REGIS CORP
Form 10-Q
November 09, 2012
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2012

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 1-12725

Regis Corporation

(Exact name of registrant as specified in its charter)

Minnesota (State or other jurisdiction of incorporation or organization)	**41-0749934** (I.R.S. Employer Identification No.)
7201 Metro Boulevard, Edina, Minnesota (Address of principal executive offices)	**55439** (Zip Code)

(952) 947-7777

(Registrant s telephone number, including area code)

N/A

(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 x No o

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

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

Large accelerated filer x	Accelerated filer o
Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as defined by Rule 12b-2 of the Act). Yes o No x

Indicate the number of shares outstanding of each of the issuer s classes of common stock as of October 24, 2012:

Common Stock, $.05 par value	**57,526,940**
Class	Number of Shares

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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

REGIS CORPORATION

CONDENSED CONSOLIDATED BALANCE SHEET (Unaudited)

As of September 30, 2012 and June 30, 2012
(Dollars in thousands, except per share data)

	September 30, 2012	June 30, 2012
ASSETS		
Current assets:		
Cash and cash equivalents	$ 222,458	$ 111,943
Receivables, net	32,424	28,954
Inventories	155,990	142,276
Deferred income taxes	14,520	14,503
Income tax receivable	14,175	14,098
Other current assets	24,233	55,903
Current assets held for sale (Note 2)	17,202	17,000
Total current assets	481,002	384,677
Property and equipment, net	303,150	305,799
Goodwill	463,917	462,279
Other intangibles, net	23,375	23,395
Investment in and loans to affiliates	59,910	160,987
Other assets	60,824	59,488
Long-term assets held for sale (Note 2)	176,204	175,221
Total assets	$ 1,568,382	$ 1,571,846
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities:		
Long-term debt, current portion	$ 28,883	$ 28,937
Accounts payable	63,428	47,890
Accrued expenses	134,565	157,026
Current liabilities related to assets held for sale (Note 2)	15,959	18,120
Total current liabilities	242,835	251,973
Long-term debt and capital lease obligations	251,178	258,737
Other noncurrent liabilities	148,594	143,972
Long- term liabilities related to assets held for sale (Note 2)	28,063	28,007
Total liabilities	670,670	682,689
Commitments and contingencies (Note 8)		
Shareholders equity:		
Common stock, $0.05 par value; issued and outstanding 57,527,496 and 57,415,241 common shares at September 30, 2012 and June 30, 2012, respectively	2,876	2,871

Additional paid-in capital		347,408		346,943
Accumulated other comprehensive income		38,173		55,114
Retained earnings		509,255		484,229
Total shareholders equity		897,712		889,157
Total liabilities and shareholders equity	$	1,568,382	$	1,571,846

The accompanying notes are an integral part of the unaudited Condensed Consolidated Financial Statements.

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REGIS CORPORATION

CONDENSED CONSOLIDATED STATEMENT OF OPERATIONS (Unaudited)

For The Three Months Ended September 30, 2012 and 2011

(Dollars and shares in thousands, except per share data amounts)

	2012	2011
Revenues:		
Service	$ 393,416	$ 415,017
Product	102,284	106,773
Royalties and fees	9,660	9,556
	505,360	531,346
Operating expenses:		
Cost of service	232,528	235,665
Cost of product	53,132	53,023
Site operating expenses	52,347	54,811
General and administrative	55,872	65,870
Rent	81,499	82,176
Depreciation and amortization	20,709	30,797
Total operating expenses	496,087	522,342
Operating income	9,273	9,004
Other income (expense):		
Interest expense	(6,829)	(7,360)
Interest income and other, net (Note 3)	24,726	1,317
Income from continuing operations before income taxes and equity in income of affiliated companies	27,170	2,961
Income taxes	(2,986)	(1,209)
Equity in income of affiliated companies, net of income taxes	577	3,870
Income from continuing operations	24,761	5,622
Income from discontinued operations, net of taxes (Note 2)	3,777	2,715
Net income	$ 28,538	$ 8,337
Net income per share:		
Basic:		
Income from continuing operations	0.43	0.10
Income from discontinued operations	0.07	0.05
Net income per share, basic(1)	$ 0.50	$ 0.15
Diluted:		
Income from continuing operations	0.39	0.10
Income from discontinued operations	0.06	0.05
Net income per share, diluted(1)	$ 0.45	$ 0.15
Weighted average common and common equivalent shares outstanding:		
Basic	57,283	56,849
Diluted	68,589	57,098

Cash dividends declared per common share	$	0.06	$	0.06

(1) Total is a recalculation; line items calculated individually may not sum to total due to rounding.

The accompanying notes are an integral part of the unaudited Condensed Consolidated Financial Statements.

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REGIS CORPORATION

CONDENSED CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME (LOSS) (Unaudited)

For The Three Months Ended September 30, 2012 and 2011

(Dollars in thousands)

	2012	2011
Net income	$ 28,538	$ 8,337
Other comprehensive loss, net of tax:		
Foreign currency translation adjustments	7,038	(20,552)
Change in fair market value of financial instruments designated as cash flow hedges	(23)	446
Recognition of deferred compensation and other		(1)
Reclassifications associated with liquidation of foreign entities (Note 3)	(23,956)	
Other comprehensive loss	(16,941)	(20,107)
Comprehensive income (loss)	$ 11,597	$ (11,770)

The accompanying notes are an integral part of the unaudited Condensed Consolidated Financial Statements.

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REGIS CORPORATION

CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS (Unaudited)

For The Three Months Ended September 30, 2012 and 2011

(In thousands)

	2012	2011
Cash flows from operating activities:		
Net income	$ 28,538	$ 8,337
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	20,433	31,638
Amortization	728	2,468
Equity in income of affiliated companies	(907)	(4,032)
Dividends received from affiliated companies	347	270
Deferred income taxes	7,120	(2,800)
Accumulated other comprehensive income reclassifications (Note 3)	(23,956)	
Excess tax benefits from stock-based compensation plans	(35)	
Stock-based compensation	1,818	2,440
Amortization of debt discount and financing costs	1,749	1,613
Other noncash items affecting earnings	98	(477)
Changes in operating assets and liabilities (1):		
Receivables	(3,355)	(907)
Inventories	(13,534)	(23,612)
Income tax receivable	(57)	4,260
Other current assets	1,790	1,806
Other assets	1,408	509
Accounts payable	14,599	11,376
Accrued expenses	(24,670)	(7,906)
Other noncurrent liabilities	(3,648)	(11,528)
Net cash provided by operating activities	8,466	13,455
Cash flows from investing activities:		
Capital expenditures	(18,077)	(16,827)
Proceeds from sale of assets	21	369
Asset acquisitions, net of cash acquired and certain obligations assumed		(2,077)
Proceeds from loans and investments	130,281	1,290
Net cash provided by (used in) investing activities	112,225	(17,245)
Cash flows from financing activities:		
Borrowings on revolving credit facilities		23,900
Payments on revolving credit facilities		(23,900)
Repayments of long-term debt and capital lease obligations	(8,905)	(9,669)
Excess tax benefits from stock-based compensation plans	35	
Dividends paid	(3,448)	(3,494)
Proceeds from exercise of stock options and stock appreciation rights	45	
Net cash used in financing activities	(12,273)	(13,163)
Effect of exchange rate changes on cash and cash equivalents	2,097	(3,637)
Increase (decrease) in cash and cash equivalents	110,515	(20,590)
Cash and cash equivalents:		

Beginning of period		111,943		96,263
End of period	$	222,458	$	75,673

(1) Changes in operating assets and liabilities exclude assets acquired and liabilities assumed through acquisitions.

The accompanying notes are an integral part of the unaudited Condensed Consolidated Financial Statements.

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REGIS CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. BASIS OF PRESENTATION OF UNAUDITED INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

The unaudited interim Condensed Consolidated Financial Statements of Regis Corporation (the Company) as of September 30, 2012 and for the three months ended September 30, 2012 and 2011, reflect, in the opinion of management, all adjustments necessary to fairly state the consolidated financial position of the Company as of September 30, 2012 and the consolidated results of its operations and its cash flows for the interim periods. Adjustments consist only of normal recurring items, except for any discussed in the notes below. The results of operations and cash flows for any interim period are not necessarily indicative of results of operations and cash flows for the full year.

The Consolidated Balance Sheet data for June 30, 2012 was derived from audited Consolidated Financial Statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America (GAAP). The unaudited interim Condensed Consolidated Financial Statements should be read in conjunction with the Company s Annual Report on Form 10-K for the year ended June 30, 2012 and other documents filed or furnished with the Securities and Exchange Commission (SEC) during the current fiscal year.

The unaudited condensed consolidated financial statements of the Company as of September 30, 2012 and for the three month periods ended September 30, 2012 and 2011 included in this Form 10-Q have been reviewed by PricewaterhouseCoopers LLP, an independent registered public accounting firm. Their separate report dated November 9, 2012 appearing herein, states that they did not audit and they do not express an opinion on that unaudited financial information. Accordingly, the degree of reliance on their report on such information should be restricted in light of the limited nature of the review procedures applied. PricewaterhouseCoopers LLP is not subject to the liability provisions of Section 11 of the Securities Act of 1933 for their report on the unaudited financial information because that report is not a report or a part of the registration statement prepared or certified by PricewaterhouseCoopers LLP within the meaning of Sections 7 and 11 of the Act.

Reclassifications:

Beginning in the first quarter of fiscal year 2013, salon marketing and advertising expenses that were presented within cost of service and general and administrative operating expense line items in prior filings were reclassified to site operating expenses within the Condensed Consolidated Statement of Operations. The reclassifications were made to better present how management of the Company views the respective salon marketing and advertising expenses. The prior period amounts have been reclassified to conform to the current year presentation. These reclassifications had no impact on operating income or net income. The table below presents the impact of the reclassification to the three months ended September 30, 2011 and excludes discontinued operations:

For the Three Months Ended, September 30, 2011

	Prior Presentation(1)	Reclassification	As Presented
		(Dollars in thousands)	
Cost of service	$ 235,969	$ (304)	$ 235,665
Site operating expenses	50,971	3,840	54,811
General and administrative	69,406	(3,536)	65,870

(1) Prior presentation amounts exclude amounts related to discontinued operations. See Note 2 to the Condensed Consolidated Statement of Operations.

In addition, expenses associated with our distribution centers were reclassified from Corporate to our North America reportable segment. The reclassifications were made to better present how management of the Company views the respective distribution centers expenses. This reclassification had no impact on our Condensed Consolidated Statement of Operations. The prior period amounts have been reclassified to conform to the current year presentation. The table below presents the impact of the reclassification of general and administrative, rent and depreciation and amortization expenses between the Company s Corporate and North America reportable segments:

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	For the three months ended, September 30, 2011					
	North America			Corporate		
	Prior Presentation(1)	Reclassification (Dollars in thousands)	As Presented(3)	Prior Presentation	Reclassification (Dollars in thousands)	As Presented(3)
General and administrative(2)	$ 29,706	$ 2,939	$ 32,645	$ 36,775	$ (6,191)	$ 30,584
Rent	73,215	165	73,380	197	(165)	32
Depreciation and amortization	17,970	571	18,541	11,521	(571)	10,950

(1) Prior presentation amounts exclude amounts related to discontinued operations. See Note 2 to the Condensed Consolidated Statement of Operations.

(2) The North America general and administrative reclassification consists of a $6,191 increase for the offset to the Corporate reclassification within this line item, partially offset by a decrease of $3,252 applicable to North America for the marketing and advertising expense reclassification above.

(3) See Note 11 to the Condensed Consolidated Statement of Operations for presentation of segment information.

Stock-Based Employee Compensation:

Stock-based awards are granted under the terms of the 2004 Long Term Incentive Plan (2004 Plan). Additionally, the Company has outstanding stock options under its 2000 Stock Option Plan (2000 Plan), although the 2000 Plan terminated in 2010. Under these plans, five types of stock-based compensation awards are granted: stock options, equity-based stock appreciation rights (SARs), restricted stock awards (RSAs), restricted stock units (RSUs) and performance share units (PSUs). Stock options, SARs and RSAs granted prior to July 1, 2011 under the 2004 Plan generally vest at a rate of 20.0 percent annually on each of the first five anniversaries of the date of grant. The stock options and SARs have a maximum term of ten years. The RSUs granted prior to fiscal year 2012 cliff vest after five years and payment of the RSUs is deferred until January 31 of the year following vesting.

During fiscal year 2012, the Company granted RSAs and RSUs. Certain of the RSAs vest at a rate of 20.0 percent annually on the first five anniversaries of the date of grant while the other RSAs cliff vest two years after the grant date. The RSUs granted to the Company s non-employee directors occurred in the last month of fiscal year 2012, with retroactive vesting on a monthly basis, generally from the Company s 2011 annual shareholder meeting date. The distribution of vested RSUs is deferred until the non-employee director s separation of service from the Company, at which time the vested RSUs will be converted into common stock. Awards granted prior to July 1, 2012 do not contain acceleration of vesting terms for retirement of eligible recipients.

During the three months ended September 30, 2012, the Company granted SARs, RSAs, RSUs, and PSUs. The SARs and RSUs granted to employees vest 33.3 percent annually on the first three anniversaries of the date of grant and become fully vested on the third anniversary of the date of grant. The Company also granted RSUs to the Company s Chief Executive Officer that will vest in full and convert to common stock if the Company s stock price reaches a certain price for twenty consecutive days prior to the fifth anniversary of his start date. The RSAs granted cliff vest after five years. The PSUs represent shares potentially issuable in the future. Issuance of the PSUs is based on the Company s performance during fiscal year 2013 as it relates to the Company achievement of same-store sales and adjusted earnings before interest, taxes, and depreciation and amortization.

Awards granted after July 1, 2012 generally contain various acceleration of vesting terms depending on the type of award for eligible recipients aged sixty-two years or older and employees aged fifty-five and have fifteen years of continuous service.

Unvested awards are subject to forfeiture in the event of termination of employment. The Company utilizes an option-pricing model to estimate the fair value of options and SARs at their grant date. Stock options and SARs are granted at not less than fair market value on the date of grant. The Company utilized a Monte Carlo simulation model to estimate the fair value of the market-based restricted stock unit.The Company generally recognizes compensation expense for its stock-based compensation awards on a straight-line basis over the respective awards vesting period. Compensation expense related to the PSUs is recognized based on the Company s estimate for the number of shares that will ultimately be issued. Historically, the Company s primary employee stock-based compensation grant occurs during the fourth fiscal quarter.

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Total compensation cost for stock-based payment arrangements totaled $1.8 and $2.4 million for each of the three month periods ended September 30, 2012 and 2011, respectively.

Stock options outstanding and weighted average exercise price as of September 30, 2012 were as follows:

Options	Shares (in thousands)		Weighted Average Exercise Price
Outstanding at June 30, 2012	652	$	32.53
Granted			
Exercised	(3)		18.90
Forfeited or expired	(64)		29.77
Outstanding at September 30, 2012	585	$	32.89
Exercisable at September 30, 2012	531	$	33.94

Outstanding options of 584,938 at September 30, 2012 had an intrinsic value (the amount by which the stock price exceeded the exercise or grant date price) of zero and a weighted average remaining contractual term of 3.6 years. Exercisable options of 530,568 at September 30, 2012 had an intrinsic value of zero and a weighted average remaining contractual term of 3.3 years. Of the outstanding and unvested options and due to estimated forfeitures, 49,399 are expected to vest with a $22.96 per share weighted average grant price, a weighted average remaining contractual life of 6.7 years and a total intrinsic value of zero.

All options granted relate to stock option plans that have been approved by the shareholders of the Company.

The table below contains a rollforward of RSAs, RSUs and SARs outstanding, as well as other relevant terms of the awards:

	Restricted Stock Outstanding			SARs Outstanding		
	Shares/Units (in thousands)		Weighted Average Grant Date Fair Value	Shares (in thousands)		Weighted Average Exercise Price
Balance, June 30, 2012	660	$	25.44	734	$	26.02
Granted	284		17.52	581		18.01
Vested/Exercised	(17)		17.96	(3)		16.60
Forfeited or expired	(3)		18.01	(287)		28.00
Balance, September 30, 2012	924	$	23.18	1,025	$	20.95

Outstanding and unvested RSAs of 500,701 at September 30, 2012 had an intrinsic value of $9.2 million and a weighted average remaining vesting term of 2.5 years. Due to estimated forfeitures, 452,826 are expected to vest with a total intrinsic value of $8.3 million.

Outstanding RSUs of 423,782 at September 30, 2012 had an intrinsic value of $7.8 million and a weighted average remaining vesting term of 1.0 years. Vested RSUs of 250,907 at September 30, 2012 had an intrinsic value of $4.6 million. Unvested RSUs of 164,106 at September 30, 2012 had an intrinsic value of $3.0 million and a weighted average remaining vesting term of 2.6 years. The payment of 215,000 vested RSUs is deferred until January 31, 2013. The payment of the remaining 35,907 vested RSUs is deferred until the non-employee director no longer serves on the Board of Directors, at which time the vested RSUs will be converted into common stock.

Outstanding SARs of 1,024,725 at September 30, 2012 had a total intrinsic value of $0.3 million and a weighted average remaining contractual term of 8.1 years. Exercisable SARs of 299,080 at September 30, 2012 had a total intrinsic value of less than $0.1 million and a weighted average remaining contractual term of 5.2 years. Of the outstanding and unvested rights and due to estimated forfeitures, 672,567 are expected to vest with a $18.18 per share weighted average grant price, a weighted average remaining contractual life of 9.4 years and a total intrinsic value of $0.3 million.

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Performance share units outstanding and weighted average grant date fair value as of September 30, 2012 were as follows:

	Nonvested		
Performance Share	**Units (1) (in thousands)**		**Weighted Average Grant Date Fair Value**
Outstanding at June 30, 2012		$	
Granted	193		18.38
Vested			
Forfeited			
Outstanding at September 30, 2012	193	$	18.38

(1) Assumes attainment of targeted payout rates as set forth in the performance criteria based in thousands of share units.

Future compensation expense for currently unvested PSUs could reach a maximum of $7.1 million, assuming payout of all unvested performance units. Assuming attainment of targeted payout rates, future compensation expense for currently unvested PSUs would be $3.5 million.

During the three months ended September 30, 2012 and 2011 total cash received from the exercise of share-based instruments was less than $0.1 million and zero, respectively. As of September 30, 2012, the total unrecognized compensation cost related to all unvested stock-based compensation arrangements was $17.8 million. The related weighted average period over which such cost is expected to be recognized was approximately 2.9 years as of September 30, 2012.

The total intrinsic value of all stock-based compensation that was exercised during each of the three month periods ended September 30, 2012 and 2011 was less than $0.1 million.

The total fair value of stock awards that vested and were distributed during the months ended September 30, 2012 and 2011, was $0.3 and less than $0.1 million, respectively.

Using the fair value of each grant on the date of grant, the weighted average fair values per stock-based compensation award granted during the three months ended September 30, 2012 and 2011 were as follows:

		2012		**2011**
SARs	$	6.64	$	
Restricted stock awards		18.01		13.59
Restricted stock units		17.16		
Performance share units		18.38		

The expense associated with the RSA and RSU grants is based on the market price of the Company s stock at the date of grant. The significant assumptions used in determining the underlying fair value on the date of grant of the SAR and market-based RSU grants issued during the three months ended September 30 2012 is presented below:

	SAR	RSU
Risk-free interest rate	0.85%	0.66%
Expected term (in years)	6.00	N/A
Expected volatility	44.00%	47.00%
Expected dividend yield	1.33%	1.33%

The risk free rate of return is determined based on the U.S. Treasury rates approximating the expected life of the respective awards granted. Expected volatility is established based on historical volatility of the Company s stock price. Estimated expected life was based on an analysis of historical stock options granted data which included analyzing grant activity including grants exercised, expired, and canceled. The expected dividend yield is determined based on the Company s annual dividend amount as a percentage of the strike price at the time of the grant. The Company uses historical data to estimate pre-vesting forfeiture rates.

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Goodwill:

As of the fiscal year 2012 annual impairment testing of goodwill, the estimated fair value of the Promenade salon concept and Hair Restoration Centers reporting units exceeded the carrying value by approximately 14.0 and 12.0 percent, respectively. The respective fair values of the Company s remaining reporting units exceeded carrying value by greater than 20.0 percent. While the Company has determined the estimated fair value of Promenade to be appropriate based on the historical level of revenue growth, operating income and cash flows, it is reasonably likely that Promenade may experience additional impairment in future periods. As previously disclosed, the Company has agreed to sell the Hair Restoration Centers reporting unit in fiscal year 2013; however, until this reporting unit is sold, it is reasonably likely that there could be impairment of the Hair Restoration Centers reporting unit s goodwill in future periods. See Note 2 to the Condensed Consolidated Financial Statements for details of Hair Restoration Center s goodwill balance. The term reasonably likely refers to an occurrence that is more than remote but less than probable in the judgment of the Company. Because some of the inherent assumptions and estimates used in determining the fair value of the reportable segment are outside the control of management, changes in these underlying assumptions can adversely impact fair value. Potential impairment of a portion or all of the carrying value of goodwill for the Promenade salon concept and Hair Restoration Centers reporting units is dependent on many factors and cannot be predicted with certainty.

As of September 30, 2012, the Company s estimated fair value, as determined by the sum of our reporting units fair value, reconciled to within a reasonable range of our market capitalization which included an assumed control premium. The Company concluded there were no triggering events requiring the Company to perform an interim goodwill impairment test between the annual impairment testing and September 30, 2012.

A summary of the Company s goodwill balance as of September 30, 2012 and June 30, 2012 by reporting unit is as follows:

Reporting Unit		As of September 30, 2012		As of June 30, 2012
		(Dollars in thousands)		
Regis	$	35,957	$	35,910
MasterCuts		4,652		4,652
SmartStyle		48,780		48,558
Supercuts		129,634		129,621
Promenade		244,894		243,538
Total North America Salons	$	463,917	$	462,279

See Note 5 to the Condensed Consolidated Financial Statements for further details on the Company s goodwill balance.

Property and Equipment:

Historically, because of the Company s large size and scale requirements it has been necessary for the Company to internally develop and support its own proprietary point-of-sale (POS) information system. During the fourth quarter of fiscal year 2011, the Company identified a third party POS alternative. At June 30, 2011 and throughout fiscal year 2012, the Company reassessed and adjusted the remaining useful life of the Company s capitalized POS software. As of June 30, 2012, the existing POS information system was fully depreciated. Depreciation expense related to the existing POS information system totaled zero and $9.4 million during the three months ended September 30, 2012 and 2011, respectively.

Prior to September 30, 2012, the Company decided the third party POS alternative would only be utilized in United Kingdom (U.K.). The Company reviewed the third party POS alternative capitalized software carrying value for impairment at September 30, 2012. As a result of the Company s long-lived asset impairment testing at September 30, 2012 for this grouping of assets, no impairment charges were recorded. There was no adjustment to the useful life as the Company expects to fully utilize the third party POS alternative in the U.K. salons. The Company is currently evaluating another third party POS solution for salons in North America.

Recent Accounting Standards Adopted by the Company:

Testing Goodwill for Impairment

In September 2011, the Financial Accounting Standards Board (FASB) updated the accounting guidance related to annual and interim goodwill impairment testing. The updated accounting guidance allows entities to first assess qualitative factors before performing a quantitative assessment of the fair value of a reporting unit. If it is determined on the basis of qualitative factors that the fair value of the reporting

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unit is more likely than not less than the carrying amount, the existing quantitative impairment test is required. Otherwise, no further impairment testing is required. The Company adopted this guidance in the first quarter of fiscal year 2013.

Comprehensive Income

In June 2011, and subsequently amended in December 2011, the FASB issued final guidance on the presentation of comprehensive income. Under the newly issued guidance, net income and comprehensive income may only be presented either as one continuous statement or in two separate, but consecutive statements. The Company retrospectively adopted this guidance in the first quarter of fiscal year 2013, with comprehensive income shown as a separate statement immediately following the Condensed Consolidated Statements of Operations.

Accounting Standards Recently Issued But Not Yet Adopted by the Company:

Disclosures about Offsetting Assets and Liabilities

In December 2011, the FASB issued new accounting guidance related to disclosures on offsetting assets and liabilities on the balance sheet. This newly issued accounting standard requires an entity to disclose both gross and net information about instruments and transactions eligible for offset in the balance sheet as well as instruments and transactions executed under a master netting or similar arrangement and was issued to enable users of financial statements to understand the effects or potential effects of those arrangements on its financial position. This accounting guidance is required to be applied retrospectively and is effective for the Company beginning in the first quarter of fiscal year 2014. Since the accounting guidance only impacts disclosure requirements, its adoption will not have a material impact on the Company s consolidated financial statements.

Testing Indefinite-Lived Intangible Assets for Impairment

In July 2012, the FASB updated the accounting guidance related to annual and interim indefinite-lived intangible asset impairment testing. The updated accounting guidance allows entities to first assess qualitative factors before performing a quantitative assessment of the fair value of indefinite-lived intangible assets. If it is determined on the basis of qualitative factors that the fair value of indefinite-lived intangible assets is more likely than not less than the carrying amount, the existing quantitative impairment test is required. Otherwise, no further impairment testing is required. The updated guidance is effective for the Company beginning in the first quarter of fiscal year 2014 with early adoption permitted under certain circumstances. The Company will adopt this accounting guidance in the first quarter of fiscal year 2014 and does not expect it to have a material impact on the Company s consolidated financial statements.

2. DISCONTINUED OPERATIONS:

Hair Restoration Centers

On July 13, 2012, the Company entered into a definitive agreement to sell its Hair Club for Men and Women business (Hair Club), a provider of hair restoration services, for cash of $163.5 million to Aderans, Co., Ltd. The definitive agreement includes a working capital adjustment provision that could impact the final sale price. The sale includes the Company s 50.0 percent interest in Hair Club for Men, Ltd. accounted for by the Company under the equity method. The transaction is expected to close during fiscal year 2013. The Company is currently anticipating recognizing a gain upon closing of the deal.

As of September 30, 2012, the Company classified the results of operations of Hair Club as discontinued operations for all periods presented in the Condensed Consolidated Statement of Operations. The assets and liabilities of this business to be sold met the criteria to be classified as held for sale and have been aggregated and reported as current assets held for sale, long-term assets held for sale, current liabilities related to assets held for sale and long-term liabilities related to assets held for sale in the Condensed Consolidated Balance Sheet for all periods presented. The classification was based on the Company entering into the agreement to sell Hair Club, the centers being available for sale in present condition, and the sale being probable as of September 30, 2012. The operations and cash flows of Hair Club will be eliminated from ongoing operations of the Company, which was previously recorded as the Hair Restoration reporting segment. There will be no significant continuing involvement by the Company in the operations of Hair Club after disposal.

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The following summarizes the assets and liabilities of our Hair Club operations at September 30, 2012 and June 30, 2012:

	September 30, 2012	June 30, 2012
	(Dollars in thousands)	
Current assets held for sale		
Receivables, net	$ 2,563	$ 2,624
Inventories	6,564	6,165
Deferred income taxes	3,229	2,892
Other current assets	4,846	5,319
Total current assets held for sale	17,202	17,000
Property and equipment, net	18,559	17,261
Goodwill	74,374	74,376
Other intangibles, net	78,119	78,395
Investment in affiliates	5,152	5,189
Total long-term assets held for sale	176,204	175,221
Total assets held for sale	$ 193,406	$ 192,221
Current liabilities related to assets held for sale		
Accounts payable	$ 1,806	$ 2,564
Accrued expenses	14,153	15,556
Total current liabilities related to assets held for sale	15,959	18,120
Other non-current liabilities related to assets held for sale	28,063	28,007
Total liabilities related to assets held for sale	$ 44,022	$ 46,127

The following summarizes the results of operations of our discontinued hair restoration service operations for the periods presented:

	For the Periods Ended September 30, Three Months	
	2012	2011
	(Dollars in thousands)	
Revenues	$ 38,951	$ 37,403
Income from discontinued operations, before income taxes	5,872	4,067
Income tax provision on discontinued operations	(2,299)	(1,514)
Equity in income of affiliated companies, net of tax	204	162
Income from discontinued operations, net of income taxes	3,777	2,715

Income taxes have been allocated to continuing and discontinued operations based on the methodology required by interim reporting and accounting for income taxes guidance. Depreciation and amortization were ceased during the three months ended September 30, 2012 in accordance with accounting for discontinued operations.

On February 16, 2009, the Company sold its Trade Secret salon concept (Trade Secret). The Company reported Trade Secret as a discontinued operation. The carrying value of the note receivable with the purchaser of Trade Secret was fully reserved as of June 30, 2011.

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The purchaser of Trade Secret emerged from bankruptcy in March 2012 and in conjunction, the Company entered into a credit and security agreement in which the principal balance of the note receivable was reduced from $35.7 to $18.0 million. Payments of $0.5 million are due quarterly beginning on May 31, 2012. Upon receipt of the quarterly payments through February 2019 the remaining principal and unpaid interest will be forgiven. The purchaser of Trade Secret partially satisfied the principal payment during the first fiscal quarter of 2013 by providing the Company with $0.3 million of saleable inventory. The Company recorded the recovery of bad debt expense upon receipt of the inventory during the three months ended September 30, 2012. The carrying value of the note receivable continues to be fully reserved at September 30, 2012.

Effective in the second quarter of fiscal year 2010, the Company has an agreement in which the Company provides warehouse services to the purchaser of Trade Secret. Under the warehouse services agreement, the Company recognized $0.2 and $0.5 million of other income related to warehouse services during the three months ended September 30, 2012 and 2011, respectively. The carrying value of the receivable related to warehouse services was $0.2 and $0.1 million as of September 30, 2012 and 2011, respectively.

The Company utilized the consolidation of variable interest entities guidance to determine whether or not Trade Secret was a VIE, and if so, whether the Company was the primary beneficiary of Trade Secret. The Company concluded that Trade Secret is a VIE based on the fact that the equity investment at risk in Trade Secret is insufficient. The Company determined that the purchaser of Trade Secret has met the power criterion due to the purchaser of Trade Secret having the authority to direct the activities that most significantly impact Trade Secret s economic performance. The Company concluded based on the consideration above that the primary beneficiary of Trade Secret is the purchaser of Trade Secret. The exposure to loss related to the Company s involvement with Trade Secret is the guarantee of approximately 20 operating leases. The Company has determined the exposure to the risk of loss on the guarantee of the operating leases to be immaterial to the financial statements.

3. SHAREHOLDERS EQUITY:

Net Income Per Share:

The Company s basic earnings per share is calculated as net income divided by weighted average common shares outstanding, excluding unvested outstanding RSAs and RSUs. The Company s dilutive earnings per share is calculated as net income divided by weighted average common shares and common share equivalents outstanding, which includes shares issuable under the Company s stock option plan and long-term incentive plan, and dilutive securities. Stock-based awards with exercise prices greater than the average market value of the Company s common stock are excluded from the computation of diluted earnings per share. The Company s dilutive earnings per share will also reflect the assumed conversion under the Company s convertible debt if the impact is dilutive, along with the exclusion of interest expense, net of taxes. The impact of the convertible debt is excluded from the computation of diluted earnings per share when interest expense per common share obtainable upon conversion is greater than basic earnings per share.

The following table sets forth a reconciliation of shares used in the computation of basic and diluted earnings per share:

	For the Three Months Ended September 30,	
	2012	2011
	(Shares in thousands)	

Weighted average shares for basic earnings per share	57,283	56,849
Effect of dilutive securities:		
Dilutive effect of stock-based compensation	67	249
Dilutive effect of convertible debt	11,239	
Weighted average shares for diluted earnings per share	68,589	57,098

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The following table sets forth the awards which are excluded from the various earnings per share calculations:

	For the Three Months Ended September 30,	
	2012	2011