HEALTH FITNESS CORP /MN/
Form 10-Q
November 14, 2003

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

FORM 10-Q

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

For the quarterly period ended September 30, 2003

OR

[ ] 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: 0-25064

HEALTH FITNESS CORPORATION
(Exact name of registrant as specified in its charter)

Minnesota — 41-1580506
(State of incorporation or organization) — (I.R.S. Employer Identification No.)

3600 American Boulevard West, Bloomington, Minnesota — 55431
(Address of principal executive offices) — (Zip Code)

(952) 831-6830
(Registrant's telephone number, including area code)

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 past 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. [X] Yes [ ] No

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

The number of shares outstanding of each of the registrant's classes of capital stock, as of November 7, 2003 was:

Common Stock, $0.01 par value, 12,351,084 shares

1

HEALTH FITNESS CORPORATION

CONSOLIDATED FINANCIAL STATEMENTS
TABLE OF CONTENTS

		PAGE
PART I.	FINANCIAL INFORMATION	
Item 1.	Consolidated Financial Statements (unaudited)	
	Consolidated Balance Sheets as of September 30, 2003 and December 31, 2002	3
	Consolidated Statements of Earnings for the three and nine months ended September 30, 2003 and 2002	4
	Consolidated Statements of Cash Flows for the nine months ended September 30, 2003 and 2002	5
	Notes to Consolidated Financial Statements	6
Item 2.	Management's Discussion and Analysis of Financial Condition and Results of Operations	9
Item 3.	Quantitative and Qualitative Disclosures About Market Risk	12
Item 4.	Controls and Procedures	12
PART II.	OTHER INFORMATION	13
Item 1.	Legal Proceedings	
Items 2-5.	Not Applicable	
Item 6.	Exhibits and Reports on Form 8-K	
Signatures		14
Exhibit Index		15

2

HEALTH FITNESS CORPORATION
CONSOLIDATED BALANCE SHEETS
(UNAUDITED)

	Septembe 2003
ASSETS	
CURRENT ASSETS	

Cash	$ 744
Trade and other accounts receivable, less allowances of $94,000 and $88,900	3,600
Prepaid expenses and other	207
Deferred tax assets	731
Total current assets	5,283
PROPERTY AND EQUIPMENT, net	225
OTHER ASSETS	
Cash held in escrow	5,250
Goodwill	5,308
Deferred tax assets	1,929
Other	609
	$ 18,606
LIABILITIES AND STOCKHOLDERS' EQUITY	
CURRENT LIABILITIES	
Note payable	$
Trade accounts payable	289
Accrued salaries, wages, and payroll taxes	1,606
Other accrued liabilities	293
Accrued self funded insurance	261
Deferred revenue	1,229
Total current liabilities	3,680
LONG-TERM OBLIGATIONS, less current maturities	5,250
COMMITMENTS AND CONTINGENCIES	
STOCKHOLDERS' EQUITY	
Preferred stock, $0.01 par value; 5,000,000 shares authorized, none issued or outstanding	
Common stock, $0.01 par value; 25,000,000 shares authorized; 12,351,084 and 12,297,661 shares issued and outstanding	123
Additional paid-in capital	17,020
Accumulated deficit	(7,468
	9,675
	$ 18,606

See notes to consolidated financial statements.

HEALTH FITNESS CORPORATION
CONSOLIDATED STATEMENTS OF EARNINGS
(UNAUDITED)

	Three Months Ended September 30,		Nine Mon Septem
	2003	2002	2003
REVENUE	$ 7,445,094	$ 6,934,758	$ 22,695,925
COSTS OF REVENUE	5,979,326	5,514,309	17,994,616
GROSS PROFIT	1,465,768	1,420,449	4,701,309
OPERATING EXPENSES			
Salaries	834,781	702,243	2,407,539
Selling, general and administrative	393,018	463,824	1,223,937
Total operating expenses	1,227,799	1,166,067	3,631,476
OPERATING INCOME	237,969	254,382	1,069,833
OTHER EXPENSES			
Interest expense	(59,031)	(100,586)	(82,987)
Other, net	(32,949)	(2,967)	(34,808)
EARNINGS BEFORE INCOME TAXES	145,989	150,829	952,038
INCOME TAX EXPENSE (BENEFIT)	58,203	(626,636)	378,939
NET EARNINGS	$ 87,786	$ 777,465	$ 573,099
NET EARNINGS PER SHARE:			
Basic	$ 0.01	$ 0.06	$ 0.05
Diluted	0.01	0.06	0.05
WEIGHTED AVERAGE COMMON SHARES:			
Basic	12,341,284	12,289,558	12,324,292
Diluted	12,743,441	12,413,530	12,542,024

See notes to consolidated financial statements.

HEALTH FITNESS CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

	Nine Months Ended September 30,	
	2003	2
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net earnings	$ 573,099	$ 2,3
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation and amortization	66,921	2
Deferred taxes	325,632	(1,6
Changes in operating assets and liabilities:		
Trade and other accounts receivable	436,581	(6
Prepaid expenses and other	59,629	(
Other assets	(439,320)	
Trade accounts payable	(120,042)	
Accrued liabilities and other	406,121	6
Deferred revenue	(178,301)	
Net cash provided by operating activities	1,130,320	9
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of property and equipment	(107,515)	(
Net cash used in investing activities	(107,515)	(
CASH FLOWS FROM FINANCING ACTIVITIES:		
Borrowings under note payable	2,252,934	19,7
Repayments of note payable	(2,557,523)	(20,7
Proceeds from issuance of common stock	24,039	
Proceeds from issuance of bridge note financing	3,000,000	
Payment to cash escrow account	(3,000,000)	
Payment of financing costs	(89,433)	(
Net cash used in financing activities	(369,983)	(1,0
NET INCREASE (DECREASE) IN CASH	652,822	(
CASH AT BEGINNING OF PERIOD	91,658	2
CASH AT END OF PERIOD	$ 744,480	$ 1
Supplemental disclosures of non-cash financing activities:		
Proceeds from the Wells Loan (see note 3) escrowed for pending acquisition	2,250,000	

See notes to consolidated financial statements.

HEALTH FITNESS CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

NOTE 1. BASIS OF PRESENTATION

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information. They should be read in conjunction with the annual financial statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2002. In the opinion of management, the interim consolidated financial statements include all adjustments necessary for the fair presentation of the results for interim periods presented. Operating results for the three and nine months ended September 30, 2003 are not necessarily indicative of the operating results for the year ending December 31, 2003.

Certain reclassifications have been made to the consolidated financial statements as of December 31, 2002 and for the three and nine months ended September 30, 2002 to conform to the presentation used in 2003. Such reclassifications had no effect on net earnings or stockholders' equity as previously reported.

NOTE 2: PENDING ACQUISITION

On August 25, 2003, the Company signed an agreement to acquire the business assets of the Health & Fitness Services Division (the "HFS Division") of Johnson & Johnson Health Care Systems Inc. ("JJHCS"). Assets to be acquired consist primarily of client contracts, in addition to proprietary wellness, lifestyle and health promotion programs and services (the "Acquired Assets"). The agreement between the Company and JJHCS also includes a three-year services agreement with Johnson & Johnson Services, Inc. under which the Company will manage corporate health fitness centers for Johnson & Johnson operating companies and provide other health, wellness and fitness programs, products and services.

As consideration for the Acquired Assets, the Company will pay up to $5,250,000 (the "Purchase Price"), which the Company has placed into escrow pending the closing of the acquisition (the "Acquisition Closing"). The Purchase Price will be reduced to not less than $4,500,000 to the extent that customers of the HFS Division representing less than 90% of 2002 fixed fee revenue consent to the assignment of their customer contract to the Company prior to the Acquisition Closing or during the six months immediately thereafter.

NOTE 3. FINANCING ARRANGEMENTS

On August 22, 2003, the Company entered into a $7,500,000 Credit Agreement with Wells Fargo Bank, N.A. ("Wells Fargo") to provide the Company with acquisition financing and general working capital (the "Wells Loan"). The initial draw on the Wells Loan was in the amount of $1,255,204, which was used to refinance the revolving line of credit the Company previously maintained with Merrill Lynch Business Financial Services, Inc. ("Merrill Lynch"). The Company repaid all amounts owed to Merrill Lynch and canceled the Company's line of credit with Merrill Lynch, which accrued interest at the one-month LIBOR rate plus 2.35% (effective rate of 3.77% at December 31, 2002). On August 25, 2003, the Company made a draw of $2,250,000 on the Wells Loan, the proceeds of which the Company placed into escrow to fund a portion of the Purchase Price that will be payable to JJHCS at the Acquisition Closing. Future advances from the Wells Loan will be based upon a percentage of the Company's eligible accounts receivable, less any amounts previously drawn. At the option of the Company, the Wells Loan bears interest at prime or the one-month LIBOR plus a margin of 2.25% to 2.75% based upon the Company's Senior Leverage Ratio. The availability of the Wells Loan will decrease $250,000 on the last day of each calendar quarter, beginning September 30, 2003, and will expire on June 30, 2007. Borrowings under the Wells Loan are collateralized by substantially all of the Company's assets. The Company is also required to comply with certain monthly financial covenants, including a senior cash flow leverage ratio, senior leverage ratio and current ratio. At September 30, 2003, the Company had $2,250,000 outstanding under the Wells Loan, and was in compliance with all of its financial covenants.

On August 25, 2003, the Company entered into a $3,000,000 Securities Purchase Agreement with Bayview Capital Partners LP ("Bayview") to provide the Company with acquisition financing and general working capital (the "Bayview Investment"). The Bayview Investment is secured by a subordinated security interest in substantially all of the Company's assets. The Bayview Investment is currently structured as a bridge note (the "Bridge Note"), the proceeds of which the Company placed into escrow to fund a portion of the Purchase Price that will be payable to JJHCS at the Acquisition Closing. The

6

Bridge Note bears interest at 12% per year, payable monthly, with the principal due and payable on the earliest to occur of (i) the Acquisition Closing (see note 2), and (ii) December 1, 2003. In the event the Acquisition Closing does not occur prior to December 1, 2003, the Company's repayment of principal on December 1, 2003 must be accompanied by a 5% premium. The Company is required to comply with certain monthly financial covenants, including a senior cash flow leverage ratio, senior leverage ratio and current ratio. At September 30, 2003, the Company was in compliance with all of its financial covenants.

At the Acquisition Closing, the Bridge Note will convert into a $2,000,000 term note (the "Term Note"), $1,000,000 in Series A Convertible Preferred Stock of the Company (the "Preferred Stock") and a warrant to purchase common stock of the Company (the "Warrant"). The Term Note will bear interest at 12% per year, payable monthly, and will mature on the fifth anniversary of the Acquisition Closing. The Term Note may be prepaid, in whole or in part, at any time, provided that the prepayment is accompanied by a premium ranging from 5% in year 1 to 1% in year 5. The Company will be required to continue to comply under the Term Note with the same monthly financial covenants, including a senior cash flow leverage ratio, senior leverage ratio and current ratio, required under the Bridge Note.

The Preferred Stock will be issued to Bayview at a price of $1.00 per share, resulting in 1,000,000 shares to be issued at the Acquisition Closing. The Preferred Stock has a stated dividend rate of 6% per year, computed on a simple interest basis, paid in kind in the form of additional shares of Preferred Stock using a price of $1.00 per share ("PIK Dividends"). At the option of the holder, the Preferred Stock, including any PIK Dividends, may be converted into common stock of the Company at a price of $0.50 per share.

The Warrant issued to Bayview at the acquisition closing will represent the right to purchase 8% of the Company's common stock outstanding on a fully diluted basis, excluding the common stock issuable to Bayview upon conversion of the Preferred Stock. At September 30, 2003, the number of shares contingently issuable under this Warrant is approximately 1,200,000. The Warrant will be exercisable at any time for a period of ten years at an exercise price equal to $0.50 per share.

The Company has agreed to register, upon the request of Bayview, the sale of all shares of common stock issuable upon conversion of the Preferred Stock and upon exercise of the Warrant under the Securities Act of 1933, as amended, within 360 days following the date of the Acquisition Closing.

NOTE 4. STOCK-BASED COMPENSATION

The Company utilizes the intrinsic value method of accounting for its stock based employee compensation plans. All options granted had an exercise price equal to the market value of the underlying common stock on the date of grant and accordingly, no compensation cost is reflected in net earnings for the three and nine months ended September 30, 2003 and 2002. The following table illustrates the effect on net earnings and earnings per share if the Company had applied the fair value method of accounting for stock options:

	Three Months ended September 30,	
	2003	2002
Net earnings, as reported	$87,786	$777,465
Less: Compensation expense determined under the fair value method, net of tax	(17,810)	(13,162)
Proforma net earnings	$69,976	$764,303
Earnings per Share:		
Basic, as reported	$0.01	$0.06
Basic, proforma	$0.01	$0.06
Diluted, as reported	$0.01	$0.06
Diluted, proforma	$0.01	$0.06

7

The proforma information above should be read in conjunction with the related historical information.

The fair value of each option grant is estimated on the grant date using the Black-Scholes option-pricing model with the following assumptions and results for the grants:

	2003	2002
Dividend yield	None	None
Expected volatility	90%-105%	105%
Expected life of option	1 to 4 years	1 to 4 years
Risk-free interest rate	2.9%	5.5%

Weighted average fair value of options on grant date	$0.24	$0.32

NOTE 5. INCOME TAXES

Income taxes are calculated based on management's estimate of the Company's effective tax rate. Income taxes for the three and nine months ended September 30, 2002 differed from the effective rate due to benefits realized from a reduction of the Company's deferred tax asset valuation allowance totaling $625,300 and $1,875,900, respectively. The Company also recognized $30,000 of a federal refund due to a tax law change in the third quarter of 2002. The refund, federal and state income tax, and management's estimate of minimum state and federal taxes due resulted in additional benefits of $1,300 and additional expense of $229,200 for the three and nine months ended September 30, 2002, respectively.

NOTE 6. RECENT ACCOUNTING PRONOUNCEMENTS

In January 2003, the Financial Accounting Standards Board (FASB) issued Financial Interpretations No. 46 (FIN 46), "Consolidation of Variable Interest Entities." FIN 46 is an interpretation of Accounting Research Bulletin No. 51, "Consolidated Financial Statements," and addresses consolidation by business enterprises of variable interest entities. FIN 46 applies immediately to variable interest entities created or obtained after January 31, 2003 and applies in the first fiscal year or interim period beginning after June 15, 2003, to variable interest entities in which an enterprise holds a variable interest that it acquired before February 1, 2003. This interpretation is not anticipated to have an impact on the Company's consolidated financial position or results of operations.

In April 2003, the FASB issued Statement 149, Amendment of Statement 133 on Derivative Instruments and Hedging Activities. Statement 149 clarifies implementation issues and amends Statement 133, to include the conclusions reached by the FASB on certain FASB Staff Implementation Issues that, while inconsistent with Statement 133's conclusions, were considered by the Board to be preferable, amends discussion of financial guarantee contracts and the application of the shortcut method to an interest-rate swap agreement that includes an embedded option, and amends other pronouncements. Statement 149 is effective to contracts entered into or modified, and hedging arrangements designated after June 30, 2003, with various exceptions as outlined in the statement. Adoption of Statement 149 is not anticipated to have an impact on the Company's consolidated financial position or results of operations.

In May 2003, the FASB issued Statement 150, Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity. Statement 150 changes the classification in the statement of financial position of certain common financial instruments from either equity or mezzanine presentation to liabilities and requires an issuer of those financial statements to recognize changes in fair value or redemption amount, as applicable, in earnings. SFAS 150 is effective for financial instruments entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003. Adoption of Statement 150 is not anticipated to have an impact on the Company's financial position or results of operations.

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

GENERAL. Health Fitness Corporation and its wholly owned subsidiaries (the "Company"), provide fitness and wellness management services and programs to corporations, hospitals, communities and universities located in the United States of America and Canada. Fitness and wellness management services include the development, marketing and management of corporate, hospital, community and university based fitness centers, injury prevention and work-injury management consulting, and on-site physical therapy and occupational health services. Programs include wellness and health programs for individual customers, including health risk assessments, nutrition and weight loss programs, smoking cessation, massage therapy, back care and ergonomic injury prevention.

RESULTS OF OPERATIONS FOR THE QUARTER ENDED SEPTEMBER 30, 2003 AS COMPARED TO THE QUARTER ENDED SEPTEMBER 30, 2002.

REVENUE. Revenue increased $510,000 or 7.4% to $7,445,000 for the three months ended September 30, 2003, from $6,935,000 for the three months ended September 30, 2002. Fitness center management fee and consulting revenue increased $410,000 or 6.1% and occupational health services revenue increased $100,000 or 37.8%. These increases are attributed to the addition of new contracts and expansion of existing contracts.

GROSS PROFIT. Gross profit increased $46,000 or 3.2% to $1,466,000 for the three months ended September 30, 2003, from $1,420,000 for the three months ended September 30, 2002. Fitness center management fee and consulting gross profit increased $10,000 or .8% while occupational health services gross profit increased $35,000 or 57.5%. These increases are attributed to the addition of new contracts and the expansion of existing contracts.

OPERATING EXPENSES AND OPERATING INCOME. Operating expenses increased $62,000 or 5.3% to $1,228,000 for the three months ended September 30, 2003 from $1,166,000 for the three months ended September 30, 2002. This increase is due to increased salary expense of $133,000 offset by a reduction of $71,000 in selling, general and administrative expenses. The increase in salary expense is primarily attributed to increased employee benefit costs and an investment in additional sales and marketing staff the Company made during 2002. The reduction in selling, general and administrative expenses is due to decreased contract services and other expenses. Operating expenses as a percent of revenue was 16.5% for the three months ended September 30, 2003 compared to 16.8% for the three months ended September 30, 2002.

Operating income decreased $16,000 to $238,000 for the three months ended September 30, 2003 from $254,000 for the three months ended September 30, 2002. This decrease is the net result of the increase in operating expenses offset by the increase in gross profit as previously discussed.

OTHER INCOME AND EXPENSE. Interest expense decreased $42,000 to $59,000 for the three months ended September 30, 2003, compared to $101,000 for the same period in 2002. This decrease is due to decreased levels of borrowing and a lower interest rate. The Company's cost of borrowed funds decreased from an average of 9.0% for the third quarter of 2002 to 3.5% for the third quarter of 2003.

INCOME TAXES. Income taxes increased $685,000 to an expense of $58,000 for the three months ended September 30, 2003 from a benefit of $627,000 for the three months ended September 30, 2002. The increase is primarily due to the third quarter of 2002 including a $625,000 deferred tax benefit related to the reversal of a deferred tax asset valuation allowance.

NET EARNINGS. As a result of the above, net earnings decreased $689,000 to $88,000 for the three months ended September 30, 2003 from $777,000 for the three months ended September 30, 2002.

RESULTS OF OPERATIONS FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2003 AS COMPARED TO THE NINE MONTHS ENDED SEPTEMBER 30, 2002.

REVENUE. Revenue increased $2,387,000 or 11.8% to $22,696,000 for the nine months ended September 30, 2003, from $20,309,000 for the nine months ended September 30, 2002. Fitness center management fee and consulting revenue increased $2,094,000 or 10.7% and occupational health services revenue increased $293,000 or 38.2%. These increases are attributed to the addition of new contracts and the expansion of existing contracts.

GROSS PROFIT. Gross profit increased $353,000 or 8.1% to $4,701,000 for the nine months ended September 30, 2003, from $4,348,000 for the nine months ended September 30, 2002. Fitness center management fee and consulting gross profit increased $221,000 or 5.3% while occupational health services gross profit increased $132,000 or 76.3%. These increases are attributed to the addition of new contracts and the expansion of existing contracts.

OPERATING EXPENSES AND OPERATING INCOME. Operating expenses increased $279,000 or 8.3% to $3,631,000 for the nine months ended September 30, 2003 from $3,352,000 for the nine months ended September 30, 2002. This increase is due to increased salary expense of $349,000 offset by a reduction of $70,000 in selling, general and administrative expenses. The increase in salary expense is primarily attributed to increased employee benefit costs and an investment in additional sales and marketing staff the Company made during 2002. The reduction in selling, general and administrative expenses is due to decreased depreciation and amortization expense. Operating expenses as a percentage of revenue decreased to 16.0% for the nine months ended September 30, 2003 compared to 16.5% for the nine months ended September 30, 2002.

Operating income increased $74,000 to $1,070,000 for the nine months ended September 30, 2003 from $996,000 for the nine months ended September 30, 2002. This increase is the net result of the increase in gross profit offset by the decrease operating expenses as previously discussed.

OTHER INCOME AND EXPENSE. Interest expense decreased $216,000 to $83,000 for the nine months ended September 30, 2003, compared to $299,000 for the same period in 2002. This decrease is due to decreased levels of borrowing and a lower interest rate. The Company's cost of borrowed funds decreased from an average of 9.0% for the nine months ended September 30, 2002 to 3.6% for the nine months ended September 30, 2003.

INCOME TAXES. Income taxes increased $2,026,000 to an expense of $379,000 for the nine months ended September 30, 2003 from a benefit of $1,647,000 for the nine months ended September 30, 2002. The increase is primarily due to the first nine months of 2002 including a $1,876,000 deferred tax benefit related to the reversal of a deferred tax asset valuation allowance.

NET EARNINGS. As a result of the above, net earnings decreased $1,763,000 to $573,000 for the nine months ended September 30, 2003 from $2,336,000 for the nine months ended September 30, 2002.

LIQUIDITY AND CAPITAL RESOURCES

The Company had working capital of $1,603,000 at September 30, 2003, compared to working capital of $1,250,000 at December 31, 2002. The increase in working capital is primarily due to the repayment of working capital obligations.

On August 22, 2003, the Company entered into a $7,500,000 Credit Agreement with Wells Fargo Bank, N.A. ("Wells Fargo") to provide the Company with acquisition financing and general working capital (the "Wells Loan"). The initial draw on the Wells Loan was in the amount of $1,255,204, which was used to refinance the revolving line of credit the Company previously maintained with Merrill Lynch Business Financial Services, Inc. ("Merrill Lynch"). The Company repaid all amounts owed to Merrill Lynch and canceled the Company's line of credit with Merrill Lynch, which accrued interest at the one-month LIBOR rate plus 2.35% (effective rate of 3.77% at December 31, 2002). On August 25, 2003, the Company made a draw of $2,250,000 on the Wells Loan, the proceeds of which the Company placed into escrow to fund a portion of the Purchase Price that will be payable to JJHCS at the Acquisition Closing. Future advances from the Wells Loan will be based upon a percentage of the Company's eligible accounts receivable, less any amounts previously drawn. At the option of the Company, the Wells Loan bears interest at prime or the one-month LIBOR plus a margin of 2.25% to 2.75% based upon the Company's Senior Leverage Ratio. The availability of the Wells Loan will decrease $250,000 on the last day of each calendar quarter, beginning September 30, 2003, and will expire on June 30, 2007. Borrowings under the Wells Loan are collateralized by substantially all of the Company's assets. The Company is also required to comply with certain monthly financial covenants, including a senior cash flow leverage ratio, senior leverage ratio and current ratio. At September 30, 2003, the Company had $2,250,000 outstanding under the Wells Loan, and was in compliance with all of its financial covenants.

On August 25, 2003, the Company entered into a $3,000,000 Securities Purchase Agreement with Bayview Capital Partners LP ("Bayview") to provide the Company with acquisition financing and general working capital (the "Bayview Investment"). The Bayview Investment is secured by a subordinated security interest in substantially all of the Company's assets.

The Bayview Investment is currently structured as a bridge note (the "Bridge Note"), the proceeds of which the Company placed into escrow to fund a portion of the Purchase Price that will be payable to JJHCS at the Acquisition Closing. The Bridge Note bears interest at 12% per year, payable monthly, with the principal due and payable on the earliest to occur of (i) the Acquisition Closing, and (ii) December 1, 2003. In the event the Acquisition Closing does not occur prior to December 1, 2003, the Company's repayment of principal on December 1, 2003 must be accompanied by a 5% premium. The Company is required to comply with certain monthly financial covenants, including a senior cash flow leverage ratio, senior leverage ratio and current ratio. At September 30, 2003, the Company was in compliance with all of its financial covenants.

As of September 30, 2003, the Company has no off-balance sheet arrangements or transactions with unconsolidated, limited purpose entities. Refer to the footnotes in the Company's Annual Report on Form 10-K for the year ended December 31, 2002 for disclosure related to the Company's "Commitments and Contingencies."

On a short and long-term basis, the Company believes that sources of capital to meet future obligations will be provided by cash generated through operations and the Company's revolving line of credit. The Company does not believe that inflation has had a significant impact on the results of its operations.

RECENTLY ISSUED ACCOUNTING POLICIES

As indicated in our notes to the financial statements, we are not aware of any recently issued accounting pronouncements that will have a material impact on the Company's financial position or results of operations.

CAUTIONARY STATEMENT

This Form 10-Q contains forward-looking statements within the meaning of federal securities laws. These statements include statements regarding intent, belief, or current expectations of the Company and its management and specifically include the statement regarding cash expected to be available from operations. These forward-looking statements are not guarantees of the future performance and involve a number of risks and uncertainties that may cause the Company's actual results to differ materially from the results discussed in these statements. Please refer to Management's Discussion and Analysis contained within the Company's Annual Report on Form 10-K for the year ended December 31, 2002, for cautionary statements on important factors to consider in evaluating the forward-looking statements included in this Form 10-Q.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company has no history of, and does not anticipate in the future, investing in derivative financial instruments, derivative commodity instruments or other such financial instruments. Transactions with international customers are entered into in U.S. dollars, precluding the need for foreign currency hedges. As a result, the exposure to market risk is not material.

ITEM 4. CONTROLS AND PROCEDURES

The Company's Chief Executive Officer and Chief Financial Officer (collectively, the "Certifying Officers") are responsible for establishing and maintaining disclosure controls and procedures for the Company. The Certifying Officers have concluded (based upon their evaluation of these controls and procedures as of the end of the period covered by this report) that the Company's disclosure controls and procedures are effective to ensure that information required to be disclosed by the Company in reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the rules of the Securities and Exchange Commission. The Certifying Officers also have indicated that there were no changes in the Company's internal control over financial reporting that occurred during the period covered by this report that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II. - OTHER INFORMATION

Item 1. Legal Proceedings

In April 2000, HealthSouth Corporation filed a lawsuit against the Company and two former employees in U.S. District Court in Minnesota arising out of HealthSouth's purchase of several rehabilitation and physical therapy clinics from the Company in May 1999. HealthSouth claimed that the two former employees improperly diverted business away from the purchased clinics. HealthSouth claimed damages in excess of $3,000,000, alleging misrepresentations and breaches of warranties in the purchase agreement.

In February 2002, the U.S. District Court in Minneapolis dismissed all of HealthSouth's claims in connection with a summary judgment motion filed by the Company, and issued an order awarding the Company a judgment of $43,156 for its counterclaim relating to certain accounts receivable. HealthSouth paid the $43,156 counterclaim judgment in full, but appealed the dismissal of HealthSouth's original claims. In June 2003, while awaiting the final outcome of HealthSouth's appeal, the Company paid HealthSouth approximately $25,000 in settlement of all of HealthSouth's remaining claims.

Item 2. Changes in Securities and Use of Proceeds

None

Item 3. Defaults Upon Senior Securities

None.

Item 4. Submission of Matters to a Vote of Security Holders

None

Item 5. Other Information

None.

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits

See Exhibit Index on page following signatures

(b) Reports on Form 8-K

The Company filed a Report on Form 8-K on August 8, 2003 to disclose that a press release dated August 6, 2003 was issued to announce and furnish the Company's results of operations and financial condition for the 2nd quarter of 2003.

The Company filed a Report on Form 8-K on August 26, 2003 to disclose that a press release dated August 26, 2003 was issued to announce that the Company had entered into an agreement to acquire certain assets of Johnson & Johnson Health Care Systems Inc.

SIGNATURES

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

Dated: November 14, 2003 HEALTH FITNESS CORPORATION

By /s/ Jerry V. Noyce

Jerry V. Noyce
Chief Executive Officer
(Principal Executive Officer)

By /s/ Wesley W. Winnekins

Wesley W. Winnekins
Chief Financial Officer
(Principal Financial and Accounting Officer)

EXHIBIT INDEX
HEALTH FITNESS CORPORATION
FORM 10-Q

Exhibit No.	Description
3.1	Articles of Incorporation, as amended, of the Company - incorporated by reference to the Company's Quarterly Report on Form 10-QSB for the quarter ended June 30, 1997
3.2	Restated By-Laws of the Company - incorporated by reference to the Company's Registration Statement on Form SB-2 No. 33-83784C
4.1	Specimen of Common Stock Certificate - incorporated by reference to the Company's Registration Statement on Form SB-2 No. 33-83784C
**10.11	Credit Agreement, dated August 22, 2003, between the Company and Wells Fargo Bank, National Association
**10.12	Securities Purchase Agreement, dated August 25, 2003, between the Company and certain of its subsidiaries, on the one hand, and Bayview Capital Partners LP, on the other hand
**10.13	Asset Purchase Agreement, dated August 25, 2003, between the Company and Johnson & Johnson Health Care Systems Inc.
**10.14	Third Amendment, dated August 25, 2003, to Standard Office Lease Agreement dated as of June 13, 1996, between the Company and NEOC Holdings LLC
**11.0	Statement re: Computation of Earnings per Share
**31.1	Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
**31.2	Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
**32.1	Certification of Chief Executive Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
**32.2	Certification of Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

----

*   Indicates management contract or compensatory plan or arrangement

** Filed herewith