REGIS CORP
Form 10-Q
February 09, 2009
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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 December 31, 2008

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	**41-0749934**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

7201 Metro Boulevard, Edina, Minnesota	**55439**
(Address of principal executive offices)	(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 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 February 6, 2009:

Common Stock, $.05 par value	**43,213,321**
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 December 31, 2008 and June 30, 2008
(In thousands, except share data)

	December 31, 2008	June 30, 2008
ASSETS		
Current assets:		
Cash and cash equivalents	$ 64,303	$ 127,627
Receivables, net	36,423	37,824
Inventories	194,459	212,468
Deferred income taxes	72,179	15,954
Other current assets	47,659	51,278
Total current assets	415,023	445,151
Property and equipment, net	415,270	481,851
Goodwill	759,751	870,993
Other intangibles, net	130,390	144,291
Investment in and loans to affiliates	232,157	247,102
Other assets	46,266	46,483
Total assets	$ 1,998,857	$ 2,235,871
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities:		
Long-term debt, current portion	$ 151,952	$ 230,224
Accounts payable	77,037	69,693
Accrued expenses	195,231	207,605
Total current liabilities	424,220	507,522
Long-term debt and capital lease obligations	580,579	534,523
Other noncurrent liabilities	205,202	217,640
Total liabilities	1,210,001	1,259,685
Commitments and contingencies (Note 8)		
Shareholders equity:		
Common stock, $0.05 par value; issued and outstanding 43,213,321 and 43,070,927 common shares at December 31, 2008 and June 30, 2008, respectively	2,160	2,153
Additional paid-in capital	150,363	143,265
Accumulated other comprehensive income	39,757	101,973
Retained earnings	596,576	728,795
Total shareholders equity	788,856	976,186

Total liabilities and shareholders equity	$	1,998,857	$	2,235,871

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 December 31, 2008 and 2007

(In thousands, except per share data)

	2008	2007
Revenues:		
Service	$ 445,078	$ 450,851
Product	132,774	142,256
Royalties and fees	9,574	21,559
	587,426	614,666
Operating expenses:		
Cost of service	256,838	259,402
Cost of product	65,078	69,036
Site operating expenses	47,620	44,079
General and administrative	72,531	83,060
Rent	81,981	89,191
Depreciation and amortization	27,519	28,254
Goodwill impairment	41,661	
Lease termination costs	847	
Total operating expenses	594,075	573,022
Operating (loss) income	(6,649)	41,644
Other income (expense):		
Interest expense	(10,878)	(11,716)
Interest income and other, net	3,462	2,090
(Loss) income from continuing operations before income taxes and equity in (loss) income of affiliated companies	(14,065)	32,018
Income taxes	(9,383)	(11,679)
Equity in (loss) income of affiliated companies, net of income taxes	(2,338)	386
(Loss) income from continuing operations	(25,786)	20,725
(Loss) income from discontinued operations, net of income taxes (Note 2)	(117,466)	1,831
Net (loss) income	$ (143,252)	$ 22,556
Net (loss) income per share:		
Basic:		
(Loss) income from continuing operations	(0.60)	0.48
(Loss) income from discontinued operations, net of income taxes	(2.74)	0.04
Net (loss) income per share, basic	$ (3.34)	$ 0.52
Diluted:		
(Loss) income from continuing operations	(0.60)	0.47
(Loss) income from discontinued operations, net of income taxes	(2.74)	0.04
Net (loss) income per share, diluted	$ (3.34)	$ 0.51

Weighted average common and common equivalent shares outstanding:		
Basic	42,897	43,369
Diluted	42,897	43,915
Cash dividends declared per common share	$ 0.04	$ 0.04

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 six months ended December 31, 2008 and 2007

(In thousands, except per share data)

	2008	2007
Revenues:		
Service	$ 914,113	$ 903,614
Product	266,957	275,916
Royalties and fees	19,885	42,466
	1,200,955	1,221,996
Operating expenses:		
Cost of service	523,915	516,055
Cost of product	130,697	132,648
Site operating expenses	96,022	93,410
General and administrative	150,295	166,316
Rent	174,192	176,440
Depreciation and amortization	54,787	56,537
Goodwill impairment	41,661	
Lease termination costs	1,998	
Total operating expenses	1,173,567	1,141,406
Operating income	27,388	80,590
Other income (expense):		
Interest expense	(21,098)	(22,229)
Interest income and other, net	5,197	4,245
Income from continuing operations before income taxes and equity in (loss) income of affiliated companies	11,487	62,606
Income taxes	(19,340)	(22,485)
Equity in (loss) income of affiliated companies, net of income taxes	(1,846)	52
(Loss) income from continuing operations	(9,699)	40,173
(Loss) income from discontinued operations, net of income taxes (Note 2)	(119,066)	2,982
Net (loss) income	$ (128,765)	$ 43,155
Net (loss) income per share:		
Basic:		
(Loss) income from continuing operations	(0.23)	0.92
(Loss) income from discontinued operations, net of income taxes	(2.78)	0.07
Net (loss) income per share, basic	$ (3.01)	$ 0.99
Diluted:		
(Loss) income from continuing operations	(0.23)	0.91
(Loss) income from discontinued operations, net of income taxes	(2.78)	0.07
Net (loss) income per share, diluted	$ (3.01)	$ 0.98

Weighted average common and common equivalent shares outstanding:		
Basic	42,842	43,559
Diluted	42,842	44,172
Cash dividends declared per common share	$ 0.08	$ 0.08

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

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REGIS CORPORATION

CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS (Unaudited)
for the six months ended December 31, 2008 and 2007

(In thousands)

	2008	2007
Cash flows from operating activities:		
Net (loss) income	$ (128,765)	$ 43,155
Adjustments to reconcile net (loss) income to net cash provided by operating activities:		
Depreciation	57,562	57,271
Amortization	5,067	5,915
Equity in loss (income) of affiliated companies	1,846	(52)
Deferred income taxes	(59,808)	(1,202)
Impairment on discontinued operations	171,004	
Goodwill impairment	41,661	
Excess tax benefits from stock-based compensation plans	(284)	(1,295)
Stock-based compensation	3,829	3,303
Other noncash items affecting earnings	(2,535)	707
Changes in operating assets and liabilities:		
Receivables	(3,072)	(4,217)
Inventories	(19,318)	(9,686)
Other current assets	(1,886)	(8,062)
Other assets	2,865	(2,270)
Accounts payable	12,397	(8,572)
Accrued expenses	(8,725)	2,287
Other noncurrent liabilities	2,136	14,987
Net cash provided by operating activities	73,974	92,269
Cash flows from investing activities:		
Capital expenditures	(48,793)	(44,399)
Proceeds from sale of assets	28	16
Asset acquisitions, net of cash acquired and certain obligations assumed	(30,965)	(53,297)
Proceeds from loans and investments	9,793	10,000
Disbursements for loans and investments	(5,971)	(22,500)
Transfer of cash related to contribution of schools		(7,254)
Net cash used in investing activities	(75,908)	(117,434)
Cash flows from financing activities:		
Borrowings on revolving credit facilities	3,711,400	4,773,800
Payments on revolving credit facilities	(3,813,500)	(4,711,600)
Proceeds from issuance of long-term debt	85,000	50,000
Repayments of long-term debt and capital lease obligations	(21,165)	(63,612)
Repurchase of common stock		(49,957)
Excess tax benefits from stock-based compensation plans	284	1,295
Proceeds from issuance of common stock	2,306	7,372
Dividends paid	(3,453)	(3,530)
Other	(4,117)	(653)
Net cash (used in) provided by financing activities	(43,245)	3,115
Effect of exchange rate changes on cash and cash equivalents	(18,145)	10,120

Decrease in cash and cash equivalents		(63,324)		(11,930)
Cash and cash equivalents:				
Beginning of period		127,627		184,785
End of period	$	64,303	$	172,855

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 December 31, 2008 and for the three and six months ended December 31, 2008 and 2007, reflect, in the opinion of management, all adjustments necessary to fairly state the consolidated financial position of the Company as of December 31, 2008 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, 2008 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, 2008 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 December 31, 2008 and for the three and six month periods ended December 31, 2008 and 2007 included in this Form 10-Q, have been reviewed by PricewaterhouseCoopers LLP, an independent registered public accounting firm. Their separate report dated February 9, 2009 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.

Inventories:

Inventories consist principally of hair care products held either for use in services or for sale. Cost of product used in salon services is determined by applying estimated gross profit margins to service revenues, which are based on historical factors including product pricing trends and estimated shrinkage. In addition, the estimated gross profit margin is adjusted based on the results of physical inventory counts performed at least semi-annually and the monthly monitoring of factors that could impact the Company s usage rate estimates. These factors include mix of service sales, discounting, and special promotions. Cost of product sold to salon customers is determined based on the weighted average cost of product to the Company, adjusted for an estimated shrinkage factor. Product and service inventories are adjusted based on the results of physical inventory counts performed at least semi-annually.

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 $3.8 and $3.3 million for the six months ended December 31, 2008 and 2007, respectively.

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Stock options outstanding, weighted average exercise price and weighted average fair values as of December 31, 2008 were as follows:

Options	Shares (in thousands)		Weighted Average Exercise Price
Outstanding at June 30, 2008	1,713	$	24.55
Granted	2		26.79
Exercised	(133)		17.17
Forfeited or expired	(6)		36.24
Outstanding at September 30, 2008	1,576	$	25.14
Granted			
Exercised	(1)		19.28
Forfeited or expired	(19)		33.10
Outstanding at December 31, 2008	1,556	$	25.05
Exercisable at December 31, 2008	1,202	$	22.41

Outstanding options of 1,555,996 at December 31, 2008 had an intrinsic value of less than $0.1 million and a weighted average remaining contractual term of 4.0 years. Exercisable options of 1,202,296 at December 31, 2008 had an intrinsic value of less than $0.1 million and a weighted average remaining contractual term of 2.8 years. An additional 336,822 options are expected to vest with a $34.08 per share weighted average grant price and a weighted average remaining contractual life of 8.1 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.

Stock options were granted under the 2004 Plan in fiscal year 2008.

Grants of RSAs, RSUs and SARs outstanding under the 2004 Plan, 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, 2008	523	$	36.76	527	$	35.70
Granted						
Vested/Exercised						
Forfeited or expired	(8)		34.31	(14)		38.27
Balance, September 30, 2008	515	$	36.80	513	$	35.69
Granted						
Vested/Exercised	1		34.01			
Forfeited or expired						
Balance, December 31, 2008	516	$	36.80	513	$	35.69

Outstanding and unvested RSAs of 300,974 at December 31, 2008 had an intrinsic value of $4.4 million and a weighted average remaining contractual term of 1.8 years. An additional 288,162 awards are expected to vest with a total intrinsic value of $4.2 million.

Outstanding and unvested RSUs of 215,000 at December 31, 2008 had an intrinsic value of $3.1 million and a weighted average remaining contractual term of 3.2 years. All unvested RSUs are expected to vest.

Outstanding SARs of 513,150 at December 31, 2008 had a total intrinsic value of zero and a weighted average remaining contractual term of 7.6 years. Exercisable SARs of 176,980 at December 31, 2008 had a total intrinsic value of zero and a weighted average remaining contractual term of 6.5 years. An additional 326,435 rights are expected to vest with a $34.05 per share weighted average grant price, a weighted average remaining contractual life of 8.2 years and a total intrinsic value of zero.

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Total cash from the exercise of share-based instruments for the three and six months ended December 31, 2008 was less than $0.1 million and $2.3 million, respectively. Total cash received from the exercise of share-based instruments for the three and six months ended December 31, 2007 was $6.7 and $7.4 million, respectively.

As of December 31, 2008, the total unrecognized compensation cost related to all unvested stock-based compensation arrangements was $19.5 million. The related weighted average period over which such cost is expected to be recognized was approximately 3.3 years as of December 31, 2008.

The total intrinsic value of all stock-based compensation (the amount by which the respective December 31 stock price exceeded the exercise or grant date price) that was exercised during the three and six months ended December 31, 2008 and 2007 was less than $0.1 and $1.6 million, respectively. The total intrinsic value of all stock-based compensation (the amount by which the respective December 31 stock price exceeded the exercise or grant date price) that was exercised during the three and six months ended December 31, 2007 was $6.1 and $6.3 million, respectively.

The total fair value of awards vested during the six months ended December 31, 2008 and 2007 was zero and less than $0.1 million, respectively.

Recent Accounting Pronouncements:

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standard No. 157, *Fair Value Measurements* (SFAS No. 157). SFAS No. 157 establishes a single definition of fair value and a framework for measuring fair value, sets out a fair value hierarchy to be used to classify the source of information used in fair value measurements, and requires new disclosures of assets and liabilities measured at fair value based on their level in the hierarchy. This statement applies under other accounting pronouncements that require or permit fair value measurements, but does not change existing guidance as to whether or not an instrument is carried at fair value. In February 2008, the FASB issued FASB Staff Position (FSP) No. 157-1 and No. 157-2, which, respectively, removed leasing transactions from the scope of SFAS No. 157 and deferred for one year the effective date for SFAS No. 157 as it applies to certain nonfinancial assets and liabilities. On July 1, 2008, the Company adopted, on a prospective basis, SFAS No. 157 and became subject to the new disclosure requirements (excluding FSP 157-2) with respect to the Company s fair value measurements of (a) nonfinancial assets and liabilities that are recognized or disclosed at fair value in our financial statements on a recurring basis (at least annually) and (b) all financial assets and liabilities. The Company s adoption did not impact its consolidated financial position or results of operations as all fair value measurements were in accordance with SFAS No. 157 upon adoption. The additional disclosures required by SFAS No. 157 are included in Note 4. The Company is evaluating the impact FSP No. 157-2 will have on its nonfinancial assets and liabilities that are measured at fair value, but are recognized or disclosed at fair value on a nonrecurring basis.

In December 2007, the FASB issued SFAS No. 141(R), *Business Combinations* (SFAS No. 141(R)). SFAS No. 141(R) replaces SFAS No. 141, *Business Combinations*. SFAS No. 141(R) establishes principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, any noncontrolling interests in the acquiree and the goodwill acquired. Some of the key changes under SFAS No. 141(R) will change the accounting treatment for certain specific acquisition related items including: (1) accounting for acquired in process research and development as an indefinite-lived intangible asset until approved or discontinued rather than as an immediate expense; (2) expensing acquisition costs rather than adding them to the cost of an acquisition; (3) expensing restructuring costs in connection with an acquisition rather than adding them to the cost of an acquisition; (4) including the fair value of contingent consideration at the date of an acquisition in the cost of an acquisition; and (5) recording at the date of an acquisition the fair value of contingent liabilities that are more than likely than not to occur. SFAS No. 141(R) also includes a substantial number of new disclosure requirements. SFAS No. 141(R) will be effective for the Company s fiscal year 2010 and must be applied prospectively to all new acquisitions closing on or after July 1, 2009. Early adoption is prohibited. SFAS No. 141(R) is expected to have a material impact on how the Company will identify, negotiate and value future acquisitions and may materially impact the Company s Consolidated Financial Statements.

In March 2008, the FASB issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities* (SFAS No. 161). SFAS No. 161 requires enhanced disclosures about how and why an entity uses derivative instruments, how derivative instruments and related hedge items are accounted for under SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, and its related interpretations, and how derivative instruments and related hedged items affect an entity s financial position, financial performance, and cash flows. SFAS No. 161

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is effective for fiscal years and interim periods beginning after November 15, 2008 (i.e. the Company s third quarter of fiscal year 2009). The Company intends to comply with the disclosure requirements upon adoption.

2. DISCONTINUED OPERATIONS:

On January 26, 2009, the Company entered into an agreement to sell 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 includes 659 company-owned salons and 62 franchise salons, all of which have historically been reported within the Company s North America reportable segment. The sale of Trade Secret is expected to close on February 15, 2009.

During the three months ended December 31, 2008, steps were taken to market and identify potential buyers of Trade Secret. The Company concluded that Trade Secret qualified as held for sale under Statement of Financial Accounting Standard No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets* (SFAS. No. 144), as of December 31, 2008 and is presented as discontinued operations in the Condensed Consolidated Statements of Operations for all periods presented. The conclusion was based on management having the authority to commit the Company to sell Trade Secret within parameters approved by the Board of Directors, the salons being available for sale in present condition, negotiations were being held with a potential buyer and the sale was probable as of December 31, 2008. The operations and cash flows of Trade Secret will be eliminated from ongoing operations of the Company and there will be no significant continuing involvement in the operations after disposal pursuant to Emerging Issues Task Force (EITF) Issue No. 03-13, *Applying the Conditions in Paragraph 42 of FASB Statement No. 144 in Determining Whether to Report Discontinued Operations*. The agreement includes a provision that the Company will supply product to the buyer of Trade Secret and provide certain administrative services for a transition period of six months following the date of sale with possible extension to not more than eleven months.

As the proceeds the Company will receive from the sale of Trade Secret are negligible, the Company recognized an impairment charge during the three months ended December 31, 2008 set forth in the following table.

		(Dollars in thousands)
Inventories	$	33,599
Property and equipment, net		56,491
Goodwill		78,126
Other intangibles, net		7,187
Other assets		2,896
Other noncurrent liabilities		(6,477)
Impairment loss before income taxes	$	171,822

The (loss) income from discontinued operations are summarized below:

	For the Periods Ended December 31,			
	Three Months		**Six Months**	
	2008	**2007**	**2008**	**2007**
	(Dollars in thousands)		**(Dollars in thousands)**	

Revenues	$	67,807	$	67,575	$	134,547	$	127,770
(Loss) income from discontinued operations, before income taxes		(174,670)		3,173		(177,445)		5,168
Income tax benefit (provision) on discontinued operations		57,204		(1,342)		58,379		(2,186)
(Loss) income from discontinued operations, net of income taxes	$	(117,466)	$	1,831	$	(119,066)	$	2,982

Income taxes have been allocated to continuing and discontinued operations based on the methodology required by Financial Accounting Interpretation No. 18, *Accounting for Income Taxes in Interim Periods an Interpretation of APB Opinion No. 28 (FIN 18)*.

Pursuant to the agreement the Company will retain certain assets and liabilities of Trade Secret. These balances are classified in the Condensed Consolidated Balance Sheet within their natural balance sheet classification. Remaining Trade Secret assets and liabilities at December 31, 2008 to be retained consist of $1.3 million in cash and cash equivalents, $2.7 million in receivables, net, $8.9 million in inventory estimated to be sold prior to the expected closing date, $1.4 million in other currents assets, $14.5 million in accrued expenses, $0.9 million in other current

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liabilities, and $1.4 million in long-term debt and capital lease obligations. Pursuant to the agreement, the Company will reimburse the buyer for loss contingencies including any losses imposed against the buyer arising from existing litigation and for the termination of an existing office lease.

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. For the three and six months ended December 31, 2008, diluted loss per share equals basic loss per share, as the assumed exercise of shares under the Company s stock option plan and long-term incentive plan would have an anti-dilutive effect.

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

	For the Periods Ended December 31,			
	Three Months		Six Months	
	2008	2007	2008	2007
	(Shares in thousands)			
Weighted average shares for basic earnings per share	42,897	43,369	42,842	43,559
Effect of dilutive securities:				
Dilutive effect of stock-based compensation (1)		442		509
Contingent shares issuable under contingent stock agreements		104		104
Weighted average shares for diluted earnings per share	42,897	43,915	42,842	44,172

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(1) For the three and six months ended December 31, 2008, 2,040 and 166,343 common stock equivalents, respectively, of potentially dilutive Common Stock were not included in the diluted earnings per share calculation because to do so would have been anti-dilutive.

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

	For the Periods Ended December 31,			
	Three Months		Six Months	
	2008	2007	2008	2007
	(Shares in thousands)		(Shares in thousands)	
Basic earnings per share:				
RSAs (1)	301	247	301	247
RSUs (1)	215	215	215	215
	516	462	516	462
Diluted earnings per share:				
Stock options (2)	1,560	494	803	482
SARs (2)	513	390	516	392
RSAs (2)	289	117	289	117
RSUs (2)	215	215	215	215
	2,577	1,216	1,823	1,206

(1) Shares were not vested

(2) Shares were anti-dilutive

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Additional Paid-In Capital:

The change in additional paid-in capital during the six months ended December 31, 2008 was due to the following:

		(Dollars in thousands)
Balance, June 30, 2008	$	143,265
Exercise of stock options		2,299
Tax benefit realized upon exercise of stock options		592
Stock-based compensation		3,829
Franchise stock incentive plan		380
Taxes related to restricted stock		(2)
Balance, December 31, 2008	$	150,363

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 (loss) income for the three and six months ended December 31, 2008 and 2007 was as follows:

	For the Periods Ended December 31,							
	Three Months				Six Months			
	2008		2007		2008		2007	
	(Dollars in thousands)				(Dollars in thousands)			
Net (loss) income	$	(143,252)	$	22,556	$	(128,765)	$	43,155
Other comprehensive income (loss):								
Changes in fair market value of financial instruments designated as cash flow hedges of interest rate exposure and foreign currency exposure, net of taxes		(3,150)		(1,101)		(3,097)		(2,841)
Change in cumulative foreign currency translation		(39,103)		9,543		(59,119)		21,737
Total comprehensive (loss) income	$	(185,505)	$	30,998	$	(190,981)	$	62,051

4. FAIR VALUE MEASUREMENTS:

As discussed in Note 1 to the Consolidated Financial Statements, the Company adopted SFAS No. 157, subject to the deferral provisions of FSP No. 157-2, on July 1, 2008. This standard defines fair value, establishes a framework for measuring fair value and expands disclosure requirements about fair value measurements. SFAS No. 157 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 SFAS No. 157 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.

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.

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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. Our 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 table sets forth by level within the fair value hierarchy, our financial assets and liabilities that were accounted for at fair value on a recurring basis at December 31, 2008, according to the valuation techniques the Company used to determine their fair values.

	Fair Value at December 31, 2008	Fair Value Measurements Using Inputs Considered as Level 1	Level 2	Level 3
	(Dollars in thousands)			
ASSETS				
Noncurrent assets				
Derivative instruments	$ 1,014		$ 1,014	
LIABILITIES				
Long-term liabilities				
Derivative instruments	8,043		8,043	
Equity put option	22,131			$ 22,131

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 assets and liabilities in active markets at the measurement date, as provided by sources independent from the Company.

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 option and an equity call option. See further discussion within Note 6 of 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 based on available market data. At June 30, 2008, the fair value of the equity put option was $24.8 million. The value of the equity put option as of December 31, 2008 was determined to be consistent with the value recorded at June 30, 2008. The $2.7 million decrease in the fair value of the equity put option since June 30, 2008 relates to foreign currency translation and has been recorded in accumulated other comprehensive income in the December 31, 2008 Condensed Consolidated Balance Sheet. The Company determined the equity call option to have no value at December 31, 2008.

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

As indicated in Note 1 to the Consolidated Financial Statements, the aspects of SFAS No. 157 for which the effective date was deferred for one year (i.e., the Company s first quarter of fiscal year 2010) under FSP No. 157-2 relate to nonfinancial assets and liabilities that are measured at fair value, but are recognized or disclosed at fair value on a nonrecurring basis. This deferral applies to such items as nonfinancial assets and liabilities initially measured at fair value in a business combination (but not measured at fair value in subsequent periods) or nonfinancial long-lived asset groups measured at fair value for an impairment assessment.

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5. GOODWILL AND OTHER INTANGIBLES:

The table below contains details related to the Company s recorded goodwill as of December 31, 2008 and June 30, 2008:

	Salons North America	Salons International	Hair Restoration Centers	Consolidated
	(Dollars in thousands)			
Balance at June 30, 2008	$ 668,799	$ 48,461	$ 153,733	$ 870,993
Goodwill acquired	24,615	(1,255)	540	23,900
Translation rate adjustments	(9,810)	(5,545)		(15,355)
Goodwill impairment	(78,126)	(41,661)		(119,787)
Balance at December 31, 2008	$ 605,478	$	$ 154,273	$ 759,751

Goodwill acquired includes adjustments to prior year acquisitions, primarily representing the finalization of purchase price allocations. For the six months ended December 31, 2008 the $1.3 million reduction to international goodwill related to the settlement of the escrow account on an acquisition that closed in September 2007.

Goodwill is tested for impairment annually or at the time of a triggering event in accordance with the provisions of SFAS No. 142, *Goodwill and Other Intangible Assets* (SFAS No. 142). Fair values are estimated based on the Company s best estimate of the expected present value of future cash flows and compared with the corresponding carrying value of the reporting unit, including goodwill. Where available and as appropriate comparative market multiples are used to corroborate the results of the present value method. The Company considers its various concepts to be reporting units when it tests for goodwill impairment because that is where the Company believes goodwill resides. The Company s policy is to perform its annual goodwill impairment test during its third quarter of each fiscal year ending June 30.

During the three months ended December 31, 2008 the fair value of the Company s stock declined such that it began trading below book value per share. Due to the adverse changes in operating results and the continuation of the Company s stock trading below book value per share, the Company performed an interim impairment test of goodwill during the three months ended December 31, 2008. The fair value of the Company s reporting units was estimated based on discounted cash flows that utilize estimates of revenues, driven by assumed same-store sales rates, estimated future gross margins and expense rates, as well as acquisition integration and maturation and appropriate discount rates.

The Regis, Mastercuts, SmartStyle, Supercuts and Promenade reporting units within the Company s North America reportable segment had estimated fair values that exceeded carrying values by a minimum of approximately 30.0 percent as of December 31, 2008 and therefore goodwill in those reporting units was not impaired. The remaining reporting unit within the North America reportable segment is Trade Secret. See Note 2 of the Condensed Consolidated Financial Statements for discussion on the $78.1 million goodwill impairment of Trade Secret recorded within discontinued operations.

A $41.7 million impairment charge for the full carrying amount of goodwill within the salon concepts in the United Kingdom was recorded within continuing operations during the three months ended December 31, 2008. The recent performance challenges of the International salon operations indicated that the estimated fair value was less than the current carrying value of this reporting unit s net assets, including goodwill.

The estimated fair value of Hair Restoration Centers exceeded its carrying value by approximately five percent at December 31, 2008 and therefore no goodwill impairment was recorded. The Hair Restoration Centers were acquired on December 1, 2004 at fair market value. Since the date of acquisition the financial performance of the Hair Restoration Centers has continued to meet or exceed the Company s internal expectations, however, because of some of the inherent assumptions and estimates in determining fair value are outside the control of management, changes in these assumptions can adversely impact fair value.

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As of December 31, 2008, our estimated fair value as determined by the sum of our reporting units based upon discounted cash flow calculations reconciled to within a reasonable range of our market capitalization which included an assumed control premium. Subsequent to December 31, 2008, the fair value of our stock continues to fluctuate and regularly trades below our book value per share. Adverse changes in expected operating results, an extended period of our stock trading significantly below book value per share, and unfavorable changes in other economic factors may result in further impairments of goodwill. We will reassess the possible impairment of goodwill during the third quarter of fiscal year 2009 as part of our annual assessment.

No impairment of goodwill was recorded during the three months ended December 31, 2007.

The table below presents other intangible assets as of December 31, 2008 and June 30, 2008:

	December 31, 2008				June 30, 2008		
	Cost	Accumulated Amortization (1)	Trade Secret Impairment (2)	Net	Cost	Accumulated Amortization (1)	Net
	(Dollars in thousands)						
Amortized intangible assets:							
Brand assets and trade names	$ 80,336	$ (8,909)	$ (1,733)	$ 69,694	$ 81,407	$ (8,072)	$ 73,335
Customer lists	52,045	(20,542)		31,503	51,316	(17,444)	33,872
Franchise agreements	26,096	(6,603)	(4,897)	14,596	27,115	(6,363)	20,752
Lease intangibles	14,729	(3,346)	(475)	10,908	14,771	(2,887)	11,884
Non-compete agreements	703	(597)	(35)	71	785	(631)	154
Other	6,743	(3,078)	(47)	3,618	7,974	(3,680)	4,294
	$ 180,652	$ (43,075)	$ (7,187)	$ 130,390	$ 183,368	$ (39,077)	$ 144,291

(1) Balance sheet accounts are converted at the applicable exchange rates effective as of the reported balance sheet dates, while income statement accounts are converted at the average exchange rates for the year-to-date periods presented.

(2) The net book value of the Trade Secret intangible assets as of December 31, 2008 was written off as of December 31, 2008 as part of the sale of Trade Secret (see Note 2).

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 obtained by the Company in that reporting period. The weighted average amortization periods, in total and by major intangible asset class, are as follows:

Weighted Average Amortization Period

	(In years)	
	December 31, 2008	**June 30, 2008**
Amortized intangible assets:		
Brand assets and trade names	39	39
Customer lists	10	10
Franchise agreements	22	21
Lease intangibles	20	20
Non-compete agreements	4	5
Other	18	17
Total	26	26

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Total amortization expense related to the amortizable intangible assets was approximately $2.5 and $2.9 million during the three months ended December 31, 2008 and 2007, respectively, and $5.1 and $5.8 million during the six months ended December 31, 2008 and 2007, respectively. As of December 31, 2008, future estimated amortization expense related to amortizable intangible assets is estimated to be:

Fiscal Year		**(Dollars in thousands)**
2009 (Remainder: six-month period)	$	4,776
2010		9,656
2011		9,458
2012		9,258
2013		8,985

6. ACQUISITIONS, INVESTMENT IN AND LOANS TO AFFILIATES:

Acquisitions

During the six months ended December 31, 2008 and 2007, the Company made salon and hair restoration center acquisitions and the purchase prices have been allocated to assets acquired and liabilities assumed based on their estimated fair values at the dates of acquisition. Operations of the acquired companies have been included in the operations of the Company since the date of the respective acquisition.

The components of the aggregate purchase prices of the acquisitions made during the six months ended December 31, 2008 and 2007 and the allocation of the purchase prices were as follows:

	For the Six Months Ended December 31,			
Allocation of Purchase Prices		**2008**		**2007**
	(Dollars in thousands)			
Components of aggregate purchase prices:				
Cash	$	30,965	$	53,297
Deferred purchase price		75		2,602
	$	31,040	$	55,899
Allocation of the purchase price:				
Current assets	$	986	$	2,022
Property and equipment		3,819		5,664
Deferred income taxes		1,788		
Goodwill		23,900		41,636
Identifiable intangible assets		770		7,978
Other long-term assets				1,210
Accounts payable and accrued expenses		(140)		(2,611)
Other noncurrent liabilities		(83)		
	$	31,040	$	55,899

The majority of the purchase price in salon acquisitions is accounted for as residual goodwill rather than identifiable intangible assets. This stems from the value associated with the walk-in customer base of the acquired salons, which is not recorded as an identifiable intangible asset, as well as the limited value and customer preference associated with the acquired hair salon brand. Key factors considered by consumers of hair salon services include personal relationships with individual stylists, service quality and price point competitiveness. These attributes represent the going concern value of the salon.

Residual goodwill further represents the Company s opportunity to strategically combine the acquired business with the Company s existing structure to serve a greater number of customers through its expansion strategies. In the acquisitions of international salons and hair restoration centers, the residual goodwill primarily represents the growth prospects that are not captured as part of acquired tangible or identified intangible assets. Generally, the goodwill recognized in the North American salon transactions is expected to be fully deductible for tax purposes and the goodwill recognized in the international salon transactions is non-deductible for tax purposes. Goodwill generated in certain acquisitions is not deductible for tax purposes due to the acquisition structure of the transaction.

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During the six months ended December 31, 2008 and 2007, certain of the Company s salon acquisitions were from its franchisees. The Company evaluated the effective settlement of the preexisting franchise contracts and associated rights afforded by those contracts in accordance with Emerging Issues Task Force (EITF) No. 04-1, *Accounting for Preexisting Relationships Between the Parties to a Business Combination.* The Company determined that the effective settlement of the preexisting franchise contracts at the date of the acquisition did not result in a gain or loss, as the agreements were neither favorable nor unfavorable when compared to similar current market transactions, and no settlement provisions exist in the preexisting contracts. Therefore, no settlement gain or loss was recognized with respect to the Company s franchise buybacks.

Investment in and loans to affiliates

The table below presents the carrying amount of investments in and loans to affiliates as of December 31, 2008 and June 30, 2008:

	December 31, 2008	June 30, 2008
	(Dollars in thousands)	
Provalliance	$ 109,374	$ 119,353
Empire Education Group, Inc.	101,659	109,307
Intelligent Nutrients, LLC		5,657
MY Style	16,095	7,756
Hair Club for Men, Ltd.	5,029	5,029
	$ 232,157	$ 247,102

Provalliance

On January 31, 2008, the Company merged its continental European franchise salon operations with the operations of the Franck Provost Salon Group in exchange for a 30.0 percent equity interest in the newly formed Provalliance entity (Provalliance). The merger with the operations of the Franck Provost Salon Group which are also located in continental Europe, created Europe s largest salon operator with approximately 2,400 company-owned and franchise salons as of December 31, 2008.

The merger agreement contains a right (Equity Put) to require the Company to purchase additional ownership interest in Provalliance between specified dates in 2010 to 2018. The acquisition price is determined based on the earnings before interest, taxes, depreciation and amortization of Provalliance for a trailing twelve month period which is intended to approximate fair value. The estimated fair value of the Equity Put has been included as a component of the Company s investment in Provalliance. A corresponding liability for the same amount as the Equity Put has been recorded in other noncurrent liabilities. Any changes in the fair value of the Equity Put in periods after fiscal year 2008, will be recorded in the Company s consolidated statement of operations. The merger agreement also contains an option (Equity Call) whereby the Company can acquire additional ownership interest in Provalliance between specific dates in 2018 to 2020 at an acquisition price determined consistent with the Equity Put.

The Company s investment in Provalliance is accounted for under the equity method of accounting. The Company concluded that Provalliance is a variable interest entity for which the Company is not the primary beneficiary. This assessment was based on the Company s 30.0 percent equity ownership interest, and the impact and expected timing of the equity put option. During the six month period ended December 31, 2008, the Company recorded $2.9 million of equity in income related to its investment in Provalliance. The decline in investment balance above is due to translation. The exposure to loss related to the Company s involvement with Provalliance is the carrying value of the investment and future changes in fair value of the Equity Put.

Empire Education Group, Inc.

On August 1, 2007, the Company contributed its 51 wholly-owned accredited cosmetology schools to Empire Education Group, Inc. (EEG) in exchange for a 49.0 percent equity interest in EEG. In January 2008, the Company s effective ownership interest increased to 55.1 percent related to the buyout of EEG s minority interest shareholder. This transaction leverages EEG s management expertise, while enabling the Company to maintain a vested interest in the beauty school industry. Once the integration of the Regis schools is complete, the Company expects to share in significant synergies and operating improvements. EEG operates 86 accredited cosmetology schools.

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At December 31, 2008 the Company had $28.4 million in outstanding loans with EEG. During the three and six months ended December 31, 2008 and 2007 the Company recorded $0.3 and $0.7 million, respectively, and $0.2 and 0.3 million of interest income, respectively, related to the loan.

The Company accounts for the investment in EEG under the equity method of accounting as Empire Beauty School retains majority voting interest and has full responsibility for managing EEG. During the six months ended December 31, 2008 and 2007, the Company recorded $0.3 and $0.7 million, respectively, of equity earnings related to its investment in EEG. The exposure to loss related to the Company s involvement with EEG is the carrying value of the investment and the outstanding loans.

Intelligent Nutrients LLC

The Company holds a 49.0 percent interest in Intelligent Nutrients, LLC. The Company s ownership percentage decreased from 50.0 percent to 49.0 percent during the Company s 2008 fiscal year due to the issuance of additional shares by Intelligent Nutrients, LLC to the other investor.

Intelligent Nutrients, LLC currently carries a wide variety of organic, harmonically grown products, including dietary supplements, coffees, teas and aromatics. In addition, professional hair care and personal care products are currently available. These products are offered at the Company s corporate and franchise salons, and eventually in other independently owned salons. The Company s investment in Intelligent Nutrients, LLC is accounted for under the equity method of accounting. The Company completed $3.0 million of loans to Intelligent Nutrients, LLC in August 2008 of which $3.0 million was outstanding as of December 31, 2008. During the three and six months ended December 31, 2008, the Company recorded less than $0.1 and less than $0.1 million of interest income related to the loans.

During the three months ended December 31, 2008, the Company determined that its investment in and loan to Intelligent Nutrients, LLC was impaired and the fair value was zero due to Intelligent Nutrients, LLC s inability to develop a professional organic brand of shampoo and conditioner with broad consumer appeal. The Company also determined that the loss in value was other-than-temporary and recognized a pretax, non-cash impairment charge of $7.8 million for the full carrying value of the investment and loan as of December 31, 2008. The loss is included within the equity in loss of affiliated companies on the Statement of Operations. The Company has no further exposure to loss related to the Company s involvement with Intelligent Nutrients, LLC.

MY Style

In April 2007, the Company purchased exchangeable notes issued by Yamano Holding Corporation (Exchangeable Note) and a loan obligation of a Yamano Holdings subsidiary, MY Style, formally known as Beauty Plaza Co. Ltd., (My Style Note) for an aggregate amount of 1.3 billion JPY ($11.3 million). In September 2008, the Company advanced an additional 300 million JPY ($2.9 million) to Yamano Holding Corporation and extended the maturity date of the existing Exchangeable Note to September 2011. In connection with the 300 million JPY advance the exchangeable portion of the Exchangeable Note increased from approximately 14.8 percent to 27.1 percent of the outstanding shares of MY Style. The exchangeable portion of the Exchangeable Note is recorded as an equity method investment as it is probable that the Company will exercise its right to exchange a portion of the note into equity of My Style.

As of December 31, 2008 the amount outstanding under the Exchangeable Note and My Style Note were $8.1 and $3.2 million, respectively. As of December 31, 2008, $1.8 and $9.5 million are recorded in the Condensed Consolidated Balance Sheet as current assets and investment in affiliates and loans, respectively representing the outstanding principal of the notes. The notes are due in installments in September of fiscal years 2010 through 2012. The Company recorded less than $0.1 and $0.1 million in interest income related to the Exchangeable Note and My Style Note during the three and six months ended December 31, 2008 and 2007, respectively. The exposure to loss related to the Company s involvement with MY Style is the carrying value of the investment and the outstanding notes.

Yamano Holding Corporation and the Company have an agreement with respect to their joint pursuit of opportunities relating to retail hair salons in Asia.

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Hair Club for Men, Ltd.

The Company acquired a 50.0 percent interest in Hair Club for Men, Ltd. through its acquisition of Hair Club in fiscal year 2005. The Company accounts for its investment in Hair Club for Men, Ltd. under the equity method of accounting. Hair Club for Men, Ltd. operates Hair Club centers in Illinois and Wisconsin. During the six months ended December 31, 2008 and 2007 the Company recorded income of $0.3 and $0.8 million, respectively. The exposure to loss related to the Company s involvement with Hair Club for Men, Ltd. is the carrying value of the investment.

Cool Cuts 4 Kids, Inc.

The Company holds an interest of less than 20 percent in the preferred stock of a privately held entity, Cool Cuts 4 Kids, Inc. This investment is accounted for under the cost method. During fiscal year 2006, the Company determined that its investment was impaired and recognized an impairment loss for the full carrying value of the investment. The Company s securities purchase agreement contains a call provision, giving the Company the right of first refusal should the privately held entity receive a bona fide offer from another company, as well as the right to purchase all of the assets of the privately held entity during the period from April 1, 2008 to January 31, 2009 for a multiple of cash flow. The Company exercised the right to purchase all of the Cool Cuts 4 Kids, Inc. assets for which the purchase is expected to close within the current fiscal year.

7. LEASE TERMINATION COSTS:

In July 2008, the Company approved a plan to close up to 160 underperforming company-owned salons in fiscal year 2009. Approximately 100 locations are regional mall based concepts, another 40 locations are strip center concepts and 20 locations are in the United Kingdom. The timing of the closures is dependent on successfully completing lease termination agreements and is therefore subject to change. The Company expects to offer employment to associates affected by such closings at nearby Regis-owned salons. The decision is a result of a comprehensive evaluation of the Company s salon portfolio, further continuing the Company s initiatives to enhance profitability.

The Company anticipated the pre-tax charge for the store closings would total approximately $20 to $25 million. This included approximately $4.5 million, of incremental non-cash asset write-downs which were recognized in the fourth quarter of fiscal year 2008. The incremental non-cash asset write-down in the fourth quarter of fiscal year 2008 was $3.4 million for the North America reportable segment and $1.1 million for the International reportable segment. The balance of approximately $15 to $20 million was related to the original estimate of lease termination costs that were expected to be recognized primarily in fiscal year 2009.

As of December 31, 2008, 35 stores ceased using the right to use the leased property or negotiated a lease termination agreement with the lessor in which the Company will cease using the right to the leased property subsequent to December 31, 2008. Of the 35 stores, 34 stores were within the North America reportable segment and one store within the International segment. Lease termination costs from continuing operations are presented as a separate line item in the Consolidated Statement of Operations. Lease termination costs related to the Trade Secret salon concept are reported within discontinued operations. As lease settlements are negotiated the Company has found that some lessors are willing to negotiate rent reductions which has allowed the Company to keep operating certain stores. As a result, the Company expects that the number of stores to be closed will be less than the 160 stores originally communicated, reducing the estimated lease termination costs of $15 to $20 million to approximately $6.0 million. Therefore, we now expect future store closings expense to be approximately $3.5 million.

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Lease termination expense represents either the lease settlement or the net present value of remaining contractual lease payments related to closed stores, after reduction by estimated sublease rentals. The activity reflected in the accrual for lease termination costs is as follows:

		Accrual for lease terminations (Dollars in thousands)
Balance at July 1, 2008	$	
Provision for lease termination expense:		
Provisions associated with store closings		1,173
Change in assumptions about lease terminations and sublease income		
Cash payments		(695)
Balance at September 30, 2008	$	478
Provision for lease termination expense:		
Increase in provisions associated with store closings		1,298
Change in assumptions about lease terminations and sublease income		
Cash payments		(1,105)
Balance at December 31, 2008	$	671

The $2.5 million of lease termination expense for the six months ended December 31, 2008 includes $0.9 million of lease termination expense associated with five salons within the Trade Secret concept, accounted for within the loss on discontinued operations as of December 31, 2008. Cash payments of $0.5 million have been made on three of the five salons within the Trade Secret concept.

8. LITIGATION:

The Company is a defendant in various lawsuits and claims arising out of the normal course of business. Like certain other large retail employers, the Company has been faced with allegations of purported class-wide wage and hour violations. Litigation is inherently unpredictable and the outcome of these matters cannot presently be determined. Although company counsel believes that the Company has valid defenses in these matters, it could in the future incur judgments or enter into settlements of claims that could have a material adverse effect on its results of operations in any particular period.

9. DERIVATIVE FINANCIAL INSTRUMENTS:

The primary market risk exposure of the Company relates to changes in interest rates in connection with its debt, some of which bears interest at variable rates based on LIBOR plus an applicable borrowing margin. Additionally, the Company is exposed to foreign currency translation risk related to its net investments in its foreign subsidiaries and, to a lesser extent, foreign currency denominated transactions. The Company has established policies and procedures that govern the management of these exposures through the use of derivative financial instrument contracts. By policy, the Company does not enter into such contracts for the purpose of speculation.

Interest Rate Swaps

In November 2008 the Company entered into two interest rate swap contracts of $20.0 million each which pay fixed rates of interest and receive variable rates of interest (based on the one-month LIBOR rate). The Company will pay fixed rates of interest of 2.9825 percent and 3.345 percent on $20.0 and $20.0 million, respectively. The contracts are on an aggregate notional amount of indebtedness of $40.0 million related to the $85.0 million term loan, which the Company entered into in October 2008. The contracts expire in July 2011 and the debt matures in July 2012. These interest rate swap contracts were designed and are effective as cash flow hedges. They were recorded at fair value within other noncurrent liabilities in the Condensed Consolidated Balance Sheet, with corresponding offsets in deferred income taxes and other comprehensive income within shareholders equity.

Freestanding Derivative Forward Contract

Freestanding derivative forward contracts are used to offset the Company s exposure to the change in value of certain foreign currency denominated intercompany assets and liabilities. These derivatives are not designated as hedges and therefore, changes in the value of these forward contracts are recognized currently in earnings, thereby offsetting the current earnings effect of the related foreign currency denominated assets and liabilities. The aggregate foreign currency transaction gains were $3.0 million and zero for the three and six months ended

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December 31, 2008 and 2007, respectively, and were recognized within other income in the Condensed Consolidated Statement of Operations.

10. FINANCING ARRANGEMENTS:

On October 3, 2008, the Company completed an $85 million term loan that matures in July 2012. The monthly interest payments are based on a one-month LIBOR rate plus a 1.75% spread. The term loan includes customary financial covenants including a leverage ratio, fixed charge ratio and minimum net equity test. The Company used the proceeds from the term loan to pay down the Company s revolving line of credit facility.

11. INCOME TAXES:

Income taxes have been allocated to continuing and discontinued operations based on the methodology required by FIN 18. Discontinued operations are excluded in determining the estimated effective income tax rate from continuing operations and the corresponding income tax expense (benefit). The determination of the annual effective income tax rate is based upon a number of significant estimates and judgments, including the estimated annual pretax income of the Company in each tax jurisdiction in which it operates and the development of tax planning strategies during the year. In addition, as a global enterprise, the Company s interim tax expense (benefit) can be impacted by changes in tax rates or laws, the finalization of tax audits or reviews, as well as other factors that cannot be predicted with certainty. As such, there can be significant volatility in interim tax provisions.

During the three and six months ended December 31, 2008, the Company s continuing operations recognized tax expense of $9.4 million and $19.3 million, respectively, with corresponding effective tax rates of 66.7 percent and 168.4 percent. This was compared to tax expense of $11.7 million and $22.5 million with corresponding effective tax rates of 36.5 percent and 35.9 in the comparable periods of the prior year. The increase in the effective tax rate during the three and six months ended December 31, 2008 is primarily due to substantially all of the $41.7 million goodwill impairment of the salon concepts in the United Kingdom not being deductible for tax purposes, which increased the tax provision by approximately $11.4 million for each of the three and six months ended December 31, 2008.

The Company accrues for the effects of open uncertain tax positions and the related potential penalties and interest. There were no material adjustments to our recorded liability for unrecognized tax benefits during the three and six months ended December 31, 2008. It is reasonably possible that the amount of the unrecognized tax benefit with respect to certain of our unrecognized tax positions will increase or decrease during the next 12 months; however, we do not expect the change to have a significant effect on our consolidated results of operations or financial position.

The Company files tax returns and pays tax primarily in the United States, Canada, the United Kingdom, and the Netherlands as well as states, cities, and provinces within these jurisdictions. In the United States, fiscal years 2005 and after remain open for federal tax audit. For state tax audits, the statute of limitations generally spans three to four years, resulting in a number of states remaining open for tax audits dating back to fiscal year 2004. However, the company is under audit in a number of states in which the statute of limitations has been extended to fiscal years 2000 and forward. Internationally (including Canada), the statute of limitations for tax audits varies by jurisdiction, but generally ranges from three to five years.

12. SEGMENT INFORMATION:

As of December 31, 2008, the company owned, franchised, or held ownership interests in over 13,600 worldwide locations. The Company s locations consisted of 10,271 North American salons (located in the United States, Canada and Puerto Rico), 469 international salons, 94 hair restoration centers and approximately 2,800 locations in which the Company maintains an ownership interest. The Company operates its North American salon operations through six primary concepts: Regis Salons, MasterCuts, Trade Secret, SmartStyle, Supercuts and Promenade salons. The concepts offer similar products and services, concentrate on the mass market consumer marketplace and have consistent distribution channels. All of the company-owned and franchise salons within the North American salon concepts are located in high traffic, retail shopping locations that attract mass market consumers, and the individual salons display similar economic characteristics. The salons share interdependencies and a common support base.

See Note 2 of the Condensed Consolidated Financial Statements on the classification of the Trade Secret concept as

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a discontinued operation as of December 31, 2008. The locations listed above include 659 company-owned salons and 62 franchised salons that are within the Trade Secret concept being accounted for as a discontinued operation.

The Company operates its international salon operations, primarily in the United Kingdom, through three primary concepts: Regis, Supercuts, and Sassoon salons. Consistent with the North American concepts, the international concepts offer similar products and services, concentrate on the mass market consumer marketplace and have consistent distribution channels. All of the international salon concepts are company-owned and are located in malls, leading department stores, and high-street locations Individual salons display similar long-term economic characteristics. The salons share interdependencies and a common support base.

The Company s company-owned and franchise hair restoration centers are located in the United States and Canada. The Company s hair restoration centers offer three hair restoration solutions; hair systems, hair transplants and hair therapy, which are targeted at the mass market consumer. Hair restoration centers are located primarily in office and professional buildings within larger metropolitan areas.

Based on the way the Company manages its business, it has reported its North American salons, International salons and hair restoration centers as three separate reportable segments.

Financial information for the Company s reporting segments is shown in the following tables:

Total Assets by Segment	**December 31, 2008**	**June 30, 2008**
	(Dollars in thousands)	
North American salons	$ 1,001,963	$ 1,249,827
International salons	63,705	120,443
Hair restoration centers	328,651	284,898
Unallocated corporate	604,538	580,703
Consolidated	$ 1,998,857	$ 2,235,871

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	For the Three Months Ended December 31, 2008(1)				
	Salons North America	Salons International	Hair Restoration Centers	Unallocated Corporate	Consolidated
	(Dollars in thousands)				
Revenues:					
Service	$ 399,961	$ 28,823	$ 16,294	$	$ 445,078
Product	102,491	12,445	17,838		132,774
Royalties and fees	8,961		613		9,574
	511,413	41,268	34,745		587,426
Operating expenses:					
Cost of service	232,126	15,670	9,042		256,838
Cost of product	52,762	7,052	5,264		65,078
Site operating expenses	42,801	3,535	1,284		47,620
General and administrative	30,086	4,387	7,750	30,308	72,531
Rent	69,057	10,088	2,272	564	81,981
Depreciation and amortization	18,538	1,466	2,780	4,735	27,519
Goodwill impairment		41,661			41,661
Lease termination costs	847				847
Total operating expenses	446,217	83,859	28,392	35,607	594,075
Operating income (loss)	65,196	(42,591)	6,353	(35,607)	(6,649)
Other income (expense):					
Interest expense				(10,878)	(10,878)
Interest income and other, net				3,462	3,462
Income (loss) from continuing operations before income taxes and equity in (loss) income of affiliated companies	$ 65,196	$ (42,591)	$ 6,353	$ (43,023)	$ (14,065)

(1) As of December 31, 2008, the Trade Secret concept within the North American reportable segment was accounted for as a discontinued operation. All comparable periods will reflect Trade Secret as a discontinued operation. See further discussion at Note 2 in these Notes to the Condensed Consolidated Financial Statements.

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	For the Three Months Ended December 31, 2007(1)			
Salons			Hair Restoration	Unallocated
North America	International			