

WEIGHT WATCHERS INTERNATIONAL INC
Form 10-Q
November 09, 2006

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2006

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 No. 000-03389

WEIGHT WATCHERS INTERNATIONAL, INC.

(Exact name of registrant as specified in its charter)

Virginia
(State or other jurisdiction of
incorporation or organization)

11-6040273
(I.R.S. Employer
Identification No.)

11 Madison Avenue, 17th Floor, New York, New York 10010
(Address of principal executive offices) (Zip code)

Registrant's telephone number, including area code:

(212) 589-2700

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes

No

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Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Ruler 12b-2 of the Exchange Act. (Check one):

Large Accelerated Filer Accelerated Filer Non Accelerated Filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

The number of shares of common stock outstanding as of October 31, 2006 was 97,375,965.

WEIGHT WATCHERS INTERNATIONAL, INC. AND SUBSIDIARIES

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PART I - FINANCIAL INFORMATION**ITEM 1. FINANCIAL STATEMENTS****WEIGHT WATCHERS INTERNATIONAL, INC. AND SUBSIDIARIES
UNAUDITED CONSOLIDATED BALANCE SHEETS AT
(IN THOUSANDS)**

	September 30, 2006	December 31, 2005
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	\$ 58,806	\$ 31,476
Receivables, net	39,311	28,040
Inventories, net	25,475	31,678
Prepaid expenses and other current assets	29,427	25,638
Deferred income taxes	1,483	10,878
TOTAL CURRENT ASSETS	154,502	127,710
Property and equipment, net	25,847	20,775
Franchise rights acquired	629,665	555,604
Goodwill	51,311	51,305
Trademarks and other intangible assets, net	17,407	8,837
Deferred income taxes	47,714	61,917
Deferred financing costs and other noncurrent assets	8,652	9,343
TOTAL ASSETS	\$ 935,098	\$ 835,491
LIABILITIES AND SHAREHOLDERS' DEFICIT		
CURRENT LIABILITIES		
Portion of long-term debt due within one year	\$ 14,648	\$ 4,700
Accounts payable	26,784	19,714
Dividend payable	17,029	
Accrued liabilities	99,509	82,025
Income taxes payable	7,001	13,710
Deferred income taxes	7,250	7,250
Deferred revenue	54,815	38,489
TOTAL CURRENT LIABILITIES	227,036	165,888
Long-term debt	802,392	741,425
Deferred income taxes		26
Other	8,939	8,803
TOTAL LIABILITIES	1,038,367	916,142
SHAREHOLDERS' DEFICIT		
Dividend to Artal Luxembourg S.A.	(304,835)	(304,835)
Common stock, \$0 par value; 1,000,000 shares authorized; 111,988 shares issued and outstanding		
Treasury stock, at cost, 14,680 shares at September 30, 2006 and 11,410 shares at December 31, 2005	(541,099)	(390,864)
Retained earnings	736,148	609,053
Accumulated other comprehensive income	6,517	5,995
TOTAL SHAREHOLDERS' DEFICIT	(103,269)	(80,651)
TOTAL LIABILITIES AND SHAREHOLDERS' DEFICIT	\$ 935,098	\$ 835,491

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

WEIGHT WATCHERS INTERNATIONAL, INC. AND SUBSIDIARIES
UNAUDITED CONSOLIDATED STATEMENTS OF OPERATIONS
(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

	Three Months Ended	
	September 30,	October 1,
	2006	2005
Meeting fees, net	\$ 166,845	\$ 152,377
Product sales and other, net	84,815	77,380
Online revenues	33,093	27,726
Revenues, net	284,753	257,483
Cost of meetings, products and other	120,713	108,916
Cost of online subscriptions	8,317	6,395
Cost of revenues	129,030	115,311
Gross profit	155,723	142,172
Marketing expenses	30,678	27,851
Selling, general and administrative expenses	32,756	29,658
Operating income	92,289	84,663
Interest expense, net	13,169	5,308
Other (income)/expense, net	(76)	126
Income before income taxes	79,196	79,229
Provision for income taxes	28,581	29,777
Net income	\$ 50,615	\$ 49,452
Earnings per share:		
Basic	\$ 0.52	\$ 0.48
Diluted	\$ 0.52	\$ 0.47
Weighted average common shares outstanding:		
Basic	97,425	103,227
Diluted	98,036	104,336
Dividends declared per common share	\$ 0.18	\$

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

WEIGHT WATCHERS INTERNATIONAL, INC. AND SUBSIDIARIES
UNAUDITED CONSOLIDATED STATEMENTS OF OPERATIONS
(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

	Nine Months Ended September 30, 2006	October 1, 2005
Meeting fees, net	\$ 552,671	\$ 532,911
Product sales and other, net	297,228	284,795
Online revenues	97,961	82,375
Revenues, net	947,860	900,081
Cost of meetings, products and other	396,502	379,652
Cost of online subscriptions	22,651	20,116
Cost of revenues	419,153	399,768
Gross profit	528,707	500,313
Marketing expenses	125,492	127,365
Selling, general and administrative expenses	101,428	137,770
Operating income	301,787	235,178
Interest expense, net	35,931	14,469
Other (income)/expense, net	(821)	1,899
Early extinguishment of debt	1,321	
Income before income taxes	265,356	218,810
Provision for income taxes	99,827	83,258
Net income	\$ 165,529	\$ 135,552
Earnings per share:		
Basic	\$ 1.67	\$ 1.32
Diluted	\$ 1.66	\$ 1.30
Weighted average common shares outstanding:		
Basic	99,152	103,046
Diluted	99,872	104,610
Dividends declared per common share	\$ 0.53	\$

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

WEIGHT WATCHERS INTERNATIONAL, INC. AND SUBSIDIARIES
UNAUDITED CONSOLIDATED STATEMENT OF CHANGES
IN SHAREHOLDERS' EQUITY/(DEFICIT)
(IN THOUSANDS)

	Common Stock Shares	Amount	Treasury Stock Shares	Amount	Accumulated Other Comprehensive Income	Dividend to Artal Luxembourg S.A.	Retained Earnings	Total
Balance at January 1, 2005	111,988	\$	9,575	\$ (222,547)	\$ 5,794	\$	\$ 413,192	\$ 196,439
Comprehensive Income:								
Net income							174,402	174,402
Translation adjustment, net of taxes of \$853					(1,272)			(1,272)
Change in fair value of derivatives accounted for as hedges, net of taxes of (\$942)					1,473			1,473
Total Comprehensive Income								174,603
Issuance of treasury stock under employee stock plans			(1,897)	7,663			(3,951)	3,712
Tax benefit of stock options exercised							26,770	26,770
Exercise of WeightWatchers.com warrants							(4,261)	(4,261)
Dividend to Artal Luxembourg S.A.						(304,835)		(304,835)
Purchase of treasury stock			3,732	(175,980)				(175,980)
Compensation expense on restricted stock awards							2,901	2,901
Balance at December 31, 2005	111,988	\$	11,410	\$ (390,864)	\$ 5,995	\$ (304,835)	\$ 609,053	\$ (80,651)
Comprehensive Income:								
Net income							165,529	165,529
Translation adjustment, net of taxes of \$(383)					708			708
Change in fair value of derivatives accounted for as hedges, net of taxes of \$177					(186)			(186)
Total Comprehensive Income								166,051
Issuance of treasury stock under employee stock plans			(357)	1,443			1,801	3,244
Tax benefit of restricted stock units vested and stock options exercised							3,329	3,329
Purchase of treasury stock			3,627	(151,678)				(151,678)
Compensation expense on share-based awards							8,711	8,711

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Dividends							(51,787)	(51,787)						
Secondary offering fees							(488)	(488)						
Balance at September 30, 2006	111,988	\$	14,680	\$	(541,099)	\$	6,517	\$	(304,835)	\$	736,148	\$	(103,269)

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

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WEIGHT WATCHERS INTERNATIONAL, INC. AND SUBSIDIARIES
UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS
(IN THOUSANDS)

	Nine Months Ended September 30, 2006	October 1, 2005
Cash provided by operating activities	\$ 234,033	\$ 255,788
Investing activities:		
Capital expenditures	(10,227)	(9,434)
Capitalized software expenditures	(8,355)	(1,797)
Website development expenditures	(3,633)	(2,222)
Cash paid for acquisitions	(74,597)	(75,997)
Other items, net	(213)	9)
Cash used for investing activities	(97,025)	(89,441)
Financing activities:		
Net (decrease)/increase in short-term borrowings	(832)	238)
Proceeds from new term loan	350,000	
Proceeds/(repayments) from revolver	160,000	(105,000)
Payments of long-term debt	(439,085)	(2,250)
Proceeds from stock options exercised	4,090	4,384
Tax benefit from restricted stock units vested and stock options exercised	3,329	
Repurchase of treasury stock	(151,678)	(42,551)
Costs of public equity offering	(280)	
Payment of dividends	(34,758)	
Deferred financing costs	(1,744)	
Cash used for financing activities	(110,958)	(145,179)
Effect of exchange rate changes on cash/cash equivalents and other	1,280	(3,283)
Net increase in cash and cash equivalents	27,330	17,885
Cash and cash equivalents, beginning of period	31,476	35,156
Cash and cash equivalents, end of period	\$ 58,806	\$ 53,041

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

WEIGHT WATCHERS INTERNATIONAL, INC. AND SUBSIDIARIES
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS
(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

1. Basis of Presentation

The accompanying consolidated financial statements include the accounts of Weight Watchers International, Inc., and its wholly-owned subsidiaries, which effective December 16, 2005 includes WeightWatchers.com, Inc. and its subsidiaries (collectively, WW.com). The term the Company as used throughout this document is used to indicate Weight Watchers International, Inc. and its wholly owned subsidiaries. The term WWI as used throughout this document is used to indicate Weight Watchers International, Inc. and its wholly-owned subsidiaries other than WW.com.

The consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America and include amounts that are based on management's best estimates and judgments. While all available information has been considered, actual amounts could differ from those estimates. The consolidated financial statements are unaudited but, in the opinion of management, reflect all adjustments of a normal recurring nature necessary for a fair statement of the interim results presented.

These statements should be read in conjunction with the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2005, which includes additional information about the Company, its results of operations, its financial position and its cash flows.

2. Summary of Significant Accounting Policies

The Company adopted the provisions of Statement of Financial Accounting Standards (SFAS) No. 123(R) Share-Based Payment on January 1, 2006. This standard requires the Company to recognize the cost of all share-based awards based on their grant-date fair value over the related service period of such awards. Determining the fair value of options at the grant date requires judgment, including estimating the expected term that stock options will be outstanding prior to exercise, the associated volatility and the expected dividends. Prior to adopting SFAS No. 123(R), the Company applied the recognition and measurement principles of Accounting Principles Board (APB) Opinion No. 25, Accounting for Stock Issued to Employees and related Interpretations, in accounting for its share-based compensation plans. All employee stock options were granted with an exercise price equal to the fair market price as determined in accordance with our Stock Plans (as defined in Note 8). Accordingly, no compensation expense was recognized for stock option grants in prior periods. In accordance with SFAS No. 123(R), judgment is required in estimating the amount of share-based awards expected to be forfeited prior to vesting. If actual forfeitures differ significantly from these estimates, share-based compensation expense could be materially impacted.

For a discussion of the Company's other significant accounting policies, see Summary of Significant Accounting Policies beginning on page F-8 of the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2005.

3. Acquisitions

Summary

The acquisitions of certain franchisees have been accounted for under the purchase method of accounting and, accordingly, earnings have been included in the consolidated operating results of the Company since their dates of acquisition. Details of these franchise acquisitions are outlined below.

Pursuant to a merger agreement effective July 2, 2005, WWI increased its ownership interest in WW.com from approximately 20% to approximately 53% for a total cash outlay of \$136,385, including \$107,900 paid to WW.com. Further to this, on December 16, 2005, WW.com redeemed all of the equity

interest in WW.com owned by Artal Luxembourg S.A. (together with its affiliates, Artal) for the aggregate cash consideration of \$304,835. As a result of this redemption, WW.com became a wholly-owned subsidiary of WWI. See further discussion below for the accounting treatment of this transaction.

Franchise Acquisitions

On August 17, 2006, the Company acquired substantially all of the assets of the Canadian franchisee, Walmar (Eastern Canada) Limited (Walmar), and of Vale Printing Limited (Vale), and collectively with Walmar, Eastern Canada). The net purchase price was approximately \$49,800, the majority of which has been preliminarily allocated to franchise rights acquired. Due to the timing of this acquisition, the Company has not yet finalized the purchase price allocation. Pro forma results of operations, assuming this acquisition had been completed at the beginning of each period presented, would not differ materially from the reported results.

On July 27, 2006, the Company acquired substantially all of the assets of its Indiana franchisee, Weight Watchers of Greater Indiana, Inc., for a purchase price of approximately \$24,900, the majority of which has been preliminarily allocated to franchise rights acquired. Due to the timing of this acquisition, the Company has not yet finalized the purchase price allocation. Pro forma results of operations, assuming this acquisition had been completed at the beginning of each period presented, would not differ materially from the reported results.

Acquisition of WW.com

On June 13, 2005, WWI entered into an agreement to acquire its affiliate WW.com. As a result, WWI increased its ownership interest in WW.com from approximately 20% to approximately 53% as follows: on July 1, 2005, WWI exercised its 6,395 warrants to purchase WW.com common stock for a total price of \$45,660; and on July 2, 2005, WWI acquired through a merger of a subsidiary of WWI with WW.com (the Merger), 1,126 shares of WW.com common stock owned by the employees of WW.com and other parties not related to Artal for a total price of \$28,383, and acquired an additional 2,759 shares of WW.com common stock, representing outstanding stock options then held by WW.com employees, for a total price of \$62,342.

The acquisition of the 1,126 shares represented shares owned outright by the employees of WW.com and other parties not related to Artal. This component of the transaction has been accounted for under the provisions of SFAS No. 141, Business Combinations, (FAS 141). The acquisition of these shares resulted in an increase to goodwill of \$26,185 and an increase to finite-lived intangible assets of \$1,161, primarily customer relations and information technology. These amounts represent the excess of the purchase price of \$28,383 over the net book value of the assets acquired plus transaction costs.

The acquisition of the 2,759 shares of WW.com stock represented vested and unvested options owned by employees of WW.com. Because at the time of the acquisition of these shares Artal owned approximately 47% of WW.com and is the majority shareholder of WWI, the acquisition of these shares is considered to be a transaction between entities under common control, and therefore, the provisions of FAS 141 are not applicable. Under the guidance of FASB Interpretation No. 44, Accounting for Certain Transactions Involving Stock Compensation, (FIN 44), and Emerging Issues Task Force Issue No. 00-23, Issues Related to the Accounting for Stock Compensation under APB Opinion No. 25 and FIN 44, (EITF 00-23), the Company was required to record a compensation charge related to the 2,293 vested options of \$39,647 in the second quarter 2005. This amount represents the difference between the purchase price per share and the exercise price per share of the vested options. The 466 unvested options were exchanged for 134 restricted stock units of WWI, resulting in deferred compensation of \$7,214, which is being recorded as compensation expense in future periods as the restricted stock units vest.

In connection with the acquisition of the WW.com shares, WWI also purchased and canceled all 103 outstanding WW.com options held by WWI employees for a total settlement price of \$2,415. Under the guidance of FIN 44 and EITF 00-23, the Company was required to record the full settlement price as a compensation charge in the second quarter of 2005. This charge, coupled with the aforementioned \$39,647 compensation charge recorded in connection with the vested options held by WW.com employees, resulted in a total compensation charge of \$42,062, which was recorded as a component of selling, general and administrative expenses in the second quarter of 2005.

On June 13, 2005, WW.com entered into a redemption agreement with Artal (the Redemption) to purchase the 12,092 shares of WW.com then owned by Artal. Pursuant to the Redemption on December 16, 2005, WW.com redeemed the remaining 47% of its outstanding shares of common stock held by Artal for the aggregate cash consideration of \$304,835, the same purchase price per share as that paid by WWI in the Merger. The Redemption was funded with cash on hand of approximately \$89,800 and the proceeds from its two credit facilities (see Note 5) which totaled \$215,000. In accordance with the provisions of SFAS No. 150, Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity, because at the time of the Redemption Artal owned approximately 47% of WW.com and is the majority shareholder of WWI, the Redemption was considered to be a transaction between entities under common control. Therefore, the Redemption was recorded as a dividend to Artal in the shareholders' deficit section of the balance sheet.

4. Goodwill and Intangible Assets

In accordance with SFAS No. 142, Goodwill and Other Intangible Assets, the Company no longer amortizes goodwill or other indefinite lived intangible assets, primarily franchise rights acquired. The Company performed its annual fair value impairment testing as of December 31, 2005 on its goodwill and other indefinite lived intangible assets and determined that no impairment existed. Unamortized goodwill is due mainly to the acquisition of the Company by the H.J. Heinz Company in 1978 and the aforementioned transactions with WW.com. Franchise rights acquired are due mainly to acquisitions of the Company's franchised territories. For the nine months ended September 30, 2006, the change in goodwill is due to foreign currency fluctuations, while the increase in franchise rights acquired is primarily due to the acquisition of our Canadian franchisee and our Indiana franchisee as explained in Note 3.

In accordance with SFAS No. 142, aggregate amortization expense for finite lived intangible assets was recorded in the amounts of \$1,193 and \$3,777 for the three and nine months ended September 30, 2006, respectively. Aggregate amortization expense was \$991 and \$2,655 for the three and nine months ended October 1, 2005, respectively.

The carrying amount of the amortized intangible assets as of September 30, 2006 and December 31, 2005 was as follows:

	September 30, 2006		December 31, 2005	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Deferred software costs	\$ 16,007	\$ 5,828	\$ 7,435	\$ 4,280
Trademarks	8,337	7,570	8,112	7,352
Non-compete agreement	1,200	1,200	1,200	1,200
Web site development costs	13,631	8,400	9,998	6,661
Other	5,385	4,155	5,382	3,797
	\$ 44,560	\$ 27,153	\$ 32,127	\$ 23,290

Estimated amortization expense of existing finite lived intangible assets for the next five fiscal years is as follows:

Remainder of 2006	\$ 1,075
2007	\$ 5,686
2008	\$ 5,068
2009	\$ 3,277
2010	\$ 140

5. Long-Term Debt

WWI Credit Facility

WWI's Credit Agreement dated as of January 16, 2001 and amended and restated as of January 21, 2004, as supplemented on October 19, 2004 and as amended on June 24, 2005 (the "WWI Credit Agreement") consisted of a Term Loan B, Additional Term Loan B and a revolving line of credit.

On May 8, 2006, WWI entered into a refinancing to reduce its effective interest rate while increasing its borrowing capacity and extending the maturities of borrowings under the WWI Credit Agreement (as refinanced, the "WWI Credit Facility"). In connection with the refinancing, WWI's Term Loan B and Additional Term Loan B in the aggregate amount of \$294,375 were repaid and replaced with a new Term Loan A in the amount of \$350,000 (the "Term Loan A"). The additional funds of \$55,625 were used to pay down the revolving line of credit. Also, in connection with this refinancing, WWI's then existing revolving line of credit was repaid and replaced with a new revolving line of credit (the "Revolver") which increased borrowing capacity from \$350,000 to \$500,000. At September 30, 2006, WWI had \$226,400 of availability under the Revolver. The WWI Credit Facility has a maturity date of June 30, 2011.

In connection with the early extinguishment of debt resulting from this refinancing, the Company recorded a charge of \$1,321 in the second quarter of 2006 relating to the write-off of a portion of the deferred financing costs associated with its old debt.

WWI's Term Loan A and the Revolver bear interest at an initial rate equal to LIBOR plus 0.875% per annum or, at WWI's option, the alternate base rate (as defined in the WWI Credit Facility). In addition to paying interest on outstanding principal under the WWI Credit Facility, WWI is required to pay a commitment fee to the lenders under the Revolver with respect to the unused commitments at an initial rate equal to 0.175% per annum.

The WWI Credit Facility contains customary covenants including covenants that in certain circumstances restrict WWI's ability to incur additional indebtedness, pay dividends on and redeem capital stock, make other restricted payments, including investments, sell its assets and enter into consolidations, mergers and transfers of all or substantially all of its assets. The WWI Credit Facility also requires WWI to maintain specified financial ratios and satisfy financial condition tests. At September 30, 2006, WWI complied with all of the required financial ratios and also met all of the financial condition tests and is expected to continue to do so. The WWI Credit Facility contains customary events of default. Upon the occurrence of an event of default under the WWI Credit Facility, the lenders thereunder may cease making loans and declare amounts outstanding to be immediately due and payable. The WWI Credit Facility is guaranteed by certain of the Company's existing and future subsidiaries, other than WW.com. Substantially all the assets of WWI collateralize the WWI Credit Facility.

On June 13, 2006, Standard & Poor's confirmed its BB rating for WWI's corporate credit and assigned a BB+ rating to the WWI Credit Facility. On September 22, 2006, Moody's assigned a Ba1 rating to WWI's corporate credit and the WWI Credit Facility.

WW.com Credit Facilities

On December 16, 2005, WW.com borrowed \$215,000 pursuant to two credit facilities (the WW.com Credit Facilities), consisting of (i) a five year, senior secured first lien term loan facility in an aggregate principal amount of \$170,000 (the First Lien Term Credit Facility) and (ii) a five and one-half year, senior secured second lien term loan facility in an aggregate principal amount of \$45,000 (the Second Lien Term Credit Facility). The WW.com Credit Facilities are governed by two credit agreements among WW.com, Credit Suisse, as administrative agent and collateral agent, and the lenders party thereto.

The First Lien Term Credit Facility bears an interest rate equal to LIBOR plus 2.25% per annum, or, at WW.com's option, the alternate base rate, (as defined in the First Lien Term Credit Facility), plus 1.25% per annum. The Second Lien Term Credit Facility bears an interest rate equal to LIBOR plus 4.75% per annum or, at WW.com's option, the alternate base rate, (as defined in the Second Lien Term Credit Facility), plus 3.75% per annum.

Loans outstanding under the WW.com Credit Facilities (i) must be prepaid with certain percentages of excess cash flow and net cash proceeds of asset sales, issuances, offerings or placements of debt obligations of WW.com and issuances of equity securities of WW.com, and (ii) may be voluntarily prepaid at any time in whole or in part without premium or penalty, with certain exceptions depending upon the date of payment. The rights and priorities of the lenders under the WW.com Credit Facilities are governed by an inter-creditor agreement.

The WW.com Credit Facilities contain customary covenants, including affirmative and negative covenants that, in certain circumstances, restrict WW.com's ability to incur additional indebtedness, pay dividends on and redeem capital stock, make other restricted payments, including investments, sell WW.com assets and enter into consolidations, mergers and transfers of all or substantially all of WW.com's assets. The WW.com Credit Facilities also require WW.com to maintain specified financial ratios and satisfy financial condition tests, which become more restrictive over time. At September 30, 2006, WW.com complied with all of the required financial ratios and also met all of the financial condition tests and is expected to continue to do so. The WW.com Credit Facilities contain customary events of default. Upon the occurrence of an event of default under the WW.com Credit Facilities, the lenders thereunder may cease making loans and declare amounts outstanding to be immediately due and payable. Each of WW.com's existing and future domestic subsidiaries have guaranteed the WW.com Credit Facilities and the WW.com Credit Facilities are secured by substantially all the assets of WW.com and these subsidiaries. WWI has not guaranteed the WW.com Credit Facilities.

On November 4, 2005, Standard & Poor's assigned its B+ corporate credit rating to WW.com. In addition, Standard & Poor's assigned ratings of B+ to the First Lien Term Credit Facility and B- to the Second Lien Term Credit Facility. On September 22, 2006, Moody's assigned ratings of Ba2 to the First Lien Term Credit Facility and B2 to the Second Lien Term Credit Facility.

6. Treasury Stock

On October 9, 2003, the Company, at the direction of WWI's Board of Directors, authorized a program to repurchase up to \$250,000 of the Company's outstanding common stock. On June 13, 2005, the Company, at the direction of WWI's Board of Directors, authorized adding an additional \$250,000 to this program. On May 25, 2006, the Company, at the direction of WWI's Board of Directors, authorized adding an additional \$250,000 to this program.

The repurchase program allows for shares to be purchased from time to time in the open market or through privately negotiated transactions. No shares will be purchased from Artal under the program.

From October 9, 2003 through December 31, 2005, the Company purchased 9,184 shares of common stock in the open market for a total cost of \$381,877. During the nine months ended September 30, 2006 and October 1, 2005, the Company purchased 3,627 and 888 shares of common stock, respectively, in the open market at a total cost of \$151,678 and \$42,551, respectively.

7. Earnings Per Share

Basic earnings per share (EPS) computations are calculated utilizing the weighted average number of common shares outstanding during the periods presented. Diluted EPS is calculated utilizing the weighted average number of common shares outstanding adjusted for the effect of dilutive common stock equivalents.

The following table sets forth the computation of basic and diluted earnings per share:

	Three Months Ended		Nine Months Ended	
	September 30, 2006	October 1, 2005	September 30, 2006	October 1, 2005
Numerator:				
Net income	\$ 50,615	\$ 49,452	\$ 165,529	\$ 135,552
Denominator:				
Weighted-average shares	97,425	103,227	99,152	103,046
Effect of dilutive common stock equivalents	611	1,109	720	1,564
Denominator for diluted EPS-Weighted-average shares	98,036	104,336	99,872	104,610
EPS:				
Basic	\$ 0.52	\$ 0.48	\$ 1.67	\$ 1.32
Diluted	\$ 0.52	\$ 0.47	\$ 1.66	\$ 1.30

The number of anti-dilutive common stock equivalents excluded from the calculation of weighted average shares for diluted EPS was 1,762 and 12 for the three months ended September 30, 2006 and October 1, 2005, respectively, and 1,282 and 58 for the nine months ended September 30, 2006 and October 1, 2005, respectively.

8. Stock Plans

On May 12, 2004 and December 16, 1999, respectively, the Company's shareholders approved the 2004 Stock Incentive Plan (the 2004 Plan) and the 1999 Stock Purchase and Option Plan (the 1999 Plan, and together with the 2004 Plan, the Stock Plans). These plans are designed to promote the long-term financial interests and growth of the Company by attracting and retaining management with the ability to contribute to the success of the business. The Board of Directors or a committee thereof administers the plans.

Under the 2004 Plan, grants may take the following forms at the committee's sole discretion: non-qualified stock options, incentive stock options, stock appreciation rights, restricted stock units and other share-based awards. The maximum number of shares available for grant under the 2004 Plan is 2,500 as of the plan's effective date.

Under the 1999 Plan, grants may take the following forms at the committee's sole discretion: non-qualified stock options, incentive stock options, stock appreciation rights, restricted stock, purchase stock, dividend equivalent rights, performance units, performance shares and other share-based grants. The maximum number of shares available for grant under this plan was 5,647 shares of authorized common stock as of the plan's effective date. In 2001, the number of shares available for grant was increased to 7,058 shares.

Through December 31, 2005, as permitted by SFAS No. 123, the Company applied the recognition and measurement principles of APB No. 25, Accounting for Stock Issued to Employees, and related interpretations in accounting for these plans. As such, for all periods presented through fiscal 2005, no compensation expense for employee stock options was reflected in earnings as all options were granted with an exercise price equal to the fair market price as determined in accordance with our Stock Plans.

The following table illustrates the effect on net income and diluted earnings per share if the Company had applied the fair value recognition provisions of SFAS No. 123:

	Three Months Ended October 1, 2005	Nine Months Ended October 1, 2005
Net income, as reported	\$ 49,452	\$ 135,552
Add:		
Total share-based employee compensation as recorded under FIN 44 and APB 25, net of related tax effect	861	25,500
Deduct:		
Total share-based employee compensation expense determined under the fair value method for all stock option awards, net of related tax effect	(1,863)	(28,162)
Pro forma net income	\$ 48,450	\$ 132,890
EPS:		
Basic-as reported	\$ 0.48	\$ 1.32
Basic-pro forma	\$ 0.47	\$ 1.29
Diluted-as reported	\$ 0.47	\$ 1.30
Diluted-pro forma	\$ 0.46	\$ 1.27

The Company adopted the provisions of SFAS 123(R), Share-Based Payment on January 1, 2006. Upon adopting this standard, the Company began recognizing the cost of all share-based awards based on their grant-date fair value over the related service period of such awards. For the three and nine months ended September 30, 2006, the impact of adopting SFAS 123(R) was to reduce income before income taxes by \$1,603 and \$4,556, respectively and net income by \$978 and \$2,779, respectively, with a corresponding reduction in basic and diluted earnings per share of \$0.01 and \$0.03, respectively. In accordance with SFAS 123(R), the Company has elected to apply the modified prospective transition method to all past awards outstanding and unvested as of the date of adoption and has begun to recognize the associated expense over the remaining vesting period based on the fair values previously determined and disclosed as part of its pro forma disclosures. The Company has not restated the results of prior periods.

The total compensation cost that has been charged against income for these plans was \$2,931 and \$8,711 for the three and nine months ended September 30, 2006, respectively. Such amount has been included as a component of selling, general and administrative expenses. The total income tax benefit recognized in the income statement for all share-based compensation arrangements was \$1,143 and \$3,397 for the three and nine months ended September 30, 2006, respectively. No compensation costs were capitalized. As of September 30, 2006, there was \$25,552 of total unrecognized compensation cost related to stock options and restricted stock units (RSUs) granted under the plans. That cost is expected to be recognized over a weighted-average period of 3.1 years.

While the plans permit various types of awards, grants under the plans have historically been either stock options or RSUs. The following describes some further details of these awards.

Stock Option Awards

The fair value of each option award is estimated on the date of grant using the Black-Scholes option pricing model with the weighted average assumptions noted in the following table. Expected volatility is based on the historical volatility of the Company's stock with certain time periods excluded due to historical events which are not expected to recur. Since the Company's option exercise history is limited, it has estimated the expected term of option grants to be the midpoint between the vesting period and the contractual term of each award, as is permitted under Staff Accounting Bulletin No. 107, Share-Based Payment (SAB 107). The risk free interest rate is based on the U.S. Treasury yield curve in effect on the date of grant which corresponds to the expected term of the option.

	Three Months Ended September 30, 2006		October 1, 2005		Nine Months Ended September 30, 2006		October 1, 2005	
Dividend yield	1.5	%	0	%	1.4	%	0	%
Volatility	26.6	%	28.1	%	27.2	%	28.3	%
Risk-free interest rate	4.9% - 5.0	%	4.0% - 4.2	%	4.3% - 5.2	%	3.3% - 4.3	%
Expected term (years)	7.5		5.8		7.5		5.2	

A summary of option activity under the plans for the nine months ended September 30, 2006 is presented below:

	Shares	Weighted- Average Exercise Price	Weighted- Average Remaining Contractual Term (Yrs.)	Aggregate Intrinsic Value
Outstanding at January 1, 2006	2,825	\$ 28.14		
Granted	369	\$ 45.00		
Exercised	(328)	\$ 12.48		
Canceled	(89)	\$ 41.68		
Outstanding at September 30, 2006	2,777	\$ 31.79	5.24	\$ 37,869
Exercisable at September 30, 2006	1,223	\$ 17.81	4.09	\$ 32,826

The weighted-average grant-date fair value of options granted was \$15.41 and \$15.46 for the nine months ended September 30, 2006 and October 1, 2005, respectively. The total intrinsic value of options exercised was \$11,375 and \$77,829 for the nine months ended September 30, 2006 and October 1, 2005, respectively.

Cash received from options exercised during the nine months ended September 30, 2006 was \$4,090. The tax benefits realized from options exercised and RSUs vested resulting from tax deductions in excess of share-based employee compensation expense recognized in the statement of operations totaled \$3,329 for the nine months ended September 30, 2006. With the adoption of SFAS 123(R), this amount is now shown as a cash inflow from financing activities. Prior to the adoption of SFAS 123(R), this amount was shown as a cash inflow from operating activities. Because the Company elected the modified prospective transition method of adoption, prior period financial statements have not been restated.

Restricted Stock Units

The fair value of RSUs is determined using the market price of the Company's common stock on the date of grant. A summary of RSU activity under the plans for the nine months ended September 30, 2006 is presented below:

	Shares	Weighted-Average Grant-Date Fair Value
Outstanding at January 1, 2006	181	\$ 48.77
Granted	178	\$ 48.88
Vested	(48)	\$ 50.87
Forfeited	(21)	\$ 49.72
Outstanding at September 30, 2006	290	\$ 48.40

The total fair value of RSUs vested during the nine months ended September 30, 2006 was \$2,459.

9. Income Taxes

Prior to December 16, 2005, WWI and WW.com were separate tax paying entities. Effective with the completion of the Redemption (see Note 3), WW.com is included in WWI's consolidated federal tax return.

The effective tax rate for the three and nine months ended September 30, 2006 was 36.1% and 37.6%, respectively. The effective tax rate for the three and nine months ended October 1, 2005 was 37.6% and 38.1%, respectively. For the three and nine months ended September 30, 2006 the primary differences between the U.S. federal statutory tax rate and the Company's effective tax rate were state income taxes, offset by lower statutory tax rates in certain foreign jurisdictions, the reversal of \$1,000 of tax reserves, primarily due to the resolution of an audit issue, and net operating loss carryforwards utilized by WW.com. For the three and nine months ended October 1, 2005, the primary differences between the U.S. federal statutory rate and the Company's effective tax rate were state income taxes, offset by lower statutory rates in certain foreign jurisdictions and net operating loss carryforwards utilized by WW.com.

In June 2006, the Financial Accounting Standards Board issued FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109 (FIN 48), which prescribes accounting for and disclosure of uncertainty in tax positions. This interpretation defines the criteria that must be met for the benefits of a tax position to be recognized in the financial statements and the

measurement of tax benefits recognized. The provisions of FIN 48 are effective as of the beginning of the Company's 2007 fiscal year, with the cumulative effect of the change in accounting principle to be recorded as an adjustment to opening retained earnings. The Company is currently evaluating the impact of adopting FIN 48 on the consolidated financial statements.

10. Legal

In March 2006, the Company agreed to settle a litigation filed on behalf of a purported class of employees under the California Labor Code and the Federal Fair Labor Standards Act for \$2,300 plus other costs and expenses. This settlement was accrued for in fiscal 2005 and is subject to approval and certification of the class status by the court.

On July 7, 2006, the Company filed an amended notice of appeal with the U.K. VAT and Duties Tribunal appealing Her Majesty's Revenue and Customs (HMRC) ruling that from April 1, 2005 Weight Watchers meetings fees in the U.K. should be fully subject to 17.5% standard rated value added tax (VAT). For over a decade prior to April 1, 2005, HMRC had determined that Weight Watchers meetings fees in the U.K. were only partially subject to 17.5% VAT. It is the Company's view that this prior determination by HMRC should remain in effect and the Company intends to vigorously pursue this appeal. The Company expects a hearing before the UK VAT and Duties Tribunal to occur during the first quarter of fiscal 2007. In the event the Company's appeal is unsuccessful, we may incur monetary liability in excess of reserves previously recorded, and our U.K. results of operations may be adversely affected in the future.

Due to the nature of its activities, the Company is also, at times, subject to pending and threatened legal actions that arise out of the normal course of business. We have had and continue to have disputes with certain of our franchisees. In the opinion of management, based in part upon advice of legal counsel, the disposition of all such matters is not expected to have a material effect on the Company's results of operations, financial condition or cash flows.

11. Derivative Instruments and Hedging

The Company enters into interest rate swaps to hedge a substantial portion of its variable rate debt. These contracts are used primarily to reduce risk associated with variable interest rate debt obligations. As of September 30, 2006 and October 1, 2005, the Company held contracts for interest rate swaps with notional amounts totaling \$257,500 and \$150,000, respectively. The Company is hedging forecasted transactions for periods not exceeding the next three years. At September 30, 2006, given the current configuration of its debt, the Company estimates that no derivative gains or losses reported in accumulated other comprehensive income will be reclassified to the Statement of Operations within the next 12 months.

As of September 30, 2006 and October 1, 2005, cumulative gains/(losses) for qualifying hedges were reported as a component of accumulated other comprehensive income in the amounts of \$1,217, (\$1,998 before taxes) and \$1,220, (\$1,999 before taxes), respectively. For the three and nine months ended September 30, 2006 and October 1, 2005, there were no fair value adjustments recorded in the statement of operations since all hedges are considered qualifying.

12. Comprehensive Income

Comprehensive income for the Company includes net income, the effects of foreign currency translation and changes in the fair value of derivative instruments. Comprehensive income is as follows: