REGIS CORP
Form 10-Q
November 09, 2010
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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, 2010

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 November 2, 2010:

Common Stock, $.05 par value	**57,593,802**
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, 2010 and June 30, 2010
(In thousands, except share data)

	September 30, 2010	June 30, 2010
ASSETS		
Current assets:		
Cash and cash equivalents	$ 194,835	$ 151,871
Receivables, net	24,894	24,312
Inventories	161,709	153,380
Deferred income taxes	16,897	16,892
Income tax receivable	17,834	46,207
Other current assets	34,581	36,203
Total current assets	450,750	428,865
Property and equipment, net	355,887	359,250
Goodwill	740,965	736,989
Other intangibles, net	116,308	118,070
Investment in and loans to affiliates	205,368	195,786
Other assets	84,152	80,612
Total assets	$ 1,953,430	$ 1,919,572
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities:		
Long-term debt, current portion	$ 58,422	$ 51,629
Accounts payable	62,097	57,683
Accrued expenses	149,915	160,797
Total current liabilities	270,434	270,109
Long-term debt and capital lease obligations	381,247	388,400
Other noncurrent liabilities	255,223	247,770
Total liabilities	906,904	906,279
Commitments and contingencies (Note 9)		
Shareholders equity:		
Common stock, $0.05 par value; issued and outstanding 57,553,569 and 57,561,180 common shares at September 30, 2010 and June 30, 2010, respectively	2,878	2,878
Additional paid-in capital	334,850	332,372
Accumulated other comprehensive income	61,764	47,032
Retained earnings	647,034	631,011

Total shareholders equity		1,046,526		1,013,293
Total liabilities and shareholders equity	$	1,953,430	$	1,919,572

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, 2010 and 2009

(In thousands, except per share data)

	2010	2009
Revenues:		
Service	$ 439,529	$ 449,278
Product	128,605	146,153
Royalties and fees	10,111	10,119
	578,245	605,550
Operating expenses:		
Cost of service	249,501	255,969
Cost of product	61,075	79,495
Site operating expenses	49,009	52,676
General and administrative	74,074	72,560
Rent	85,108	85,825
Depreciation and amortization	26,044	27,191
Lease termination costs		3,577
Total operating expenses	544,811	577,293
Operating income	33,434	28,257
Other income (expense):		
Interest expense	(8,923)	(27,316)
Interest income and other, net	777	2,232
Income from continuing operations before income taxes and equity in income of affiliated companies	25,288	3,173
Income taxes	(9,647)	(1,619)
Equity in income of affiliated companies, net of income taxes	2,679	3,057
Income from continuing operations	18,320	4,611
Income from discontinued operations, net of taxes (Note 2)		3,161
Net income	$ 18,320	$ 7,772
Net income per share:		
Basic:		
Income from continuing operations	0.32	0.09
Income from discontinued operations		0.06
Net income per share, basic (1)	$ 0.32	$ 0.14
Diluted:		
Income from continuing operations	0.30	0.09
Income from discontinued operations		0.06
Net income per share, diluted (1)	$ 0.30	$ 0.14

Weighted average common and common equivalent shares outstanding:				
Basic		56,629		54,143
Diluted		67,961		54,184
Cash dividends declared per common share	$	0.04	$	0.04

(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 CASH FLOWS (Unaudited)

For The Three Months Ended September 30, 2010 and 2009

(In thousands)

	2010	2009
Cash flows from operating activities:		
Net income	$ 18,320	$ 7,772
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	23,612	24,697
Amortization	2,432	2,494
Equity in income of affiliated companies	(2,679)	(2,880)
Deferred income taxes	(6)	(3,018)
Impairment on discontinued operations		(154)
Excess tax benefits from stock-based compensation plans	(3)	
Stock-based compensation	2,369	2,308
Amortization of debt discount and financing costs	1,582	1,948
Other noncash items affecting earnings	815	(1,030)
Changes in operating assets and liabilities (1):		
Receivables	(267)	14,931
Inventories	(7,343)	(4,152)
Income tax receivable	28,373	8,737
Other current assets	1,748	2,747
Other assets	(1,643)	(32,065)
Accounts payable	4,163	17,144
Accrued expenses	(11,851)	(2,404)
Other noncurrent liabilities	4,562	1,449
Net cash provided by operating activities	64,184	38,524
Cash flows from investing activities:		
Capital expenditures	(16,007)	(12,646)
Proceeds from sale of assets	15	19
Asset acquisitions, net of cash acquired and certain obligations assumed	(3,861)	(543)
Proceeds from loans and investments	15,000	15,177
Disbursements for loans and investments	(15,000)	
Net cash (used in) provided by investing activities	(19,853)	2,007
Cash flows from financing activities:		
Borrowings on revolving credit facilities		337,000
Payments on revolving credit facilities		(342,000)
Proceeds from issuance of long-term debt, net of $5.2 million underwriting discount in 2009		167,325
Repayments of long-term debt and capital lease obligations	(3,334)	(301,004)
Excess tax benefits from stock-based compensation plans	3	
Proceeds from issuance of common stock, net of $7.2 million underwriting discount in 2009	59	156,436
Dividends paid	(2,297)	(2,284)
Other	3	(2,880)
Net cash (used in) provided by financing activities	(5,566)	12,593
Effect of exchange rate changes on cash and cash equivalents	4,199	4,967
Increase in cash and cash equivalents	42,964	58,091

Cash and cash equivalents:				
Beginning of period		151,871		42,538
End of period	$	194,835	$	100,629

(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, 2010 and for the three months ended September 30, 2010 and 2009, reflect, in the opinion of management, all adjustments necessary to fairly state the consolidated financial position of the Company as of September 30, 2010 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, 2010 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, 2010 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, 2010 and for the three month periods ended September 30, 2010 and 2009 included in this Form 10-Q have been reviewed by PricewaterhouseCoopers LLP, an independent registered public accounting firm. Their separate report dated November 9, 2010 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.

Stock-Based Employee Compensation:

Stock-based awards are granted under the terms of the 2004 Long Term Incentive Plan (2004 Plan) and the 2000 Stock Option Plan (2000 Plan). Additionally, the Company has outstanding stock options under its 1991 Stock Option Plan (1991 Plan), although the Plan terminated in 2001. Under these plans, four types of stock-based compensation awards are granted: stock options, equity-based stock appreciation rights (SARs), restricted stock awards (RSAs) and restricted stock units (RSUs). The stock-based awards, other than the RSUs, expire within ten years from the grant date. The RSUs cliff vest after five years, and payment of the RSUs is deferred until January 31 of the year following vesting. 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 s primary employee stock-based compensation grant occurs during the fourth fiscal quarter. The Company generally recognizes compensation expense for its stock-based compensation awards on a straight-line basis over a five-year vesting period. Awards granted do not contain acceleration of vesting terms for retirement eligible recipients.

Total compensation cost for stock-based payment arrangements totaled $2.4 and $2.3 million for the three months ended September 30, 2010 and 2009 respectively.

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Stock options outstanding, weighted average exercise price and weighted average fair values as of September 30, 2010 were as follows:

Options	Shares (in thousands)		Weighted Average Exercise Price
Outstanding at June 30, 2010	980	$	29.48
Granted			
Exercised	(4)		15.09
Forfeited or expired	(4)		22.90
Outstanding at September 30, 2010	972	$	29.56
Exercisable at September 30, 2010	697	$	30.93

Outstanding options of 972,321 at September 30, 2010 had an intrinsic value (the amount by which the stock price exceeded the exercise or grant date price) of $0.3 million and a weighted average remaining contractual term of 5.0 years. Exercisable options of 696,971 at September 30, 2010 had an intrinsic value of $0.3 million and a weighted average remaining contractual term of 3.7 years. Of the outstanding and unvested options, 253,408 are expected to vest with a $26.46 per share weighted average grant price, a weighted average remaining contractual life of 8.2 years and a total intrinsic value of less than $0.1 million.

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

A rollforward of RSAs, RSUs and SARs outstanding, as well as other relevant terms of the awards, were as follows:

	Nonvested			SARs Outstanding		
	Restricted Stock Outstanding Shares/Units (in thousands)		Weighted Average Grant Date Fair Value	Shares (in thousands)		Weighted Average Exercise Price
Balance, June 30, 2010	1,146	$	24.70	1,110	$	26.24
Granted	7		16.77			
Vested/Exercised	3		19.50			
Forfeited or expired	(18)		21.94	(21)		25.58
Balance, September 30, 2010	1,138	$	24.68	1,089	$	26.25

Outstanding and unvested RSAs of 922,881 at September 30, 2010 had an intrinsic value of $17.7 million and a weighted average remaining contractual term of 2.1 years. Of the outstanding and unvested awards, 874,321 are expected to vest with a total intrinsic value of $16.7 million.

Outstanding and unvested RSUs of 215,000 at September 30, 2010 had an intrinsic value of $4.1 million and a weighted average remaining contractual term of 1.5 years. All unvested RSUs are expected to vest in fiscal year 2012.

Outstanding SARs of 1,088,550 at September 30, 2010 had a total intrinsic value of zero and a weighted average remaining contractual term of 7.4 years. Exercisable SARs of 459,120 at September 30, 2010 had a total intrinsic value of zero and a weighted average remaining contractual term of 6.2 years. Of the outstanding and unvested rights, 606,186 are expected to vest with a $22.12 per share weighted average grant price, a weighted average remaining contractual life of 8.2 years and a total intrinsic value of zero.

During the three months ended September 30, 2010 and 2009 total cash received from the exercise of share-based instruments was less than $0.1 million and zero, respectively.

As of September 30, 2010, the total unrecognized compensation cost related to all unvested stock-based compensation arrangements was $25.7 million. The related weighted average period over which such cost is expected to be recognized was approximately 3.3 years as of September 30, 2010.

The total intrinsic value of all stock-based compensation that was exercised during the three months ended September 30, 2010 and 2009 was less than $0.1 million and zero, respectively.

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Goodwill:

Goodwill is tested for impairment annually or at the time of a triggering event. In evaluating whether goodwill is impaired, the Company compares the carrying value of each reporting unit, including goodwill, to the estimated fair value of the reporting unit. The carrying value of each reporting unit is based on the assets and liabilities associated with the operations of the reporting unit, including allocation of shared or corporate balances among reporting units. Allocations are generally based on the number of salons in each reporting unit as a percent of total company-owned salons.

The Company calculates the estimated fair value of the reporting units based on discounted future cash flows that utilize estimates in annual revenue, gross margins, fixed expense rates, allocated corporate overhead, and long-term growth for determining terminal value. The Company s estimated future cash flows also take into consideration acquisition integration and maturation. Where available and as appropriate, comparative market multiples are used to corroborate the results of the discounted cash flow. The Company considers its various concepts to be reporting units when testing for goodwill impairment because that is where the Company believes the goodwill resides. The Company periodically engages third-party valuation consultants to assist in evaluation of the Company s estimated fair value calculations. The Company s policy is to perform its annual goodwill impairment test during its third quarter of each fiscal year ending June 30.

In the situations where a reporting unit s carrying value exceeds its estimated fair value, the amount of the impairment loss must be measured. The measurement of impairment is calculated by determining the implied fair value of a reporting unit s goodwill. In calculating the implied fair value of goodwill, the fair value of the reporting unit is allocated to all other assets and liabilities of that unit based on the relative fair values. The excess of the fair value of the reporting unit over the amount assigned to its assets and liabilities is the implied fair value of goodwill. The goodwill impairment is measured as the excess of the carrying value of goodwill over its implied fair value.

As a result of the Company s annual impairment analysis of goodwill during the third quarter of fiscal year 2010, a $35.3 million impairment charge was recorded within continuing operations for the excess of the carrying value of goodwill over the implied fair value of goodwill for the Regis salon concept. The estimated fair value of the Promenade salon concept exceeded its respective carrying value by approximately 10.0 percent. The respective fair values of the Company s remaining reporting units exceeded fair value by greater than 20.0 percent. While the Company has determined the estimated fair values of Regis and Promenade to be appropriate based on the historical level of revenue growth, operating income and cash flows, it is reasonably likely that Regis and Promenade may become impaired in future periods. 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 the Regis salon concept and Promenade salon concept goodwill is dependent on many factors and cannot be predicted with certainty.

As of September 30, 2010, 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, 2010.

A summary of the Company s goodwill balance as of September 30, 2010 by reporting unit is as follows:

Reporting Unit		As of September 30, 2010
		(Dollars in thousands)
Regis	$	103,784
MasterCuts		4,652
SmartStyle		48,477
Supercuts		121,702
Promenade		311,978
Total North America Salons		590,593
Hair Restoration Centers		150,372
Total	$	740,965

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Recent Accounting Standards Adopted by the Company:

Disclosures about Fair Value of Financial Instruments

In January 2010, the FASB issued guidance to amend the disclosure requirements related to recurring and nonrecurring fair value measurements. The guidance requires new disclosures on the transfers of assets and liabilities between Level 1 (quoted prices in active market for identical assets or liabilities) and Level 2 (significant other observable inputs) of the fair value measurement hierarchy, including the reasons and the timing of the transfers. Additionally, the guidance requires a roll forward of activities on purchases, sales, issuance, and settlements of the assets and liabilities measured using significant unobservable inputs (Level 3 fair value measurements).

The Company adopted the new disclosure guidance on January 1, 2010, except for the disclosure on the roll forward activities for Level 3 fair value measurements, which will be adopted by the Company on July 1, 2011.

Multiple-Deliverable Revenue Arrangements

In October 2009, the FASB issued guidance on the accounting for multiple-deliverable revenue arrangements. The guidance removes the criterion that entities must use objective and reliable evidence of fair value in separately accounting for deliverables and provides entities with a hierarchy of evidence that must be considered when allocating arrangement consideration. The new guidance also requires entities to allocate arrangement consideration to the separate units of accounting based on the deliverables relative selling price. The adoption of the new guidance on July 1, 2010, for multiple-deliverable revenue arrangements, did not have a material effect on the Company s financial position, results of operations, and cash flows.

Amendments to Accounting for Variable Interest Entities

In June 2009, the FASB issued guidance on the accounting for variable interest entities (VIE). The guidance requires a qualitative approach to identifying a controlling financial interest in a VIE and requires ongoing assessment of whether an entity is a VIE and whether an entity is a primary beneficiary of a VIE. This guidance requires enhanced disclosures that will provide users of financial statements with more transparent information about an enterprise s involvement in a VIE. The adoption of the new guidance on July 1, 2010, for variable interest entities, did not have a material effect on the Company s financial position, results of operations, and cash flows.

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

Disclosure about the Credit Quality of Financing Receivables and the Allowance for Credit Losses

In July 2010, the FASB issued guidance to amend the disclosure requirements related to the credit quality of financing receivables and the allowance for credit losses. The guidance requires disclosures on a disaggregated basis on two defined levels: (1) portfolio segment; and (2) class of financing receivable. The guidance amends existing disclosures to require an entity to provide the following disclosures on a disaggregated basis: rollforward schedule of the allowance for credit losses from the beginning to the end of the reporting period on a portfolio segment basis, the related recorded investment in financing receivables for each disaggregated ending balance, the nonaccrual status of financing receivables by class of financing receivables, and impaired financing receivables by class of financing receivables. Additionally, the guidance requires, among other things, new disclosures on the credit quality indicators of financing receivables at the end of the reporting period by class of financing receivables, the aging of past due financing receivables at the end of the reporting period by class of financing receivables, and the nature and extent of troubled debt restructurings that occurred during the period by class of financing receivables and their effect on the allowance for credit losses. The new and amended disclosures presented as of the end of a reporting period are effective for interim and annual reporting periods ending on or after December 15, 2010. The new and amended disclosures about activity that occurs during a reporting period are effective for interim and annual reporting periods beginning on or after December 15, 2010. The Company will adopt the enhanced disclosure requirements in the quarter ending December 31, 2010.

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2. DISCONTINUED OPERATIONS:

On February 16, 2009, the Company sold its Trade Secret salon concept (Trade Secret). The Company concluded, after a comprehensive review of strategic and financial options, to divest Trade Secret. The sale of Trade Secret included 655 company-owned salons and 57 franchise salons, all of which had historically been reported within the Company s North America reportable segment. The sale of Trade Secret included CCI. CCI owned and operated PureBeauty and BeautyFirst salons which were acquired by the Company on February 20, 2008.

The Company concluded that Trade Secret qualified as held for sale as of December 31, 2008, under accounting for the impairment or disposal of long-lived asset guidance, and is presented as discontinued operations in the Condensed Consolidated Statements of Operations for all periods presented. The operations and cash flows of Trade Secret have been eliminated from ongoing operations of the Company and there will be no significant continuing involvement in the operations after disposal pursuant to guidance in determining whether to report discontinued operations. The agreement included a provision that the Company would supply product to the buyer of Trade Secret and provide certain administrative services for a transition period. Under this agreement, the Company recognized zero and $20.0 million of product revenues on the supply of product sold to the purchaser of Trade Secret during the three months ended September 30, 2010 and 2009, respectively, and zero and $1.9 million of other income related to the administrative services during the three months ended September 30, 2010 and 2009, respectively. The agreement was substantially complete as of September 30, 2009.

Beginning within 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 $0.7 million of other income related to warehouse services during the three months ended September 30, 2010.

The following table provides the amounts due to the Company from the purchaser of Trade Secret:

	Classification	**September 30, 2010**	**June 30, 2010**
		(Dollars in thousands)	
Carrying Value:			
Warehouse services	Receivables, net	$ 347	$ 359
Note receivable, current	Other current assets	4,026	2,838
Note receivable, current valuation allowance	Other current assets	(1,299)	(611)
Note receivable, long-term	Other assets	28,500	29,000
Total note receivable, net		$ 31,574	$ 31,586

During fiscal year 2010, the Company entered into a formal note receivable agreement with the purchaser of Trade Secret. On July 6, 2010, the purchaser of Trade Secret filed for Chapter 11 bankruptcy. In connection with the bankruptcy by the purchaser of Trade Secret, the note receivable agreement was amended in October 2010. The note receivable agreement accrues interest at 8.0 percent which is payable quarterly beginning in December 2010. Principal payments of $0.5 million are due quarterly beginning in December 2011 with the remainder of the principal due in September 2015. Collateral for the receivables under the agreement is assets, including property and equipment, inventory, promissory notes and cash, of the purchaser of Trade Secret that the Company believes fully collateralizes the $31.6 million net receivable. Should the collateral decline there is a risk the Company may need to record reserves in future quarters.

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 it is not the primary beneficiary of Trade Secret based on its exposure to the expected losses of Trade Secret and as it is not the variable interest holder that is most closely associated with the relationship and the significance of the activities of Trade Secret. The exposure to loss related to the Company s involvement with Trade Secret is the carrying value of the amount due from the purchaser of Trade Secret and the guarantee of less than 30 operating leases. The Company has determined the exposure to the risk of loss on the guarantee of the operating leases to be remote.

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The income from discontinued operations is summarized below:

	For the Three Months Ended September 30, 2010		2009
	(Dollars in thousands)		
Income from discontinued operations, before income taxes	$	$	154
Income tax benefit on discontinued operations			3,007
Income from discontinued operations, net of income taxes	$	$	3,161

During the first quarter of fiscal year 2010, the Company recorded a $3.0 million tax benefit in discontinued operations to correct the prior year calculation of the income tax benefit related to the disposition of the Trade Secret salon concept. The Company does not believe the adjustment is material to its results of operations for the three months ended September 30, 2009 or its financial position or results of operations of any prior periods.

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 restricted stock awards and restricted stock units. 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 diluted 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, 2010	2009
	(Shares in thousands)	
Weighted average shares for basic earnings per share	56,629	54,143
Effect of dilutive securities:		
Dilutive effect of stock-based compensation	174	41
Dilutive effect of convertible debt	11,158	
Weighted average shares for diluted earnings per share	67,961	54,184

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

	For the Three Months Ended September 30, 2010	2009
	(Shares in thousands)	
Basic earnings per share:		
RSAs (1)	923	817
RSUs (1)	215	215
	1,138	1,032
Diluted earnings per share:		
Stock options (2)	900	1,324
SARs (2)	1,089	1,109
RSAs (2)	430	817
Shares issuable upon conversion of debt (3)		9,460
	2,419	12,710

(1) Awards were not vested

(2) Awards were anti-dilutive

(3) Awards were anti-dilutive for the three months ended September 30, 2009.

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The following table sets forth a reconciliation of the net income from continuing operations available to common shareholders and the net income from continuing operations for diluted earnings per share under the if-converted method:

	For the Three Months Ended September 30, 2010	2009
	(Dollars in thousands)	
Net income from continuing operations available to common shareholders	$ 18,320	$ 4,611
Effect of dilutive securities:		
Interest on convertible debt, net of taxes	2,013	
Net income from continuing operations for diluted earnings per share	$ 20,333	$ 4,611

Additional Paid-In Capital:

The change in additional paid-in capital during the three months ended September 30, 2010 was due to the following:

	(Dollars in thousands)
Balance, June 30, 2010	$ 332,372
Stock-based compensation	2,369
Exercise of stock options	59
Franchise stock incentive plan	48
Other	2
Balance, September 30, 2010	$ 334,850

Comprehensive Income:

Components of comprehensive income for the Company include net income, changes in fair market value of financial instruments designated as hedges of interest rate or foreign currency exposure and foreign currency translation charged or credited to the cumulative translation account within shareholders equity. Comprehensive income for the three months ended September 30, 2010 and 2009 was as follows:

	For the Three Months Ended September 30, 2010	2009
	(Dollars in thousands)	
Net income	$ 18,320	$ 7,772
Other comprehensive (loss) income:		
Changes in fair market value of financial instruments designated as cash flow hedges of interest rate exposure, net of taxes	(64)	2,101
Cumulative foreign currency translation	14,796	13,286
Total comprehensive income	$ 33,052	$ 23,159

4. FAIR VALUE MEASUREMENTS:

On July 1, 2008, the Company adopted fair value measurement guidance for financial assets and liabilities. On July 1, 2009, the Company adopted fair value measurement guidance for nonfinancial assets and liabilities. This guidance defines fair value, establishes a framework for measuring fair value and expands disclosure requirements about fair value measurements. This guidance defines fair value as the price that would be received to sell an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. The fair value hierarchy prescribed by this guidance contains three levels as follows:

Level 1 Unadjusted quoted prices that are available in active markets for the identical assets or liabilities at the measurement date.

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Level 2 Other observable inputs available at the measurement date, other than quoted prices included in Level 1, either directly or indirectly, including:

- Quoted prices for similar assets or liabilities in active markets;
- Quoted prices for identical or similar assets in non-active markets;
- Inputs other than quoted prices that are observable for the asset or liability; and
- Inputs that are derived principally from or corroborated by other observable market data.

Level 3 Unobservable inputs that cannot be corroborated by observable market data and reflect the use of significant management judgment. These values are generally determined using pricing models for which the assumptions utilize management s estimates of market participant assumptions.

Assets and Liabilities that are Measured at Fair Value on a Recurring Basis

The fair value hierarchy requires the use of observable market data when available. In instances in which the inputs used to measure fair value fall into different levels of the fair value hierarchy, the fair value measurement has been determined based on the lowest level input that is significant to the fair value measurement in its entirety. The Company s assessment of the significance of a particular item to the fair value measurement in its entirety requires judgment, including the consideration of inputs specific to the asset or liability. The following tables sets forth by level within the fair value hierarchy, the Company s financial assets and liabilities that were accounted for at fair value on a recurring basis at September 30, 2010 and June 30, 2010, according to the valuation techniques the Company used to determine their fair values.

	Fair Value at September 30, 2010	Level 1	Fair Value Measurements Using Inputs Considered as Level 2 (Dollars in thousands)	Level 3
ASSETS				
Non-current assets				
Preferred shares	$ 3,732	$	$	$ 3,732
LIABILITIES				
Current liabilities				
Derivative instruments	$ 48	$	$ 48	$
Non-current liabilities				

Derivative instruments	$	874	$		$	874	$	
Equity put option		24,523						24,523

		Fair Value at June 30, 2010		Level 1		Fair Value Measurements Using Inputs Considered as Level 2 (Dollars in thousands)		Level 3
ASSETS								
Non-current assets								
Derivative instruments	$	274	$		$	274	$	
Preferred shares		3,502						3,502
LIABILITIES								
Current liabilities								
Derivative instruments	$	401	$		$	401	$	
Non-current liabilities								
Derivative instruments	$	1,039	$		$	1,039	$	
Equity put option		22,009						22,009

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Changes in Financial Instruments Measured at Level 3 Fair Value on a Recurring Basis

The following tables present the changes during the three months ended September 30, 2010 and 2009 in our Level 3 financial instruments that are measured at fair value on a recurring basis.

	Changes in Financial Instruments Measured at Level 3 Fair Value Classified as		
	Preferred Shares	**Equity Put Option**	**Total**
		(Dollars in thousands)	
Balance at July 1, 2010	$ 3,502	$ 22,009	$ 25,511
Total realized and unrealized gains including translation:			
Included in other comprehensive income	230	2,514	2,744
Balance at September 30, 2010	$ 3,732	$ 24,523	$ 28,255

	Changes in Financial Instruments Measured at Level 3 Fair Value Classified as	
	Equity Put Option	**Total**
	(Dollars in thousands)	
Balance at July 1, 2009	$ 24,161	$ 24,161
Total realized and unrealized gains (losses) including translation:		
Included in other comprehensive income	1,029	1,029
Balance at September 30, 2009	$ 25,190	$ 25,190

The following methods and assumptions were used to estimate the fair value of each class of financial instrument:

Derivative instruments. The Company s derivative instrument assets and liabilities consist of cash flow hedges represented by interest rate swaps and forward foreign currency contracts. The instruments are classified as Level 2 as the fair value is obtained using observable inputs available for similar liabilities in active markets at the measurement date, as provided by sources independent from the Company. See breakout by type of contract and reconciliation to the balance sheet line item that each contract is classified within Note 7 of the Condensed Consolidated Financial Statements.

Equity put option. The Company s merger of the European franchise salon operations with the operations of the Franck Provost Salon Group on January 31, 2008 contained an equity put and an equity call. See further discussion within Note 6 to the Condensed Consolidated Financial Statements. The equity put option is valued using binomial lattice models that incorporate assumptions including the business enterprise value at that date and future estimates of volatility and earnings before interest, taxes, and depreciation and amortization multiples.

Preferred Shares. The Company has preferred shares in Yamano Holding Corporation. See further discussion within Note 6 to the Condensed Consolidated Financial Statements. The preferred shares are classified as Level 3 as there are no quoted market prices and minimal market participant data for preferred shares of similar rating. The preferred shares are classified within investment in and loans to affiliates on the Condensed Consolidated Balance Sheet. The fair value of the preferred shares is based on the financial health of Yamano Holding Corporation and terms within the preferred share agreement which allow the Company to convert the subscription amount of the preferred shares into equity of MY Style, a wholly owned subsidiary of Yamano Holding Corporation. As of September 30, 2010, the subscription value of the preferred shares of 311,131,284 Yen ($3.7 million) represents the fair value of the preferred shares.

Financial Instruments. In addition to the financial instruments listed above, the Company s financial instruments also include cash, cash equivalents, receivables, accounts payable and debt.

The fair value of cash and cash equivalents, receivables and accounts payable approximated the carrying values as of September 30, 2010. At September 30, 2010, the estimated fair values and carrying amounts of debt were $464.7 and $439.7 million, respectively. The estimated fair value of debt was determined based on internal valuation models, which utilize quoted market prices and interest rates for the same or similar instruments.

Assets and Liabilities Measured at Fair Value on a Nonrecurring Basis. We measure certain assets, including the Company s equity method investments, at fair value on a nonrecurring basis when they are deemed to be other-than-temporarily impaired. The fair values of our investments are determined based on valuation techniques using the best information available, and may include quoted market prices, market comparables, and discounted cash flow projections.

There were no assets measured at fair value on a nonrecurring basis during the three months ended September 30, 2010 and 2009.

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5. GOODWILL AND OTHER INTANGIBLES:

The table below contains details related to the Company s recorded goodwill as of September 30, 2010 and June 30, 2010:

	Salons North America	Salons International	Hair Restoration Centers	Consolidated
	(Dollars in thousands)			
Gross goodwill at June 30, 2010	$ 700,012	$ 41,661	$ 150,380	$ 892,053
Accumulated impairment losses (1)	(113,403)	(41,661)		(155,064)
Net goodwill at June 30, 2010	586,609		150,380	736,989
Goodwill acquired (2)	2,299			2,299
Translation rate adjustments	1,685		(8)	1,677
Gross goodwill at September 30, 2010	703,996	41,661	150,372	896,029
Accumulated impairment losses (1)	(113,403)	(41,661)		(155,064)
Net goodwill at September 30, 2010	$ 590,593	$	$ 150,372	$ 740,965

(1) As a result of the Company s annual impairment testing of goodwill during the three months ended March 31, 2010, a $35.3 million impairment charge was recorded within continuing operations for the excess of the carrying value of goodwill over the implied fair value of goodwill for the Regis salon concept.

(2) See Note 6 to the Condensed Consolidated Financial Statements.

The table below presents other intangible assets as of September 30, 2010 and June 30, 2010:

	September 30, 2010 Cost	September 30, 2010 Accumulated Amortization	September 30, 2010 Net	June 30, 2010 Cost	June 30, 2010 Accumulated Amortization	June 30, 2010 Net
			(Dollars in thousands)			
Amortized intangible assets:						
Brand assets and trade names	$ 79,885	$ (12,649)	$ 67,236	$ 79,596	$ (12,139)	$ 67,457
Customer lists	52,045	(30,014)	22,031	52,045	(28,652)	23,393
Franchise agreements	21,465	(7,897)	13,568	21,245	(7,543)	13,702
Lease intangibles	14,843	(4,577)	10,266	14,674	(4,360)	10,314
Non-compete agreements	330	(167)	163	320	(146)	174
Other	5,174	(2,130)	3,044	6,755	(3,725)	3,030
	$ 173,742	$ (57,434)	$ 116,308	$ 174,635	$ (56,565)	$ 118,070

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All intangible assets have been assigned an estimated finite useful life and are amortized over the number of years that approximate their respective useful lives (ranging from one to 40 years). The cost of intangible assets is amortized to earnings in proportion to the amount of economic benefits obtaine