with Wells Fargo Bank, N.A. (the Wells Loan). Effective with the renewal of the Wells Loan on March 24, 2009, interest will be computed using the daily three month LIBOR rate plus a markup of 2.75% (effective rate of 3.345% and 5.0% at June 30, 2009 and 2008, respectively). The Wells Loan matures on June 30, 2011, as amended. Working capital advances from the Wells Loan are based upon a percentage of our eligible accounts receivable, less any amounts drawn and outstanding. The facility provided maximum borrowing capacity of $3,250,000 at June 30, 2009 and December 31, 2008, respectively and no debt was outstanding on those dates. There were no borrowings under the line of credit during the six months ended June 30, 2009. Although we do not anticipate borrowing from the Wells Loan in 2009, we have extended the agreement, as previously discussed, to provide an additional source of funding. All borrowings are collateralized by substantially all of our assets. At June 30, 2009, we were in compliance with all of our financial covenants and expect to remain in compliance with the covenants over the life of the credit agreement.

We believe our short and long-term capital needs will be met with cash flows generated by operations. We anticipate investment activities in 2009 will be near 2008 levels and will be funded through operating cash flows. Capitalized software development costs, as previously discussed, are primarily related to enhancements to our eHealth platform. These enhancements are made to improve efficiencies and/or generate additional revenues and are, thus, discretionary in nature.

We did not see a material change in the payment activities of our customers in 2008 and do not anticipate a material change in 2009. We do, however, expect to realize approximately $2.5 million in revenue from our existing automotive contracts in 2009 and will continue to monitor their financial health as it relates to outstanding accounts receivable. On April 30, 2009, an automotive customer in our fitness management segment filed for bankruptcy protection under Chapter 11. Our outstanding receivable from this customer was approximately $34,000. The customer has paid the outstanding balance and continues to make timely payments on the continued monthly service billings. In addition, we collected receivable payments of approximately $137,000 from the customer during the 90 days before the bankruptcy filing. Such payments may constitute preferential payments recoverable under the Bankruptcy Code. We believe we have valid defenses to any potential claim for these payments and will not be required to repay the full amount. This customer has assumed our contract as of May 22, 2009. On June 1, 2009, another automotive customer in our fitness management segment filed for bankruptcy protection under Chapter 11. Our outstanding receivable from this customer was approximately $283,000. The customer has paid the outstanding balance and continues to make timely payments on the continued monthly service billings. In addition, we collected receivable payments of approximately $110,000 from the customer during the 90 days before bankruptcy. Such payments may constitute preferential payments recoverable under the Bankruptcy Code. We believe we also have valid defenses to any potential claim for these payments. This customer has assumed our contracts as of July 10, 2009. Our revenue from these customers was approximately $2,909,000 and $746,000 for the year ended December 31, 2008 and the six months ended June 30, 2009, respectively.

INFLATION

We do not believe that inflation has significantly impacted our results of operations in any of the last three completed fiscal years.

OFF-BALANCE SHEET ARRANGEMENTS

As of June 30, 2009, the Company had no off-balance sheet arrangements or transactions with unconsolidated, limited purpose entities.

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PRIVATE SECURITIES LITIGATION REFORM ACT

The Private Securities Litigation Reform Act of 1995 provides a safe harbor for forward-looking statements. Such forward-looking information is included in this Form 10-K, including this Item 7, as well as in other materials filed or to be filed by the Company with the Securities and Exchange Commission (as well as information included in oral statements or other written statements made or to be made by the Company).

Forward-looking statements include all statements based on future expectations and specifically include, among other things, statements relating to revenue loss in our Fitness Management segment; our belief the current recession may have an adverse impact on many industries, which could affect our customers and lead to further revenue loss from contract termination or service reduction; our belief that revenue decline will continue during 2009 due to the effects of the recessionary economy, employment reductions and our members decreasing their spending on discretionary services; our belief that the number of opportunities to bid on new fitness management business during 2009 should be consistent with past years; our belief that we will need to lower our pricing to be competitive in the fitness management market, which may result lower profitability; our ability to increase 2009 revenue on a basis consistent with past growth; our ability to improve gross profit and margins in 2009 on a basis consistent with past growth; our expectation that we will not borrow from the Wells Loan in 2009 and that we will remain in compliance with all of our financial covenants over the life of the credit agreement; our belief that our short and long-term capital needs will be met with cash flows generated by operations; our anticipation that investment activities in 2009 will be at or below 2008 levels and will be funded through operating cash flows; our anticipation that we will not see a material change in the payment activities of our customers in 2009; statements regarding the potential effects of automotive company bankruptcies on our accounts receivable, contract continuation and prior payments and related claims and defenses regarding repayment of preferential payments, and our belief that inflation has not significantly impacted our results of operations in any of the last three completed fiscal years, as well as statements regarding projections and outlook relating to the industries in which we compete and the economy in general, increasing revenue, improving margins, marketing efforts, competitive conditions, the effect of price competition and changes to the economy, and the sufficiency of our liquidity and capital resources. In addition, the estimated annualized revenue value of our new, lost and existing contracts is a forward looking statement, which is based upon an estimate of the anticipated annualized revenue to be realized or lost. Such information should be used only as an indication of the activity we have recently experienced in our two business segments. These estimates, when considered together, should not be considered an indication of the total net, incremental revenue growth we expect to generate in any year, as actual net growth may differ from these estimates due to actual staffing levels, participation rates and contract duration, in addition to other revenue we may lose in the future due to contract termination. Any statements that are not based upon historical facts, including the outcome of events that have not yet occurred and our expectations for future performance, are forward-looking statements. The words potential, believe, estimate, expect, intend, may, could, will, p and similar words and expressions are intended to identify forward-looking statements. Such statements are based upon the current beliefs and expectations of our management. Such forward-looking information involves important risks and uncertainties that could significantly affect anticipated results in the future and, accordingly, such results may differ from those expressed in any forward-looking statements made by or on behalf of the Company. These risks and uncertainties include, but are not limited to, our inability to deliver the health management services demanded by major corporations and other clients, our inability to successfully cross-sell health management services to our fitness management clients, our inability to successfully obtain new business opportunities, our failure to have sufficient resources to make investments, our ability to make investments and implement strategies successfully, continued delays in obtaining new commitments and implementing services, the continued deterioration of general economic conditions, the actions of automotive customers and bankruptcy courts, and those matters identified and discussed in Item 1A of the 2008 Form 10-K under Risk Factors.

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ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are exposed to market risks related to changes in U.S. and international interest rates. The Company s borrowings under the Wells Loan bear interest at a variable rate. There were no borrowings outstanding under the Wells Loan at June 30, 2009.

We have no history of, nor do we anticipate in the future, investing in derivative financial instruments, derivative commodity instruments or other such financial instruments. We invoice our Canadian customers in their local currency, and such transactions are considered immaterial in relation to our total billings. As a result, the exposure to foreign currency fluctuations and other market risks is not material.

ITEM 4. CONTROLS AND PROCEDURES

Our Chief Executive Officer and Chief Financial Officer, referred to collectively herein as the Certifying Officers, are responsible for establishing and maintaining our disclosure controls and procedures. The Certifying Officers have reviewed and evaluated the effectiveness of the Company s disclosure controls and procedures (as defined in Rules 240.13a-15(e) and 15d-15(e) promulgated under the Securities Exchange Act of 1934) as of June 30, 2009. Based on that review and evaluation, which included inquiries made to certain other employees of the Company, the Certifying Officers have concluded that, as of the end of the period covered by this Report, the Company s disclosure controls and procedures, as designed and implemented, are effective in ensuring that information relating to the Company required to be disclosed in the reports that the Company files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission s rules and forms, including ensuring that such information is accumulated and communicated to the Company s management, including the Chief Executive Officer and the Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

There were no changes in the Company s internal controls over financial reporting during the quarter ended June 30, 2009 that may have materially affected, or are reasonably likely to materially affect, the Company s internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

Refer to Item 3 (Legal Proceedings) in the Company s Annual Report on Form 10-K for the year ended December 31, 2008.

ITEM 1A. RISK FACTORS

In addition to the other information set forth in this report, including the important information in Private Securities Litigation Reform Act, you should carefully consider the Risk Factors discussed in our Annual Report on Form 10-K for the year ended December 31, 2008. Those factors, if they were to occur, could cause our actual results to differ materially from those expressed in our forward-looking statements in this report, and materially adversely affect our financial condition or future results. Although we are not aware of any other factors that we currently anticipate will cause our forward-looking statements to differ materially from our future actual results, or materially affect the Company s financial condition or future results, additional risks and uncertainties not currently known to us or that we currently deem to be immaterial might materially adversely affect our actual business, financial condition and/or operating results.

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ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

(a) The Annual Meeting of the Company s shareholders was held on Wednesday, May 27, 2009.

(b) Proxies for the Annual Meeting were solicited pursuant to Regulation 14A under the Securities Exchange Act of 1934. There was no solicitation in opposition to management s nominees, and the shareholders elected the following persons as directors of the Company to serve until the next annual meeting of shareholders:

Nominee	Number of Votes For	Number of Votes Withheld
David F. Durenberger	8,728,211	79,828
K. James Ehlen, M.D.	8,721,736	86,303
Linda Hall Keller	8,729,236	78,803
Gregg O. Lehman	8,728,306	79,733
Robert J. Marzec	8,729,236	78,803
John C. Penn	8,729,236	78,803
Curtis M. Selquist	8,729,236	78,803
Mark W. Sheffert	8,721,736	86,303
Rodney A. Young	8,729,236	78,803

(c) By a vote of 8,221,529 shares in favor, 579,457 shares opposed, 7,053 shares abstaining, and 0 shares represented by broker nonvotes, the shareholders ratified the selection of Grant Thornton LLP as the Company s independent auditor for the current fiscal year.

(d) By a vote of 5,200,867 shares in favor, 333,658 shares opposed, 27,035 shares abstaining, and 3,246,479 shares represented by broker nonvotes, the shareholders approved a 200,000 share increase in the number of shares reserved for the Company s 1995 Employee Stock Purchase Plan.

ITEM 5. OTHER INFORMATION

None

ITEM 6. EXHIBITS

(a) Exhibits See Exhibit Index on page following signatures

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Company has duly caused this Report to be signed on its behalf by the undersigned, thereunto duly authorized.

Dated: August 13, 2009		HEALTH FITNESS CORPORATION
	By	/s/ Gregg O. Lehman Gregg O. Lehman President and Chief Executive Officer (Principal Executive Officer)
	By	/s/ Wesley W. Winnekins Wesley W. Winnekins Chief Financial Officer and Treasurer (Principal Financial and Accounting Officer)

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EXHIBIT INDEX
HEALTH FITNESS CORPORATION
FORM 10-Q

Exhibit No.	Description
*10.1	1995 Employee Stock Purchase Plan, as amended incorporated by reference to Exhibit 10.1 to our Form 8-K dated May 27, 2009
**11.0	Statement re: Computation of Earnings per Share
**31.1	Certification of President and Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
**31.2	Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
**32.1	Certification of President and Chief Executive Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
**32.2	Certification of Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

* Indicates management contract or compensatory plan or arrangement

** Filed herewith