REGIS CORP
Form 10-Q
January 29, 2019

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, 2018
OR
¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to
Commission file number 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 ¨

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 ¨

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

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

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the

Exchange Act. ¨

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock as of January 24, 2019:

Common Stock, $.05 par value	40,235,526
Class	Number of Shares

REGIS CORPORATION

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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

REGIS CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEET (Unaudited)
(Dollars in thousands, except share data)

	December 31, 2018	June 30, 2018
ASSETS		
Current assets:		
Cash and cash equivalents	$ 96,954	$ 110,399
Receivables, net	32,329	52,430
Inventories	85,583	79,363
Other current assets	34,267	47,867
Total current assets	249,133	290,059
Property and equipment, net	96,133	105,860
Goodwill	393,774	412,643
Other intangibles, net	9,736	10,557
Other assets	40,379	37,616
Total assets	$ 789,155	$ 856,735
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 57,127	$ 57,738
Accrued expenses	86,634	100,716
Total current liabilities	143,761	158,454
Long-term debt	90,000	90,000
Long-term lease liability	17,646	—
Other noncurrent liabilities	112,738	121,843
Total liabilities	364,145	370,297
Commitments and contingencies (Note 7)		
Shareholders' equity:		
Common stock, $0.05 par value; issued and outstanding 41,472,468 and 45,258,571 common shares at December 31, 2018 and June 30, 2018 respectively	2,074	2,263
Additional paid-in capital	128,964	194,436
Accumulated other comprehensive income	8,145	9,656
Retained earnings	285,827	280,083
Total shareholders' equity	425,010	486,438
Total liabilities and shareholders' equity	$ 789,155	$ 856,735

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 and Six Months Ended December 31, 2018 and 2017
(Dollars and shares in thousands, except per share data amounts)

	Three Months Ended December 31,		Six Months Ended December 31,	
	2018	2017	2018	2017
Revenues:				
Service	$190,419	$223,278	$398,267	$458,908
Product	61,649	71,832	119,240	132,790
Royalties and fees	22,603	18,739	44,999	37,615
	274,671	313,849	562,506	629,313
Operating expenses:				
Cost of service	114,931	134,850	236,428	274,686
Cost of product	36,350	39,864	68,531	70,026
Site operating expenses	35,563	38,598	72,384	78,627
General and administrative	45,836	48,592	93,563	83,758
Rent	34,642	65,473	70,620	107,889
Depreciation and amortization	8,900	24,951	19,102	37,206
Total operating expenses	276,222	352,328	560,628	652,192
Operating (loss) income	(1,551)	(38,479)	1,878	(22,879)
Other (expense) income:				
Interest expense	(1,072)	(2,169)	(2,078)	(4,307)
Gain (loss) from sale of salon assets to franchisees, net	2,865	(104)	(1,095)	18
Interest income and other, net	629	2,019	989	2,439
Income (loss) from continuing operations before income taxes	871	(38,733)	(306)	(24,729)
Income tax (expense) benefit	(454)	80,825	260	75,266
Income (loss) from continuing operations	417	42,092	(46)	50,537
Income (loss) from discontinued operations, net of taxes	6,113	(6,601)	5,849	(40,368)
Net income	$6,530	$35,491	$5,803	$10,169
Net income per share:				
Basic:				
Income (loss) from continuing operations	$0.01	$0.90	$0.00	$1.08
Income (loss) from discontinued operations	0.14	(0.14)	0.13	(0.86)
Net income per share, basic (1)	$0.15	$0.76	$0.13	$0.22
Diluted:				
Income (loss) from continuing operations	$0.01	$0.89	$0.00	$1.07
Income (loss) from discontinued operations	0.14	(0.14)	0.13	(0.86)
Net income per share, diluted (1)	$0.15	$0.75	$0.13	$0.22

Weighted average common and common equivalent shares outstanding:				
Basic	43,619	46,821	44,175	46,719
Diluted	44,479	47,314	44,175	47,053

(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.

REGIS CORPORATION
CONDENSED CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME (Unaudited)
For The Three and Six Months Ended December 31, 2018 and 2017
(Dollars in thousands)

	Three Months Ended December 31,		Six Months Ended December 31,	
	2018	2017	2018	2017
Net income	$6,530	$35,491	$5,803	$10,169
Other comprehensive (loss) income, net of tax:				
Foreign currency translation adjustments during the period:				
Foreign currency translation adjustments	(2,592)	(376)	(1,511)	2,276
Reclassification adjustments for losses included in net income (Note 3)	—	6,152	—	6,152
Net current period foreign currency translation adjustments	(2,592)	5,776	(1,511)	8,428
Comprehensive income	$3,938	$41,267	$4,292	$18,597

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

REGIS CORPORATION
CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS (Unaudited)
For The Six Months Ended December 31, 2018 and 2017
(Dollars in thousands)

	Six Months Ended December 31,	
	2018	2017
Cash flows from operating activities:		
Net income	$5,803	$10,169
Adjustments to reconcile net income to net cash used in operating activities:		
Non-cash impairment and other adjustments related to discontinued operations	176	25,095
Depreciation and amortization	16,799	20,491
Depreciation related to discontinued operations	—	3,038
Deferred income taxes	(7,915)	(80,691)
Gain on life insurance	—	(7,986)
Loss (gain) from sale of salon assets to franchisees, net	1,095	(18)
Salon asset impairments	2,303	16,715
Accumulated other comprehensive income reclassification adjustment	—	6,152
Stock-based compensation	4,552	4,618
Amortization of debt discount and financing costs	138	703
Other non-cash items affecting earnings	(681)	(105)
Changes in operating assets and liabilities, excluding the effects of asset sales	(33,223)	(10,593)
Net cash used in operating activities	(10,953)	(12,412)
Cash flows from investing activities:		
Capital expenditures	(16,804)	(13,773)
Capital expenditures related to discontinued operations	—	(1,171)
Proceeds from sale of assets to franchisees	24,050	2,696
Proceeds from company-owned life insurance policies	24,616	18,108
Net cash provided by investing activities	31,862	5,860
Cash flows from financing activities:		
Proceeds on issuance of common stock	330	—
Repurchase of common stock	(65,136)	—
Settlement of equity awards	—	(375)
Taxes paid for shares withheld	(2,305)	(2,039)
Net proceeds from sale and leaseback transaction	18,068	—
Net cash used in financing activities	(49,043)	(2,414)
Effect of exchange rate changes on cash and cash equivalents	(174)	253
Decrease in cash, cash equivalents, and restricted cash	(28,308)	(8,713)
Cash, cash equivalents and restricted cash:		
Beginning of period	148,774	208,634
Cash, cash equivalents and restricted cash included in current assets held for sale	—	1,352
Beginning of period, total cash, cash equivalents and restricted cash	148,774	209,986
End of period	$120,466	$201,273

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

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, 2018 and for the three and six months ended December 31, 2018 and 2017, reflect, in the opinion of management, all adjustments necessary to fairly state the consolidated financial position of the Company as of December 31, 2018 and its consolidated results of operations, comprehensive income and 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 accompanying interim unaudited condensed consolidated financial statements have been prepared by the Company pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). Accordingly, they do 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, 2018 and other documents filed or furnished with the SEC during the current fiscal year.

Goodwill:

As of December 31, 2018 and June 30, 2018, the Company-owned reporting unit had $166.9 million and $184.8 million of goodwill, respectively, and the Franchise salons reporting unit had $226.9 million and $227.9 million of goodwill, respectively. See Note 9 to the Consolidated Financial Statements. The Company assesses goodwill impairment on an annual basis, during the Company’s fourth fiscal quarter, and between annual assessments if an event occurs, or circumstances change, that would more likely than not reduce the fair value of a reporting unit below its carrying amount. An interim impairment analysis was not required in the six months ended December 31, 2018.
The Company performs its annual impairment assessment as of April 30. For the fiscal year 2018 annual impairment assessment, due to the transformational efforts completed during the year, the Company elected to forgo the optional Step 0 assessment and performed the quantitative impairment analysis on the Company-owned and Franchise reporting units. The Company compared the carrying value of the reporting units, including goodwill, to their estimated fair value. The results of these assessments indicated that the estimated fair value of our reporting units exceeded their carrying value. The Franchise reporting unit had substantial headroom and the Company-owned reporting unit had headroom of approximately 24%. The fair value of the Company-owned reporting unit was determined based on a discounted cash flow analysis and comparable market multiples. The assumptions used in determining fair value were the number and pace of salons sold to franchisees, proceeds for salon sales, weighted average cost of capital, general and administrative expenses and utilization of net operating loss benefits. We selected the assumptions by considering our historical financial performance and trends, historical salon sale proceeds and estimated salon sale activities. The preparation of our fair value estimate includes uncertain factors and requires significant judgments and estimates which are subject to change. A 100 basis point increase in our weighted average cost of capital within the Company-owned reporting unit would result in a reduction in headroom to approximately 17%.
Other uncertain factors or events exist which may result in a future triggering event and require us to perform an interim impairment analysis with respect to the carrying value of goodwill for the Company-owned reporting unit prior to our annual assessment. These internal and external factors include but are not limited to the following:
- Changes in the company-owned salon strategy,

- Franchise expansion and sales opportunities,
- Future market earnings multiples deterioration,
- Our financial performance falls short of our projections due to internal operating factors,
- Economic recession,
- Reduced salon traffic, as defined by total transactions, and/or revenue,
- Deterioration of industry trends,
- Increased competition,
- Inability to reduce general and administrative expenses as company-owned salon count potentially decreases,
- Other factors causing our cash flow to deteriorate.

If the triggering event analysis indicates the fair value of the Company-owned reporting unit has potentially fallen below more than the 24% headroom, we may be required to perform an updated impairment assessment which may result in a non-cash impairment charge to reduce the carrying value of goodwill.
Assessing goodwill for impairment requires management to make assumptions and to apply judgment, including forecasting future sales and expenses, and selecting appropriate discount rates, which can be affected by economic conditions and other factors that can be difficult to predict. The Company does not believe there is a reasonable likelihood that there will be a material change in the estimates or assumptions it uses to calculate impairment losses of goodwill. However, if actual results are not consistent with the estimates and assumptions used in the calculations, or if there are significant changes to the Company's planned strategy for company-owned salons, the Company may be exposed to future impairment losses that could be material.
Accounting Standards Recently Adopted by the Company:

Revenue from Contracts with Customers

In May 2014, the FASB issued amended guidance for revenue recognition which provides a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers. The Company retrospectively adopted these standards on July 1, 2018. The impact of these standards was applied to all periods presented and the cumulative effect of applying the standard was recognized at the beginning of the earliest period presented. See Note 2 to the unaudited Condensed Consolidated Financial Statements for additional information regarding the impact of the adoption of the revenue recognition guidance.

Restricted Cash

In November 2016, the FASB issued cash flow guidance requiring restricted cash and restricted cash equivalents to be included in the cash and cash equivalent balances in the statement of cash flows. Transfers between cash and cash equivalents and restricted cash are no longer presented in the statement of cash flows and a reconciliation between the balance sheet and statement of cash flows must be disclosed. The Company retrospectively adopted this guidance on July 1, 2018. The impact of this standard was applied to all periods presented. As a result of including restricted cash in the beginning and end of period balances, cash, cash equivalents and restricted cash presented in the statement of cash flows increased $38.4 million, $23.5 million and $37.6 million as of June 30, 2018, December 31, 2018 and June 30, 2017, respectively.

Statement of Cash Flows

In August 2016, the FASB issued updated cash flow guidance clarifying cash flow classification and presentation for certain items. The Company retrospectively adopted this guidance on July 1, 2018. The adoption of this standard did not have a material impact on the Company's consolidated statement of cash flows.

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

Leases

In February 2016, the FASB issued updated guidance requiring organizations that lease assets to recognize the rights and obligations created by those leases on the consolidated balance sheet. The new standard is effective for the Company in the first quarter of fiscal year 2020, with early adoption permitted. In July 2018, the FASB issued ASU 2018-11, which provides companies with the option to apply the new lease standard either at the beginning of the earliest comparative period presented or in the period of adoption. The Company will elect this optional transition relief amendment that allows for a cumulative-effect adjustment in the period of adoption and will not restate prior periods. The Company is leveraging its lease management system to facilitate the adoption of this standard. The

Company is continuing to evaluate the effect the new standard will have on the Company's consolidated financial statements but expects this adoption will result in a material increase in the assets and liabilities on the Company's consolidated balance sheet, as substantially all of its operating lease commitments will be subject to the new guidance.

2. REVENUE RECOGNITION:

In May 2014, the FASB issued amended guidance for revenue recognition which provides a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers. The Company adopted the amended revenue recognition guidance, ASC Topic 606, on July 1, 2018 using the full retrospective transition method which required the adjustment of each prior reporting period presented. The adjusted amounts include the application of a practical expedient that permitted the Company to reflect the aggregate effect of all modifications that occurred prior to fiscal year 2017 when identifying the satisfied and unsatisfied performance obligation, determining the transaction price and allocating the transaction price to the satisfied and unsatisfied performance obligation. As a result of adopting this new standard the Company is providing its updated revenue recognition policies.

Revenue Recognition and Deferred Revenue:

Revenue recognized at point of sale
Company-owned salon revenues are recognized at the time when the services are provided. Product revenues are recognized when the guest receives and pays for the merchandise. Revenues from purchases made with gift cards are also recorded when the guest takes possession of the merchandise or services are provided. Gift cards issued by the Company are recorded as a liability (deferred revenue) upon sale and recognized as revenue upon redemption by the customer. Gift card breakage, the amount of gift cards which will not be redeemed, is recognized proportional to redemptions using estimates based on historical redemption patterns. Product sales by the Company to its franchisees are included within product revenues in the Condensed Consolidated Statement of Operations and recorded at the time product is delivered to the franchisee. Payment for franchisee product revenue is generally collected within 30 days of delivery.

Revenue recognized over time
Franchise revenues primarily include royalties, advertising fund fees, franchise fees and other fees. Royalty and advertising fund revenues represent sales-based royalties that are recognized in the period in which the sales occur. Generally, royalty and advertising fund revenue is billed and collected monthly in arrears. Advertising fund revenues and expenditures, which must be spent on marketing and related activities per the franchise agreement, are recorded on a gross basis within the Condensed Consolidated Statement of Operations. This increases both the gross amount of reported franchise revenue and site operating expense and generally has no impact on operating income and net income. Franchise fees are billed and received upon the signing of the franchise agreement. Upon adoption of the new revenue recognition guidance, recognition of these fees is deferred until the salon opening and is then recognized over the term of the franchise agreement, typically ten years. Under previous guidance the initial franchise fees were recognized in full upon salon opening.

The following table disaggregates revenue by timing of revenue recognition and is reconciled to reportable segment revenues as follows:

	Three Months Ended December 31, 2018		Three Months Ended December 31, 2017	
	Company-owned	Franchise	Company-owned	Franchise
	(in thousands)			
Revenue recognized at a point in time:				
Service	$190,419	$—	$223,278	$—
Product	43,831	17,818	56,764	15,068
Total revenue recognized at a point in time	$234,250	$17,818	$280,042	$15,068

Revenue recognized over time:

Royalty and other franchise fees	$—	$ 14,736	$—	$ 12,260
Advertising fund fees	—	7,867	—	6,479
Total revenue recognized over time	$—	$ 22,603	$—	$ 18,739
Total revenue	$234,250	$ 40,421	$280,042	$ 33,807

	Six Months Ended December 31, 2018		Six Months Ended December 31, 2017	
	Company-owned	Franchise	Company-owned	Franchise
	(in thousands)			
Revenue recognized at a point in time:				
Service	$398,267	$—	$458,908	$—
Product	85,793	33,447	110,000	22,790
Total revenue recognized at a point in time	$484,060	$33,447	$568,908	$22,790
Revenue recognized over time:				
Royalty and other franchise fees	$—	$29,156	$—	$24,410
Advertising fund fees	—	15,843	—	13,205
Total revenue recognized over time	$—	$44,999	$—	$37,615
Total revenue	$484,060	$78,446	$568,908	$60,405

Information about receivables, broker fees and deferred revenue subject to the amended revenue recognition guidance is as follows:

	December 31, 2018	June 30, 2018	Balance Sheet Classification
	(in thousands)		
Receivables from contracts with customers, net	$17,861	$21,504	Accounts receivable, net
Broker fees	$15,584	$14,002	Other assets
Deferred revenue:			
Current			
Gift card liability	$4,613	$3,320	Accrued expenses
Deferred franchise fees unopened salons	172	2,306	Accrued expenses
Deferred franchise fees open salons	3,428	3,030	Accrued expenses
Total current deferred revenue	$8,213	$8,656	
Non-current			
Deferred franchise fees unopened salons	$13,472	$11,161	Other non-current liabilities
Deferred franchise fees open salons	20,112	18,346	Other non-current liabilities
Total non-current deferred revenue	$33,584	$29,507	

Receivables relate primarily to payments due for royalties, franchise fees, advertising fees, and sales of salon services and product. The receivable balance is presented net of an allowance for expected losses (i.e., doubtful accounts), primarily related to receivables from franchisees. As of December 31, 2018 and June 30, 2018, the balance in the allowance for doubtful accounts was $2.0 million and $1.2 million, respectively. Activity in the period was not significant. Broker fees are the costs associated with using external brokers to identify new franchisees. These fees are paid upon the signing of the franchise agreement and recognized as General and Administrative expense over the term of the agreement. The adoption of the amended revenue recognition guidance did not significantly change the Company's accounting for broker fees.

The following table is a rollforward of the broker fee balance for the periods indicated (in thousands):

Balance as of June 30, 2018	$14,002
Additions	2,752
Amortization	(1,158)
Write-offs	(12)
Balance as of December 31, 2018	$15,584

Deferred revenue includes the gift card liability and deferred franchise fees for unopened salons and open salons. Gift card revenue for the three months ended December 31, 2018 and 2017 was $1.1 million and $1.3 million, respectively, and for the six months ended December 31, 2018 and 2017 was $2.2 million and $2.7 million, respectively. Deferred franchise fees related to open salons are generally recognized on a straight-line basis over the term of the franchise agreement. Franchise fee revenue for the three months ended December 31, 2018 and 2017 was $0.8 million and $0.7 million, respectively, and for the six months ended December 31, 2018 and 2017 was $1.7 million and $1.3 million. Estimated revenue expected to the recognized in the future related to deferred franchise fees for open salons as of December 31, 2018 is as follows (in thousands):

Remainder of 2019	$1,643
2020	3,326
2021	3,238
2022	3,118
2023	2,941
Thereafter	9,274
Total	$23,540

The amended revenue recognition guidance impacted the Company's previously reported financial statements as follows:

CONDENSED CONSOLIDATED BALANCE SHEET (Unaudited)
June 30, 2018
(Dollars in thousands)

		Adjustments for new revenue recognition guidance				
	Previously Reported	Franchise Fees	Advertising Funds	Gift Card Breakage	Taxes	Adjusted
ASSETS						
Current assets:						
Cash and cash equivalents	$ 110,399	$ —	$ —	$ —	$ —	$ 110,399
Receivables, net	52,430					