GNC CORP
Form 10-K
March 30, 2005

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

(Mark One)

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

For the fiscal year ended December 31, 2004

OR

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

For the transition period from _____ to_____.

Commission file number: 333-116040

GNC CORPORATION

(Exact name of registrant as specified in its charter)

DELAWARE	**72-1575170**
(state or other jurisdiction of Incorporation or organization)	(I.R.S. Employer Identification No.)
300 Sixth Avenue Pittsburgh, Pennsylvania (Address of principal executive offices)	15222 (Zip Code)

Registrant s telephone number, including area code: (412) 288-4600

Securities Registered Pursuant to Section 12(b) of the Act: None

Securities Registered Pursuant to Section 12(g) of the Act: None

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13, or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2), has been subject to such filing requirements for the past 90 days. þ Yes o No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (229.405 of this chapter) is not contained herein, and will not be contained, to the best of Registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. o

Indicate by check mark whether the Registrant is an accelerated filer (as defined in Rule 12b-2 of the Act). o Yes þ No

As of March 30, 2004, 29,854,663 shares of the registrant s Common Stock, par value $0.01 per share (the Common Stock) were outstanding. There is no established public trading market for the Common Stock.

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FORWARD LOOKING STATEMENTS

This Annual Report on Form 10-K (the Report) contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 with respect to the financial condition, results of operations and business of GNC Corporation, a Delaware corporation (GNC or the Company), (f/k/a General Nutrition Centers Holding Company.) Discussions containing such forward-looking statements may be found in Items 1, 2, 3, 7 and 7A hereof, as well as within this Report generally. In addition, when used in this Report, the words subject to, believe, expect, plan, estimate, intend, may, will, should, can, or anticipate, or the negative thereof, or variati similar expressions are intended to identify forward-looking statements, which are inherently uncertain. Similarly, discussions of strategy, although believed to be reasonable, are also forward-looking statements and are inherently uncertain.

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 we may not realize our expectations and our beliefs may not prove correct. Important risk factors that could cause our actual results to differ materially from the forward-looking statements include:

- significant competition in our industry;
- unfavorable publicity or consumer perception of our products;
- the incurrence of material product liability and product recall costs;
- costs of compliance with governmental regulations;
- the failure of our franchisees to conduct their operations profitably;
- economic, political and other risks associated with our international operations;
- our failure to keep pace with the demands of our customers for new products and services;
- the lack of long-term experience with human consumption of some of our products with innovative ingredients; and
- increases in the frequency and severity of insurance claims, particularly claims for which we are self-insured.

Consequently, such forward-looking statements should be regarded solely as the Company s current plans, estimates and beliefs. Readers are cautioned not to place undue reliance on forward-looking statements. The Company cannot guarantee future results, events, and levels of activity, performance or achievements. The Company does not undertake and specifically declines any obligation to update, republish or revise forward-looking statements to reflect events or circumstances after the date hereof or to reflect the occurrences of unanticipated events.

Industry data used throughout this Report was obtained from industry publications and internal Company estimates. While the Company believes such information to be reliable, its accuracy has not been independently verified and cannot be guaranteed.

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PART I

ITEM 1. BUSINESS

GNC Corporation

We are a holding company and all of our operations are conducted through our operating subsidiaries. We were formed as a Delaware corporation in November 2003 by affiliates of Apollo Advisors, L.P. and certain members of our management to acquire General Nutrition Companies, Inc. (GNCI) from Numico USA, Inc. (together with its parent company, Koninklijke (Royal) Numico N.V., Numico). On December 4, 2003, in a transaction sponsored by Apollo Management, L.P. and certain other co-investors, our wholly owned subsidiary and operating company, General Nutrition Centers, Inc. (Centers), purchased 100% of the outstanding equity interests of GNCI from Numico (the Acquisition). As such, the financial results described and presented below represent the aggregate of the financial results of GNCI from January 1, 2003 to December 4, 2003 and the results of the Company from December 5, 2003 to December 31, 2003 and for all of 2004.

We are the largest global specialty retailer of nutritional supplements, which include sports nutrition products, diet products, VMHS (vitamins, minerals and herbal supplements) and specialty supplements. We derive our revenues principally from product sales through our company-owned stores, franchise activities and sales of products manufactured in our facilities to third parties. We sell products through a worldwide network of more than 5,700 locations operating under the GNC® brand name. Our product mix, which is focused on high-margin, value-added nutritional products, is sold under our GNC proprietary brands, including Mega Men®, Ultra Mega®, Pro Performance®, Total Lean and Preventive Nutrition®, and under nationally recognized third-party brands, including Muscletech®, EAS® and Atkins®.

Our principal executive offices are located at 300 Sixth Avenue, Pittsburgh, Pennsylvania 15222, and our telephone number is (412) 288-4600. We also maintain a website at www.gnc.com. Our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and all amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended (the Exchange Act), are available, free of charge on our website or upon written request to 300 Sixth Avenue, Pittsburgh, Pennsylvania 15222, Attention: Chief Legal Officer as soon as reasonably practicable after the Company electronically files such materials with the Securities and Exchange Commission (the SEC). The contents of our website are not incorporated by reference in this Annual Report on Form 10-K and shall not be deemed filed under the Exchange Act.

In this Report, unless the context requires otherwise, references to we, us, our, Company, or GNC refer to GN Corporation and its subsidiaries and, for the periods prior to December 5, 2003, our predecessor.

Business Overview

The following charts illustrate, for the year ended December 31, 2004, the percentage of our net revenues generated by our three business segments and the percentage of our net U.S. retail supplement revenues generated by our product categories:

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Retail Locations

Our retail network represents the largest specialty retail store network in the nutritional supplements industry according to the Nutritional Business Journal s 2004 Supplement Report (the NBJ 2004 Supplement Report), As of December 31, 2004, there were 4,966 GNC locations in the United States and Canada and 739 franchised stores operating in other international locations under the GNC name. Of our U.S. and Canadian locations, 2,642 were company-owned stores, 1,297 were franchised stores and 1,027 were GNC store-within-a-store locations under our strategic alliance with Rite Aid®. Most of our U.S. stores are between 1,000 and 2,000 square feet and are located in shopping malls and strip shopping centers.

Franchise Activities

We generate income from franchise activities primarily through product sales to franchisees, royalties on franchise retail sales and franchise fees. To assist our franchisees in the successful operation of their stores and to protect our brand image, we offer a number of services to franchisees including training, site selection, construction assistance and accounting services. We believe that our franchise program enhances our brand awareness and market presence and will enable us to expand our store base internationally with limited capital expenditures by us.

Store-Within-a-Store Locations

To increase brand awareness and promote access to customers who may not frequent specialty nutrition stores, we entered into a strategic alliance with Rite Aid to open our GNC store-within-a-store locations. Through this strategic alliance, we generate revenues from sales to Rite Aid of our products at wholesale prices, the manufacture of Rite Aid private label products and retail sales of consignment inventory. In May 2004, we extended our alliance with Rite Aid through April 30, 2009, with Rite Aid s commitment to open 300 new store-within-a-store locations by December 31, 2006. At December 31, 2004, Rite Aid had opened 42 of these 300 new store-within-a-store locations.

Products

We offer a wide range of high-quality nutritional supplements sold under our GNC proprietary brand names and under nationally recognized third-party brand names. Sales of our proprietary brands at our company-owned stores represented approximately 46% of our net retail product revenues for the year ended December 31, 2004.

Marketing

We market our proprietary brands of nutritional products through an integrated marketing program that includes television, print and radio media, storefront graphics, direct mailings to members of our Gold Card program and point of purchase promotional materials.

Manufacturing and Distribution

With our technologically sophisticated manufacturing and distribution facilities supporting our retail stores, we are a low-cost, vertically integrated producer and supplier of high-quality nutritional supplements. By controlling the production and distribution of our proprietary products, we can protect product quality, monitor delivery times and maintain appropriate inventory levels.

Industry Overview

According to the NBJ 2004 Supplement Report, the U.S. nutritional supplements retail industry, which includes nutritional supplements sold through all channels, is large and highly fragmented, with no single industry participant accounting for a majority of total industry retail sales in 2003. (The 2004 NBJ Report utilized data through the end of 2003.) Participants include specialty retailers, supermarkets, drugstores, mass merchants, multi-level marketing organizations, mail order and a variety of other smaller participants. The nutritional supplements sold through these channels are divided into four major product categories: sports nutrition products, diet products, VMHS and specialty supplements. Most supermarkets, drugstores and mass merchants have narrow nutritional supplement product offerings limited primarily to simple vitamins and herbs, with less knowledgeable sales associates than specialty retailers. We believe that these merchants share of the nutritional supplements market over the last five years has remained relatively constant.

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During the mid 1990s, our industry underwent a period of rapid expansion following the passage of the Dietary Supplement Health & Education Act of 1994 (DSHEA). In 1998 the industry began to slow down and no longer exhibited year over year double-digit growth. According to the NBJ 2003 Supplement Report, strong annual growth peaked in the post-DSHEA era at around 14% in 1995-1997, continued at 11% in 1998, but fell to 6.5% in 1999, 5% in 2000, 4.5% in 2001, just barely 4% in 2002. However, in 2003, sales growth outperformed 2002, boosting sales nearly 6% in 2003, according to NBJ s comprehensive annual research. In addition, total industry sales in the United States were approximately $19.8 billion in 2003 and were estimated to grow at a compound annual growth rate of 4% from 2004 through 2013.

Several demographic, healthcare and lifestyle trends are expected to drive the continued growth of the nutritional supplements industry. These trends include:

Aging Population: The average age of the U.S. population is increasing. U.S. Census Bureau data indicates that the number of Americans age 65 or older is expected to increase by 54% from 2000 to 2010. We believe that these consumers are significantly more likely to use VMHS products than younger persons.

Rising Healthcare Costs and Use of Preventive Measures: Healthcare related costs have increased substantially in the United States. According to a leading healthcare provider, private health insurance premiums are expected to increase an average of 7.8% from 2004 to 2005. To reduce medical costs and avoid the complexities of dealing with the healthcare system, many consumers take preventive measures, including alternative medicines and nutritional supplements.

Increasing Focus on Fitness: The number of Americans belonging to health clubs has grown 23% from 29.5 million in 1998 to 39.4 million in 2003, according to the International Health, Racquet & Sportsclub Association. We believe that fitness-oriented consumers are interested in taking sports nutrition products to increase energy, endurance and strength during exercise.

Increasing Incidence of Obesity: According to data from the 1999-2002 National Health Nutrition Examination Survey, 65% of adults in the United States are either overweight or obese. Obesity may lead to more serious health conditions, such as diabetes, heart disease and high blood pressure. An estimated 49% of adults in the United States are currently dieting, according to a 2004 Gallup Study of Dieting and the Market for Diet Products and Services.

Business Segments

We generate revenues primarily from our three business segments, Retail, Franchise and Manufacturing/ Wholesale. The following chart outlines our business segments and the historical contribution to our consolidated revenues by those segments, after intercompany eliminations. For a description of operating income (loss) by business segment, our total assets by business segment, total revenues by geographic area, and total assets by geographic area, see the Segments note to our consolidated financial statements included elsewhere in this Report.

	Predecessor				Successor			
	Twelve Months Ended December 31,		Period from January 1, 2003 to December 4,		27 Days Ended December 31,		Twelve Months Ended December 31,	
(dollars in millions)	2002		2003		2003		2004	
Retail	$ 1,068.6	75.0%	$ 993.3	74.1%	$ 66.2	74.1%	$ 1,001.8	74.5%
Franchise	256.1	18.0%	241.3	18.0%	14.2	15.9%	226.5	16.8%

Manufacturing/Wholesale (Third Party)	100.3	7.0%	105.6	7.9%	8.9	10.0%	116.4	8.7%
Total	$ 1,425.0	100.0%	$ 1,340.2	100.0%	$ 89.3	100.0%	$ 1,344.7	100.0%

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Retail

Our Retail segment generates revenues from sales of products to customers at our company-owned stores in the United States and Canada.

Locations

As of December 31, 2004, we operated 2,642 company-owned stores across 50 states and in Canada, Puerto Rico and Washington, D.C. Most of our U.S. company-owned stores are between 1,000 and 2,000 square feet and are located primarily in shopping malls and strip shopping centers. Traditional mall and strip center locations typically generate a large percentage of our total retail sales. With the exception of our downtown stores, all of our company-owned stores follow one of two consistent formats, one for mall locations and one for strip shopping center locations. Our store graphics are periodically redesigned to better identify with our GNC customers and provide product information to allow the consumer to make educated decisions regarding product purchases and usage. Our product labeling is consistent within our product lines and the stores are designed to present a unified approach to packaging with emphasis on added information for the consumer. As an on going practice, we continue to reset and upgrade all of our company-owned stores to maintain a more modern and customer-friendly layout, while promoting our GNC Live Well theme.

Products

We offer a wide range of high-quality nutritional supplements sold under our GNC proprietary brand names, including, Mega Men, Pro Performance, Total Lean and Preventive Nutrition, and under nationally recognized third-party brand names, including Muscletech, EAS and Atkins. We operate in four major nutritional supplement categories: sports nutrition products, diet products, VMHS and specialty supplements. We offer an extensive mix of brands and products, including approximately 2,100 SKUs across multiple categories. This variety is designed to provide our customers with a vast selection of products to fit their specific needs. Sales of our proprietary brands at our company-owned stores represented approximately 46% of our net retail product revenues for the year ended December 31, 2004.

Products are delivered to our retail stores through our distribution operations located in Leetsdale, Pennsylvania; Anderson, South Carolina; and Phoenix, Arizona. Our distribution centers support our company-owned stores as well as franchised stores and Rite Aid locations. Our distribution fleet delivers our finished goods and third-party products through our distribution centers to our company-owned and domestic franchise stores on a weekly or biweekly basis depending on sales volume of the store. Each of our distribution centers has a quality control department that monitors products received from our vendors to determine if they meet our requirements.

Based on data collected from our point of sale systems (POS), excluding certain required accounting adjustments of $3.4, $0.4, $(0.5) million for the years ended December 31, 2004, 2003 and 2002, respectively, below is a comparison of our company-owned domestic store retail product sales by major product category and the respective percentage of our company-owned domestic store retail product sales for the period shown (prior years categories have been adjusted to be comparable with the current year s presentation):

	For the Year Ended December 31,					
Category	**2002**		**2003 (1)**		**2004**	
(dollars in millions)						
Sports Nutrition Products	$ 288.6	28.1%	$ 300.3	29.7%	$ 293.1	31.0%
Diet and Weight Management Products	267.2	26.0%	265.7	26.3%	193.1	20.5%

VMHS	252.8	24.7%	237.9	23.6%	242.9	25.7%
Specialty Supplements	139.8	13.6%	126.6	12.5%	119.6	12.7%
Other	77.8	7.6%	79.4	7.9%	95.3	10.1%
Total	$ 1,026.2	100.0%	$ 1,009.9	100.0%	$ 944.0	100.0%

(1) *This data is shown on a combined basis for comparability purposes and represents the sum of the period from January 1, 2003 through December 4, 2003 and the 27 days ended December 31, 2003.*

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Sports Nutrition Products

Sports nutrition products are designed to be taken in conjunction with an exercise and fitness regimen. Our target consumer for sports nutrition products is the 18-49 year old male. We typically offer a broad selection of sports nutrition products, such as protein and weight gain powders, sports drinks, sports bars, and high potency vitamin formulations, including GNC brands such as Pro Performance and popular third-party products.

Diet Products

Diet products consist of various formulas designed to supplement the diet and exercise plans of weight conscious consumers. Our target consumer for diet products is the 18-49 year old female. We typically offer a variety of diet products, including pills, meal replacements, shakes, diet bars and teas. Our retail stores offer our proprietary and third-party products suitable for different diet and weight management approaches, including low-carbohydrate and products designed to increase thermogenesis (a change in the body s metabolic rate measured in terms of calories) and metabolism. We also offer several ephedra-free diet products, including our Total Lean and our Body Answers product lines.

VMHS

We sell vitamins and minerals in single vitamin and multi-vitamin form and in different potency levels. Our vitamin and mineral products are available in liquid, tablets, soft gelatin and hard-shell capsules and powder forms. Many of our special vitamin and mineral formulations, such as Mega Men and Ultra Mega®, are available only at GNC locations. In addition to our selection of VMHS products with unique formulations, we also offer the full range of standard alphabet vitamins. We sell herbal supplements in various solid dosage and soft gelatin capsules, tea and liquid forms. We have consolidated our traditional herbal offerings under a single umbrella brand, Herbal Plus®. In addition to the Herbal Plus line, we offer a full line of whole food-based supplements and top selling herb and natural remedy products. Our target customers for VMHS products are women over the age of 35.

Specialty Supplements

Specialty supplements is a catch-all category for nutritional supplements that do not fit within the bounds of the other nutritional supplement categories. Specialty supplements include products containing glucosamine (a sugar produced in the body that is involved in the formation of cartilage, ligaments, tendons, bones, eyes, nails and heart valves) and melatonin (a hormone linked to regulation of the body s sleep-wake cycle), as well as products that are designed to provide nutritional support to specific areas of the body. Our target customers for specialty supplements are women over the age of 35. Many of our specialty supplements have ingredients unique to our formulations that are not available at other outlets. Our specialty supplements emphasize recent third-party research and available literature regarding the positive benefits from certain ingredients. Our comprehensive Preventive Nutrition product line includes Heart Advance , a product designed to support healthy heart and blood vessel function, Triple Cleanse , a product designed to support healthy digestive function, and Fast Flex , a product designed to provide comprehensive joint support. Our specialty supplements are located in designated wall areas that include information and other products that offer a comprehensive solution to meet a customer s particular nutritional concerns.

Other

The other product category consists primarily of sales of our Gold Card and sales of other nonsupplement products, including cosmetics, food items, health management products, books and video tapes.

Product Development

We believe a key driver of customer traffic and purchases is the introduction of new products. According to the GNC 2004 Awareness Tracking Study Report by Parker Marketing Research Innovators, (2004 Parker Awareness Study), 45% of consumers surveyed rated the availability of new, innovative products as extremely or very important when making purchase decisions and rated this as one of our competitive strengths. We identify changing customer trends through interactions with our customers and leading industry vendors to assist in the development, manufacturing and marketing of our new products. We develop proprietary products independently and through the collaborative effort of our dedicated development team. During 2004, we targeted our product development efforts on sports nutrition products, diverse diet products and specialty supplements, including ephedra-free and low-carbohydrate weight management products and new sports formulas and delivery systems. During the twelve months ended December 31, 2004 and 2003, we launched 73 and 37 new products, respectively.

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Research and Development

We have an internal research and development group that performs scientific research on potential new products and enhancements to existing products, in part to assist our product development team in creating new products, and in part to support claims that may be made as to the purpose and function of the product. We incurred $1.7 million, $0.1 million, $1.0 million and $1.4 million in our internal research and development for the twelve months ended December 31, 2004, the 27 days ended December 31, 2003, the period from January 1, 2003 to December 4, 2003, and the year ended December 31, 2002, respectively. Additionally, prior to the Acquisition, Numico provided research and development services and allocated costs to us of $4.2 million and $4.6 million for the period ended December 4, 2003, and the year ended December 31, 2002, respectively.

NSF Certification

On a voluntary basis the Company is fully pursuing a program to ensure that GNC branded products and manufacturing facilities meet the rigorous requirements of the National Sanitation Foundation s (NSF) independent testing and certification program. NSF is an independent, not-for-profit testing organization offering product testing of supplements. NSF conducts product testing in their own accredited laboratories to ensure that the actual contents of supplements match those printed on the label. There are three main components of the NSF Dietary Supplements Certification Program: (1) Verification that the contents of the supplement actually match what is printed on the label, (2) assurance that there are no ingredients present in the supplement that are not openly disclosed on the label, and (3) assurance that there are no unacceptable levels of contaminants present in the supplement. Supplements that have been certified by NSF, are regularly checked through NSF conducted annual audits and periodical retests of each supplement to ensure continued compliance. The Company products that have been certified thus far can be found on NSF s Internet website at the following address: www.nsf.org.

Franchise

Our Franchise segment is comprised of our domestic and international franchise operations. Our Franchise segment generates revenues from franchise activities primarily through product sales to franchisees, royalties on franchise retail sales and franchise fees.

As a means of enhancing our operating performance and building our store base, we began opening franchised locations in 1988. As of December 31, 2004, there were 2,036 franchised stores operating, including 1,297 stores in the United States and Canada and 739 stores operating in other international locations. Approximately 90% of our franchises in the United States are in strip shopping centers and are typically between 1,200 and 1,800 square feet. The international franchised stores are smaller, typically an average of 750 square feet and, depending upon the country and cultural preferences, are located in mall, strip shopping center, street or store-within-a-store locations. Typically, our international stores have a store format and signage similar to our U.S. franchised stores. To assist our franchisees in the successful operation of their stores and to protect our brand image, we offer site selection, construction assistance, accounting services and a three-part training program, which consists of classroom instruction, training in a company-owned location and actual on-site training after the franchised store opens. We believe we have good relationships with our franchisees, as evidenced by our franchisee renewal rate of over 98% between 2000 and 2004. In addition, we do not have heavy reliance on any single franchise operator in the United States, as the largest franchisee owns and/or operates 15 store locations.

All of our franchised stores in the United States offer both our proprietary products and third-party products, with a product selection similar to that of our company-owned stores. Our international franchised stores offer a more limited product selection than our franchised stores in the United States. Products are distributed to our franchised stores in the United States through our distribution centers and transportation fleet in the same manner as our company-owned

stores.

Franchises in the United States

Revenues from our franchisees in the United States accounted for approximately 82% of our total franchise revenues for the year ended December 31, 2004. In 2004, new franchisees in the United States were required to pay an initial fee of $40,000 for a franchise license. Existing GNC franchise operators may purchase an additional franchise license at the rate of $30,000. We typically offer limited financing to qualified franchisees in the United States for terms up to five years. Once a store is established, franchisees are required to pay us a continuing royalty of 6% of sales and contribute 3% of sales to a national advertising fund. Our standard franchise agreements for the United States are effective for a ten-year period with two five-year renewal options. At the end of the initial term and each of the renewal periods, the renewal fee is 33% of the franchisee fee that is then in effect. The franchisee renewal option is at our election for all franchise agreements executed after December 1995. Our franchisees in the United States receive limited geographical exclusivity and are required to follow the GNC store format.

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Franchisees must meet certain minimum standards and duties prescribed by our franchise operations manual and we conduct periodic field visit reports to ensure our minimum standards are maintained. Generally, we enter into a five-year lease with two five-year renewal options with landlords for our franchised locations in the United States. This allows us to secure space at cost-effective rates, which we sublease to our franchisees at cost. By subleasing to our franchisees, we have greater control over the location and have greater bargaining power for lease negotiations than an individual franchisee typically would have, and we can elect not to renew subleases for underperforming locations. If a franchisee does not meet specified performance and appearance criteria, the franchise agreement specifies the procedures under which we are permitted to terminate the franchise agreement. In these situations, we may take possession of the location, inventory, and equipment, and operate the store as a company-owned store or re-franchise the location. Our U.S. franchise agreements and operations in the United States are regulated by the FTC. See the subsequent Government Regulation and Franchise Regulation sections in this Report.

International Franchises

Revenues from our international franchises accounted for approximately 18% of our total franchise revenues for the year ended December 31, 2004. In 2004, new international franchisees were required to pay an average initial fee of approximately $20,000 for a franchise license for each store and on average continuing royalty fees of approximately 5%, with fees and royalties varying depending on the country and the store type. Our franchise program has enabled us to expand into international markets with limited capital expenditures. We expanded our international presence from 457 international franchised locations at the end of 2001 to 746 international locations as of December 31, 2004, without incurring any capital expenditures related to such expansion. Our international franchised stores generate greater sales per square foot of store space than our domestic store locations. However, we typically generate less revenue from franchises outside the United States due to lower international royalty rates and due to the franchises purchasing a smaller percentage of products from us compared to our domestic franchises.

Franchisees in international locations enter into development agreements with us for either full size stores or a store-within-a-store at a host location. The development agreement grants the franchisee the right to develop a specific number of stores in a territory, often the entire country. The international franchisee then enters into a franchise agreement for each location. The full-size store franchise agreement has an initial ten-year term with two five-year renewal options. At the end of the initial term and renewal periods, the international franchisee has the option to renew the agreement at 33% of the franchise fee that is then in effect. Franchise agreements for international store-within-a-store locations have an initial term of five years, with two five-year renewal options. At the end of the initial term and each of the renewal periods, the international franchisee of a store-within-a-store location has the option to renew the agreement for 50% of the franchise fee that is then in effect. Our international franchisees often receive exclusive franchising rights to the entire country franchised, excluding military bases. Our international franchisee must meet minimum standards and duties similar to our U.S. franchisees and our international franchise agreements and international operations may be regulated by various state, local and international laws. See the subsequent Government Regulation and Franchise Regulation sections in this Report.

Manufacturing/Wholesale

Our Manufacturing/Wholesale segment is comprised of our manufacturing operations in South Carolina and Australia and our wholesale sales business. This segment supplies our Retail and Franchise segments as well as various third parties with finished products. Our Manufacturing/Wholesale segment generates revenues through sales of manufactured products to third parties, and the sale of our proprietary and third-party brand products to Rite Aid and drugstore.com.

Manufacturing

Our technologically sophisticated manufacturing and warehousing facilities support our Retail and Franchise segments and enable us to control the production and distribution of our proprietary products, to better control costs, to protect product quality, to monitor delivery times and to maintain appropriate inventory levels. We operate two main manufacturing facilities in the United States, one in Greenville, South Carolina and one in Anderson, South Carolina and a smaller facility in Australia. We utilize our plants primarily for the production of proprietary products. Our manufacturing operations are designed to allow low-cost production of a variety of products of different quantities, sizes and packaging configurations while maintaining strict levels of quality control. Our manufacturing procedures are designed to promote consistency and quality in our finished goods. We conduct sample testing on raw materials and finished products, including weight, purity and micro-bacterial testing. Our manufacturing facilities also service our wholesale operations, including the manufacture and supply of Rite Aid private label products for distribution to Rite Aid locations. We also use our available capacity at these facilities to produce products for sale to third-party customers.

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The principal raw materials used in the manufacturing process are natural and synthetic vitamins, herbs, minerals, and gelatin. We maintain multiple sources for the majority of our raw materials, with the remaining being single sourced due to the uniqueness of the material. As of December 31, 2004, no one vendor supplied more than 10% of our raw materials. In the event any of our third-party suppliers or vendors were to become unable or unwilling to continue to provide raw materials in the required volumes and quality levels or in a timely manner, we would be required to identify and obtain acceptable replacement supply sources. If we are unable to obtain alternative suppliers, our business could be adversely affected. Our distribution fleet delivers raw materials and components to our manufacturing facilities and also delivers our finished goods and third-party products to our distribution centers.

Wholesale

Store-Within-a-Store Locations

To increase brand awareness and promote access to customers who may not frequent specialty nutrition stores, we entered into a strategic alliance with Rite Aid to open GNC store-within-a-store locations. As of December 31, 2004, we had 1,027 store-within-a-store locations. Through this strategic alliance, we generate revenues from sales to Rite Aid of our products at wholesale prices, the manufacture of Rite Aid private label products, retail sales of consignment inventory and license fees. We are Rite Aid s sole supplier for the PharmAssure® vitamin brand and a number of Rite Aid private label supplements. In May 2004, we extended our alliance with Rite Aid through April 30, 2009, with Rite Aid s commitment to open 300 new store-within-a-store locations by December 31, 2006. At December 31, 2004, Rite Aid had opened 42 of these 300 new store-within-a-store locations.

Distribution Agreement with drugstore.com

We have an Internet distribution agreement with drugstore.com, inc. Through this strategic alliance, drugstore.com became the exclusive Internet retailer of our proprietary products, the PharmAssure vitamin brand and certain other nutritional supplements. The initial term of the agreement expires in July 2009, subject to early termination provisions, and the exclusivity period expires in June 2005. This alliance allows us to access a larger customer base, who may not otherwise live close to, or have the time to visit, a GNC store. We generate revenues from the distribution agreement with drugstore.com through sales of our proprietary and third-party products on a wholesale basis and through retail sales of certain other products on a consignment basis.

Our wholesale operations, including our Rite Aid and drugstore.com wholesale operations, are supported primarily by our Anderson, S.C. distribution center.

Competition

The U.S. nutritional supplements retail industry is a large, highly fragmented and growing industry, with no single industry participant accounting for a majority of total industry retail sales. Competition is based primarily on price, quality and assortment of products, customer service, marketing support and availability of new products. In addition, the market is highly sensitive to the introduction of new products.

We compete with publicly owned and privately owned companies, which are highly fragmented in terms of geographical market coverage and product categories. We compete with other specialty retailers, supermarkets, drugstores, mass merchants, multi-level marketing organizations, mail order companies and a variety of other smaller participants. In addition, the market is highly sensitive to the introduction of new products, including various prescription drugs, which may rapidly capture a significant share of the market. In the United States, we compete with supermarkets, drugstores and mass merchants with heavily advertised national brands manufactured by large pharmaceutical and food companies and other retailers. Most supermarkets, drugstores and mass merchants have

narrow product offerings limited primarily to simple vitamins and herbs and popular third-party diet products. Our international competitors also include large international pharmacy chains and major international supermarket chains as well as other large U.S.-based companies with international operations. Our wholesale and manufacturing operations also compete with other wholesalers and manufacturers of third-party nutritional supplements.

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Trademarks and Other Intellectual Property

We believe trademark protection is particularly important to the maintenance of the recognized brand names under which we market our products. We own or have rights to material trademarks or trade names that we use in conjunction with the sale of our products, including the GNC brand name. We also rely upon trade secrets, know-how, continuing technological innovations and licensing opportunities to develop and maintain our competitive position. We protect our intellectual property rights through a variety of methods, including trademark, patent and trade secret laws, as well as confidentiality agreements and proprietary information agreements with vendors, employees, consultants and others who have access to our proprietary information. Protection of our intellectual property often affords us the opportunity to enhance our position in the marketplace by precluding our competitors from using or otherwise exploiting our technology and brands. We are also a party to several intellectual property license agreements relating to certain of our products. For example, several of our products are covered by patents which we license from Numico. The scope and duration of our intellectual property protection varies throughout the world by jurisdiction and by individual product.

Insurance and Risk Management

We purchase insurance to cover standard risks in the nutritional supplements industry, including policies to cover general products liability, workers compensation, auto liability and other casualty and property risks. Our insurance rates are based on our safety record as well as trends in the insurance industry. We also maintain workers compensation insurance and auto insurance policies that are retrospective in that the cost per year will vary depending on the frequency and severity of claims in the policy year. Prior to the Acquisition, we were covered by some of Numico s insurance policies. Following the consummation of the Acquisition, we obtained our own insurance policies to replace those Numico policies, including policies for general product liability. We currently maintain products liability insurance and general liability insurance.

We face an inherent risk of exposure to product liability claims in the event that, among other things, the use of products sold by GNC results in injury. With respect to product liability coverage, we carry insurance coverage typical of our industry and product lines. Our coverage involves self-insured retentions with primary and excess liability coverage above the retention amount. We have the ability to refer claims to most of our vendors and their insurers to pay the costs associated with any claims arising from such vendors products. In most cases, our insurance covers such claims that are not adequately covered by a vendor s insurance and provides for excess secondary coverage above the limits provided by our product vendors.

We self-insure certain property and casualty risks due to our analysis of the risk, the frequency and severity of a loss, and the cost of insurance for the risk. We believe that the amount of self-insurance is not significant and will not have an adverse impact on our performance. In addition, we may from time to time self-insure liability with respect to specific ingredients in products that we may sell.

Employees

As of December 31, 2004, we had a total of 5,120 full-time and 8,498 part-time employees, of whom approximately 11,204 were employed in our Retail segment; 39 were employed in our Franchise segment; 1,225 were employed in our Manufacturing/Wholesale segment; 527 were employed in corporate support functions; and 623 were employed in Canada. None of our employees belongs to a union or is a party to any collective bargaining or similar agreement. We consider our relationships with our employees to be good.

Government Regulation

Product Regulation

Domestic

The processing, formulation, manufacturing, packaging, labeling, advertising and distribution of our products are subject to regulation by one or more federal agencies, including the Food and Drug Administration (FDA), the Federal Trade Commission (FTC), 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 our products are sold. Pursuant to the Federal Food, Drug, and Cosmetic Act (FDCA), the FDA regulates the formulation, safety, manufacture, packaging, labeling and distribution of dietary supplements, (including vitamins, minerals, and herbs) and over-the-counter drugs. The FTC has jurisdiction to regulate the advertising of these products.

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The FDCA has been amended several times with respect to dietary supplements, in particular by the Dietary Supplement Health and Education Act of 1994 (DSHEA). DSHEA established a new framework governing the composition, safety, labeling and marketing of dietary supplements. Dietary supplements are defined as vitamins, minerals, herbs, other botanicals, amino acids and other dietary substances for human use to supplement the diet, as well as concentrates, metabolites, constituents, extracts or combinations of such dietary ingredients. Generally, under DSHEA, dietary ingredients that were on the market prior to October 15, 1994 may be used in dietary supplements without notifying the FDA. New dietary ingredients (i.e., dietary ingredients that were not marketed in the United States before October 15, 1994) must be the subject of a new dietary ingredient notification submitted to the FDA unless the ingredient has been present in the food supply as an article used for food without being chemically altered. A new dietary ingredient notification must provide the FDA evidence of a history of use or other evidence of safety establishing that use of the dietary ingredient will reasonably be expected to be safe. A new dietary ingredient notification must be submitted to the FDA at least 75 days before the initial marketing of the new dietary ingredient. There is no certainty that the FDA will accept any particular evidence of safety for any new dietary ingredient. The FDA s refusal to accept such evidence could prevent the marketing of such dietary ingredients.

The FDA issued a consumer warning in 1996, followed by proposed regulations in 1997, covering dietary supplements that contain ephedra or an active substance, ephedrine alkaloids. In February 2003 the Department of Health and Human Services announced a series of actions that the Department of Health and Human Services and the FDA planned to execute with respect to products containing ephedra, including the solicitation of evidence regarding the significant or unreasonable risk of illness or injury from dietary supplements containing ephedra and the immediate execution of a series of actions against ephedra products making unsubstantiated claims about sports performance enhancement. In addition, many states proposed regulations and three states enacted laws restricting the promotion and distribution of ephedra-containing dietary supplements. The botanical ingredient ephedra was formerly used in several third-party and private label dietary supplement products. In January 2003, we began focusing our diet category on products that would replace ephedra products. In early 2003, we instructed all of our locations to stop selling products containing ephedra that were manufactured by GNC or one of our affiliates. Subsequently, we instructed all of our locations to stop selling any products containing ephedra by June 30, 2003. Sales of products containing ephedra amounted to approximately $35.2 million or 3.3% of our retail sales in 2003 and $182.9 million, or 17.1% of our retail sales in 2002. In February 2004, the FDA issued a final regulation declaring dietary supplements containing ephedra illegal under the FDCA because they present an unreasonable risk of illness or injury under the conditions of use recommended or suggested in labeling, or if no conditions of use are suggested or recommended in labeling, under ordinary conditions of use. The rule took effect April 12, 2004 and banned the sale of dietary supplement products containing ephedra. Similarly, the FDA issued a consumer advisory in 2002 with respect to dietary supplements that contain the ingredient Kava, and the FDA is currently investigating adverse effects associated with ingestion of this ingredient. One of our subsidiaries, Nutra Manufacturing, Inc. (f/k/a Nutricia Manufacturing USA, Inc.) manufactured products containing Kava Kava from December 1995 until August 2002. All stores were instructed to stop selling products containing Kava Kava in December 2002. The FDA could take similar actions against other products or product ingredients which it determines present an unreasonable health risk to consumers.

DSHEA permits statements of nutritional support to be included in labeling for dietary supplements without FDA pre-market approval. Such statements must be submitted to FDA within thirty days of marketing and must bear a label disclosure that This statement has not been evaluated by the Food and Drug Administration. This product is not intended to diagnose, treat, cure, or prevent any disease. Such statements may describe how a particular dietary ingredient affects the structure, function or general well-being of the body, or the mechanism of action by which a dietary ingredient may affect body structure, function or well-being, but may not expressly or implicitly represent that a dietary supplement will diagnose, cure, mitigate, treat, or prevent a disease. A company that uses a statement of nutritional support in labeling must possess scientific evidence substantiating that the statement is truthful and not misleading. If the FDA determines that a particular statement of nutritional support is an unacceptable drug claim or

an unauthorized version of a health claim, or, if the FDA determines that a particular claim is not adequately supported by existing scientific data or is false or misleading, we would be prevented from using the claim.

In addition, DSHEA provides that so-called third-party literature, e.g., a reprint of a peer-reviewed scientific publication linking a particular dietary ingredient with health benefits, may be used in connection with the sale of a dietary supplement to consumers without the literature being subject to regulation as labeling. Such literature: (1) must not be false or misleading; (2) may not promote a particular manufacturer or brand of dietary supplement; (3) must present balanced view of the available scientific information on the subject matter; (4) if displayed in an establishment, it must be physically separate from the dietary supplements; and (5) should not have appended to it any information by sticker or any other method. If the literature fails to satisfy each of these requirements, we may be prevented from disseminating such literature with our products, and any dissemination could subject our product to regulatory action as an illegal drug.

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We expect that the FDA will adopt in the near future the final regulations, proposed on March 13, 2003, regarding Good Manufacturing Practice in manufacturing, packing, or holding dietary ingredients and dietary supplements authorized by DSHEA. These regulations would require dietary supplements to be prepared, packaged and held in compliance with certain rules, and might require quality control provisions similar to those in the Good Manufacturing Practice regulations for drugs. We or our third-party suppliers or vendors may not be able to comply with the new rules without incurring substantial additional expenses. In addition, if our third-party suppliers or vendors are not able to timely comply with the new rules, we may experience increased costs or delays in obtaining certain raw materials and third-party products.

The FDA has broad authority to enforce the provisions of the FDCA applicable to dietary supplements, including powers to issue a public warning letter to a company, to publicize information about illegal products, to request a recall of illegal products from the market, and to request the Department of Justice to initiate a seizure action, an injunction action, or a criminal prosecution in the United States courts. The regulation of dietary supplements may increase or become more restrictive in the future.

Legislation was pending in Congress in 2004 to impose substantial new regulatory requirements for dietary supplements, e.g., S.722, S.1538, S.1780, H.R. 3377 and H.R. 3866. S.722 would have imposed adverse event reporting, post market surveillance requirements, FDA reviews of dietary supplement ingredients, and other requirements. H.R. 3377 would have imposed similar requirements as well as safety testing and records inspection. S.1538 would have increased FDA appropriations to allow full implementation and enforcement of DSHEA. The dietary supplement industry supported S.1538. Key members of Congress and the dietary supplement industry have indicated that they have reached agreement to support legislation requiring adverse event reporting. If enacted, S.722 and H.R. 3377 would have raised our costs and hindered our business. While these bills are no longer pending, we anticipate these bills will be reintroduced in 2005. In October 2004, legislation was passed subjecting specified substances currently used in some dietary supplements, such as androstenedione or andro, to the requirements of the Controlled Substances Act. Under the new law, these substances may no longer be sold as dietary supplements.

The FTC exercises jurisdiction over the advertising of dietary supplements. In recent years, the FTC has instituted numerous enforcement actions against dietary supplement companies for failure to have adequate substantiation for claims made in advertising or for the use of false or misleading advertising claims. We continue to be subject to three consent orders issued by the FTC. In 1984, the FTC instituted an investigation of General Nutrition, Incorporated, one of our subsidiaries, alleging deceptive acts and practices in connection with the advertising and marketing of certain of its products. General Nutrition, Incorporated accepted a proposed consent order which was finalized in 1989, under which it agreed to refrain from, among other things, making certain claims with respect to certain of its products unless the claims are based on and substantiated by reliable and competent scientific evidence. We also entered into a consent order in 1970 with the FTC, which generally addressed iron deficiency anemia type products. As a result of routine monitoring by the FTC, disputes arose concerning its compliance with these orders, and with regard to advertising for certain hair care products. While General Nutrition, Incorporated believes that, at all times, it operated in material compliance with the orders; it entered into a settlement in 1994 with the FTC to avoid protracted litigation. As a part of this settlement, General Nutrition, Incorporated entered into a consent decree and paid, without admitting liability, a civil penalty in the amount of $2.4 million and agreed to adhere to the terms of the 1970 and 1989 consent orders and to abide by the provisions of the settlement document concerning hair care products. We do not believe that future compliance with the outstanding consent decrees will materially affect our business operations. In 2000, the FTC amended the 1970 order to clarify language in the 1970 order that was believed to be ambiguous and outmoded.

The FTC continues to monitor our advertising and, from time to time, requests substantiation with respect to such advertising to assess compliance with the various outstanding consent decrees and with the Federal Trade Commission Act. Our policy is to use advertising that complies with the consent decrees and applicable regulations. We review all

products brought into our distribution centers to assure that such products and their labels comply with the consent decrees. We also review the use of third-party point of purchase materials such as store signs and promotional brochures. Nevertheless, there can be no assurance that inadvertent failures to comply with the consent decrees and applicable regulations will not occur. Approximately 20% of the products sold by franchised stores are purchased by franchisees directly from other vendors and these products do not flow through our distribution centers. Although franchise contracts contain strict requirements for store operations, including compliance with federal, state, and local laws and regulations, we cannot exercise the same degree of control over franchisees as we do over our company-owned stores. As a result of our efforts to comply with applicable statutes and regulations, we have from time to time reformulated, eliminated or relabeled certain of our products and revised certain provisions of our sales and marketing program. We believe we are in material compliance with the various consent decrees and with applicable federal, state and local rules and regulations concerning our products and marketing program. Compliance with the provisions of national, state and local environmental laws and regulations has not had a material effect upon our capital expenditures, earnings, financial position, liquidity or competitive position.

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Foreign

Our products sold in foreign countries are also subject to regulation under various national, local, and international laws that include provisions governing, among other things, the formulation, manufacturing, packaging, labeling, advertising and distribution of dietary supplements and over-the-counter drugs. Government regulations in foreign countries may prevent or delay the introduction, or require the reformulation, of certain of our products. We cannot determine what effect additional domestic or international governmental legislation, regulations or administrative orders, when and if promulgated, would have on our business in the future. New legislation or regulations may require the reformulation of certain products to meet new standards, require the recall or discontinuance of certain products not capable of reformulation, impose additional record keeping or require expanded documentation of the properties of certain products, expanded or different labeling, or scientific substantiation.

Franchise Regulation

We must comply with regulations adopted by the FTC and with several state laws that regulate the offer and sale of franchises. The FTC s Trade Regulation Rule on Franchising and certain state laws require that we furnish prospective franchisees with a franchise offering circular containing information prescribed by the Trade Regulation Rule on Franchising and applicable state laws and regulations.

We also must comply with a number of state laws that regulate some substantive aspects of the franchisor-franchisee relationship. These laws may limit a franchisor s business practices in a number of ways, including limiting the ability to:

terminate or not renew a franchise without good cause;

interfere with the right of free association among franchisees;

disapprove the transfer of a franchise;

discriminate among franchisees with regard to charges, royalties and other fees; and

place new stores near existing franchises.

To date, these laws have not precluded us from seeking franchisees in any given area and have not had a material adverse effect on our operations. Bills intended to regulate certain aspects of franchise relationships have been introduced into Congress on several occasions during the last decade, but none have been enacted.

Our international franchise agreements and franchise operations are regulated by various foreign laws, rules and regulations. To date, these laws have not precluded us from seeking franchisees in any given area and have not had a material adverse effect on our operations.

Environmental Compliance

We are subject to numerous federal, state, local and foreign environmental laws and regulations governing our operations, including the handling, transportation and disposal of our products, and our non-hazardous and hazardous substances and wastes, as well as emissions and discharges into the environment, including discharges to air, surface water and groundwater. Failure to comply with such laws and regulations could result in costs for corrective action, penalties or the imposition of other liabilities. Changes in laws or the interpretation thereof or the development of new facts could also cause us to incur additional capital and operation expenditures to maintain compliance with environmental laws and regulations. We also are 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 properties to which substances or wastes were sent by current or former operations at our facilities. The presence of contamination from such substances or wastes could also adversely affect our ability to sell or lease our properties, or to use them as collateral for financing. From time to time, we have incurred costs and obligations for correcting environmental noncompliance matters and for remediation at or relating to certain of our properties. We believe we have complied with, or are currently complying with our environmental obligations to date and that such liabilities will not have a material adverse effect on our business or financial performance. However, it is difficult to predict future liabilities and obligations which could be material.

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Risk Factors

The following risk factors, among others, could cause our financial performance to differ significantly from the goals, plans, objectives, intentions and expectations expressed in this Report. If any of the following risks and uncertainties or other risks and uncertainties not currently known to us or not currently considered to be material actually occur, our business, financial condition or operating results could be harmed substantially.

Risks Related to Our Substantial Indebtedness

Our substantial indebtedness could adversely affect our financial condition and otherwise adversely impact our operating income and growth prospects.

As of December 31, 2004, our total indebtedness was approximately $510.4 million, and we had an additional $67.0 million available for borrowing on a secured basis under our revolving credit facility after giving effect to the use of $8.0 million of the revolving credit facility to secure letters of credit.

Our substantial indebtedness could have important consequences to you. For example, it could:

- require us to use all or a large portion of our cash to pay principal and interest on our indebtedness, which could reduce the availability of our cash to fund working capital, capital expenditures and other business activities;
- increase our vulnerability to general adverse economic and industry conditions;
- limit our flexibility in planning for, or reacting to, changes in our business and the industry in which we operate;
- restrict us from making strategic acquisitions or exploiting business opportunities;
- make it more difficult for us to satisfy our obligations with respect to our indebtedness;
- place us at a competitive disadvantage compared to our competitors that have less debt; and
- limit our ability to borrow additional funds, dispose of assets or pay cash dividends.

Furthermore, all of our indebtedness under our credit facilities bears interest at variable rates. If these rates were to increase significantly, our ability to borrow additional funds may be reduced and the risks related to our substantial indebtedness would intensify.

If we are unable to meet our obligations with respect to our indebtedness, we could be forced to restructure or refinance our indebtedness, seek equity financing or sell assets. If we are unable to restructure, refinance or sell assets in a timely manner or on terms satisfactory to us, we may default under our obligations. As of December 31, 2004, substantially all of our indebtedness described above was subject to acceleration clauses. A default on any of our indebtedness obligations could trigger such acceleration clauses and cause those and our other obligations to become immediately due and payable. Upon an acceleration of such indebtedness, we may not be able to make payments under our indebtedness.

We will require a significant amount of cash to service our indebtedness. Our ability to generate cash depends on many factors beyond our control and, as a result, we may not be able to make payments on our debt obligations.

Our ability to make payments on and to refinance our indebtedness and to fund planned capital expenditures, product development efforts and other business activities, will depend on our ability to generate cash in the future. This is subject, to a certain extent, to general economic, financial, competitive, legislative, regulatory and other factors, many of which are beyond our control.

We may be unable to generate sufficient cash flow from operations, to realize anticipated cost savings and operating improvements on schedule or at all, or to obtain future borrowings under our credit facilities or otherwise in an amount sufficient to enable us to pay our indebtedness, or to fund our other liquidity needs. If we do not have sufficient liquidity, we may need to refinance or restructure all or a portion of our indebtedness on or before maturity, sell assets or borrow more money. We may not be able to do so on terms satisfactory to us or at all.

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Despite our and our subsidiaries current significant level of indebtedness, we may still be able to incur more indebtedness, which would intensify the risks described above.

We and our subsidiaries may be able to incur substantial additional indebtedness in the future, including secured indebtedness. Although our credit facilities, the indenture governing Centers 8 5/8% Senior Notes due 2011 (the Senior Notes) and the indenture governing Centers 8 1/2% Senior Subordinated Notes due 2010 (the Senior Subordinated Notes) contain restrictions on the incurrence of additional indebtedness, these restrictions are subject to a number of qualifications and exceptions and, under certain circumstances, indebtedness incurred in compliance with these restrictions could be substantial. If additional indebtedness is added to our or our subsidiaries current levels of indebtedness, the substantial risks described above would intensify.

Our indebtedness imposes restrictions on us that may affect our ability to successfully operate our business and our ability to make payments on our indebtedness.

The credit facilities and the indenture governing the Senior Notes and the indenture governing the Senior Subordinated Notes include certain covenants that, among other things, restrict our ability to:

incur additional indebtedness and issue preferred stock;

make restricted payments;

allow restrictions on the ability of certain subsidiaries to make distributions;

sell assets;

enter into certain transactions with affiliates; and

create liens.

We are also required by our credit facilities to maintain certain financial ratios, including, but not limited to, fixed charge coverage and maximum total leverage ratios. These covenants in our debt instruments may restrict our ability to expand or to fully pursue our business strategies and opportunities. Our ability to comply with these and other provisions of the indenture governing the Senior Notes, the indenture governing the Senior Subordinated Notes and the credit facilities may be affected by changes in our operating and financial performance, changes in general business and economic conditions, adverse regulatory developments or other events beyond our control. The breach of any of these covenants could result in a default under our indebtedness, which could cause those and other obligations to become immediately due and payable. If any of our indebtedness is accelerated, we may not be able to repay it.

Risks Relating to Our Business and Industry

We operate in a highly competitive industry. Our failure to compete effectively could adversely affect our market share, revenues and growth prospects.

The U.S. nutritional supplements retail industry is a large, highly fragmented and growing industry, with no single industry participant accounting for more than 10% of total industry retail sales. Participants include specialty retailers, supermarkets, drugstores, mass merchants, multi-level marketing organizations, on-line merchants, mail order companies and a variety of other smaller participants. The market is also highly sensitive to the introduction of new products, including various prescription drugs, which may rapidly capture a significant share of the market. In the United States, we also compete for sales with heavily advertised national brands manufactured by large pharmaceutical and food companies, as well as the Nature s Bounty® and Nature s Wealth® brands, sold by Vitamin

World® and other retailers. In addition, as certain products become more mainstream, we experience increased competition for those products as more participants enter the market. For example, as the trend in favor of low-carbohydrate products has developed, we have experienced increased competition for our diet products from supermarkets, drug stores, mass merchants and other food companies, which has adversely affected sales of our diet products. Our international competitors also include large international pharmacy chains, major international supermarket chains and other large U.S.-based companies with international operations. Our wholesale and manufacturing operations also compete with other wholesalers and manufacturers of third-party nutritional supplements such as Tree of Life® and Leiner Health Products. We may not be able to compete effectively and our attempt to do so may require us to reduce our prices, which may result in lower margins. Failure to effectively compete could adversely affect our market share, revenues and growth prospects.

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Unfavorable publicity or consumer perception of our products and any similar products distributed by other companies could cause fluctuations in our operating results and could have a material adverse effect on our reputation, the demand for our products, and our ability to generate revenues.

We are highly dependent upon consumer perception regarding the safety and quality of our products, as well as similar products distributed by other companies. Consumer perception of products can be significantly influenced by scientific research or findings, national media attention and other publicity about product use. A product may be received favorably, resulting in high sales associated with that product that may not be sustainable as consumer preferences change. Future scientific research or publicity could be unfavorable to our industry or any of our particular products and may not be consistent with earlier favorable research or publicity. A future research report or publicity that is perceived by our consumers as less favorable or that questions such earlier research or publicity could have a material adverse effect on our ability to generate revenues. For example, sales of some of our VMHS products, such as St. John s Wort, Sam-e and Melatonin, were initially strong, but decreased substantially as a result of negative publicity. As a result of the above factors, our operations may fluctuate significantly from quarter-to-quarter, which may impair our ability to make payments when due on our indebtedness. Period-to-period comparisons of our results should not be relied upon as a measure of our future performance. Adverse publicity in the form of published scientific research or otherwise, whether or not accurate, that associates consumption of our products or any other similar products with illness or other adverse effects, that questions the benefits of our or similar products or that claims that any such products are ineffective could have a material adverse effect on our reputation, the demand for our products, and our ability to generate revenues.

We may incur material product liability claims, which could increase our costs and adversely affect our reputation, revenues and operating income.

As a retailer, distributor and manufacturer of products designed for human consumption, we are subject to product liability claims if the use of our products is alleged to have resulted in injury. Our products consist of vitamins, minerals, herbs and other ingredients that are classified as foods or dietary supplements and are not subject to pre-market regulatory approval in the United States. Our products could contain contaminated substances, and some of our products contain innovative ingredients that do not have long histories of human consumption. Previously unknown adverse reactions resulting from human consumption of these ingredients could occur. In addition, many of the products we sell are produced by third-party manufacturers. As a distributor of products manufactured by third parties, we may also be liable for various product liability claims for products we do not manufacture. We have been in the past, and may be in the future, subject to various product liability claims, including, among others, that our products include inadequate instructions for use or inadequate warnings concerning possible side effects and interactions with other substances. For example, as of December 31, 2004, we have been named as a defendant in 180 pending cases involving the sale of products that contain ephedra. See the Legal Proceedings section of this report. A product liability claim against us could result in increased costs and could adversely affect our reputation with our customers, which in turn could adversely affect our revenues and operating income. All claims to date have been tendered to the third-party manufacturer or to our insurer and we have incurred no expense to date with respect to litigation involving ephedra products. Furthermore, we are entitled to indemnification by Numico for certain losses arising from claims related to products containing ephedra sold prior to December 5, 2003. All of the pending cases relate to products sold prior to such time and, accordingly, we are entitled to indemnification from Numico for all of the pending cases.

Changes in our management team could affect our business strategy and adversely impact our performance and results of operations.

In early December, our board of directors appointed Robert J. DiNicola, our Chairman of the Board of Directors, as our interim Chief Executive Officer and Curtis J. Larrimer, our former Corporate Controller, as our Chief Financial

Officer. These and other changes in management could result in changes to, or impact the execution of, our business strategy. Any such changes could be significant and could have a negative impact on our performance and results of operations. In addition, if we are unable to successfully locate and integrate a permanent replacement CEO in a timely fashion or transition the other members of management into their new positions, management resources could be constrained.

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Compliance with new and existing governmental regulations could increase our costs significantly and adversely affect our operating income.

The processing, formulation, manufacturing, packaging, labeling, advertising and distribution of our products are subject to federal laws and regulation by one or more federal agencies, including the Food and Drug Administration (FDA), the Federal Trade Commission (FTC), the Consumer Product Safety Commission, the United States Department of Agriculture and the Environmental Protection Agency. These activities are also regulated by various state, local and international laws and agencies of the states and localities in which our products are sold. Government regulations may prevent or delay the introduction, or require the reformulation, of our products, which could result in lost revenues and increased costs to us. In addition, we may be unable to market particular products or use certain statements of nutritional support on our products as a result of regulatory determinations, which could adversely affect our sales of those products. The FDA also could require us to remove a particular product from the market. For example, in April 2004, the FDA banned the sale of products containing ephedra. Sale of products containing ephedra amounted to approximately $35.2 million, or 3.3% of our retail sales, in 2003 and approximately $182.9 million, or 17.1% of our retail sales, in 2002. Any future recall or removal would result in additional costs to us, including lost revenues from any additional products that we are required to remove from the market, any of which could be material. Any such product recalls or removals could also lead to liability, substantial costs and reduced growth prospects.

Additional or more stringent regulations of dietary supplements and other products have been considered from time to time. Such developments could require reformulation of certain products to meet new standards, recalls or discontinuance of certain products not able to be reformulated, additional record-keeping requirements, increased documentation of the properties of certain products, additional or different labeling, additional scientific substantiation, adverse event reporting or other new requirements. Any such developments could increase our costs significantly. For example, legislation has been introduced in Congress to impose substantial new regulatory requirements for dietary supplements including adverse event reporting, postmarket surveillance requirements, FDA reviews of dietary supplement ingredients, safety testing and records inspection, and key members of Congress and the dietary supplement industry have indicated that they have reached an agreement to support legislation requiring adverse event reporting. If enacted, new legislation could raise our costs and negatively impact our business. In addition, we expect that the FDA soon will adopt the proposed rules on Good Manufacturing Practice in manufacturing, packaging, or holding dietary ingredients and dietary supplements, which will apply to the products we manufacture. We may not be able to comply with the new rules without incurring additional expenses, which could be significant. See the sections entitled Government Regulation Product Regulation included elsewhere in this document for additional information.

A substantial amount of our revenues are generated from our franchisees, and our revenues could decrease significantly if our franchisees do not conduct their operations profitably or we fail to attract new franchisees.

As of December 31, 2004 and December 31, 2003, approximately 36% and 35%, respectively, of our retail locations were operated by franchisees. Approximately 17% and 18% of our revenues were generated from our franchise operations for the years ended December 31, 2004 and December 31, 2003, respectively. Our revenues from franchised stores depend on the franchisees ability to operate their stores profitably and adhere to our franchise standards. The closing of unprofitable stores or the failure of franchisees to comply with our policies could adversely affect our reputation and could reduce the amount of our franchise revenues. These factors could have a material adverse effect on our revenues and operating income.

If we are unable to attract new franchisees or to convince existing franchisees to open additional stores, any growth in royalties from franchised stores will depend solely upon increases in revenues at existing franchised stores, which could be minimal. In addition, our ability to open additional franchised locations is limited by the territorial

restrictions in our existing franchise agreements as well as our ability to identify additional markets in the United States and Canada that are not currently saturated with the products we offer. If we are unable to open additional franchised locations, we will have to sustain additional growth internally by attracting new and repeat customers to our existing locations. If we are unable to do so, our revenues and operating income may decline significantly.

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Economic, political and other risks associated with our international operations could adversely affect our revenues and international growth prospects.

As of December 31, 2004, we had 739 international franchised stores in 37 international markets (excluding Canada). For the years ended December 31, 2003 and December 31, 2004, 6.2% and 7.1%, respectively, of our revenues were derived from our international operations. As part of our business strategy, we intend to expand our international franchise presence. Our international operations are subject to a number of risks inherent to operating in foreign countries, and any expansion of our international operations will exacerbate the effects of these risks. These risks include, among others:

political and economic instability of foreign markets;

foreign governments restrictive trade policies;

inconsistent product regulation or sudden policy changes by foreign agencies or governments;

the imposition of, or increase in, duties, taxes, government royalties or non-tariff trade barriers;

difficulty in collecting international accounts receivable and potentially longer payment cycles;

increased costs in maintaining international franchise and marketing efforts;

difficulty in operating our manufacturing facility abroad and procuring supplies from overseas suppliers;

exchange controls;

problems entering international markets with different cultural bases and consumer preferences; and

fluctuations in foreign currency exchange rates.

Any of these risks could have a material adverse effect on our international operations and our growth strategy.

Our failure to appropriately respond to changing consumer preferences and demand for new products and services, including as a result of diet trends, could significantly harm our customer relationships and product sales.

Our business is particularly subject to changing consumer trends and preferences, especially with respect to the diet category. For example, the current trend in favor of low-carbohydrate diets is not as dependent on diet products as many other dietary programs, which has caused (and may continue to cause) a significant reduction in sales in our diet category. We expect sales in the diet category will remain below our prior year levels through at least the second quarter of 2005. Our continued success depends in part on our ability to anticipate and respond to these changes, and we may not respond in a timely or commercially appropriate manner to such changes. If we are unable to do so, our customer relationships and product sales could be harmed significantly.

Furthermore, the nutritional supplement industry is characterized by rapid and frequent changes in demand for products and new product introductions. Our failure to accurately predict these trends could negatively impact consumer opinion of our stores as a source for the latest products, which in turn could harm our customer relationships and cause losses to our market share. The success of our new product offerings depends upon a number of factors, including our ability to:

accurately anticipate customer needs;

innovate and develop new products;

successfully commercialize new products in a timely manner;

price our products competitively;

manufacture and deliver our products in sufficient volumes and in a timely manner; and

differentiate our product offerings from those of our competitors.

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If we do not introduce new products or make enhancements to meet the changing needs of our customers in a timely manner, some of our products could be rendered obsolete, which could have a material adverse effect on our revenues and operating results.

We rely on our manufacturing operations to produce nearly all of the proprietary products we sell. Disruptions in our manufacturing system or losses of manufacturing certifications could adversely affect our sales and customer relationships.

For the years ended December 31, 2003 and December 31, 2004, our manufacturing operations produced approximately 32% and 35%, respectively, of the products we sold. Other than powders and liquids, nearly all of our proprietary products are produced in our manufacturing facility located in Greenville, South Carolina. Any significant disruption in our operations at this facility for any reason,

such as regulatory requirements and loss of certifications, power interruptions, fires, hurricanes, war or other force majeure, could disrupt our supply of products, adversely affecting our sales and customer relationships.

Our failure to comply with FTC regulations and existing consent decrees imposed on us by the FTC could result in substantial monetary penalties and could adversely affect our operating results.

The FTC exercises jurisdiction over the advertising of dietary supplements and has instituted numerous enforcement actions against dietary supplement companies, including us, for failure to have adequate substantiation for claims made in advertising or for the use of false or misleading advertising claims. As a result of these enforcement actions, we are currently subject to three consent decrees that limit our ability to make certain claims with respect to our products and required us to pay civil penalties. Failures by us or our franchisees to comply with the consent decrees and applicable regulations could occur from time to time. Violations of these orders could result in substantial monetary penalties, which could have a material adverse effect on our financial condition or results of operations.

If we fail to protect our brand name, competitors may adopt tradenames that dilute the value of our brand name.

We have invested significant resources to promote our GNC brand name in order to obtain the public recognition that we have today. However, we may be unable or unwilling to strictly enforce our trademark in each jurisdiction in which we do business. In addition, because of the differences in foreign trademark laws concerning proprietary rights, our trademark may not receive the same degree of protection in foreign countries as it does in the United States. Also, we may not always be able to successfully enforce our trademark against competitors, or against challenges by others. For example, a third party is currently challenging our right to register in the United States certain marks that incorporate our GNC Live Well trademark. Our failure to successfully protect our trademark could diminish the value and efficacy of our past and future marketing efforts, and could cause customer confusion, which could, in turn, adversely affect our revenues and profitability.

Intellectual property litigation and infringement claims against us could cause us to incur significant expenses or prevent us from manufacturing, selling or using some aspect of our products, which could adversely affect our revenues and market share.

We may be subject to intellectual property litigation and infringement claims, which could cause us to incur significant expenses or prevent us from manufacturing, selling or using some aspect of our products. Claims of intellectual property infringement also may require us to enter into costly royalty or license agreements. However, we may be unable to obtain royalty or license agreements on terms acceptable to us or at all. Claims that our technology or products infringe on intellectual property rights could be costly and would divert the attention of management and

key personnel, which in turn could adversely affect our revenues and profitability.

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We are not insured for a significant portion of our claims exposure, which could materially and adversely affect our operating income and profitability.

We are not insured for certain property and casualty risks due to the frequency and severity of a loss, the cost of insurance and the overall risk analysis. In addition, we carry product liability insurance coverage that requires us to pay deductibles/retentions with primary and excess liability coverage above the deductible/ retention amount. Because of our deductibles and self-insured retention amounts, we have significant exposure to fluctuations in the number and severity of claims. Although our deductibles/retentions for products liability claims were historically $50,000, our deductibles/retentions have increased to $1 million per claim with a $10 million annual aggregate retention. As a result, our insurance and claims expense could increase in the future. Alternatively, we could raise our deductibles/retentions, which would increase our already significant exposure to expense from claims. If any claim were to exceed our coverage, we would bear the excess expense, in addition to our other self-insured amounts. If the frequency or severity of claims or our expenses increase, our operating income and profitability could be materially adversely affected. See Business Legal Proceedings.

Franchise regulations could limit our ability to terminate or replace under-performing franchises, which could adversely impact franchise revenues.

As a franchisor, we are subject to federal, state and international laws regulating the offer and sale of franchises. These laws impose registration and extensive disclosure requirements on the offer and sale of franchises. These laws frequently apply substantive standards to the relationship between franchisor and franchisee, and limit the ability of a franchisor to terminate or refuse to renew a franchise. We may, therefore, be required to retain an under-performing franchise and may be unable to replace the franchisee, which could adversely impact franchise revenues. In addition, the nature and effect of any future legislation or regulation on our franchise operations cannot be predicted.

Our controlling stockholder may take actions that conflict with your interests. This control may have the effect of delaying or preventing changes of control or changes in management, or limiting the ability of other stockholders to approve transactions they may deem to be in their best interest.

Pursuant to our stockholders agreement, each of our current stockholders, including our Principal Stockholder, has irrevocably granted to, and has appointed, Apollo Investment Fund V, L.P. (Apollo Investment V), an affiliate of our Principal Stockholder, as its proxy and attorney-in-fact to vote all of the shares of common stock held by such stockholder party at any time, for all matters subject to the vote of the stockholder in the manner determined by Apollo Investment V in its sole and absolute discretion, whether at any meeting of the stockholders or by written consent or otherwise. The proxy remains in effect for so long as Apollo Investment V and its affiliates, which includes our Principal Stockholder in certain circumstances, own at least 2,100,000 shares of common stock. As a result, Apollo Investment V will be able to exercise control over all matters requiring stockholder approval, including the election of directors, amendment of our certificate of incorporation and approval of significant corporate transactions, and it will have significant control over our management and policies. This control may have the effect of delaying or preventing changes in control or changes in management, or limiting the ability of our other stockholders to approve transactions that they may deem to be in their best interest.

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ITEM 2. PROPERTIES

In our Retail segment, there were 2,642 company-owned stores operating in the United States and Canada as of December 31, 2004. All but one of our stores are located on leased premises that typically range in size from 1,000 to 2,000 square feet. In our Franchise segment, substantially all of our 1,297 franchised stores in the United States and Canada are located on premises we lease, and then sublease to our respective franchisees. All of our 739 franchised stores in other international locations are owned or leased directly by our franchisees. No single store is material to our operations.

As of December 31, 2004, our company-owned and franchised stores in the United States and Canada (excluding store-within-a-store locations) and our other international franchised stores consisted of:

United States and Canada	Company-Owned Retail	Franchise
Alabama	31	14
Alaska	6	5
Arizona	44	14
Arkansas	18	6
California	199	181
Colorado	46	30
Connecticut	39	7
Delaware	8	10
District of Columbia	6	2
Florida	217	116
Georgia	92	58
Hawaii	20	1
Idaho	9	5
Illinois	85	72
Indiana	47	35
Iowa	23	11
Kansas	18	15
Kentucky	36	10
Louisiana	39	8
Maine	9	0
Maryland	55	28
Massachusetts	53	12
Michigan	78	49
Minnesota	60	15
Mississippi	20	9
Missouri	43	22
Montana	4	3
Nebraska	6	18
Nevada	12	10
New Hampshire	16	5
New Jersey	68	57
New Mexico	21	2
New York	150	57

North Carolina	82	47
North Dakota	6	0
Ohio	102	66
Oklahoma	31	7
Oregon	21	11
Pennsylvania	134	51
Puerto Rico	23	0
Rhode Island	12	1
South Carolina	27	26
South Dakota	5	0
Tennessee	41	36
Texas	210	85
Utah	23	8
Vermont	5	0
Virginia	83	28
Washington	48	22
West Virginia	25	3
Wisconsin	47	11
Wyoming	4	1
Canada	135	7
Total	2,642	1,297

International	**Franchise**
Aruba	2
Australia	37
Bahamas	3
Brazil	15
Brunei	1
Cayman Islands	1
Chile	55
China	1
Columbia	1
Costa Rica	6
Dominican Republic	12
Ecuador	17
El Salvador	8
Guam	5
Guatemala	13
Honduras	1
Hong Kong	13
Indonesia	24
Israel	16
Japan	8
Kuwait	4
Lebanon	5
Malaysia	28
Mexico	171

Pakistan	1
Panama	5
Peru	13
Philippines	44
Saudi Arabia	36
Singapore	63
South Africa	1
South Korea	29
Taiwan	15
Thailand	29
Turkey	23
U.S. Virgin Islands	2
Venezuela	31
Total	739

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In our Manufacturing/Wholesale segment, we lease facilities for manufacturing, packaging, warehousing, and distribution operations. We manufacture a majority of our proprietary products at a 230,000 square foot facility in Greenville, South Carolina. We also lease a 630,000 square foot complex located in Anderson, South Carolina, for packaging, materials receipt, lab testing, warehousing, and distribution. Both the Greenville and Anderson facilities are leased on a long-term basis pursuant to fee-in-lieu-of-taxes arrangements with the counties in which the facilities are located, but we retain the right to purchase each of the facilities at any time during the lease for $1.00, subject to a loss of tax benefits. We also lease a 210,000 square foot distribution center in Leetsdale, Pennsylvania and an 112,000 square foot distribution center in Phoenix, Arizona. We conduct additional manufacturing for wholesalers and retailers of third-party products, as well as warehouse certain third-party products at a leased facility located in New South Wales, Australia.

We also lease four small regional sales offices in Clearwater, Florida; Fort Lauderdale, Florida; Laguna Hills, California; and Mississauga, Ontario. None of the regional sales offices is larger than 5,000 square feet. Our 253,000 square foot corporate headquarters in Pittsburgh, Pennsylvania is owned by Gustine Sixth Avenue Associates, Ltd., a Pennsylvania limited partnership, of which General Nutrition, Incorporated, one of our subsidiaries, is a 50% limited partner. The partnership s ownership of the land and buildings, and the partnership s interest in the ground lease to General Nutrition, Incorporated, are all encumbered by a mortgage in the original principal amount of $17.9 million, with an outstanding balance of $13.2 million as of December 31, 2004. This partnership is included in our consolidated financial statements.

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ITEM 3. LEGAL PROCEEDINGS

We are from time to time engaged in litigation. We regularly review all pending litigation matters in which we are involved and establish reserves deemed appropriate by management for these litigation matters. However, some of these matters are material and an adverse outcome in these matters could have a material impact on our financial condition and operating results.

As a manufacturer and retailer of nutritional supplements and other consumer products that are ingested by consumers or applied to their bodies, we have been and are currently subjected to various product liability claims. Although the effects of these claims to date have not been material to us, it is possible that current and future product liability claims could have a material adverse impact on our financial condition and operating results. We currently maintain product liability insurance with a deductible/retention of $1.0 million per claim with an aggregate cap on retained loss of $10 million per claim. We typically seek and have obtained contractual indemnification from most parties that supply raw materials for our products or that manufacture or market products we sell. We also typically seek to be added, and have been added, as additional insured under most of such parties insurance policies. We are 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. See Risk Factors included elsewhere in this Report for a discussion of important factors that could cause actual results to differ materially from those described or implied by the forward-looking statements contained herein. We may incur material products liability claims, which could increase our costs and adversely affect our reputation, revenues and operating income. The products involved in the following cases were for third-party products and were not manufactured by GNC.

Ephedra (Ephedrine Alkaloids). As of December 31, 2004, we have been named as a defendant in 180 pending cases involving the sale of third-party products that contain ephedra. Of those cases, one involves a proprietary GNC product. Ephedra products have been the subject of adverse publicity and regulatory scrutiny in the United States and other countries relating to alleged harmful effects, including the deaths of several individuals. In early 2003, we instructed all of our locations to stop selling products containing ephedra that were manufactured by GNC or one of our affiliates. Subsequently, we instructed all of our locations to stop selling any products containing ephedra by June 30, 2003. In April 2004, the FDA banned the sale of products containing ephedra. All claims to date have been tendered to the third-party manufacturer or to our insurer and we have incurred no expense to date with respect to litigation involving ephedra products. Furthermore, we are entitled to indemnification by Numico for certain losses arising from claims related to products containing ephedra sold prior to December 5, 2003. All of the pending cases relate to products sold prior to such time and, accordingly, we are entitled to indemnification from Numico for all of the pending cases.

Pro-Hormone/Androstenedione. On July 29, 2001, five substantially identical class action lawsuits were filed in the state courts of the States of Florida, New York, New Jersey, Pennsylvania and Illinois against us and various manufacturers of products containing pro-hormones, including androstenedione:

Brown v. General Nutrition Companies, Inc., Case No. 02-14221-AB, Florida Circuit Court for the 15th Judicial Circuit Court, Palm Beach County;

Rodriguez v. General Nutrition Companies, Inc., Index No. 02/126277, New York Supreme Court, County of New York, Commercial Division;

Abrams v. General Nutrition Companies, Inc., Docket No. L-3789-02, New Jersey Superior Court, Mercer County;

Toth v. Bodyonics, Ltd., Case No. 003886, Pennsylvania Court of Common Pleas, Philadelphia County; and

Pio v. General Nutrition Companies, Inc., Case No. 2-CH-14122, Illinois Circuit Court, Cook County.

On March 20, 2004, a similar lawsuit was filed in California (*Guzman v. General Nutrition Companies, Inc*., Case No. 04-00283). Plaintiffs allege that we have distributed or published periodicals that contain advertisements claiming that the various pro-hormone products promote muscle growth. The complaints allege that we knew the advertisements and label claims promoting muscle growth were false, but nonetheless continued to sell the products to consumers. Plaintiffs seek injunctive relief, disgorgement of profits, attorney s fees and the costs of suit. All of the products involved in these cases are third-party products. We have tendered these cases to the various manufacturers for defense and indemnification. Based upon information available to us at the present time, we believe that these matters will not have a material adverse effect upon our liquidity, financial condition or results of operations.

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California Wage Claim. On November 2, 2001, Matthew Capelouto, a former store manager in California, filed a putative class action lawsuit in the Superior Court of California, Orange County (Capelouto v. General Nutrition Corporation, Case No. 01-CC-00138). The lawsuit alleges that we misclassified store managers at our company-owned stores in California as exempt from overtime requirements and/or required them to work off the clock, and failed to pay them overtime, in violation of California s wage and hour laws. On October 23, 2003, an amended complaint was filed, adding another named plaintiff, Lamar Wright, as well as claims for failure to provide required meal periods and rest periods for GNC managers at company-owned stores in California. On May 13, 2004, we entered into an agreement in principle to settle the claims of the putative class members, without admitting any liability, for a total payment of approximately $4.6 million. In December 2004, the Court gave final approval to the settlement and we paid $4.1 million to fund our costs and the payments made to class members that filed timely claims.

Wage and Hour Claim. On or about May 10, 2004, seven former employees brought an action in the United States District Court for the Southern District of New York on behalf of themselves and a purported class of other similarly situated former employees employed by GNC within the last six years and who allegedly worked but were not paid overtime for hours worked in excess of 40 hours per week *(Shockley v. General Nutrition Corporation*, Case No. 04-CIV-2336). The complaint is brought under the federal Fair Labor Standards Act and New York State Labor Law. The plaintiffs seek actual damages, liquidated damages on claims asserted under the FLSA, an order enjoining GNC from engaging in the practices alleged in their complaint, and attorney s fees and the costs of suit. On October 29, 2004, we entered into an agreement to settle the claims of the putative class members, without admitting any liability, for a total payment of $170,000, inclusive of class counsel s attorneys fees and expenses. The settlement is subject to approval by the court and the plaintiffs class. Based on the information available to us at the present time, we believe that this matter will not have a material adverse effect upon our liquidity, financial condition or results of operations.

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

None

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PART II

ITEM 5. MARKET FOR THE REGISTRANT S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

There is no established public trading market for our Common Stock. As of March 30, 2005, there were approximately 29,854,663 shares of Common Stock outstanding, held by approximately 55 stockholders. See Item 12 Security Ownership of Certain Beneficial Owners and Management.

Dividends. We did not declare cash dividends on our Common Stock for the two most recent fiscal years. We are subject to certain restrictions on our ability to pay dividends under the terms of our $360.0 million senior credit facility and our $215.0 million aggregate principal amount of 8 1/2% senior subordinated notes due 2010, (the Senior Subordinated Notes). For a description of such restrictions, see the Long-Term Debt footnote of the Notes to consolidated financial statements in Part II, Item 8.

Securities Authorized for Issuance Under Equity Compensation Plans.

Equity Compensation Plans Approved by Security Holders	Number of Securities to be issued upon exercise of outstanding options	Weighted Average Exercise price of outstanding options	Number of Securities remaining available for future issuance under equity compensation plans
2003 Omnibus Stock Incentive Plan	2,435,393	$6 per share	1,564,607

At December 31, 2004, the Company held 100,000 shares of our Common Stock in treasury. The Company incurred $0.4 million in December 2004 to repurchase these shares from a former executive. The prior executive s shares were repurchased at the time his separation agreement was executed. The Company currently does not have a stock repurchase program.

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ITEM 6. SELECTED FINANCIAL DATA

The following selected consolidated financial data should be read together with the information under section entitled Management s Discussion and Analysis of Financial Condition and Results of Operations and our consolidated financial statements, including the notes thereto, included elsewhere in this document. The selected consolidated financial data presents the financial information as follows:

	Predecessor					Successor
	Year Ended December 31,			Period from January 1, 2003 to December 4,	27 Days Ended December 31,	Year Ended December 31,
(dollars in millions)	2000	2001	2002	2003	2003	2004
Statement of Income Data:						
Revenues:						
Retail	$ 1,075.7	$ 1,123.1	$ 1,068.6	$ 993.3	$ 66.2	$ 1,001.8
Franchising	273.4	273.1	256.1	241.3	14.2	226.5
Manufacturing/Wholesale	96.3	112.9	100.3	105.6	8.9	116.4
Total revenues	1,445.4	1,509.1	1,425.0	1,340.2	89.3	1,344.7
Cost of sales, including costs of warehousing, distribution and occupancy	953.2	1,013.3	969.9	934.9	63.6	895.2
Gross profit	492.2	495.8	455.1	405.3	25.7	449.5
Compensation and related benefits	231.8	246.6	245.2	235.0	16.7	230.0
Advertising and promotion	47.2	41.9	52.1	38.4	0.5	44.0
Other selling, general and administrative	146.1	140.7	86.0	70.9	5.1	73.8
Other expense (income) (1)	99.9	(3.4)	(211.3)	(10.1)		1.0
Impairment of goodwill and intangible assets (2)			222.0	709.4		
Operating (loss) income	(32.8)	70.0	61.1	(638.3)	3.4	100.7
Interest expense, net	142.6	140.0	136.3	121.1	2.8	34.5
Gain on sale of marketable securities			(5.0)			
(Loss) income before income taxes	(175.4)	(70.0)	(70.2)	(759.4)	0.6	66.2
Income tax (benefit) expense	(25.3)	(14.1)	1.0	(174.5)	0.2	24.5
Net (loss) income before cumulative effect of accounting change	(150.1)	(55.9)	(71.2)	(584.9)	0.4	41.7

Loss from cumulative effect of accounting change, net of tax [3]			(889.7)			
Net (loss) income	$ (150.1)	$ (55.9)	$ (960.9)	$ (584.9)	$ 0.4	$ 41.7

(1) Other expense for 2000 represents an expense associated with the reduction of the market value of certain equity investments. Other income for 2001, 2002, and the period ending December 4, 2003, primarily represents $3.6 million, $214.4 million, and $7.2 million respectively, received from legal settlement proceeds that we collected from a raw material pricing settlement. Other expense includes foreign currency (gain) loss for all of the periods presented. Other expense for the year ended December 31, 2004 represents registration costs incurred for the Company s S-1 filing. These costs were expensed, as this offering was not completed by December 31, 2004 and the registration statement has been withdrawn.

(2) On January 1, 2002, we adopted SFAS No. 142, which requires that goodwill and other intangible assets with indefinite lives no longer be subject to amortization, but instead are to be tested at least annually for impairment. For the fiscal period ending December 31, 2002 and December 4, 2003 we recorded impairment charges of $222.0 million, (pre-tax), and $709.4 million, (pre-tax), respectively, for goodwill and other intangibles as a result of decreases in expectations regarding growth and profitability, and, in 2003, due to increased competition from the mass market, negative publicity by the media on certain supplements, and increasing pressure from the FDA on the industry as a whole, each of which were identified in connection with a valuation related to the Acquisition.

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(3) Upon adoption of SFAS No. 142, we recorded a one-time, impairment charge of $889.7 million, net of taxes, to reduce the carrying amount of goodwill and other intangibles to their implied fair value. A table outlining the impact of the adoption of SFAS No. 142 on the reported net loss as a result of the non-amortization of goodwill beginning on January 1, 2002 is included in the Goodwill and Intangible Assets note in the consolidated financial statements included elsewhere in this Report.

	Predecessor				Successor	
	Year Ended December 31,			Period from January 1, 2003 to December 4,	27 Days Ended December 31,	Year Ended December 31,
(dollars in millions)	2000	2001	2002	2003	2003	2004
Balance Sheet Data:						
Cash and cash equivalents	$ 10.5	$ 16.3	$ 38.8	$ 9.4	$ 33.2	$ 85.2
Working capital [4]	215.2	140.8	153.6	96.2	199.6	282.1
Total assets	3,216.5	3,071.8	1,878.3	1,038.1	1,024.9	1,031.3
Total debt	1,892.1	1,883.3	1,840.1	1,747.4	514.2	510.4
Cumulative redeemable exchangeable preferred stock					100.5	112.7
Stockholders equity	523.1	469.0	(493.8)	(1,077.1)	177.3	208.3
Other Data:						
Net cash provided by operating activities	100.0	75.8	111.0	92.9	4.7	83.5
Net cash (used in) investing activities	(42.0)	(48.1)	(44.5)	(31.5)	(740.0)	(27.0)
Net cash (used in) provided by financing activities	(66.9)	(21.6)	(44.3)	(90.8)	759.2	(4.5)
EBITDA [5]	91.8	192.0	(765.5)	(579.2)	5.7	139.5
Capital expenditures [6]	$ 31.6	$ 29.2	$ 51.9	$ 31.0	$ 1.8	$ 28.3
Ratio of earnings to fixed charges [7]					1.11	1.93
Number of stores (at end of period):						
Company-owned stores [8]	2,842	2,960	2,898	2,757	2,748	2,642
Franchised stores [8]	1,718	1,821	1,909	1,978	2,009	2,036
Store-within-a-store locations [8]	544	780	900	988	988	1,027

Twelve months ended 2000, 2001, 2002 and the period January 1, 2003 to December 4, 2003 GNCI was owned by Numico.

27 days ended December 31, 2003 and the twelve months ended December 31, 2004 the periods subsequent to the Acquisition.

(4) Working capital represents current assets less current liabilities.

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(5) EBITDA as used herein represents net income (loss) before interest expense (net), income tax (benefit) expense, depreciation and amortization. We present EBITDA because we consider it a useful analytical tool for measuring our ability to service our debt and generate cash for other purposes. The reconciliation of net cash provided by operating activities to EBITDA as presented below is different than that used for purposes of the covenants under the indenture governing the Senior Subordinated Notes.

EBITDA is not a measurement of our financial performance under GAAP and should not be considered as an alternative to net income, operating income or any other performance measures derived in accordance with GAAP or as an alternative to cash flow from operating activities as a measure of our profitability or liquidity. Some of the limitations of EBITDA are as follows:

EBITDA does not reflect the interest expense, or the cash requirement necessary to service interest or principal payments, on our debts;

Although depreciation and amortization are non-cash charges, the assets being depreciated and amortized will often have to be replaced in the future, and EBITDA does not reflect any cash requirements for such replacements; and

Although EBITDA is frequently used by securities analysts, lenders and others in their evaluation of companies, our calculation of EBITDA may differ from other similarly titled measures of other companies, limiting its usefulness as a comparative measure.

Because of these limitations, EBITDA should not be considered as a measure of discretionary cash available to us to invest in the growth of our business. We compensate for these limitations by relying primarily on our GAAP results and using EBITDA only supplementally. See our consolidated statements of cash flows included elsewhere in this Report.

The following table reconciles net cash provided by operating activities as determined in accordance with GAAP to EBITDA for the periods indicated:

	Predecessor				Successor	
	Year Ended December 31,			Period from January 1, 2003 to December 4,	27 Days Ended December 31,	Year Ended December 31,
(in millions)	2000	2001	2002	2003	2003	2004
Net cash provided by operating activities	$ 100.0	$ 75.8	$ 111.0	$ 92.9	$ 4.7	$ 83.5
Cash paid for interest (excluding deferred financing fees)	139.9	145.6	138.0	122.5	0.7	32.7
Cash paid for taxes	21.0	15.2	30.7	2.5		5.1
Changes in accounts receivable	(26.7)	1.1	127.3	(59.9)	(2.9)	(5.3)
Changes in inventory	44.8	(71.5)	(22.2)	(29.0)	(3.8)	15.1
Changes in accounts payable	(44.2)	48.2	(18.8)	3.3	5.3	(3.9)
Changes in other assets and liabilities	(42.8)	(22.4)	(24.9)	(2.1)	1.7	12.3

Loss from cumulative effect of accounting change, net of tax			(889.7)			
Impairment of goodwill and intangible assets			(222.0)	(709.4)		
(Loss on impairment) gain on sale of marketable securities	(100.2)		5.1			
EBITDA (a)	$ 91.8	$ 192.0	$ (765.5)	$ (579.2)	$ 5.7	$ 139.5

(a) Included in EBITDA are (1) non-cash goodwill and other intangible impairment losses of $222.0 million (pre-tax) and $709.4 million (pre-tax) incurred in the year ended December 31, 2002 and the period from January 1, 2003 to December 4, 2003, respectively, and (2) a loss from the cumulative effect of an accounting change of $889.7 million, net of tax, for the year ended December 31, 2002. The impairment charges were incurred upon the testing of goodwill and other intangibles, in accordance with SFAS No. 142. Impairment resulted from decreases in expectations regarding growth and profitability due to increased competition from the mass market, negative publicity by the media on certain supplements, and increasing pressure from the FDA on the industry as a whole.

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(6) Capital expenditures for 2002 include approximately $13.9 million incurred in connection with our store reset and upgrade program.

(7) Earnings were insufficient to cover fixed charges by $175.4 million, $70.0 million, $70.2 million, and $759.4 million for the years ended December 31, 2000, 2001, 2002 and the period ended December 4, 2003, respectively.

(8) The following table summarizes our stores for the periods indicated:

	Predecessor				Successor	
	Year Ended December 31,			Period From January 1, 2003 to December 4,	27 Days Ended December 31,	Year Ended December 31,
	2000	2001	2002	2003	2003	2004
Company-owned stores						
Beginning of period balance	2,793	2,842	2,960	2,898	2,757	2,748
Store openings	160	220	117	80	4	82
Store closings	(111)	(102)	(179)	(221)	(13)	(188)
End of period balance	2,842	2,960	2,898	2,757	2,748	2,642
Franchised stores						
Beginning of period balance	1,584	1,718	1,821	1,909	1,978	2,009
Store openings	257	291	182	186	33	146
Store closings	(123)	(188)	(94)	(117)	(2)	(119)
End of period balance	1,718	1,821	1,909	1,978	2,009	2,036
Licensed stores						
Beginning of period balance	311	544	780	900	988	988
Store openings	233	237	131	93		44
Store closings		(1)	(11)	(5)		(5)
End of period balance	544	780	900	988	988	1,027

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ITEM 7. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATION

The following Management s Discussion and Analysis of Financial Condition and Results of Operations should be read in conjunction with Selected Consolidated Financial Data and our consolidated financial statements and related notes included elsewhere in this Report. The discussion in this section contains forward looking statements that involve risks and uncertainties. See Risk Factors included elsewhere in this Report for a discussion of important factors that could cause actual results to differ materially from those described or implied by the forward-looking statements contained herein.

On October 16, 2003, the Company entered into a purchase agreement (the Purchase Agreement) with Numico and Numico USA, Inc. to acquire 100% of the outstanding equity interest of GNCI from Numico USA Inc. On December 5, 2003, Centers acquired 100% of the outstanding equity interests of GNCI from Numico for an aggregate purchase price of $747.4 million, consisting of $733.2 million in cash and the assumption of $14.2 million of mortgage indebtedness (the Acquisition). At December 31, 2003 the Company had recorded $15.7 million receivable from Numico related to a working capital contingent purchase price adjustment and an estimated $3.0 million payable to Numico related to a tax purchase price adjustment. Subsequent to the Acquisition, in 2004, the Company received a cash payment of $15.7 million from Numico related to a working capital contingent purchase price adjustment and the Company remitted a payment to Numico of $5.9 million related to a tax purchase price adjustment. Simultaneously with the closing of the Acquisition, Centers entered into a new senior credit facility with a syndicate of lenders, consisting of a $285.0 million term loan facility and a $75.0 million revolving credit facility. Centers borrowed the full amount of the term loan facility to fund a portion of the Acquisition purchase price, but made no borrowings under the revolving credit facility. We have guaranteed Centers obligations under the senior credit facility. Centers also issued $215.0 million aggregate principal amount of its Senior Subordinated Notes to fund a portion of the Acquisition purchase price. In addition, GNC Investors, LLC, (our Principal Stockholder), certain of our directors, members of our management and other employees made an equity contribution of $277.5 million in exchange for 29,566,666 shares of our Common Stock and, in the case of our Principal Stockholder, 100,000 shares of our 12% Series A Exchangeable Preferred Stock (Series A Preferred Stock). We contributed the full amount of the equity contribution to Centers to fund a portion of the Acquisition. Our Principal Stockholder subsequently resold all of the Series A Preferred Stock to other institutional investors.

Our consolidated financial statements reflect our financial position as of December 31, 2003 and December 31, 2004 and our results of operations and cash flows for the 27 days ended December 31, 2003 and the year ended December 31, 2004, and the financial position of our predecessor entity, on a carve-out basis, as of December 31, 2002 and its results of operations and cash flows for the year ended December 31, 2002, and the period from January 1, 2003 to December 4, 2003. See the Critical Accounting Estimates and Basis of Presentation sections below

Overview

We are the largest global specialty retailer of nutritional supplements, which include sports nutrition products, diet products, VMHS (vitamins, minerals and herbal supplements) and specialty supplements. We derive our revenues principally from product sales through our company-owned stores, franchise activities and sales of products manufactured in our facilities to third parties. We sell products through a worldwide network of more than 5,700 locations operating under the GNC brand name.

Revenues from Business Segments

Revenues are derived from our three business segments, Retail, Franchise and Manufacturing/Wholesale, primarily as follows:

Retail revenues are generated by sales to consumers at our company-owned stores.

Franchise revenues are generated primarily from:

(1) product sales to our franchisees;

(2) royalties on franchise retail sales; and

(3) franchise fees, which are charged for initial franchise awards, renewals and transfers of franchises.

Manufacturing/Wholesale revenues are generated through sales of manufactured products to third parties, generally for third-party private label brands, and the sale of our proprietary and third-party products to and through Rite Aid and drugstore.com.

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Trends and Other Factors Affecting Our Business

Our performance is affected by trends that affect the nutritional supplements industry generally. Current trends affecting our business include the aging population, rising healthcare costs, increasing focus on fitness and increasing incidence of obesity. Changes in these trends and other factors, which we may not foresee, may also impact our business. Our business allows us to respond to changing consumer preferences and drive revenues by emphasizing new product development, introducing targeted third-party products, and adjusting our product mix. Some of the trends that have impacted our business include the following:

Historically, our primary product sales have been in the sports nutrition and VMHS categories. Sales of sports nutrition products have been driven largely by the increasing focus on fitness and the introduction of new products. Sales of VMHS products have been driven largely by the aging population and rising healthcare costs. Within this category, herbal supplement sales tend to be more significantly impacted by publicity and changes in consumer trends.

Sales of diet products are generally more sensitive to consumer trends, resulting in higher volatility than our other products. In 1999, our diet category began to grow more rapidly with the introduction of ephedra products, which reached a high point in 2001 and began to decline in the second half of 2002. Although our locations ceased sales of ephedra beginning in early 2003, our introduction of low carbohydrate and other ephedra substitute products in 2003 partially offset these declines in the first half of 2003, and resulted in increased sales in the diet product category in the second half of 2003. However, in the second quarter of 2004, we experienced a sharp decline in sales in our diet category, we believe in large part

because of the availability of low carbohydrate products expanding in the marketplace. Even though we launched new diet products in 2004, sales in the diet category remained below our prior year levels throughout 2004 and we expect this trend to continue through at least the second quarter of 2005. Since the most significant portion of the decline in sales did not occur until the third quarter of 2004, our comparable store sales will continue to be compared to strong historical periods through the second quarter of 2005.

When diets featuring products low in carbohydrates (low carb) became popular in the first quarter of 2003, we purchased most of the available inventory of certain specialty low carb products, primarily snacks and bars, and we became a destination for many new customers. As the popularity of low carb diet programs increased, manufacturers increased their production levels and product offerings and food manufacturers followed the low carb dieting trend by offering low carb diet products, including staple foods such as pastas, ketchup and sauces. These products became widely distributed into the food, drug and mass channels of distribution, which led to lower levels of sales of low carb specialty products in our stores starting in the latter half of the second quarter of 2004. Additionally, programs based on a low carb dietary approach typically do not require diet supplements as a component of the program. As a larger percentage of the dieting

population pursued a low carb program, sales of our diet supplements declined.

As part of our annual planning process and as part of a renewed focus on improving store productivity, we recently reviewed our strategy related to the stores. Through this review, we adopted a strategy that was developed, in part, as a result of consumer perception in the marketplace that our products are overpriced unless purchased during the gold card week promotion. In 2005, we will invest in a new strategy through more competitive pricing on the most highly recognizable products, and through increased national advertising, that will highlight certain GNC brand and third-party products in television and print advertising campaigns. In addition we will review our operations and overhead cost structures in an effort to eliminate excess costs and to streamline operations where applicable. We do not anticipate this new strategy will offset the impact from the strong historical periods of low-carb diet sales in the first two quarters of 2004.

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Other factors that have impacted our business include:

Changes to Store Base. During the 1990s, we embarked on a plan to significantly increase our store base, including expansion from suburban shopping malls into secondary malls and strip mall locations and by adding international franchise locations. Additionally, in 1999, we entered into a strategic alliance with Rite Aid to open our store-within-a-store locations. In 2003, in addition to our normal store closings, we identified 117 underperforming stores to be closed in the near future. We subsequently reduced this number to 98 stores, primarily as the others became cash flow positive. As of December 31, 2004, we had closed all of these stores. We expect to continue to look for real estate opportunities in the United States to expand our store base; however, we believe the primary store expansion opportunity in the near term will be through international franchising. Costs to us related to any international franchising expansion would be immaterial, as the international franchisee bears the majority of the responsibility and costs for doing business in each country.

Changes to Pricing. In the fourth quarter of 2002, we thoroughly reviewed our proprietary product pricing and determined that our single unit pricing was not competitive with other market participants. A primary reason for higher single unit pricing was the creation of artificially high single unit prices to compensate for our overall BOGO (Buy One Get One half price) pricing strategy. As a result of the review, we repriced most of our proprietary products and eliminated the strategy of BOGO pricing substantially all of our products in December of 2002. After the elimination of BOGO, we found that, although customers bought single units instead of two units, the shorter cycle time between customer visits led to a corresponding increase in transaction counts and an increase in product sales, particularly in our VMHS product category. We believe that our repricing strategy was one of the key drivers of our profitability during the second half of 2003. We continually review our pricing to ensure that we are competitive in key items in the marketplace, in particular items that are readily comparable by the consumer, and will continue to utilize what we believe is the most effective pricing strategy to increase revenue at favorable margins.

Basis of Presentation

Purchase Accounting. The Acquisition of GNCI was accounted for under the purchase method of accounting. As a result, the financial data presented for 2003 include a predecessor period from January 1, 2003 through December 4, 2003 and a successor period from December 5, 2003 through December 31, 2003. As a result of the Acquisition, the consolidated statements of operations for the successor periods include: interest and amortization expense resulting from Centers credit facility and the issuance of Centers Senior Subordinated Notes, amortization of intangible assets related to the Acquisition, and management fees that did not exist prior to the Acquisition. Further, as a result of purchase accounting, the fair values of our assets on the date of the Acquisition became their new cost basis. Results of operations for the successor periods are affected by the newly established cost basis of these assets. We allocated the Acquisition consideration to the tangible and intangible assets acquired and liabilities assumed by us based upon their respective fair values as of the date of the Acquisition, which resulted in a significant change in our annual depreciation and amortization expenses.

The accompanying financial statements for the periods prior to the Acquisition are labeled as Predecessor and the periods subsequent to the Acquisition are labeled as Successor .

Successor. Our consolidated financial statements for the year ended December 31, 2004 and the 27 days ended December 31, 2003 include the accounts of the Company and its wholly owned subsidiaries. Included in 27 days ended December 31, 2003 are fair value adjustments to assets and liabilities, including inventory, goodwill, other intangible assets and property, plant and equipment. Also included is the corresponding effect these adjustments had to cost of sales, depreciation, and amortization expenses.

Predecessor . Our consolidated financial statements for the period ended December 4, 2003, and the period ending December 31, 2002 presented herein have been prepared on a carve-out basis and reflect GNCI s consolidated financial position, results of operations and cash flows in accordance with GAAP. In order to depict GNCI s financial position, results of operations and cash flows on a stand-alone basis, GNCI s financial statements reflect amounts that have been pushed down from Numico to us prior to consummation of the Acquisition. As a result of recording these amounts, our predecessor s consolidated financial statements for these periods may not be indicative of the results that would be presented if we had operated as an independent, stand-alone entity.

In the accompanying discussion of results of operations, the period ended December 4, 2003 and the 27 days ended December 31, 2003 have been combined for comparability to the year ended December 31, 2002.

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Related Parties. GNCI had related party transactions with Numico and other affiliates during the period January 1, 2003 to December 4, 2004 and the year ended December 31, 2002. For further discussion of these transactions, see the Related Party Transactions footnote to our consolidated financial statements.

Recent Developments

On January 18, 2005, Centers issued $150.0 million aggregate principal amount of Senior Notes due 2011, with an interest rate of 8 5/8%. Centers used the net proceeds of this offering of $145.6 million, together with $39.4 million of cash on hand, to repay a portion of the indebtedness under its term loan facility. The offering was made only to qualified institutional buyers in accordance with Rule 144A under the Securities Act of 1933, as amended, and to non-U.S. persons in off shore transactions in accordance with Regulation S under the Securities Act. The securities sold have not been registered under the Securities Act of 1933.

Results of Operations

The information presented below as of and for the year ended December 31, 2004, the period January 1, 2003 to December 4, 2003 and the 27 days ended December 31, 2003 and the year ended December 31, 2002, was derived from our audited consolidated financial statements and accompanying notes. In the table below and in the accompanying discussion, the 27 days ended December 31, 2003 and the period January 1, 2003 to December 4, 2003 have been combined for discussion purposes.

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Results of Operations and Comprehensive Income
(Dollars in millions and percentages expressed as a percentage of net revenues)

	Predecessor				Successor				Successor	
	Year Ended December 31, 2002		Period from January 1, 2003 to December 4, 2003		27 days Ended December 31, 2003		Combined Year Ended December 31, 2003		Year Ended December 31, 2004	
Revenues:										
Retail	$ 1,068.6	75.0%	$ 993.3	74.1%	$ 66.2	74.1%	$ 1,059.5	74.1%	$ 1,001.8	74.5%
Franchise	256.1	18.0%	241.3	18.0%	14.2	15.9%	255.5	17.9%	226.5	16.8%
Manufacturing / Wholesale	100.3	7.0%	105.6	7.9%	8.9	10.0%	114.5	8.0%	116.4	8.7%
Total net revenues	1,425.0	100.0%	1,340.2	100.0%	89.3	100.0%	1,429.5	100.0%	1,344.7	100.0%
Operating expenses:										
Cost of sales, including costs of warehousing, distribution and occupancy	969.9	68.0%	934.9	69.7%	63.6	71.2%	998.5	69.9%	895.2	66.5%
Compensation and related benefits	245.2	17.2%	235.0	17.5%	16.7	18.7%	251.7	17.6%	230.0	17.1%
Advertising and promotion	52.1	3.7%	38.4	2.9%	0.5	0.6%	38.9	2.7%	44.0	3.3%
Other selling, general and administrative expenses	75.9	5.3%	64.1	4.8%	4.8	5.4%	68.9	4.8%	69.8	5.2%
Amortization expense	10.1	0.7%	6.8	0.5%	0.3	0.3%	7.1	0.5%	4.0	0.3%
Income from legal settlement	(214.4)	-15.0%	(7.2)	-0.5%		0.0%	(7.2)	-0.5%		0.0%
Foreign currency (gain) loss	3.1	0.2%	(2.9)	-0.2%		0.0%	(2.9)	-0.2%	(0.3)	0.0%
Impairment of goodwill and intangible assets	222.0	15.6%	709.4	52.9%		0.0%	709.4	49.6%		0.0%
Other expense		0.0%		0.0%		0.0%		0.0%	1.3	0.1%

Total operating expenses	1,363.9	95.7%	1,978.5	147.6%	85.9	96.2%	2,064.4	144.4%	1,244.0	92.5%
Operating Income										
Retail	86.8	6.1%	79.1	5.9%	6.6	7.3%	85.7	6.0%	107.7	8.0%
Franchise	65.4	4.6%	63.7	4.8%	2.4	2.7%	66.1	4.6%	62.4	4.6%
Manufacturing / Wholesale	25.8	1.8%	24.3	1.8%	1.4	1.6%	25.7	1.8%	38.6	2.9%
Unallocated corporate and other costs:										
Warehousing & distribution costs	(40.3)	-2.8%	(40.7)	-3.0%	(3.4)	-3.8%	(44.1)	-3.1%	(49.3)	-3.7%
Corporate costs	(69.0)	-4.8%	(62.5)	-4.7%	(3.6)	-4.0%	(66.1)	-4.6%	(57.4)	-4.2%
Income from legal settlement	214.4	15.0%	7.2	0.5%		0.0%	7.2	0.5%		0.0%
Impairment of goodwill and intangible assets	(222.0)	-15.6%	(709.4)	-52.9%		0.0%	(709.4)	-49.6%		0.0%
Other expense		0.0%		0.0%		0.0%		0.0%	(1.3)	-0.1%
Sub total unallocated corporate and other costs	(116.9)	-8.2%	(805.4)	-60.1%	(7.0)	-7.8%	(812.4)	-56.8%	(108.0)	-8.0%
Total operating income (loss)	61.1	4.3%	(638.3)	-47.6%	3.4	3.8%	(634.9)	-44.4%	100.7	7.5%
Interest expense, net	136.3		121.1		2.8		123.9		34.5	
Gain on sale of marketable securities	(5.0)									
(Loss) income before income taxes	(70.2)		(759.4)		0.6		(758.8)		66.2	
Income tax expense (benefit)	1.0		(174.5)		0.2		(174.3)		24.5	

Net (loss) income before cumulative effect of accounting change	(71.2)	(584.9)	0.4	(584.5)	41.7
Loss from cumulative effect of accounting change	(889.7)		&		