

Marathon Petroleum Corp
Form 10-Q
May 09, 2013
Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the Quarterly Period Ended March 31, 2013

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 001-35054

Marathon Petroleum Corporation

(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	27-1284632 (I.R.S. Employer Identification No.)
539 South Main Street, Findlay, Ohio (Address of principal executive offices)	45840-3229 (Zip code)
(419) 422-2121	

(Registrant's telephone number, including area code)

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

Edgar Filing: Marathon Petroleum Corp - Form 10-Q

to such filing requirements for the past 90 days. Yes 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 submit and post such files.) Yes No

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 the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer (Do not check if a smaller reporting company)

Smaller reporting company

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

There were 324,787,372 shares of Marathon Petroleum Corporation common stock outstanding as of April 30, 2013.

Table of Contents

MARATHON PETROLEUM CORPORATION

Form 10-Q

Quarter Ended March 31, 2013

INDEX

	Page
<u>PART I FINANCIAL INFORMATION</u>	
<u>Item 1. Financial Statements:</u>	
<u>Consolidated Statements of Income (Unaudited)</u>	2
<u>Consolidated Statements of Comprehensive Income (Unaudited)</u>	3
<u>Consolidated Balance Sheets (Unaudited)</u>	4
<u>Consolidated Statements of Cash Flows (Unaudited)</u>	5
<u>Consolidated Statements of Equity (Unaudited)</u>	6
<u>Notes to Consolidated Financial Statements (Unaudited)</u>	7
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	28
<u>Item 3. Quantitative and Qualitative Disclosures about Market Risk</u>	44
<u>Item 4. Controls and Procedures</u>	45
<u>Supplementary Statistics (Unaudited)</u>	46
<u>PART II OTHER INFORMATION</u>	
<u>Item 1. Legal Proceedings</u>	48
<u>Item 1A. Risk Factors</u>	48
<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	49
<u>Item 6. Exhibits</u>	50
<u>Signatures</u>	51

Unless otherwise stated or the context otherwise indicates, all references in this Form 10-Q to MPC, us, our, we or the Company mean Marathon Petroleum Corporation and its consolidated subsidiaries.

Table of Contents**Part I Financial Information****Item 1. Financial Statements****Marathon Petroleum Corporation****Consolidated Statements of Income (Unaudited)**

	Three Months Ended March 31,	
	2013	2012
<i>(In millions, except per share data)</i>		
Revenues and other income:		
Sales and other operating revenues (including consumer excise taxes)	\$ 23,328	\$ 20,264
Sales to related parties	2	1
Income from equity method investments		2
Net gain on disposal of assets	1	2
Other income	14	6
Total revenues and other income	23,345	20,275
Costs and expenses:		
Cost of revenues (excludes items below)	20,034	17,321
Purchases from related parties	72	63
Consumer excise taxes	1,458	1,380
Depreciation and amortization	287	230
Selling, general and administrative expenses	249	251
Other taxes	89	74
Total costs and expenses	22,189	19,319
Income from operations	1,156	956
Net interest and other financial income (costs)	(48)	(22)
Income before income taxes	1,108	934
Provision for income taxes	378	338
Net income	730	596
Less net income attributable to noncontrolling interests	5	
Net income attributable to MPC	\$ 725	\$ 596
Per Share Data (See Note 7)		
Basic:		
Net income attributable to MPC per share	\$ 2.19	\$ 1.71
Weighted average shares outstanding	331	348
Diluted:		
Net income attributable to MPC per share	\$ 2.17	\$ 1.70
Weighted average shares outstanding	333	350
Dividends paid	\$ 0.35	\$ 0.25

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

Table of Contents**Marathon Petroleum Corporation****Consolidated Statements of Comprehensive Income (Unaudited)**

	Three Months Ended March 31,	
<i>(In millions)</i>	2013	2012
Net income	\$ 730	\$ 596
Other comprehensive income (loss):		
Defined benefit postretirement and post-employment plans:		
Actuarial changes, net of tax of \$54 and \$8	90	16
Prior service costs, net of tax of (\$5) and \$1	(8)	1
Other comprehensive income	82	17
Comprehensive income	812	613
Less comprehensive income attributable to noncontrolling interests	5	
Comprehensive income attributable to MPC	\$ 807	\$ 613

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

Table of Contents**Marathon Petroleum Corporation****Consolidated Balance Sheets (Unaudited)**

<i>(In millions, except per share data)</i>	March 31, 2013	December 31, 2012
Assets		
Current assets:		
Cash and cash equivalents	\$ 4,737	\$ 4,860
Receivables, less allowance for doubtful accounts of \$9 and \$10	5,509	4,610
Inventories	4,879	3,449
Other current assets	172	110
Total current assets	15,297	13,029
Equity method investments	327	321
Property, plant and equipment, net	13,850	12,643
Goodwill	930	930
Other noncurrent assets	369	300
Total assets	\$ 30,773	\$ 27,223
Liabilities		
Current liabilities:		
Accounts payable	\$ 8,872	\$ 6,785
Payroll and benefits payable	316	364
Consumer excise taxes payable	401	325
Accrued taxes	965	598
Long-term debt due within one year	22	19
Other current liabilities	152	112
Total current liabilities	10,728	8,203
Long-term debt	3,394	3,342
Deferred income taxes	2,094	2,050
Defined benefit postretirement plan obligations	1,214	1,266
Deferred credits and other liabilities	931	257
Total liabilities	18,361	15,118
Commitments and contingencies (see Note 22)		
Equity		
MPC stockholders' equity:		
Preferred stock, no shares issued and outstanding (par value \$0.01 per share, 30 million shares authorized)		
Common stock:		
Issued 361 million and 361 million shares (par value \$0.01 per share, 1 billion shares authorized)	4	4
Held in treasury, at cost 34 million and 28 million shares	(1,787)	(1,253)
Additional paid-in capital	9,676	9,527
Retained earnings	4,489	3,880
Accumulated other comprehensive loss	(382)	(464)
Total MPC stockholders' equity	12,000	11,694
Noncontrolling interests	412	411

Edgar Filing: Marathon Petroleum Corp - Form 10-Q

Total equity		12,412		12,105
Total liabilities and equity		\$ 30,773	\$	27,223

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

Table of Contents**Marathon Petroleum Corporation****Consolidated Statements of Cash Flows (Unaudited)**

	Three Months Ended March 31,	
	2013	2012
<i>(In millions)</i>		
Increase (decrease) in cash and cash equivalents		
Operating activities:		
Net income	\$ 730	\$ 596
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	287	230
Pension and other postretirement benefits, net	28	52
Deferred income taxes	6	192
Net gain on disposal of assets	(1)	(2)
Equity method investments, net	4	6
Changes in the fair value of derivative instruments	(57)	9
Changes in:		
Current receivables	(884)	(406)
Inventories	(517)	(32)
Current accounts payable and accrued liabilities	2,491	(332)
All other, net	(8)	34
Net cash provided by operating activities	2,079	347
Investing activities:		
Additions to property, plant and equipment	(195)	(309)
Acquisitions	(1,493)	
Disposal of assets	3	2
Investments loans and advances	(21)	(7)
redemptions and repayments	11	
All other, net	13	3
Net cash used in investing activities	(1,682)	(311)
Financing activities:		
Long-term debt repayments	(5)	(3)
Debt issuance costs	(2)	
Issuance of common stock	28	27
Common stock repurchased	(431)	(850)
Dividends paid	(116)	(87)
Distribution to noncontrolling interests	(4)	
All other, net	10	3
Net cash used in financing activities	(520)	(910)
Net decrease in cash and cash equivalents	(123)	(874)
Cash and cash equivalents at beginning of period	4,860	3,079
Cash and cash equivalents at end of period	\$ 4,737	\$ 2,205

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

Table of Contents**Marathon Petroleum Corporation****Consolidated Statements of Equity (Unaudited)**

	MPC Stockholders Equity				Accumulated Other Comprehensive Income (Loss)	Noncontrolling Interests	Total Equity
	Common Stock	Treasury Stock	Additional Paid-in Capital	Retained Earnings			
<i>(In millions)</i>							
Balance as of December 31, 2011	\$ 4	\$	\$ 9,482	\$ 898	\$ (879)	\$	\$ 9,505
Net income				596			596
Dividends paid				(87)			(87)
Other comprehensive income					17		17
Shares repurchased		(742)	(108)				(850)
Shares issued (returned) stock based compensation		(1)	34				33
Stock-based compensation			11				11
Other			(9)				(9)
Balance as of March 31, 2012	\$ 4	\$ (743)	\$ 9,410	\$ 1,407	\$ (862)	\$	\$ 9,216
Balance as of December 31, 2012	\$ 4	\$ (1,253)	\$ 9,527	\$ 3,880	\$ (464)	\$ 411	\$ 12,105
Net income				725		5	730
Dividends paid				(116)			(116)
Distribution to noncontrolling interests						(4)	(4)
Other comprehensive income					82		82
Shares repurchased		(531)	100				(431)
Shares issued (returned) stock based compensation		(3)	27				24
Stock-based compensation			22				22
Balance as of March 31, 2013	\$ 4	\$ (1,787)	\$ 9,676	\$ 4,489	\$ (382)	\$ 412	\$ 12,412
<i>(Shares in millions)</i>							
Balance as of December 31, 2011	357						
Shares repurchased		(18)					
Shares issued stock-based compensation	1						
Balance as of March 31, 2012	358	(18)					
Balance as of December 31, 2012	361	(28)					
Shares repurchased		(6)					
Balance as of March 31, 2013	361	(34)					

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

Table of Contents

Notes to Consolidated Financial Statements (Unaudited)

1. Description of the Business and Basis of Presentation

Description of the Business As used in this report, the terms MPC, we, us, the Company or our may refer to Marathon Petroleum Corporation or one or more of its consolidated subsidiaries or all of them taken as a whole.

Our business consists of refining and marketing, retail marketing and pipeline transportation operations conducted primarily in the Midwest, Gulf Coast and Southeast regions of the United States, through subsidiaries, including Marathon Petroleum Company LP, Speedway LLC and MPLX LP and its subsidiaries (MPLX).

See Note 9 for additional information about our operations.

Basis of Presentation All significant intercompany transactions and accounts have been eliminated.

These interim consolidated financial statements are unaudited; however, in the opinion of our management, these statements reflect all adjustments necessary for a fair statement of the results for the periods reported. All such adjustments are of a normal, recurring nature unless otherwise disclosed. These interim consolidated financial statements, including the notes, have been prepared in accordance with the rules of the Securities and Exchange Commission applicable to interim period financial statements and do not include all of the information and disclosures required by United States generally accepted accounting principles (US GAAP) for complete financial statements.

These interim consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2012. The results of operations for the three months ended March 31, 2013 are not necessarily indicative of the results to be expected for the full year.

In the fourth quarter of 2012, we reclassified certain expenses from selling, general and administrative expenses to cost of revenues, which is consistent with expense classifications for MPLX, MPC's consolidated subsidiary. Historical periods were also reclassified to conform to the current period presentation. This reclassification resulted in an increase in cost of revenues and a decrease in selling, general and administrative expenses of \$12 million in the three months ended March 31, 2012.

2. Accounting Standards

Recently Adopted

In February 2013, the Financial Accounting Standards Board (FASB) issued an accounting standards update that requires an entity to provide information about the amounts reclassified out of accumulated other comprehensive income by component. If the amount reclassified is required under US GAAP to be reclassified to net income in its entirety in the same reporting period, an entity is required to present, either on the face of the financial statements or in the notes, significant amounts reclassified out of accumulated other comprehensive income by the respective line items of net income. For other amounts not required to be reclassified in their entirety to net income, an entity is required to cross-reference to other disclosures that provide additional detail about those amounts. The accounting standards update was to be applied prospectively for interim and annual periods beginning with the first quarter of 2013. The adoption of this accounting standards update in the first quarter of 2013 did not have an impact on our consolidated results of operations, financial position or cash flows. The new required disclosures are included in Note 19.

In July 2012, the FASB issued an accounting standards update that gives an entity the option to first assess qualitatively whether it is more likely than not that an indefinite-lived intangible asset is impaired. If, through the qualitative assessment, an entity determines that it is more likely than not that the intangible asset is impaired, the quantitative impairment test must then be performed. The accounting standards update was effective for annual and interim impairment tests performed in fiscal years beginning after September 15, 2012. Early adoption was permitted. The adoption of this accounting standards update in the first quarter of 2013 did not have an impact on our consolidated results of operations, financial position or cash flows. We perform the annual intangible asset impairment testing in the fourth quarter.

Table of Contents

In December 2011, the FASB issued an accounting standards update which was amended in January 2013 that requires disclosure of additional information related to recognized derivative instruments, repurchase agreements and reverse repurchase agreements, and securities borrowing and securities lending transactions that are offset or are not offset but are subject to an enforceable netting agreement. The purpose of the requirement is to help users evaluate the effect or potential effect of offsetting and related netting arrangements on an entity's financial position. The update was to be applied retrospectively and was effective for interim and annual periods beginning with the first quarter of 2013. The adoption of this accounting standards update in the first quarter of 2013 did not have an impact on our consolidated results of operations, financial position or cash flows. The new required disclosures are included in Note 16.

3. MPLX LP

MPLX is a publicly traded master limited partnership that was formed by us to own, operate, develop and acquire pipelines and other midstream assets related to the transportation and storage of crude oil, refined products and other hydrocarbon-based products. MPLX's initial assets consisted of a 51 percent general partner interest in MPLX Pipe Line Holdings LP (Pipe Line Holdings), which owns a network of common carrier crude oil and product pipeline systems and associated storage assets in the Midwest and Gulf Coast regions of the United States, and a 100 percent interest in a butane storage cavern in West Virginia. As of March 31, 2013, we owned the remaining 49 percent limited partner interest in Pipe Line Holdings.

On October 31, 2012, MPLX completed its initial public offering of 19,895,000 common units. Net proceeds to MPLX from the sale of the units were \$407 million. We own a 73.6 percent interest in MPLX, including the two percent general partner interest. We consolidate this entity for financial reporting purposes since we have a controlling financial interest, and we record a noncontrolling interest for the interest owned by the public. The initial public offering represented the sale of a 26.4 percent interest in MPLX.

On May 1, 2013, we sold an additional five percent interest in Pipe Line Holdings to MPLX for \$100 million. This increased MPLX's and reduced our ownership interest in Pipe Line Holdings to 56 percent and 44 percent, respectively.

4. Related Party Transactions

Our related parties included:

The Andersons Clymers Ethanol LLC (TACE), in which we have a 36 percent interest, and The Andersons Marathon Ethanol LLC (TAME), in which we have a 50 percent interest. These companies each own an ethanol production facility.

Centennial Pipeline LLC (Centennial), in which we have a 50 percent interest. Centennial owns a refined products pipeline and storage facility.

LOOP LLC (LOOP), in which we have a 51 percent noncontrolling interest. LOOP owns and operates the only U.S. deepwater oil port.

Other equity method investees.

Sales to related parties were as follows:

<i>(In millions)</i>	Three Months Ended	
	March 31,	
	2013	2012
Other equity method investees	\$ 2	\$ 1

Table of Contents

Purchases from related parties were as follows:

<i>(In millions)</i>	Three Months Ended March 31,	
	2013	2012
Centennial	\$	\$ 9
LOOP	10	12
TAME	30	30
TACE	26	5
Other equity method investees	6	7
Total	\$ 72	\$ 63

Related party purchases from Centennial consisted primarily of refined product transportation costs. Related party purchases from LOOP and other equity method investees consist primarily of crude oil transportation costs. Related party purchases from TAME and TACE consist of ethanol.

Receivables from related parties, which are included in receivables, less allowance for doubtful accounts on the consolidated balance sheets, were as follows:

<i>(In millions)</i>	March 31, 2013	December 31, 2012
Centennial	\$ 1	\$ 2

At March 31, 2013, we also had a \$2 million long-term receivable from Centennial, which is included in other noncurrent assets on the consolidated balance sheet.

Payables to related parties, which are included in accounts payable on the consolidated balance sheets, were as follows:

<i>(In millions)</i>	March 31, 2013	December 31, 2012
LOOP	\$ 4	\$ 4
TAME	5	5
TACE	3	2
Other equity method investees	2	2
Total	\$ 14	\$ 13

We had a throughput and deficiency agreement with Centennial, which expired on March 31, 2012. During the three months ended March 31, 2012, we impaired our \$14 million prepaid tariff with Centennial. For additional information on the impairment, see Note 14.

5. Acquisitions***Acquisition of Refinery and Related Logistics and Marketing Assets***

On February 1, 2013, we paid \$1.49 billion to acquire from BP Products North America Inc. and BP Pipelines (North America) Inc. (collectively, BP) the 451,000 barrel per calendar day refinery in Texas City, Texas, three intrastate natural gas liquid pipelines originating at the refinery, an allocation of BP's Colonial Pipeline Company shipper history, four light product terminals, branded-jobber marketing contract assignments for the supply of approximately 1,200 branded sites and a 1,040 megawatt electric cogeneration facility, as well as the inventory associated with these assets. We refer to these assets as the Galveston Bay Refinery and Related Assets. Pursuant to the purchase and sale

Edgar Filing: Marathon Petroleum Corp - Form 10-Q

agreement, we may also be required to pay to BP a contingent earnout of up to an additional \$700 million over six years, subject to certain conditions as discussed below. These assets complement our current geographic footprint and align with our strategic initiative of growing in existing and contiguous markets to enhance our portfolio. The transaction was funded with cash on hand.

Table of Contents

As of the acquisition date, we recorded a contingent liability of \$600 million, representing the preliminary fair value of contingent consideration we currently expect to pay to BP related to the earnout provision. The fair value of the contingent consideration was estimated using an income approach. The amount of cash to be paid under the arrangement is based on both a market-based crack spread and refinery throughput volumes for the months during which the contract applies, as well as established thresholds that cap the annual and total payment. The earnout payment cannot exceed \$200 million per year for the first three years of the arrangement or \$250 million per year for the last three years of the arrangement, with the total cumulative payment capped at \$700 million over the six-year period. Any excess or shortfall from the annual cap for a current year's earnout calculation will not affect subsequent years' calculations. We used internal and external forecasts for the crack spread and internal forecasts for refinery throughput volumes and applied an appropriate risk-adjusted discount rate to the range of cash flows indicated by various scenarios to determine the fair value of the arrangement. The final fair value of the contingent consideration will be reassessed each quarter, with changes recorded in income from operations. See Note 14 for additional information.

The transaction provides for a post-closing adjustment for inventory, which has not been finalized with BP. If a change is made for the inventory adjustment, the fair value of the assets acquired will be revised.

The components of the fair value of consideration transferred are as follows:

<i>(In millions)</i>	
Cash	\$ 1,491
Fair value of contingent consideration	600
Liability assumed to seller	6
Estimated post-closing adjustment	(14)
Total consideration	\$ 2,083

The estimated fair values of assets acquired and liabilities assumed at the acquisition date, pending the completion of an independent appraisal and other evaluations, are as follows:

<i>(In millions)</i>	
Inventories	\$ 913
Other current assets	1
Property, plant and equipment, net	1,303
Other noncurrent assets	72
Payroll and benefits payable	(14)
Long-term debt due within one year	(2)
Other current liabilities	(6)
Long-term debt	(58)
Defined benefit postretirement plan obligations	(48)
Deferred credits and other liabilities	(78)
Total	\$ 2,083

Neither goodwill nor a gain from a bargain purchase was recognized in conjunction with the Galveston Bay Refinery and Related Assets acquisition.

Other noncurrent assets consist of a \$20 million intangible asset related to customer relationships and a \$52 million intangible asset related to prepaid licensed refinery technology agreements. The intangible assets related to customer relationships and prepaid licensed refinery technology agreements are being amortized on a straight-line basis over four and 15 years, respectively. The weighted average life over which these acquired intangibles are being amortized is approximately 12 years.

We recognized \$6 million of acquisition-related costs associated with the Galveston Bay Refinery and Related Assets acquisition through March 31, 2013. These costs were expensed and were included in selling, general and administrative expenses.

Table of Contents

Our refineries and related assets are operated as an integrated system. As the information is not available by refinery, it is not practicable to disclose the revenues and net income associated with the acquisition that were included in our consolidated statements of income for the three months ended March 31, 2013.

The following unaudited pro forma financial information presents consolidated results assuming the Galveston Bay Refinery and Related Assets acquisition occurred on January 1, 2012. The pro forma financial information does not give effect to potential synergies that could result from the acquisition and is not necessarily indicative of the results of future operations.

<i>(In millions, except per share data)</i>	Three Months Ended	
	March 31,	
	2013	2012
Sales and other operating revenues (including consumer excise taxes)	\$ 25,296	\$ 25,318
Net income attributable to MPC	780	464
Net income attributable to MPC per share basic	\$ 2.36	\$ 1.33
Net income attributable to MPC per share diluted	2.34	1.33

The pro forma information includes adjustments to align accounting policies, an adjustment to depreciation expense to reflect the fair value of property, plant and equipment, increased amortization expense related to identifiable intangible assets and the related income tax effects.

Acquisitions of Convenience Stores

In July 2012, Speedway LLC acquired 10 convenience stores located in the northern Kentucky and southwestern Ohio regions from Road Ranger LLC in exchange for cash and a truck stop location in the Chicago metropolitan area. In connection with this acquisition, our Speedway segment recorded \$5 million of goodwill, which is deductible for income tax purposes.

In May 2012, Speedway LLC acquired 87 convenience stores situated throughout Indiana and Ohio from GasAmerica Services, Inc., along with the associated inventory, intangible assets and two parcels of undeveloped real estate. In connection with this acquisition, our Speedway segment recorded \$83 million of goodwill, which is deductible for income tax purposes.

These acquisitions support our strategic initiative to increase our Speedway segment sales. The principal factors contributing to a purchase price resulting in goodwill included the acquired stores complementing our existing network in our Midwest market, access to our refined product transportation systems and the potential for higher merchandise sales.

Assuming these transactions had been made at the beginning of any period presented, the consolidated pro forma results would not be materially different from reported results.

6. Variable Interest Entity

On December 1, 2010, we completed the sale of most of our Minnesota assets. These assets included the 74,000 barrel per calendar day St. Paul Park refinery and associated terminals, 166 convenience stores primarily branded SuperAmerica®, along with the SuperMom's bakery and certain associated trademarks, SuperAmerica Franchising LLC, interests in pipeline assets in Minnesota and associated inventories. We refer to these assets as the Minnesota Assets. Certain terms of the transaction and the subsequent settlement agreement with the buyer resulted in the creation of variable interests in a variable interest entity (VIE) that owns the Minnesota Assets. At March 31, 2013, our variable interests in this VIE included our preferred security, which was reflected at \$47 million in other noncurrent assets on our consolidated balance sheet, and store lease guarantees of \$8 million. Our maximum exposure to loss due to this VIE at March 31, 2013 was \$55 million.

We are not the primary beneficiary of this VIE and, therefore, do not consolidate it because we lack the power to control or direct the activities that impact the VIE's operations and economic performance. Our preferred security does not allow us to appoint any members to the VIE's board of managers and limits our voting ability to only certain matters. Also, individually and cumulatively, neither of our variable interests expose us to residual returns or expected losses that are significant to the VIE.

Table of Contents**7. Income per Common Share**

We compute basic earnings per share by dividing net income attributable to MPC by the weighted average number of shares of common stock outstanding. Diluted income per share assumes exercise of stock options and stock appreciation rights, provided the effect is not anti-dilutive.

Excluded from the diluted share calculation for the three months ended March 31, 2013 and 2012 are less than one million and approximately four million shares, respectively, related to stock-based compensation awards as their effect would be anti-dilutive.

MPC grants certain incentive compensation awards to employees and non-employee directors that are considered to be participating securities. Due to the presence of participating securities, we have calculated our earnings per share using the two-class method.

<i>(In millions, except per share data)</i>	Three Months Ended March 31,	
	2013	2012
Basic earnings per share:		
Allocation of earnings:		
Net income attributable to MPC	\$ 725	\$ 596
Income allocated to participating securities	1	1
Income available to common stockholders basic	\$ 724	\$ 595
Weighted average common shares outstanding	331	348
Basic earnings per share	\$ 2.19	\$ 1.71
Diluted earnings per share:		
Allocation of earnings:		
Net income attributable to MPC	\$ 725	\$ 596
Income allocated to participating securities	1	1
Income available to common stockholders diluted	\$ 724	\$ 595
Weighted average common shares outstanding	331	348
Effect of dilutive securities	2	2
Weighted average common shares, including dilutive effect	333	350
Diluted earnings per share	\$ 2.17	\$ 1.70

8. Equity

On February 1, 2012, we announced that our board of directors authorized a share repurchase plan, enabling us to purchase up to \$2.0 billion of MPC common stock over a two-year period. Through January 30, 2013, we had acquired \$1.35 billion of shares under the initial \$2.0 billion authorization. On January 30, 2013, we announced that our board of directors approved an additional \$2.0 billion share repurchase authorization. The board also extended the remaining \$650 million share repurchase authorization announced on February 1, 2012, for a total outstanding authorization of \$2.65 billion through December 2014. After the effects of the accelerated share repurchase (ASR) programs and open market repurchases shown below, \$2.22 billion of the amount authorized by our board of directors was available for repurchases at March 31, 2013. We may utilize various methods to effect the repurchases, which could include open market repurchases, negotiated block transactions, accelerated share repurchases or open market solicitations for shares, some of which may be effected through Rule 10b5-1 plans. The timing of future repurchases, if any, will depend upon several factors, including market and business conditions, and such repurchases may be discontinued at any time.

Table of Contents

In February 2012 and November 2012, we entered into \$850 million and \$500 million ASR programs, respectively, to repurchase shares of MPC common stock under the approved share repurchase plan authorized by our board of directors. The total number of shares repurchased under these ASR programs was based generally on the volume-weighted average price of our common stock during the repurchase periods. The shares repurchased under the ASR programs were accounted for as treasury stock purchase transactions, reducing the weighted average number of basic and diluted common shares outstanding by the shares repurchased, and as forward contracts indexed to our common stock. The forward contracts were accounted for as equity instruments.

Total share repurchases transacted through ASR programs and open market transactions were as follows for the three months ended March 31, 2013 and 2012:

<i>(In millions, except per share data)</i>	Three Months Ended	
	March 31,	
	2013	2012
Number of shares repurchased	6	18
Cash paid for shares repurchased	\$ 431	\$ 850
Effective average cost per delivered share	\$ 80.95	\$ 41.75

As of March 31, 2013, the total number of shares we have repurchased cumulatively through the ASR programs and open market repurchases since February 2012 was 34 million shares at an average cost per share of \$52.79. The cash paid for shares repurchased was \$1.78 billion. In addition, during the three months ended March 31, 2013, we entered into agreements to acquire additional common shares for \$31 million, which were settled in April 2013.

9. Segment Information

We have three reportable segments: Refining & Marketing; Speedway; and Pipeline Transportation. Each of these segments is organized and managed based upon the nature of the products and services they offer.

Refining & Marketing refines crude oil and other feedstocks at our refineries in the Gulf Coast and Midwest regions of the United States, purchases ethanol and refined products for resale and distributes refined products through various means, including barges, terminals and trucks that we own or operate. We sell refined products to wholesale marketing customers domestically and internationally, to buyers on the spot market, to our Speedway segment and to dealers and jobbers who operate Marathon[®] retail outlets;

Speedway sells transportation fuels and convenience products in retail markets in the Midwest, primarily through Speedway[®] convenience stores; and

Pipeline Transportation transports crude oil and other feedstocks to our refineries and other locations, delivers refined products to wholesale and retail market areas and includes the aggregated operations of MPLX and MPC's retained pipeline assets and investments.

On February 1, 2013, we acquired the Galveston Bay Refinery and Related Assets, which are part of the Refining & Marketing and Pipeline Transportation segments. Segment information for periods prior to the acquisition does not include amounts for these operations. See Note 5.

Segment income represents income from operations attributable to the reportable segments. Corporate administrative expenses and costs related to certain non-operating assets are not allocated to the reportable segments. In addition, certain items that affect comparability (as determined by the chief operating decision maker) are not allocated to the reportable segments.

Table of Contents

<i>(In millions)</i>	Refining & Marketing	Speedway	Pipeline Transportation	Total
Three Months Ended March 31, 2013				
Revenues:				
Customer	\$ 19,872	\$ 3,441	\$ 21	\$ 23,334
Intersegment ^(a)	2,199	1	104	2,304
Related parties	2			2
Segment revenues	22,073	3,442	125	25,640
Elimination of intersegment revenues	(2,199)	(1)	(104)	(2,304)

Stock-Based Employee Compensation:

Stock-based awards are granted under the terms of the 2004 Long Term Incentive Plan (2004 Plan). Additionally, the Company has outstanding stock options under its 2000 Stock Option Plan (2000 Plan), although the Plan terminated in 2010. 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 options and SARs have a maximum term of ten years. The stock-based awards, other than the RSUs, generally vest at a rate of 20.0 percent annually on each of the first five anniversaries of the date of grant. 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 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 of eligible recipients. The Company's primary employee stock-based compensation grant occurs during the fourth fiscal quarter.

Total compensation cost for stock-based payment arrangements totaled \$2.2 and \$2.6 million for the three months ended December 31, 2011 and 2010, respectively, and \$4.6 and \$5.0 million for the six months ended December 31, 2011 and 2010, respectively.

Edgar Filing: Marathon Petroleum Corp - Form 10-Q

Table of Contents

Stock options outstanding, weighted average exercise price and weighted average fair values as of December 31, 2011 were as follows:

Options	Shares	Weighted Average Exercise Price
Outstanding at June 30, 2011	838	\$ 31.48
Granted		
Exercised		
Forfeited or expired	(12)	26.86
Outstanding at September 30, 2011	826	\$ 31.54
Granted		
Exercised		
Forfeited or expired	(16)	32.42
Outstanding at December 31, 2011	810	\$ 31.53
Exercisable at December 31, 2011	649	\$ 33.29

Outstanding options of 810,388 at December 31, 2011 had an intrinsic value (the amount by which the stock price exceeded the exercise or grant date price) of zero and a weighted average remaining contractual term of 4.2 years. Exercisable options of 648,628 at December 31, 2011 had an intrinsic value of zero and a weighted average remaining contractual term of 3.4 years. Of the outstanding and unvested options and due to estimated forfeitures, 140,007 are expected to vest with a \$25.23 per share weighted average grant price, a weighted average remaining contractual life of 7.0 years and a total intrinsic value of zero.

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

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

	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, 2011	1,077	\$ 23.48	1,087	\$ 25.54
Granted	20	13.59		
Vested/Exercised	2	22.32		
Forfeited or expired	(26)	19.39	(57)	27.45
Balance, September 30, 2011	1,073	\$ 23.39	1,030	\$ 25.43
Granted				
Vested/Exercised	3	19.07		

Edgar Filing: Marathon Petroleum Corp - Form 10-Q

Forfeited or expired	(70)		18.88	(31)	25.41
Balance, December 31, 2011	1,006	\$	23.69	999	\$ 25.44

Outstanding and unvested RSAs of 791,248 at December 31, 2011 had an intrinsic value of \$13.1 million and a weighted average remaining vesting term of 1.6 years. Due to estimated forfeitures, 745,796 are expected to vest with a total intrinsic value of \$12.3 million.

Outstanding and unvested RSUs of 215,000 at December 31, 2011 had an intrinsic value of \$3.6 million and a weighted average remaining vesting term of 0.2 years. All unvested RSUs are expected to vest in fiscal year 2012.

Outstanding SARs of 998,700 at December 31, 2011 had a total intrinsic value of zero and a weighted average remaining contractual term of 6.3 years. Exercisable SARs of 546,850 at December 31, 2011 had a total intrinsic value of zero and a weighted average remaining contractual term of 5.2 years. Of the outstanding and unvested rights and due to estimated forfeitures, 389,228 are expected to vest with a \$20.32 per share weighted average grant price, a weighted average remaining contractual life of 7.1 years and a total intrinsic value of zero.

During fiscal year 2011, the Company accelerated the vesting of 68,390 unvested RSAs held by the Company's Chief Executive Officer and the Company's Executive Vice President, Fashion and Education. Under the terms of the

Table of Contents

modifications, any unvested RSAs granted to the Chief Executive Officer and the Executive Vice President, Fashion and Education fully vest on their last days of employment, which is expected to be February 8, 2012 and June 30, 2012, respectively. As a result of the modifications, the Company recognized an incremental compensation cost of \$0.1 million during the three and six months ended December 31, 2011.

During the three and six months ended December 31, 2011 total cash received from the exercise of share-based instruments was zero. During the three and six months ended December 31, 2010 total cash received from the exercise of share-based instruments was \$0.6 and \$0.7 million, respectively. As of December 31, 2011, the total unrecognized compensation cost related to all unvested stock-based compensation arrangements was \$14.1 million. The related weighted average period over which such cost is expected to be recognized was approximately 2.9 years as of December 31, 2011.

The total intrinsic value of all stock-based compensation that was exercised or vested during the three and six months ended December 31, 2011 was zero and less than \$0.1 million, respectively. The total intrinsic value of all stock-based compensation that was exercised or vested during each of the three and six month periods ended December 31, 2010 was \$0.5 million.

Goodwill:

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

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

In the situations where a reporting unit's carrying value exceeds its estimated fair value, the amount of the impairment loss must be measured. The measurement of impairment is calculated by determining the implied fair value of a reporting unit's goodwill. In calculating the implied fair

Edgar Filing: Marathon Petroleum Corp - Form 10-Q

value of goodwill, the fair value of the reporting unit is allocated to all other assets and liabilities of that unit based on the relative fair values under the assumption of a taxable transaction. The excess of the fair value of the reporting unit over the amount assigned to its assets and liabilities is the implied fair value of goodwill. The goodwill impairment is measured as the excess of the carrying value of goodwill over its implied fair value.

As previously disclosed, the Company concluded that it was reasonably likely that goodwill for the Hair Restoration Centers reporting unit might become impaired in future periods. During the three months ended December 31, 2011 the Company updated the projections used in the fiscal 2011 annual impairment test to reflect the impact of recent industry developments, including a slow down in revenue growth and increasing supply costs. The Company determined there was a triggering event as it was more likely than not that the fair value of the Hair Restoration Centers was below carrying value and performed an interim impairment test of goodwill during the three months ended December 31, 2011. There were no triggering events relative to the Company's other reporting units.

As a result of the Company's interim impairment test of goodwill related to the Hair Restoration Centers reporting unit during the second quarter of fiscal year 2012, a \$78.4 million impairment charge was recorded within continuing operations for the excess of the carrying value of goodwill over the implied fair value of the goodwill for the Hair Restorations Centers reporting unit. After the impairment charge the Hair Restoration Centers reporting unit had \$74.4 million of goodwill as of December 31, 2011. The impairment was only partially deductible for tax purposes resulting in a tax benefit of \$5.9 million. See further discussion on the effective tax rate for the three and six months ended December 31, 2011 within Note 10 to the Condensed Consolidated Financial Statements.

As of June 30, 2011, the estimated fair value of the Regis salon concept reporting unit exceeded the carrying value by approximately 18.0 percent. Excluding Regis, Hair Restoration Centers for which the Company performed an interim impairment test of goodwill during the three months ended December 31, 2011 and Promenade for which the Company recorded a \$74.1 million impairment charge as a result of the Company's impairment testing of goodwill during the third

Table of Contents

quarter of fiscal year 2011, the respective fair values of the Company's remaining reporting units exceeded fair value by greater than 20.0 percent at June 30, 2011. While the Company has determined the estimated fair values of Promenade, Hair Restoration Centers, and Regis to be appropriate based on the historical level of revenue growth, operating income and cash flows, it is reasonably likely that Promenade, Hair Restoration Centers, and Regis may experience additional impairment in future periods. The term "reasonably likely" refers to an occurrence that is more than remote but less than probable in the judgment of the Company. Because some of the inherent assumptions and estimates used in determining the fair value of the reportable segment are outside the control of management, changes in these underlying assumptions can adversely impact fair value. Potential impairment of a portion or all of the carrying value of the Promenade and Regis salon concepts and Hair Restoration Centers goodwill is dependent on many factors and cannot be predicted with certainty.

As of December 31, 2011, the Company's estimated fair value, as determined by the sum of our reporting units' fair value, reconciled to within a reasonable range of our market capitalization which included an assumed control premium.

A summary of the Company's goodwill balance as of December 31, 2011 and June 30, 2011 by reporting unit is as follows:

Reporting Unit	As of	
	December 31, 2011	June 30, 2011
	(Dollars in thousands)	
Regis	\$ 103,581	\$ 103,761
MasterCuts	4,652	4,652
SmartStyle	48,529	48,916
Supercuts	129,540	129,477
Promenade	243,428	240,910
Total North America Salons	529,730	527,716
Hair Restoration Centers	74,367	152,796
Total	\$ 604,097	\$ 680,512

See Note 4 to the Condensed Consolidated Financial Statements for further details on the Company's goodwill balance.

Property and Equipment:

Historically, because of the Company's large size and scale requirements it has been necessary for the Company to internally develop and support its own proprietary point-of-sale (POS) information system. During the fourth quarter of fiscal year 2011, the Company identified a third party POS alternative that has a system that meets current and enhanced functionality requirements and will cost less to implement and support. At June 30, 2011, the Company reassessed and adjusted the remaining useful life of the Company's capitalized POS software to

six months as locations using the Company's existing POS information system move to a third party POS alternative by December 31, 2011. Based on the results of the implementation of the third party POS alternative during the three months ended December 31, 2011, the Company reassessed and extended the useful life of the Company's capitalized POS software by three months. Depreciation expense related to the existing POS information system totaled \$7.0 and \$16.3 million during the three and six months ended December 31, 2011, respectively, including \$6.3 million (\$4.0 million net of tax or \$0.07 per diluted share) and \$15.0 million (\$9.5 million net of tax or \$0.17 per diluted share), respectively, of accelerated depreciation related to the change in useful life. The Company expects to fully depreciate the net balance of the existing POS information system, approximately \$2.0 million at December 31, 2011, during the three months ended March 31, 2012.

Due to the Company's plan to replace the POS information system, the Company reviewed the capitalized software carrying value for impairment at December 31, 2011. As a result of the Company's long-lived asset impairment testing at December 31, 2011 for this applicable grouping of assets, no impairment charges were recorded.

Recent Accounting Standards Adopted by the Company:

Disclosures about Fair Value of Financial Instruments

In January 2010, the Financial Accounting Standards Board (FASB) issued guidance to amend the disclosure requirements related to recurring and nonrecurring fair value measurements. The guidance requires a roll forward of activities, presented separately on a gross basis, on purchases, sales, issuance, and settlements of the assets and liabilities measured using significant unobservable inputs (Level 3 fair value measurements). The Company adopted the new disclosure guidance related to Level 3 fair value measurements, including the disclosure on the roll forward activities, on July 1, 2011.

Table of Contents

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

Testing Goodwill for Impairment

In September 2011, the FASB issued guidance to allow an entity to first assess qualitative factors to determine whether it is necessary to perform the two-step quantitative goodwill impairment test. If after assessing the totality of events or circumstances, an entity determines it is not more likely than not that the fair value of a reporting unit is less than its carrying amount, then performing the two-step impairment test is not required. This new guidance is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011. The Company will adopt the guidance on July 1, 2012 but does not expect it to have a material impact on the Company's financial position, results of operations or cash flows.

Comprehensive Income

In June 2011, the FASB issued guidance on the presentation of comprehensive income. Specifically, the new guidance allows an entity to present components of net income and other comprehensive income in one continuous statement, referred to as the statement of comprehensive income, or in two separate, but consecutive statements. The new guidance eliminates the current option to report other comprehensive income and its components in the statement of changes in equity. While the new guidance changes the presentation of comprehensive income, there are no changes to the components that are recognized in net income or other comprehensive income under current accounting guidance. This new guidance is effective for fiscal years and interim periods within those years beginning after December 15, 2011. The Company will adopt the guidance on a retrospective basis on July 1, 2012. The guidance will not have a material impact on the Company's financial position, results of operations or cash flows. However, it will require changing the Company's presentation and disclosure of comprehensive income.

Fair Value Measurement

In May 2011, the FASB issued guidance to achieve common fair value measurement and disclosure requirements between GAAP and International Financial Reporting Standards. This new guidance amends current fair value measurement and disclosure guidance to include increased transparency around valuation inputs and investment categorization. This new guidance is effective for fiscal years and interim periods beginning after December 15, 2011. The Company will adopt the guidance on January 1, 2012 but does not expect it to have a material impact on the Company's consolidated financial position, results of operations, cash flows or disclosures.

2. **SHAREHOLDERS EQUITY:**

Net (Loss) Income Per Share:

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

Table of Contents

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	
	2011	2010	2011	2010
	(Shares in thousands)			
Weighted average shares for basic earnings per share	56,857	56,684	56,853	56,657
Effect of dilutive securities:				
Dilutive effect of stock-based compensation (1)		294		238
Dilutive effect of convertible debt		11,158		11,158
Weighted average shares for diluted earnings per share	56,857	68,136	56,853	68,053

(1) For the three and six months ended December 31, 2011, 357 and 306 common stock equivalents of potentially dilutive common stock, respectively, 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	
	2011	2010	2011	2010
	(Shares in thousands)		(Shares in thousands)	
<i>Basic earnings per share:</i>				
RSAs (1)	791	912	791	912
RSUs (1)	215	215	215	215
	1,006	1,127	1,006	1,127
<i>Diluted earnings per share:</i>				
Stock options (2)	810	898	810	898
SARs (2)	999	1,076	999	1,076
RSAs (2)	6	109	203	109
Shares issuable upon conversion of debt (2)	11,203		11,195	
	13,018	2,083	13,207	2,083

(1) Shares were not vested

(2) Shares were anti-dilutive

Edgar Filing: Marathon Petroleum Corp - Form 10-Q

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

	For the Periods Ended December 31,			
	Three Months		Six Months	
	2011	2010	2011	2010
	(Dollars in thousands)			
Net (loss) income available to common shareholders	\$ (57,427)	\$ 14,505	\$ (49,090)	\$ 32,825
Effect of dilutive securities:				
Interest on convertible debt, net of taxes		2,013		4,027
Net (loss) income for diluted earnings per share	\$ (57,427)	\$ 16,518	\$ (49,090)	\$ 36,852

Table of Contents**Additional Paid-In Capital:**

The change in additional paid-in capital during the six months ended December 31, 2011 was due to the following:

	(Dollars in thousands)
Balance, June 30, 2011	\$ 341,190
Stock-based compensation	4,649
Vested stock option and stock appreciation rights expirations	(264)
Franchise stock incentive plan	251
Other	1
Balance, December 31, 2011	\$ 345,827

Comprehensive (Loss) Income:

Components of comprehensive (loss) income for the Company include net (loss) 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, 2011 and 2010 was as follows:

	For the Periods Ended December 31,			
	Three Months		Six Months	
	2011	2010	2011	2010
	(Dollars in thousands)		(Dollars in thousands)	
Net (loss) income	\$ (57,427)	\$ 14,505	\$ (49,090)	\$ 32,825
Other comprehensive (loss) income:				
Changes in fair market value of financial instruments designated as cash flow hedges of interest rate exposure, net of taxes	(89)	(31)	357	(95)
Change in cumulative foreign currency translation	(2,089)	2,756	(22,642)	17,552
Total comprehensive (loss) income	\$ (59,605)	\$ 17,230	\$ (71,375)	\$ 50,282

3. FAIR VALUE MEASUREMENTS:

Edgar Filing: Marathon Petroleum Corp - Form 10-Q

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

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

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

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

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

Table of Contents*Assets and Liabilities that are Measured at Fair Value on a Recurring Basis*

The fair value hierarchy requires the use of observable market data when available. In instances in which the inputs used to measure fair value fall into different levels of the fair value hierarchy, the fair value measurement has been determined based on the lowest level input that is significant to the fair value measurement in its entirety. The Company's assessment of the significance of a particular item to the fair value measurement in its entirety requires judgment, including the consideration of inputs specific to the asset or liability. The following tables sets forth by level within the fair value hierarchy, the Company's financial assets and liabilities that were accounted for at fair value on a recurring basis at December 31, 2011 and June 30, 2011, according to the valuation techniques the Company used to determine their fair values.

	Fair Value at December 31, 2011	Fair Value Measurements Using Inputs Considered as		
		Level 1	Level 2	Level 3
ASSETS				
Non-current assets				
Derivative instruments	\$ 28	\$	\$ 28	\$
Equity call option - Roosters	117			117
LIABILITIES				
Current liabilities				
Derivative instruments	\$ 21	\$	\$ 21	\$
Non-current liabilities				
Equity put option - Provalliance	\$ 20,443	\$	\$	\$ 20,443
Equity put option - Roosters	161			161

	Fair Value at June 30, 2011	Fair Value Measurements Using Inputs Considered as		
		Level 1	Level 2	Level 3
ASSETS				
Non-current assets				
Derivative instruments	\$ 212	\$	\$ 212	\$
LIABILITIES				
Current liabilities				
Derivative instruments	\$ 599	\$	\$ 599	\$
Non-current liabilities				
Equity put option - Provalliance	\$ 22,700	\$	\$	\$ 22,700

Table of Contents*Changes in Financial Instruments Measured at Level 3 Fair Value on a Recurring Basis*

The following tables present the changes during the three and six months ended December 31, 2011 and 2010 in our Level 3 financial instruments that are measured at fair value on a recurring basis:

	Changes in Financial Instruments Measured at Level 3 Fair Value Classified as		
	Roosters Equity Call Option	Roosters Equity Put Option	Provalliance Equity Put Option
	(Dollars in thousands)		
Balance at July 1, 2011	\$	\$	\$ 22,700
Total realized and unrealized losses:			
Included in other comprehensive loss			(1,576)
Issuances		161	
Purchases	117		
Balance at September 30, 2011	\$ 117	\$ 161	\$ 21,124
Total realized and unrealized losses:			
Included in other comprehensive loss			(681)
Balance at December 31, 2011	\$ 117	\$ 161	\$ 20,443

	Changes in Financial Instruments Measured at Level 3 Fair Value Classified as	
	Preferred Shares	Provalliance Equity Put Option
	(Dollars in thousands)	
Balance at July 1, 2010	\$ 3,502	\$ 22,009
Total realized and unrealized gains:		
Included in other comprehensive loss	230	2,514
Balance at September 30, 2010	\$ 3,732	\$ 24,523
Total realized and unrealized gains (losses) including translation:		
Included in other comprehensive income	99	(441)
Balance at December 31, 2010	\$ 3,831	\$ 24,082

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 forward foreign currency contracts. The instruments are classified as Level 2 as the fair value is obtained using observable inputs available for similar liabilities in active markets at the measurement date that are reviewed by the Company. See breakout by type of contract and reconciliation to the balance sheet line item that the contracts are classified within Note 7 of the Condensed Consolidated Financial Statements.

Equity put option - Provalliance. 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 (Provalliance Equity Put) and an equity call. During fiscal year 2011, a portion of the Provalliance Equity Put was settled. See further discussion within Note 5 to the Condensed Consolidated Financial Statements. The Provalliance Equity Put 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. At December 31, 2011, the fair value of the Provalliance Equity Put was \$20.4 million and is classified within other noncurrent liabilities on the Condensed Consolidated Balance Sheet.

Equity put and call options - Roosters. The purchase agreement for the Company's acquisition of a 60.0 percent ownership interest in Roosters MGC International LLC (Roosters) on July 1, 2011 contained an equity put (Roosters Equity Put) and an equity call (Roosters Equity Call). See further discussion within Note 5 to the Condensed Consolidated Financial Statements. The Roosters Equity Put and Roosters Equity Call are 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. At December 31, 2011, the fair value of the Roosters Equity Put and Roosters Equity Call were \$0.2 and \$0.1 million, respectively, and are classified within noncurrent liabilities and other assets, respectively, on the Condensed Consolidated Balance Sheet.

Table of Contents

Preferred Shares. The Company has preferred shares in Yamano Holding Corporation. The preferred shares are classified as Level 3 as there are no quoted market prices and minimal market participant data for preferred shares of similar rating. The preferred shares are classified within investment in and loans to affiliates on the Condensed Consolidated Balance Sheet. The fair value of the preferred shares is based on the financial health of Yamano Holding Corporation and terms within the preferred share agreement which allow the Company to convert the subscription amount of the preferred shares into equity of MY Style, a wholly owned subsidiary of Yamano Holding Corporation. The Company recorded an other than temporary impairment for the full carrying value of the preferred shares during the twelve months ended June 30, 2011. See further discussion within Note 5 to the Condensed Consolidated Financial Statements.

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

The fair value of cash and cash equivalents, receivables and accounts payable approximated the carrying values as of December 31, 2011. At December 31, 2011, the estimated fair values and carrying amounts of debt were \$315.6 and \$292.9 million, respectively. The estimated fair value of debt was determined based on internal valuation models, which utilize quoted market prices and interest rates for the same or similar instruments.

Assets and Liabilities Measured at Fair Value on a Nonrecurring Basis. We measure certain assets, including the Company's equity method investments, tangible fixed assets and goodwill, at fair value on a nonrecurring basis when they are deemed to be other than temporarily impaired. The fair values of our investments are determined based on valuation techniques using the best information available, and may include quoted market prices, market comparables, and discounted cash flow projections. The estimated fair values during the three months ended December 31, 2011 were as follows:

	Fair Value	Level 1	Level 2	Level 3	Total Losses
	(Dollars in thousands)				
Assets					
Goodwill Hair					
Restoration Centers	\$ 74,367	\$	\$	\$ 74,367	\$ (78,426)

During the three months ended December 31, 2011, goodwill of the Hair Restoration Centers reporting unit with a carrying value of \$152.8 million was written down to its implied fair value of \$74.4 million, resulting in an impairment charge of \$78.4 million. See Note 1 to the Condensed Consolidated Financial Statements for further information.

4. GOODWILL AND OTHER INTANGIBLES:

Edgar Filing: Marathon Petroleum Corp - Form 10-Q

The table below contains details related to the Company's recorded goodwill as of December 31, 2011 and June 30, 2011:

	Salons North America	International	Hair Restoration Centers	Consolidated
	(Dollars in thousands)			
Gross goodwill at June 30, 2011	\$ 715,219	\$ 41,661	\$ 152,796	\$ 909,676
Accumulated impairment losses	(187,503)	(41,661)		(229,164)
Net goodwill at June 30, 2011	527,716		152,796	680,512
Goodwill acquired (1)	4,966			4,966
Translation rate adjustments	(2,952)		(3)	(2,955)
Goodwill impairment (2)			(78,426)	(78,426)
Gross goodwill at December 31, 2011	717,233	41,661	152,793	911,687
Accumulated impairment losses	(187,503)	(41,661)	(78,426)	(307,590)
Net goodwill at December 31, 2011	\$ 529,730	\$	\$ 74,367	\$ 604,097

(1) See Note 5 to the Condensed Consolidated Financial Statements.

(2) As a result of the Company's interim impairment test of goodwill during the three months ended December 31, 2011, a \$78.4 million impairment charge was recorded for the excess of the carrying value of goodwill over the implied fair value of goodwill for the Hair Restoration Centers reporting unit.

Edgar Filing: Marathon Petroleum Corp - Form 10-Q

Table of Contents

The table below presents other intangible assets as of December 31, 2011 and June 30, 2011:

	December 31, 2011			June 30, 2011		
	Cost	Accumulated Amortization	Net	Cost	Accumulated Amortization	Net
(Dollars in thousands)						
Amortized intangible assets:						
Brand assets and trade names						
	\$ 79,966	\$ (15,272)	\$ 64,694	\$ 80,310	\$ (14,329)	\$ 65,981
Customer lists	53,188	(36,888)	16,300	53,188	(34,096)	19,092
Franchise agreements						
	22,302	(9,261)	13,041	22,221	(8,909)	13,312
Lease intangibles	14,882	(5,510)	9,372	14,948	(5,168)	9,780
Non-compete agreements						
	206	(99)	107	353	(232)	121
Other	4,385	(1,488)	2,897	4,429	(1,387)	3,042
	\$ 174,929	\$ (68,518)	\$ 106,411	\$ 175,449	\$ (64,121)	\$ 111,328

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	
	December 31, 2011	June 30, 2011
(In years)		
Amortized intangible assets:		
Brand assets and trade names	39	39
Customer lists	10	10
Franchise agreements	22	22
Lease intangibles	20	20
Non-compete agreements	6	5
Other	22	25
Total	26	26

Total amortization expense related to the amortizable intangible assets was approximately \$2.5 million during each of the three month periods ended December 31, 2011 and 2010, and \$4.9 million during each of the six month periods ended December 31, 2011 and 2010. As of December 31, 2011, future estimated amortization expense related to amortizable intangible assets is estimated to be:

Fiscal Year	(Dollars in thousands)
2012 (Remainder: six-month period)	\$ 4,804

2013	9,408
2014	9,195
2015	6,153
2016	3,995

5. ACQUISITIONS, INVESTMENT IN AND LOANS TO AFFILIATES:

Acquisitions

During the six months ended December 31, 2011 and 2010, the Company made salon 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. These acquisitions individually and in the aggregate are not material to the Company's operations. Operations of the acquired companies have been included in the operations of the Company since the date of the respective acquisition.

Table of Contents

Based upon purchase price allocations, the components of the aggregate purchase prices of the acquisitions made during the six months ended December 31, 2011 and 2010 and the allocation of the purchase prices were as follows:

Allocation of Purchase Prices	For the Six Months Ended December 31,	
	2011	2010
	(Dollars in thousands)	
Components of aggregate purchase prices:		
Cash (net of cash acquired)	\$ 2,225	\$ 8,106
Liabilities assumed or payable		154
	\$ 2,225	\$ 8,260
Allocation of the purchase price:		
Current assets	\$ 314	\$ 470
Property and equipment	241	2,424
Goodwill	4,966	5,146
Identifiable intangible assets	579	649
Accounts payable and accrued expenses	(1,062)	(356)
Other noncurrent liabilities	(1,313)	(73)
Noncontrolling interest	(1,500)	
	\$ 2,225	\$ 8,260

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 under current accounting guidance, 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, such as the acquisition of hair restoration centers, is not deductible for tax purposes due to the acquisition structure of the transaction.

During the six months ended December 31, 2011 and 2010, certain of the Company's salon acquisitions were from its franchisees. The Company evaluated the effective settlement of the pre-existing franchise contracts and associated rights afforded by those contracts. The Company determined that the effective settlement of the pre-existing 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 pre-existing contracts. Therefore, no settlement gain or loss was recognized with respect to the Company's franchise buybacks.

On July 1, 2011, the Company acquired 31 franchise salon locations through its acquisition of a 60.0 percent ownership interest in Roosters for \$2.3 million. The purchase agreement contains a right, Roosters Equity Put, to require the Company to purchase additional ownership interest in Roosters between specified dates in 2012 to 2015, and an option, Roosters Equity Call, whereby the Company can acquire additional ownership interest in Roosters beginning in 2015. The acquisition price is determined based on a multiple of the earnings before interest, taxes, depreciation and amortization of Roosters for a trailing twelve month period adjusted for certain items as defined in the agreement which is intended to approximate fair value. The initial estimated fair values as of July 1, 2011 of the Roosters Equity Put and Roosters Equity Call were \$0.2 and \$0.1 million, respectively. Any changes in the estimated fair value of the Roosters Equity Put and Roosters Equity Call are recorded in the Company's Condensed Consolidated Statement of Operations.

The Company utilized the consolidation of variable interest entities guidance to determine whether or not its investment in Roosters was a VIE, and if so, whether the Company was the primary beneficiary of the VIE. The Company concluded that Roosters is a VIE based on the fact that the holders of the equity investment at risk, as a group, lack the obligation to absorb the expected losses of the entity. The Roosters Equity Put is based on a formula that may or may not be at market when exercised, therefore, it could prevent the minority interest owners from absorbing its share of expected losses by transferring such obligation to the Company. Under certain circumstances, including a decline in the fair value of Roosters, the Roosters

Table of Contents

Equity Put could be exercised and the minority interest owners could be protected from absorbing the downside of the equity interest. As the Roosters Equity Put absorbs a large amount of variability this characteristic results in Roosters being a VIE.

Regis determined that the Company has met the power criterion due to the Company having the authority to direct the activities that most significantly impact Roosters' economic performance. The Company concluded based on the considerations above that it is the primary beneficiary of Roosters and therefore the financial positions, results of operations, and cash flows of Roosters are consolidated in the Company's financial statements from the acquisition date. Total assets, total liabilities and total shareholders' equity of Roosters as of December 31, 2011 were \$5.7, \$2.1 and \$3.6 million, respectively. Net loss attributable to the noncontrolling interest in Roosters was less than \$0.1 million for the three and six months ended December 31, 2011, and was recorded within interest income and other, net in the Condensed Consolidated Statement of Operations. Shareholders' equity attributable to the noncontrolling interest in Roosters was \$1.4 million as of December 31, 2011 and was recorded within retained earnings on the Condensed Consolidated Balance Sheet.

Investment in and loans to affiliates

The table below presents the carrying amount of investments in and loans to affiliates as of December 31, 2011 and June 30, 2011:

	December 31, 2011	June 30, 2011
	(Dollars in thousands)	
Empire Education Group, Inc.	\$ 106,361	\$ 104,540
Provalliance	139,374	149,245
MY Style	676	2,210
Hair Club for Men, Ltd.	5,162	5,145
	\$ 251,573	\$ 261,140

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. EEG operates 105 accredited cosmetology schools.

At December 31, 2011, the Company had a \$20.7 million outstanding loan receivable with EEG. The Company has also provided EEG with a \$15.0 million revolving credit facility, against which there were no outstanding borrowings as of December 31, 2011 and 2010. The Company reviews

the outstanding loan with EEG for changes in circumstances or the occurrence of events that suggest the Company's loan may not be recoverable. The \$20.7 million outstanding loan with EEG as of December 31, 2011 is in good standing with no associated valuation allowance. During the three months ended December 31, 2011 and 2010, the Company recorded \$0.1 and \$0.2 million, respectively, of interest income related to the loan and revolving credit facility. During the six months ended December 31, 2011 and 2010, the Company recorded \$0.3 and \$0.4 million, respectively, of interest income related to the loan and revolving credit facility. In addition, the Company received \$0.7 million in principal payments on the loan during the three and six months ended, December 31, 2011. The Company has also guaranteed a credit facility of EEG. The exposure to loss related to the Company's involvement with EEG is the carrying value of the investment, the outstanding loan and the guarantee of the credit facility.

The Company utilized consolidation of variable interest entities guidance to determine whether or not its investment in EEG was a variable interest entity (VIE), and if so, whether the Company was the primary beneficiary of the VIE. The Company concluded that EEG was not a VIE based on the fact that EEG had sufficient equity at risk. As the substantive voting control relates to the voting rights of the Board of Directors, the Company granted the other shareholder a proxy to vote such number of the Company's shares such that the other shareholder would have voting control of 51.0 percent of the common stock of EEG. The Company accounts for EEG as an equity investment under the voting interest model. During the three months ended December 31, 2011 and 2010, the Company recorded \$1.5 and \$1.7 million, respectively, of equity earnings related to its investment in EEG. During the six months ended December 31, 2011 and 2010, the Company recorded \$2.5 and \$2.9 million, respectively, of equity earnings related to its investment in EEG. EEG declared and distributed a dividend in December 2010 for which the Company received \$4.1 million in cash and recorded tax expense of \$0.3 million.

Table of Contents

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 2,600 company-owned and franchise salons as of December 31, 2011.

The merger agreement contains a right, Provalliance Equity Put, to require the Company to purchase an additional ownership interest in Provalliance between specified dates in 2010 to 2018. The acquisition price is determined based on a multiple of the earnings before interest, taxes, depreciation and amortization of Provalliance for a trailing twelve month period adjusted for certain items as defined in the agreement which is intended to approximate fair value. The initial estimated fair value of the Provalliance Equity Put as of January 31, 2008, approximately \$24.8 million, has been included as a component of the Company's investment in Provalliance. A corresponding liability for the same amount as the Provalliance Equity Put was recorded in other noncurrent liabilities. Any changes in the estimated fair value of the Provalliance Equity Put are recorded in the Company's consolidated statement of operations. There was no change in the fair value of the Provalliance Equity put during the six months ended December 31, 2011 and 2010. Any changes related to foreign currency translation are recorded in accumulated other comprehensive income. The Company recorded a \$2.3 million decrease and \$2.1 million increase in the Provalliance Equity Put related to foreign currency translation during the six months ended December 31, 2011 and 2010, respectively. See further discussion within Note 3 to the Condensed Consolidated Financial Statements. If the Provalliance Equity Put is exercised, and the Company fails to complete the purchase, the parties exercising the Provalliance Equity Put will be entitled to exercise various remedies against the Company, including the right to purchase the Company's interest in Provalliance for a purchase price determined based on a discounted multiple of the earnings before interest and taxes of Provalliance for a trailing twelve month period. The merger agreement also contains an option, Provalliance 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 Provalliance Equity Put.

In December 2010, a portion of the Provalliance Equity Put was exercised. In March of 2011, the Company elected to honor and settle a portion of the Provalliance Equity Put and acquired approximately 17 percent additional equity interest in Provalliance for \$57.3 million (approximately 40.4 million), bringing the Company's total equity interest to 46.7 percent. The Company's liability under the Provalliance Equity Put to purchase the remainder of the equity interest in Provalliance continues to exist through 2018 and is valued at \$20.4 million as of December 31, 2011.

The Company utilized the consolidation of variable interest entities guidance to determine whether or not its investment in Provalliance was a VIE, and if so, whether the Company was the primary beneficiary of the VIE. The Company concluded that Provalliance is a VIE based on the fact that the holders of the equity investment at risk, as a group, lack the obligation to absorb the expected losses of the entity. The Provalliance Equity Put is based on a formula that may or may not be at market when exercised, therefore, it could provide the Company with the characteristic

Edgar Filing: Marathon Petroleum Corp - Form 10-Q

of a controlling financial interest or could prevent the Franck Provost Salon Group from absorbing its share of expected losses by transferring such obligation to the Company. Under certain circumstances, including a decline in the fair value of Provalliance, the Provalliance Equity Put could be exercised and the Franck Provost Group could be protected from absorbing the downside of the equity interest. As the Provalliance Equity Put absorbs a large amount of variability this characteristic results in Provalliance being a VIE.

Regis determined that the Franck Provost Group has met the power criterion due to the Franck Provost Group having the authority to direct the activities that most significantly impact Provalliance's economic performance. The Company concluded based on the considerations above that the primary beneficiary of Provalliance is the Franck Provost Group. The Company has accounted for its interest in Provalliance as an equity method investment. 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 Provalliance Equity Put that is unable to be quantified as of this date.

The tables below contain details related to the Company's investment in Provalliance:

Impact on Condensed Consolidated Balance Sheet

Investment in Provalliance	Investment in and loans to affiliates	\$	139,374	\$	149,245
Equity put option - Provalliance	Other noncurrent liabilities		20,443		22,700

Table of Contents**Impact on Condensed Consolidated Statement of Operations**

Classification	For the Three Months Ended December 31,		
	2011	2010	
	(Dollars in thousands)		
Equity in income, net of income taxes	Equity in income of affiliated companies, net of income taxes	\$ 3,579	\$ 1,676

Impact on Condensed Consolidated Statement of Operations

Classification	For the Six Months Ended December 31,		
	2011	2010	
	(Dollars in thousands)		
Equity in income, net of income taxes	Equity in income of affiliated companies, net of income taxes	\$ 6,441	\$ 3,055

Impact on Condensed Consolidated Statement of Cash Flows

Classification	For the Six Months Ended December 31,		
	2011	2010	
	(Dollars in thousands)		
Equity in income, net of income taxes	Equity in income of affiliated companies, net of income taxes	\$ (6,441)	\$ (3,055)
Cash dividends received	Dividends received from affiliated companies		1,224

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 \$11.3 million (1.3 billion Yen as of April 2007). The Exchangeable Note contains an option for the Company to exchange a portion of the Exchangeable Note for 27.1 percent of the 800 outstanding shares of common stock of MY Style. This exchange feature is akin to a deep-in-the-money option permitting the Company to purchase shares of common stock of MY Style. The option is embedded in the Exchangeable Note and does not meet the criteria for

Edgar Filing: Marathon Petroleum Corp - Form 10-Q

separate accounting under accounting for derivative instruments and hedging activities. In connection with the issuance of the Exchangeable Note, the Company paid a premium of approximately \$5.5 million (573,000,000 Yen as of April 2007).

In March 2010 the Company amended the agreement with Yamano for which the Company purchased one share of Yamano Class A Preferred Stock with a subscription amount of \$1.1 million (100,000,000 Yen) and one share of Yamano Class B Preferred Stock with a subscription amount of \$2.3 million (211,131,284 Yen), collectively the Preferred Shares. Portions of the Exchangeable Note that became due as a result of the March 2010 amendments were contributed in-kind as payment for the Preferred Shares. The Preferred Shares have the same terms and rights, yield a 5.0 percent dividend that accrues if not paid and have no voting rights. The preferred shares are accounted for as an available for sale debt security.

Due to the natural disasters in Japan that occurred in March 2011, the Company was required to assess the preferred shares and premium for other than temporary impairment. The fair value of the collateral which is the equity value of MY Style, declined due to changes in projected revenue growth rates after the natural disasters. As MY Style is highly leveraged, any change in growth rates has a significant impact on fair value. The estimated fair value was negligible. The Company recorded an other than temporary impairment during the third quarter of fiscal year 2011 for the carrying value of the preferred shares and premium of \$3.9 million (326,700,000 Yen) and \$5.3 million (435,000,000 Yen), respectively.

Exchangeable Note. As of December 31, 2011, the principal amount outstanding under the Exchangeable Note is \$1.3 million (100,000,000 Yen) and is due in September 2012. The Company reviews the Exchangeable Note with Yamano for changes in circumstances or the occurrence of events that suggest the Company's note may not be recoverable. The \$1.3 million outstanding Exchangeable Note with Yamano as of December 31, 2011 is in good standing with no associated valuation allowance. The Company has determined the future cash flows of Yamano support the ability to make payments on the Exchangeable Note. The Exchangeable Note accrues interest at 1.845 percent and interest is payable on September 30, 2012 with the final principal payment. The Company recorded less than \$0.1 million in interest income related to the Exchangeable Note during the six months ended December 31, 2011 and 2010.

Table of Contents

MY Style Note. As of December 31, 2011, the principal amount outstanding under the MY Style Note is \$1.4 million (104,328,000 Yen). Principal payments of 52,164,000 Yen along with accrued interest are due annually on May 31 through May 31, 2013. The Company reviews the outstanding note with MY Style for changes in circumstances or the occurrence of events that suggest the Company's note may not be recoverable. The \$1.4 million outstanding note with MY Style as of December 31, 2011 is in good standing with no associated valuation allowance. The Company has determined the future cash flows of MY Style support the ability to make payments on the outstanding note. The MY Style Note accrues interest at 3.0 percent. The Company recorded less than \$0.1 million in interest income related to the MY Style Note during the six months ended December 31, 2011 and 2010.

As of December 31, 2011, \$2.3 and \$0.7 million are recorded in the Condensed Consolidated Balance Sheet as current assets and investment in and loans to affiliates, respectively, representing the Company's Exchangeable Note and outstanding note with MY Style. The exposure to loss related to the Company's involvement with MY Style is the carrying value of the outstanding notes.

All foreign currency transaction gains and losses on the Exchangeable Note and MY Style Note are recorded through other income within the Condensed Consolidated Statement of Operations. The foreign currency transaction gain (loss) recorded through other income was \$0.6 and \$(0.1) million during the six months ended December 31, 2011 and 2010, respectively.

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 three months ended December 31, 2011 and 2010 the Company recorded income of \$0.4 and \$0.1 million, respectively, and received cash dividends of \$0.3 and \$0.3 million, respectively. During the six months ended December 31, 2011 and 2010 the Company recorded income of \$0.6 and \$0.2 million, respectively, and received cash dividends of \$0.6 and \$0.5 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.

6. DISCONTINUED OPERATIONS:

On February 16, 2009, the Company sold its Trade Secret salon concept (Trade Secret). The Company reported Trade Secret as a discontinued operation.

Edgar Filing: Marathon Petroleum Corp - Form 10-Q

The Company has a formal note receivable agreement with the purchaser of Trade Secret. The Company recorded valuation reserves of \$9.0 and \$22.2 million during the three months ended March 31, 2011 and June 30, 2011, respectively. The carrying value of the note receivable was fully reserved as of June 30, 2011. As of December 31, 2011, there were no significant changes in the amount or timing of the expected future cash flows of the note receivable with the purchaser of Trade Secret. The Company has determined the collectibility of accrued interest on the note receivable to be less than probable. The Company suspended recognition of interest income effective April 2010, has recorded a valuation allowance of \$3.8 million as of December 31, 2011 related to the accrued interest, and will use the cash basis method for recognizing future interest income. The Company did not receive interest payments from the purchaser of Trade Secret during the six months ended December 31, 2011.

Beginning within the second quarter of fiscal year 2010, the Company has an agreement in which the Company provides warehouse services to the purchaser of Trade Secret. Under the warehouse services agreement, the Company recognized \$0.4 and \$0.7 million of other income related to warehouse services during the three months ended December 31, 2011 and 2010, respectively. During the six months ended December 31, 2011 and 2010, the Company recognized \$0.9 and \$1.4 million, respectively, of other income related to warehouse services.

Table of Contents

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

	Classification	December 31, 2011	June 30, 2011
(Dollars in thousands)			
Carrying value:			
Warehouse services	Receivables, net	\$ 203	\$ 320
Note receivable, current	Other current assets	5,006	2,607
Note receivable, current valuation allowance	Other current assets	(5,006)	(2,607)
Note receivable, long-term	Other assets	30,026	31,086
Note receivable, long-term valuation allowance	Other assets	(30,026)	(31,086)
Total note receivable, net		\$ 203	\$ 320

The Company utilized the consolidation of variable interest entities guidance to determine whether or not Trade Secret was a VIE, and if so, whether the Company was the primary beneficiary of Trade Secret. The Company concluded that Trade Secret is a VIE based on the fact that the equity investment at risk in Trade Secret is insufficient. The Company determined that the purchaser of Trade Secret has met the power criterion due to the purchaser of Trade Secret having the authority to direct the activities that most significantly impact Trade Secret's economic performance. The Company concluded based on the consideration above that the primary beneficiary of Trade Secret is the purchaser of Trade Secret. The exposure to loss related to the Company's involvement with Trade Secret is the guarantee of approximately 30 operating leases. The Company has determined the exposure to the risk of loss on the guarantee of the operating leases to be immaterial to the financial statements.

7. DERIVATIVE FINANCIAL INSTRUMENTS:

The Company's primary market risk exposures in the normal course of business are changes in interest rates and foreign currency exchange rates. The Company has established policies and procedures that govern the management of these exposures through the use of a variety of strategies, including the use of derivative financial instrument contracts. By policy, the Company does not enter into such contracts for the purpose of speculation or trading. Hedging transactions are limited to an underlying exposure. The Company has established an interest rate management policy that manages the interest rate mix of its total debt portfolio and related overall cost of borrowing. The Company's foreign currency exchange rate risk management policy includes frequently monitoring market data and external factors that may influence exchange rate fluctuations in order to minimize fluctuation in earnings due to changes in exchange rates. The Company enters into arrangements with counterparties that the Company believes are creditworthy. Generally, derivative contract arrangements settle on a net basis. The Company assesses the effectiveness of its hedges on a quarterly basis using the critical terms method in accordance with guidance for accounting for derivative instruments and hedging activities.

The Company has primarily utilized derivatives which are designated as either cash flow or fair value hedges and qualify for hedge accounting treatment. For cash flow hedges and fair value hedges, changes in fair value are deferred in accumulated other comprehensive income (loss) within shareholders' equity until the underlying hedged item is recognized in earnings. Any hedge ineffectiveness is recognized immediately in current earnings. To the extent the changes offset, the hedge is effective. Any hedge ineffectiveness the Company has historically experienced has not been material. By policy, the Company designs its derivative instruments to be effective as hedges and aims to minimize fluctuations in earnings due to market risk exposures. If a derivative instrument is terminated prior to its contract date, the Company continues to defer the related gain or loss and recognizes it in current earnings over the remaining life of the related hedged item.

The Company also utilizes freestanding derivative contracts which do not qualify for hedge accounting treatment. The Company marks to market such derivatives with the resulting gains and losses recorded within current earnings in the Condensed Consolidated Statement of Operations. For purposes of the Condensed Consolidated Statement of Cash Flows, cash flows associated with all derivatives (designated as hedges or freestanding economic hedges) are classified in the same category as the related cash flows subject to the hedging relationship.

Cash Flow Hedges

As of December 31, 2011, the Company's cash flow hedges consisted of forward foreign currency contracts.

In the past, the Company used interest rate swaps to maintain its variable to fixed rate debt ratio in accordance with its established policy. As of December 31, 2010, the Company had \$85.0 million of total variable rate debt outstanding, of which \$40.0 million was swapped to fixed rate debt, resulting in \$45.0 million of variable rate debt. The interest rate swap contracts

Table of Contents

paid fixed rates of interest and received variable rates of interest. The contracts and related debt had maturity dates during fiscal year 2012. The interest rate swaps were terminated prior to the maturity dates in conjunction with the repayments of debt and were settled for an aggregate loss of \$0.1 million. The \$0.1 million loss was recorded during the fourth quarter of fiscal year 2011 on the termination of the interest rate swaps and was recorded within interest expense in the Consolidated Statement of Operations.

The Company uses forward foreign currency contracts to manage foreign currency rate fluctuations associated with certain forecasted intercompany transactions. The Company's primary forward foreign currency contracts hedge approximately \$0.6 million of monthly payments in Canadian dollars for intercompany transactions. The Company's forward foreign currency contracts hedge transactions through September 2012.

These cash flow hedges were designed and are effective as cash flow hedges. They were recorded at fair value within other noncurrent liabilities or other current assets in the Condensed Consolidated Balance Sheet, with corresponding offsets primarily recorded in other comprehensive income (loss), net of tax.

Freestanding Derivative Forward Contracts

The Company uses freestanding derivative forward contracts to offset the Company's exposure to the change in fair value of certain foreign currency denominated investments and intercompany assets and liabilities. These derivatives are not designated as hedges and therefore, changes in the fair 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 Company had the following derivative instruments in its Condensed Consolidated Balance Sheet as of December 31, 2011 and June 30, 2011:

Type	Classification	Asset Fair Value		Classification	Liability Fair Value	
		December 31, 2011	June 30, 2011		December 31, 2011	June 30, 2011
(In thousands)						
Designated as hedging instruments						
Cash Flow Hedges:						
Forward foreign currency contracts	Other current assets	\$	\$	Other current liabilities	\$ (21)	\$ (599)

**Freestanding
derivative
contracts not
designated as
hedging
instruments:**

Forward foreign currency contracts	Other current assets	\$ 28	\$ 212	Other current liabilities	\$	\$
Total		\$ 28	\$ 212		\$ (21)	\$ (599)

The table below sets forth the gain (loss) on the Company's derivative instruments recorded within accumulated other comprehensive income (AOCI) in the Consolidated Balance Sheet for the six months ended December 31, 2011 and 2010. The table also sets forth the loss on the Company's derivative instruments that has been reclassified from AOCI into current earnings during the six months ended December 31, 2011 and 2010 within the following line items in the Condensed Consolidated Statement of Operations.

Type	Gain (Loss) Recognized in Other Comprehensive Income Six Months Ended December 31,		Classification	Gain (Loss) Reclassified from Accumulated OCI into Income Six Months Ended December 31,	
	2011 (In thousands)	2010 (In thousands)		2011 (In thousands)	2010 (In thousands)
Designated as hedging instruments Cash Flow Hedges:					
Interest rate swaps	\$	\$ 274		\$	\$
Forward foreign currency contracts	357	(321)	Cost of sales		(48)
Total	\$ 357	\$ (47)		\$	\$ (48)

As of December 31, 2011 the Company estimates that it will reclassify into earnings during the next twelve months a gain of less than \$0.1 million from the pretax amount recorded in AOCI as the anticipated cash flows occur.

Table of Contents

The table below sets forth the gain (loss) on the Company's derivative instruments for six months ended December 31, 2011 and 2010 recorded within interest income and other, net in the Condensed Consolidated Statement of Operations.

Type	Classification	Derivative Impact on Income for the Six Months Ended December 31,	
		2011	2010
(In thousands)			
Freestanding derivative contracts not designated as hedging instruments:			
Forward foreign currency contracts	Interest income and other, net	\$ (184)	\$ 401

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 consumer and wage and hour violations. In addition, the Company is a nominal defendant, and nine current and former directors and officers of the Company are named defendants, in a shareholder derivative action in Minnesota state court. The derivative shareholder alleges that the individual defendants breached their fiduciary duties to the Company in connection with their approval of certain executive compensation arrangements and certain related party transactions. Litigation is inherently unpredictable and the outcome of these matters cannot presently be determined. Although the actions are being vigorously defended, the Company 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. FINANCING ARRANGEMENTS:

The Company's long-term debt as of December 31, 2011 and June 30, 2011 consisted of the following:

	Maturity Dates (fiscal year)	Interest rate percentage		Amounts outstanding	
		December 31, 2011	June 30, 2011	December 31, 2011	June 30, 2011
Senior term notes	2013 - 2018	6.69 - 8.50%	6.69 - 8.50%	\$ 115,714	\$ 133,571
Convertible senior notes	2015	5.00	5.00	158,639	156,248
Revolving credit facility	2016				
Equipment and leasehold notes	2015 - 2016	4.90 - 8.78	8.80 - 9.14	17,803	22,273

Edgar Filing: Marathon Petroleum Corp - Form 10-Q

payable					
Other notes					
payable	2012 - 2013	5.75 - 8.00	5.75 - 8.00	725	1,319
				292,881	313,411
Less current					
portion				(28,999)	(32,252)
Long-term					
portion				\$ 263,882	\$ 281,159

The debt agreements contain covenants, including limitations on incurrence of debt, granting of liens, investments, merger or consolidation, and transactions with affiliates. In addition, the Company must adhere to specified fixed charge coverage and leverage ratios, as well as minimum net worth levels. The Company was in compliance with all covenants and other requirements of our financing arrangements as of December 31, 2011.

Table of Contents

The table below contains details related to the Company's financing arrangements during the six months ended December 31, 2011 and 2010:

Total Debt	For the Six Months Ended December 31,	
	2011	2010
	(Dollars in Thousands)	
Balance at June 30,	\$ 313,411	\$ 440,029
Repayment of long-term debt and capital lease obligations	(9,669)	(3,334)
Amortized debt discount	1,183	1,086
Other	(910)	1,888
Balance at September 30,	\$ 304,015	\$ 439,669
Repayment of long-term debt and capital lease obligations	(12,321)	(39,258)
Amortized debt discount	1,208	1,110
Other	(21)	2,624
Balance at December 31,	\$ 292,881	\$ 404,145

Private Shelf Agreement

At December 31, 2011 and June 30, 2011, the Company had \$115.7 and \$133.6 million, respectively, in unsecured, fixed rate, senior term notes outstanding under a Private Shelf Agreement, of which \$22.1 million were classified as part of the current portion of the Company's long-term debt at December 31, 2011 and June 30, 2011. The notes require quarterly payments, and final maturity dates range from June 2013 through December 2017.

Convertible Senior Notes

In July 2009, the Company issued \$172.5 million aggregate principal amount of 5.0 percent convertible senior notes due July 2014. The notes are unsecured, senior obligations of the Company and interest will be payable semi-annually in arrears on January 15 and July 15 of each year at a rate of 5.0 percent per year. Upon the July 2009 issuance the notes were convertible subject to certain conditions further described below at an initial conversion rate of 64.6726 shares of the Company's common stock per \$1,000 principal amount of notes (representing an initial conversion price of approximately \$15.46 per share of the Company's common stock). As of December 31, 2011, the conversion rate was 64.9954 shares of the Company's common stock per \$1,000 principal amount of notes (representing a conversion price of approximately \$15.39 per share of the Company's common stock).

Holder may convert their notes at their option prior to April 15, 2014 if the Company's stock price meets certain price triggers or upon the occurrence of specified corporate events as defined in the convertible senior note agreement. On or after April 15, 2014, holders may convert each of

Edgar Filing: Marathon Petroleum Corp - Form 10-Q

their notes at their option at any time prior to the maturity date for the notes.

The Company has the choice of net-cash settlement, settlement in its own shares or a combination thereof and concluded the conversion option is indexed to its own stock. As a result, the Company allocated \$24.7 million of the \$172.5 million principal amount of the convertible senior notes to equity, which resulted in a \$24.7 million debt discount. The allocation was based on measuring the fair value of the convertible senior notes using a discounted cash flow analysis. The discount rate was based on an estimated credit rating for the Company. The estimated fair value of the convertible senior notes was \$147.8 million, and the resulting \$24.7 million debt discount will be amortized over the period the convertible senior notes are expected to be outstanding, which is five years, as additional non-cash interest expense. The combined debt discount amortization and the contractual interest coupon resulted in an effective interest rate on the convertible debt of 8.9 percent.

The following table provides equity and debt information for the convertible senior notes:

Convertible Senior Notes Due 2014	As of December 31,	
	2011	2010
	(Dollars in thousands)	
Principal amount on the convertible senior notes	\$ 172,500	\$ 172,500
Unamortized debt discount	(13,861)	(18,544)
Net carrying amount of convertible debt	\$ 158,639	\$ 153,956

Table of Contents

The following table provides interest rate and interest expense amounts related to the convertible senior notes:

Convertible Senior Notes Due 2014	For the Six Months Ended	
	December 31,	
	2011	2010
	(Dollars in thousands)	
Interest cost related to contractual interest coupon		
5.0%	\$ 4,313	\$ 4,313
Interest cost related to amortization of the discount	2,391	2,196
Total interest cost	\$ 6,704	\$ 6,509

Revolving Credit Facility

As of December 31, 2011 and June 30, 2011, the Company had no outstanding borrowings under its revolving credit facility. Additionally, the Company had outstanding standby letters of credit under the facility of \$26.0 million at December 31, 2011 and June 30, 2011, primarily related to its self-insurance program. Unused available credit under the facility at December 31, 2011 and June 30, 2011 was \$374.0 million. The facility expires in June 2016.

Equipment and Leasehold Notes Payable

The equipment and leasehold notes payable are primarily comprised of capital lease obligations. In September 2011 the Company entered into an agreement to refinance existing capital leases to a three year term with a contract rate of 4.9 percent. Capital leases of \$20.5 million will be amortized at the historical rate of 9.2 percent. There was no gain or loss recorded on the refinance. The Company entered into the refinancing to reduce cash interest payments.

Other Notes Payable

The Company had \$0.7 and \$1.3 million in unsecured outstanding notes at December 31, 2011 and June 30, 2011, respectively, related to debt assumed in acquisitions.

10. INCOME TAXES:

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 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 months ended December 31, 2011, the Company recorded a goodwill impairment charge of \$78.4 million, which is only partially deductible for tax purposes. This impairment, when included as a part of the Company's estimated annual pretax income for the year, resulted in the Company estimating near break-even results for the current fiscal year. When a company estimates nominal profits or losses and has significant non-deductible differences, minor fluctuations in the estimated annual pretax income or loss can result in significant fluctuations of a company's estimated annual effective tax rate. When calculating its income tax provision for the three months ended December 31, 2011 using the annual effective tax rate method, the Company determined that a \$1.0 million increase in estimated annual pretax income would increase the tax provision by approximately \$21 million, and a \$1.0 million decrease in estimated annual pretax income would decrease the tax provision by approximately \$16 million. Based on these significant fluctuations, the Company concluded that it could not meaningfully estimate its annual effective tax rate as projected annual pretax income may fluctuate by \$1.0 million or more as part of the Company's normal earnings projection process. As a result, the Company calculated its tax rate on a year-to-date basis for the three months ended December 31, 2011 rather than utilizing its historical method of calculating an estimated annual effective tax rate. Utilizing the year-to-date method better reflects the tax effect of the events occurring during the quarter and provides more meaningful information as to the effect of income taxes on the Company's operations. The Company will also use the year-to-date method for the remainder of the year because it used the year-to-date method for the three months ended December 31, 2011.

During the three and six months ended December 31, 2011, the Company recognized tax benefits of \$3.5 and \$0.7 million, respectively, with corresponding effective tax rates of 5.2 and 1.2 percent utilizing the year-to-date method. This is compared to tax expense of \$5.3 and \$15.0 million with corresponding effective tax rates of 31.9 and 35.7 percent in the comparable periods of the prior year utilizing the estimated annual effective tax rate method. The effective income tax rates for the three and six months ended December 31, 2011 are lower than what would normally be expected because a majority of the goodwill impairment charge is not deductible for income tax purposes, resulting in the Company recording less of a tax

Table of Contents

benefit on the year-to-date loss than would otherwise be expected. The Company did record a benefit during the quarter from a \$0.6 million release of state tax reserves. The effective income tax rate for the three and six months ended December 31, 2010 was positively impacted by certain discrete items and a shift in the mix of worldwide income to lower taxing jurisdictions. The shift in the mix of worldwide income decreased the Company's income tax provision for the three and six months ended December 31, 2010 by \$0.7 million and decreased its effective income tax rate by 4.4 and 1.8 percent, respectively.

The Company accrues for the effects of open uncertain tax positions and the related potential penalties and interest. Other than the state tax reserve release described above, there were no material adjustments to our recorded liability for unrecognized tax benefits during the three and six months ended December 31, 2011. 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, Luxembourg and the Netherlands as well as states, cities, and provinces within these jurisdictions. In the United States, fiscal years 2007 and after remain open for federal tax audit. The Company's United States federal income tax returns for the years 2007 through 2009 are currently under 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 2007. 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.

11. SEGMENT INFORMATION:

As of December 31, 2011, the Company owned, franchised, or held ownership interests in approximately 12,800 worldwide locations. The Company's locations consisted of 9,453 North American salons (located in the United States, Canada and Puerto Rico), 405 international salons, 97 hair restoration centers and approximately 2,820 locations in which the Company maintains an ownership interest.

The Company operates its North American salon operations through five primary concepts: Regis, MasterCuts, 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 long-term economic characteristics. The salons share interdependencies and a common support base.

Edgar Filing: Marathon Petroleum Corp - Form 10-Q

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.

Table of Contents

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

Total Assets by Segment	December 31, 2011	June 30, 2011
	(Dollars in thousands)	
North American salons	\$ 864,497	\$ 881,526
International salons	67,866	69,932
Hair restoration centers	230,956	306,005
Unallocated corporate	533,642	548,290
Consolidated	\$ 1,696,961	\$ 1,805,753

For the Three Months Ended December 31, 2011						
	Salons		Hair Restoration Centers		Unallocated Corporate	Consolidated
	North America	International				
	(Dollars in thousands)					
Revenues:						
Service	\$ 379,694	\$ 24,331	\$ 17,274	\$	\$	\$ 421,299
Product	103,162	9,738	19,308			132,208
Royalties and fees	9,213		558			9,771
	492,069	34,069	37,140			563,278
Operating expenses:						
Cost of service	218,547	13,122	10,672			242,341
Cost of product	51,753	5,254	6,462			63,469
Site operating expenses	44,466	2,359	1,600			48,425
General and administrative	28,584	2,956	8,060	35,466		75,066
Rent	73,686	9,060	2,224	503		85,473
Depreciation and amortization	17,692	1,112	3,249	9,642		31,695
Goodwill impairment			78,426			78,426
Total operating expenses	434,728	33,863	110,693	45,611		624,895
Operating income (loss)	57,341	206	(73,553)	(45,611)		(61,617)
Other income (expense):						
Interest expense				(7,203)		(7,203)
Interest income and other, net				2,659		2,659
Income (loss) before income taxes and equity in income of affiliated companies	\$ 57,341	\$ 206	\$ (73,553)	\$ (50,155)		\$ (66,161)

Edgar Filing: Marathon Petroleum Corp - Form 10-Q

Table of Contents

For the Three Months Ended December 31, 2010					
Hair					
Salons		Restoration		Unallocated	
North America	International	Centers	Corporate	Consolidated	
(Dollars in thousands)					
Revenues:					
Service	\$ 388,656	\$ 25,634	\$ 16,649	\$	\$ 430,939
Product	103,775	11,443	18,606		133,824
Royalties and fees	9,018		591		9,609
	501,449	37,077	35,846		574,372
Operating expenses:					
Cost of service	226,739	13,314	9,652		249,705
Cost of product	51,622	6,266	6,038		63,926
Site operating expenses	46,739	2,593	1,265		50,597
General and administrative	32,485	3,259	8,276	31,828	75,848
Rent	73,454	8,903	2,314	564	85,235
Depreciation and amortization	17,423	1,161	3,169	4,444	26,197
Total operating expenses	448,462	35,496	30,714	36,836	551,508
Operating income (loss)	52,987	1,581	5,132	(36,836)	22,864
Other income (expense):					
Interest expense				(8,738)	(8,738)
Interest income and other, net				2,604	2,604
Income (loss) before income taxes and equity in income of affiliated companies	\$ 52,987	\$ 1,581	\$ 5,132	\$ (42,970)	\$ 16,730

For the Six Months Ended December 31, 2011					
Hair					
Salons		Restoration		Unallocated	
North America	International	Centers	Corporate	Consolidated	
(Dollars in thousands)					
Revenues:					
Service	\$ 769,858	\$ 49,184	\$ 33,957	\$	\$ 852,999
Product	201,299	18,374	39,452		259,125
Royalties and fees	18,769		1,134		19,903
	989,926	67,558	74,543		1,132,027
Operating expenses:					
Cost of service	441,826	25,812	20,714		488,352
Cost of product	100,197	9,833	13,418		123,448
Site operating expenses	92,762	5,034	3,084		100,880
General and administrative	58,290	5,881	17,333	72,241	153,745
Rent	146,901	17,824	4,495	700	169,920
Depreciation and amortization	35,662	2,418	6,558	21,163	65,801
Goodwill impairment			78,426		78,426
Total operating expenses	875,638	66,802	144,028	94,104	1,180,572
Operating income (loss)	114,288	756	(69,485)	(94,104)	(48,545)

Edgar Filing: Marathon Petroleum Corp - Form 10-Q

Other income (expense):						
Interest expense			(14,563)		(14,563)	
Interest income and other, net			3,975		3,975	
Income (loss) before income taxes and equity in income of affiliated companies	\$ 114,288	\$ 756	\$ (69,485)	\$ (104,692)	\$ (59,133)	

Table of Contents

For the Six Months Ended December 31, 2010					
Hair					
	Salons		Restoration	Unallocated	
	North America	International	Centers	Corporate	Consolidated
(Dollars in thousands)					
Revenues:					
Service	\$ 785,977	\$ 50,997	\$ 33,494	\$	\$ 870,468
Product	203,895	21,138	37,396		262,429
Royalties and fees	18,510		1,210		19,720
	1,008,382	72,135	72,100		1,152,617
Operating expenses:					
Cost of service	454,036	26,042	19,128		499,206
Cost of product	101,355	11,511	12,135		125,001
Site operating expenses	93,068	4,783	1,755		99,606
General and administrative	62,363	6,211	16,855	64,493	149,922
Rent	147,072	17,573	4,578	1,120	170,343
Depreciation and amortization	34,655	2,248	6,312	9,026	52,241
Total operating expenses	892,549	68,368	60,763	74,639	1,096,319
Operating income (loss)	115,833	3,767	11,337	(74,639)	56,298
Other income (expense):					
Interest expense				(17,661)	(17,661)
Interest income and other, net				3,381	3,381
Income (loss) before income taxes and equity in income of affiliated companies	\$ 115,833	\$ 3,767	\$ 11,337	\$ (88,919)	\$ 42,018

12. SUBSEQUENT EVENTS:

In January 2012, Randy L. Pearce informed the Company of his intention to retire as President and as a member of the Board of Directors effective June 30, 2012, the end of the Company's current fiscal year. As previously disclosed, Paul D. Finkelstein will step down as Chief Executive Officer of the Company in February 2012. The Board of Directors has formed a Search Committee of independent directors to begin the search for a new chief executive officer. In the interim, Mr. Pearce will perform the functions of principal executive officer in his role as President and will continue to perform these functions until a successor has been identified.

During the week ended January 27, 2012, the Company reduced the home office workforce by approximately 120 employees. In connection with the workforce reduction, the Company expects to record severance charges estimated to be in the range of \$2.5 to \$3.5 million.

Table of Contents

REVIEW REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Shareholders and Directors of Regis Corporation:

We have reviewed the accompanying condensed consolidated balance sheet of Regis Corporation as of December 31, 2011 and the related condensed consolidated statements of operations for the three and six month periods ended December 31, 2011 and 2010 and the condensed consolidated statement of cash flows for the six month periods ended December 31, 2011 and 2010. These interim financial statements are the responsibility of the Company's management.

We conducted our reviews in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board (United States), the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our review, we are not aware of any material modifications that should be made to the accompanying condensed consolidated interim financial statements for them to be in conformity with accounting principles generally accepted in the United States of America.

We previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet as of June 30, 2011, and the related consolidated statements of operations, of changes in shareholders' equity and comprehensive income and of cash flows for the year then ended (not presented herein), and in our report dated August 26, 2011, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the accompanying consolidated balance sheet information as of June 30, 2011, is fairly stated, in all material respects in relation to the consolidated balance sheet from which it has been derived.

/s/ PricewaterhouseCoopers LLP

PRICEWATERHOUSECOOPERS LLP

Minneapolis, Minnesota
February 6, 2012

Table of Contents

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A) is designed to provide a reader of our financial statements with a narrative from the perspective of our management on our financial condition, results of operations, liquidity and certain other factors that may affect our future results. Our MD&A is presented in five sections:

- Management's Overview

- Critical Accounting Policies

- Overview of Results

- Results of Operations

- Liquidity and Capital Resources

MANAGEMENT'S OVERVIEW

Regis Corporation (RGS, we, our, or us) owns, franchises or holds ownership interests in beauty salons, hair restoration centers and educational institutions. As of December 31, 2011, we owned, franchised or held ownership interests in approximately 12,800 worldwide locations. Our locations consisted of 9,858 system wide North American and international salons, 97 hair restoration centers and approximately 2,820 locations in which we maintain an ownership interest. Our salon concepts offer generally similar products and services and serve mass market consumers. Our salon operations are organized to be managed based on geographical location. Our North American salon operations include 9,453 salons, including 2,007 franchise salons, operating in the United States, Canada and Puerto Rico primarily under the trade names of Regis, MasterCuts, SmartStyle, Supercuts and Cost Cutters. Our international salon operations include 405 company-owned salons, located in the United Kingdom. Our hair restoration centers, operating under the trade name Hair Club for Men and Women, include 97 North American locations, including 29 franchise locations. As of December 31, 2011, we had approximately 54,000 corporate employees worldwide.

Edgar Filing: Marathon Petroleum Corp - Form 10-Q

On August 1, 2007, we contributed our 51 accredited cosmetology schools to Empire Education Group, Inc., creating the largest beauty school operator in North America. As of December 31, 2011, we own a 55.1 percent equity interest in Empire Education Group, Inc. (EEG). Our investment in EEG is accounted for under the equity method. The combined Empire Education Group, Inc. includes 105 accredited cosmetology schools with annual revenues of approximately \$193 million.

On January 31, 2008, we merged our continental European franchise salon operations with the Franck Provost Salon Group in exchange for a 30.0 percent equity interest in the newly formed entity, Provalliance. In March 2011 the Company acquired approximately 17 percent additional equity interest in Provalliance for \$57.3 million (approximately 40.4 million). As of December 31, 2011, we own approximately 47 percent of the equity interest in Provalliance. Our investment in Provalliance is accounted for under the equity method. 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 2,600 company-owned and franchise salons as of December 31, 2011.

Our fiscal year 2012 growth strategy is focused on increasing customer visits by improving the salon experience. We plan to execute our strategy through four focus areas of putting customers and stylists first, leveraging the power of our salon brands, technology and connectivity, and delivering improved financial performance. Initiatives of these four focus areas include:

- Putting customers and stylists first through improving both the experience for the person in the chair and behind the chair. The Company will work on attracting, developing and retaining the best stylists through orientation programs, training and development and rewards and recognition.
- Leveraging the power of our salon brands through focusing on the best brands within the best markets, enhanced focus and alignment and aggressive strategies including discounting.
- Using technology and connectivity, including internet in the salons, to enhance effectiveness of field management and improve customer satisfaction and retention.
- Delivering improved financial performance through undertaking cost savings initiatives in the range of \$35.0 to \$40.0 million, including a home office workforce reduction, renegotiated interest rates, and reduced travel costs. Net of

Table of Contents

investments in our various business initiatives and cost increases in other expense categories, our net cost savings will be approximately \$25.0 million.

Maintaining financial flexibility is a key element in continuing our successful growth. With strong operating cash flow and balance sheet, we are confident that we will be able to financially support our long-term growth objectives.

We are in compliance with all covenants and other requirements of our financing arrangements as of December 31, 2011.

Salon Business

The strength of our salon business is in the fundamental similarity and broad appeal of our salon concepts that allow flexibility and multiple salon concept placements in shopping centers and neighborhoods. Each concept generally targets the middle market customer, however, each attracts a different demographic. We believe there are growth opportunities in all of our salon concepts. When commercial opportunities arise, we anticipate testing and developing new salon concepts to complement our existing concepts.

We execute our salon growth strategy by focusing on real estate. Our salon real estate strategy is to add new units in convenient locations with good visibility and customer traffic, as well as appropriate trade demographics. Our various salon and product concepts operate in a wide range of retailing environments, including regional shopping malls, strip centers and Walmart Supercenters. We believe that the availability of real estate will augment our ability to achieve the aforementioned long-term growth objectives. In fiscal year 2012, our outlook for constructed salons is approximately 285 units. In fiscal year 2012, capital expenditures and acquisitions are expected to be approximately \$100.0 and in the range of \$5.0 to \$15.0 million, respectively.

Organic salon revenue is achieved through the combination of new salon construction and salon same-store sales results. Once customer visitations stabilize, we expect we will continue with our historical trend of building several hundred company-owned salons. We anticipate our franchisees will open approximately 100 to 120 salons in fiscal year 2012. Older, unprofitable salons will be closed or relocated. Our long-term outlook for our salon business is annual consolidated low single digit same-store sales increases. We project our annual fiscal year 2012 consolidated same-store sales to be in a range of negative 2.5 percent to negative 3.5 percent.

Historically, our salon acquisitions have varied in size from as small as one salon to over one thousand salons. The median acquisition size is approximately ten salons. From fiscal year 1994 to the second fiscal quarter of 2012, we acquired 8,051 salons, net of franchise buybacks. Once

customer visitations normalize, we anticipate adding several hundred company-owned salons each year from acquisitions. Some of these acquisitions may include buying salons from our franchisees.

Hair Restoration Business

In December 2004, we acquired Hair Club for Men and Women. Hair Club for Men and Women is a provider of hair loss solutions with an estimated five percent share of the \$4 billion domestic market. This industry is comprised of numerous locations domestically and is highly fragmented. As a result, we believe there is an opportunity to consolidate this industry through acquisition. Expanding the hair loss business organically and through acquisition would allow us to add incremental revenue which is neither dependent upon, nor dilutive to, our existing salon businesses.

Our organic growth plans for the hair restoration business include the construction of a modest number of new locations in untapped markets domestically and internationally. However, the success of our hair restoration business is not dependent on the same real estate criteria used for salon expansion. In an effort to provide confidentiality for our customers, our hair restoration centers operate primarily in professional or medical office buildings. Further, the hair restoration business is more marketing intensive. As a result, organic growth at our hair restoration centers will be dependent on successfully generating new leads and converting them into hair restoration customers. Our growth expectations for our hair restoration business are not dependent on referral business from, or cross marketing with, our hair salon business, but these concepts continue to be evaluated closely for additional growth opportunities.

During the three months ended December 31, 2011 the Company began reviewing alternatives for non-core assets, including the exploration of a potential sale of the hair restoration business.

CRITICAL ACCOUNTING POLICIES

The Condensed Consolidated Financial Statements are prepared in conformity with accounting principles generally accepted in the United States of America. In preparing the Condensed Consolidated Financial Statements, we are required to make various judgments, estimates and assumptions that could have a significant impact on the results reported in the Condensed Consolidated Financial Statements. We base these estimates on historical experience and other assumptions believed to be reasonable under the circumstances. Estimates are considered to be critical if they meet both of the following criteria: (1) the estimate requires assumptions

Table of Contents

about material matters that are uncertain at the time the accounting estimates are made, and (2) other materially different estimates could have been reasonably made or material changes in the estimates are reasonably likely to occur from period to period. Changes in these estimates could have a material effect on our Condensed Consolidated Financial Statements.

Our significant accounting policies can be found in Note 1 to the Consolidated Financial Statements contained in Part II, Item 8 of the June 30, 2011 Annual Report on Form 10-K, as well as Note 1 to the Condensed Consolidated Financial Statements contained within this Quarterly Report on Form 10-Q. We believe the accounting policies related to the valuation of goodwill, the valuation and estimated useful lives of long-lived assets, investment in and loans to affiliates, purchase price allocations, revenue recognition, self-insurance accruals, stock-based compensation expense, legal contingencies and estimates used in relation to tax liabilities and deferred taxes are most critical to aid in fully understanding and evaluating our reported financial condition and results of operations. Discussion of each of these policies is contained under Critical Accounting Policies in Part II, Item 7 of our June 30, 2011 Annual Report on Form 10-K. There were no significant changes in or application of our critical accounting policies during the three and six months ended December 31, 2011.

Goodwill:

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

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

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

is the implied fair value of goodwill. The goodwill impairment is measured as the excess of the carrying value of goodwill over its implied fair value.

As previously disclosed, the Company concluded that it was reasonably likely that goodwill for the Hair Restoration Centers reporting unit might become impaired in future periods. During the three months ended December 31, 2011 the Company updated the projections used in the fiscal 2011 annual impairment test to reflect the impact of recent industry developments, including a slow down in revenue growth and increasing supply costs. The Company determined there was a triggering event as it was more likely than not that the fair value of the Hair Restoration Centers was below carrying value and performed an interim impairment test of goodwill during the three months ended December 31, 2011. There were no triggering events relative to the Company's other reporting units.

As a result of the Company's interim impairment testing of goodwill related to the Hair Restoration Centers reporting unit during the second quarter of fiscal year 2012, a \$78.4 million impairment charge was recorded within continuing operations for the excess of the carrying value of goodwill over the implied fair value of the goodwill for the Hair Restorations Centers reporting unit. After the impairment charge the Hair Restorations Centers reporting unit had \$74.4 million of goodwill as of December 31, 2011. The impairment was only partially deductible for tax purposes resulting in a tax benefit of \$5.9 million. See further discussion on the effective tax rate for the three and six months ended December 31, 2011 within Note 10 to the Condensed Consolidated Financial Statements.

As of June 30, 2011, the estimated fair value of the Regis salon concept reporting unit exceeded the carrying value by approximately 18.0 percent. Excluding Regis, Hair Restoration Centers for which the Company performed an interim impairment test of goodwill during the three months ended December 31, 2011 and Promenade for which the Company recorded a \$74.1 million impairment charge as a result of the Company's impairment testing of goodwill during the third quarter of fiscal year 2011, the respective fair values of the Company's remaining reporting units exceeded fair value by greater than 20.0 percent at June 30, 2011. While the Company has determined the estimated fair values of Promenade, Hair Restoration Centers, and Regis to be appropriate based on the historical level of revenue growth, operating income and cash flows, it is reasonably likely that Promenade, Hair Restoration Centers,

Table of Contents

and Regis may experience additional impairment in future periods. The term "reasonably likely" refers to an occurrence that is more than remote but less than probable in the judgment of the Company. Because some of the inherent assumptions and estimates used in determining the fair value of the reportable segment are outside the control of management, changes in these underlying assumptions can adversely impact fair value. Potential impairment of a portion or all of the carrying value of the Promenade and Regis salon concepts and Hair Restoration Centers goodwill is dependent on many factors and cannot be predicted with certainty.

As of December 31, 2011, the Company's estimated fair value, as determined by the sum of our reporting units' fair value, reconciled to within a reasonable range of our market capitalization which included an assumed control premium.

As the Company performed an impairment test on the Hair Restoration Centers reporting unit goodwill during the three months ended December 31, 2011 and it is reasonably likely that there could be impairment of the Hair Restoration Centers reporting unit's goodwill in future periods, a summary of the critical assumptions utilized during the interim impairment test of the Hair Restoration Centers reporting unit is outlined below:

Annual revenue growth. Annual revenue growth is primarily driven by assumed same-store sales rates of approximately positive 1.0 to positive 3.0 percent. Other considerations include anticipated economic conditions and moderate acquisition growth.

Gross margin. Adjusted for anticipated center closures, new center construction and acquisitions. In addition, estimated future gross margins were adjusted for increasing supply costs.

Fixed expense rates. Fixed expense rate increases of approximately 1.0 to 2.0 percent based on anticipated inflation. Fixed expenses consisted of rent, site operating, and allocated general and administrative corporate overhead.

Allocated corporate overhead. Corporate overhead incurred by the home office is not allocated as the Hair Restoration Centers reporting unit incurs its own overhead.

Long-term growth. A long-term growth rate of 2.5 percent was applied to terminal cash flow based on anticipated economic conditions.

Edgar Filing: Marathon Petroleum Corp - Form 10-Q

Discount rate. A discount rate of 12.0 percent based on the weighted average cost of capital that equals the rate of return on debt capital and equity capital weighted in proportion to the capital structure common to the industry.

Structure. A nontaxable structure based on the highest economic value and feasibility of the assumed structure.

The following table summarizes the approximate impact that a change in certain critical assumptions would have on the estimated fair value of our Hair Restoration Centers reporting unit goodwill balance (the approximate impact of the change in the critical assumptions assumes all other assumptions and factors remain constant, in thousands, except percentages):

Critical Assumptions	Increase (Decrease)	Approximate Impact on Fair Value (In thousands)
Discount Rate	1.0%	\$ 12,000
Same-Store Sales	(1.0)	3,000

A summary of the Company's goodwill balance as of December 31, 2011 and June 30, 2011 by reporting unit is as follows:

Reporting Unit	As of December 31, 2011	As of June 30, 2011
	(Dollars in thousands)	
Regis	\$ 103,581	\$ 103,761
MasterCuts	4,652	4,652
SmartStyle	48,529	48,916
Supercuts	129,540	129,477
Promenade	243,428	240,910
Total North America Salons	529,730	527,716
Hair Restoration Centers	74,367	152,796
Total	\$ 604,097	\$ 680,512

Table of Contents

OVERVIEW OF RESULTS FOR THE THREE MONTHS ENDED DECEMBER 31, 2011

- Revenues decreased 1.9 percent to \$563.3 million and consolidated same-store sales decreased 3.0 percent. The Company experienced a decline in customer visitations and average ticket price.
- We acquired three corporate salon locations, all of which were franchise location buybacks. We built 53 corporate locations and closed, converted or relocated 89 locations. Our franchisees constructed 29 locations and closed, sold back to us, or relocated ten locations. As of December 31, 2011, we had 7,851 company-owned salon locations, 2,007 franchise salon locations and 97 hair restoration centers (68 company-owned and 29 franchise locations).
- The Company recorded a \$78.4 million non-cash goodwill impairment charge associated with our Hair Restoration Centers reporting unit.
- The Company recorded \$7.0 million in depreciation expense associated with its internally developed POS system. Of the \$7.0 million, there was incremental depreciation expense of \$6.3 million (\$4.0 million net of tax or \$0.07 per diluted share) associated with the adjustment to the useful life.

RESULTS OF OPERATIONS

Consolidated Results of Operations

The following table sets forth, for the periods indicated, certain information derived from our Condensed Consolidated Statement of Operations, expressed as a percent of revenues. The percentages are computed as a percent of total consolidated revenues, except as noted.

Results of Operations as a Percent of Revenues	For the Periods Ended December 31,			
	Three Months		Six Months	
	2011	2010	2011	2010
Service revenues	74.8%	75.0%	75.4%	75.5%
Product revenues	23.5	23.3	22.9	22.8
Franchise royalties and fees	1.7	1.7	1.7	1.7

Operating expenses:

Edgar Filing: Marathon Petroleum Corp - Form 10-Q

Cost of service (1)	57.5	57.9	57.3	57.3
Cost of product (2)	48.0	47.8	47.6	47.6
Site operating expenses	8.6	8.8	8.9	8.6
General and administrative	13.3	13.2	13.6	13.0
Rent	15.2	14.8	15.0	14.8
Depreciation and amortization	5.6	4.6	5.8	4.5
Goodwill impairment	13.9		6.9	
Operating (loss) income	(10.9)	4.0	(4.3)	4.9
(Loss) income before income taxes and equity in income of affiliated companies	(11.7)	2.9	(5.2)	3.6
Net (loss) income	(10.2)	2.5	(4.3)	2.8

(1) Computed as a percent of service revenues and excludes depreciation expense.

(2) Computed as a percent of product revenues and excludes depreciation expense.

Table of Contents**Consolidated Revenues**

Consolidated revenues primarily include revenues of company-owned salons, product and equipment sales to franchisees, hair restoration center revenues, and franchise royalties and fees. As compared to the respective prior period, consolidated revenues decreased 1.9 percent to \$563.3 million during the three months ended December 31, 2011 and decreased 1.8 percent to \$1,132.0 million during the six months ended December 31, 2011. The following table details our consolidated revenues by concept. All service revenues, product revenues (which include product and equipment sales to franchisees), and franchise royalties and fees are included within their respective concept detailed in the table below:

	For the Periods Ended December 31,			
	Three Months		Six Months	
	2011	2010	2011	2010
	(Dollars in thousands)			
North American salons:				
Regis	\$ 104,629	\$ 108,928	\$ 209,496	\$ 216,433
MasterCuts	40,293	41,295	80,751	83,335
SmartStyle	125,980	129,671	254,464	262,224
Supercuts	85,031	78,310	168,634	157,633
Promenade	136,136	143,245	276,581	288,757
Total North American salons	492,069	501,449	989,926	1,008,382
International salons	34,069	37,077	67,558	72,135
Hair restoration centers	37,140	35,846	74,543	72,100
Consolidated revenues	\$ 563,278	\$ 574,372	\$ 1,132,027	\$ 1,152,617
Percent change from prior year	(1.9)%	(0.2)%	(1.8)%	(2.4)%
Salon same-store sales decrease (1)	(3.0)%	(1.3)%	(3.1)%	(1.4)%

The percent changes in consolidated revenues during the three and six months ended December 31, 2011 and 2010, respectively, were driven by the following:

Percentage Increase (Decrease) in Revenues	For the Periods Ended December 31,			
	Three Months		Six Months	
	2011	2010	2011	2010
Acquisitions (previous twelve months)	0.9%	1.1%	1.1%	0.8%
Organic	(0.8)	0.0	(1.4)	(1.6)
Foreign currency	0.1	0.1	0.4	0.0
Closed salons	(2.1)	(1.4)	(1.9)	(1.6)
	(1.9)%	(0.2)%	(1.8)%	(2.4)%

(1) Salon same-store sales are calculated on a daily basis as the total change in sales for company-owned salons which were open on a specific day of the week during the current period and the corresponding prior period. Quarterly and year-to-date salon same-store sales are the sum of the same-store sales computed on a daily basis. Salons relocated within a one mile radius are

Edgar Filing: Marathon Petroleum Corp - Form 10-Q

included in same-store sales as they are considered to have been open in the prior period. International same-store sales are calculated in local currencies so that foreign currency fluctuations do not impact the calculation. Management believes that same-store sales, a component of organic growth, are useful in determining the increase in salon revenues attributable to its organic growth (new salon construction and same-store sales growth) versus growth from acquisitions.

We acquired 56 salons (including 54 franchise salon buybacks) and three hair restoration centers (all of which were franchise buybacks) during the twelve months ended December 31, 2011. The organic decrease during the three and six months ended December 31, 2011 was primarily due to consolidated same-store sales decreases of 3.0 and 3.1 percent, respectively, partially offset by the construction of 165 company-owned salons and four hair restoration centers during the twelve months ended December 31, 2011. We closed 287 salons (including 34 franchise salons) and one hair restoration center during the twelve months ended December 31, 2011.

During the three and six months ended December 31, 2011, the foreign currency impact was driven by the weakening of the United States dollar against the Canadian dollar, British pound and Euro, as compared to the exchange rates for the comparable prior periods. The impact of foreign currency was calculated by multiplying current year revenues in local currencies by the change in the foreign currency exchange rate between the current and prior fiscal year.

During the twelve months ended December 31, 2010, we acquired 76 salons (including 49 franchise salon buybacks), constructed 125 company-owned salons, and closed 284 salons (including 75 franchise salons). There was no change in organic during the three months ended December 31, 2010 as the consolidated same-store sales decrease of 1.3 percent was offset by the construction of 125

Table of Contents

company-owned salons during the twelve months ended December 31, 2010. The decrease in organic during the six months ended December 31, 2010 was primarily due to the same-store sales decrease of 1.4 percent and the completion of an agreement to supply the purchaser of Trade Secret product at cost, partially offset by the construction of 125 company-owned salons during the twelve months ended December 31, 2010. The Company generated revenues of \$20.0 million for product sold to the purchaser of Trade Secret during the six months ended December 31, 2009.

During the three months ended December 31, 2010, the foreign currency impact was driven by the weakening of the United States dollar against the Canadian dollar, partially offset by the strengthening of the United States dollar against the British pound and Euro, as compared to the exchange rates for the comparable prior periods. During the six months ended December 31, 2010, there was no foreign currency impact as the weakening of the United States dollar against the Canadian dollar was offset by the strengthening of the United States dollar against the British pound and Euro, as compared to the exchange rates for the comparable prior period. The impact of foreign currency was calculated by multiplying current year revenues in local currencies by the change in the foreign currency exchange rate between the current and prior fiscal year.

Consolidated revenues are primarily comprised of service and product revenues, as well as franchise royalties and fees. Fluctuations in these three major revenue categories were as follows:

Service Revenues. Service revenues include revenues generated from company-owned salons and service revenues generated by hair restoration centers. Total service revenues for the three and six months ended December 31, 2011 and 2010 were as follows:

Periods Ended December 31,	Revenues	Decrease Over Prior Fiscal Year	
		Dollar	Percentage
	(Dollars in thousands)		
Three Months			
2011	\$ 421,299	\$ (9,640)	(2.2)%
2010	430,939	(4,186)	(1.0)
Six Months			
2011	\$ 852,999	\$ (17,469)	(2.0)%
2010	870,468	(13,935)	(1.6)

The decrease in service revenues during the three and six months ended December 31, 2011 was due to same-store service sales decreasing 3.3 and 3.2 percent, respectively, which was primarily as a result of a decline in same-store customer visits and average ticket. The decrease in service revenues was partially offset by growth due to new and acquired salons during the previous twelve months and the weakening of the United States dollar against the British Pound, Canadian dollar, and Euro.

Edgar Filing: Marathon Petroleum Corp - Form 10-Q

The decrease in service revenues during the three and six months ended December 31, 2010 was due to same-store service sales decreasing 2.1 and 2.3 percent, respectively, as a result of a decline in same-store customer visits. Partially offsetting the decrease in service revenues was growth due to acquisitions during the previous twelve months, and price increases and sales mix as the Company continues to increase hair color and waxing services. In addition, for the three months ended December 31, 2010, the weakening of the United States dollar against the Canadian dollar partially offset the decrease in service revenues.

Product Revenues. Product revenues are primarily sales at company-owned salons, hair restoration centers and sales of product and equipment to franchisees. Total product revenues for the three and six months ended December 31, 2011 and 2010 were as follows:

Periods Ended December 31,	Revenues	(Decrease) Increase Over Prior Fiscal Year	
		Dollar	Percentage
		(Dollars in thousands)	
Three Months			
2011	\$ 132,208	\$ (1,616)	(1.2)%
2010	133,824	3,153	2.4
Six Months			
2011	\$ 259,125	\$ (3,304)	(1.3)%
2010	262,429	(14,395)	(5.2)

The decrease in product revenues during the three and six months ended December 31, 2011 was primarily due to same-store product sales decreasing 2.2 and 2.7 percent, respectively. Product sales were unfavorably impacted during the six months ended December 31, 2011 as two vendor lines were repackaged in the first fiscal quarter. The decrease in product revenues was partially offset by increased product sales of the Company's private label lines in our North American segment due to holiday promotional deals, growth

Table of Contents

due to new and acquired salons during the previous twelve months, and the weakening of the United States dollar against the British Pound, Canadian dollar, and Euro.

The increase in product revenues during the three months ended December 31, 2010 was due to same-store product sales increasing 1.5 percent. Holiday product promotional deals and new product assortments had a positive impact on same-store product sales.

The decrease in product revenues during the six months ended December 31, 2010 was due to product sales of \$20.0 million to the purchaser of Trade Secret during the prior year comparable period, partially offset by a same-store sales increase of 1.6 percent.

Royalties and Fees. Total franchise revenues, which include royalties and fees, for the three and six months ended December 31, 2011 and 2010 were as follows:

Periods Ended December 31,	Revenues	Increase Over Prior Fiscal Year	
		Dollar	Percentage
(Dollars in thousands)			
Three Months			
2011	\$ 9,771	\$ 162	1.7%
2010	9,609	40	0.4
Six Months			
2011	\$ 19,903	\$ 183	0.9%
2010	19,720	32	0.2

Total franchise locations open at December 31, 2011 were 2,036, including 29 franchise hair restoration centers, as compared to 2,006, including 32 franchise hair restoration centers, at December 31, 2010. During the six months ended December 31, 2011, we purchased a franchise network, consisting of 31 franchise locations. We purchased 54 of our franchise salons and three franchise hair restoration centers during the twelve months ended December 31, 2011. The increase in royalties and fees was primarily due to same-store sales increases at franchise locations and an increase in new store openings as compared to the corresponding periods of the prior fiscal year.

Total franchise locations open at December 31, 2010 were 2,006, including 32 franchise hair restoration centers, as compared to 2,078, including 33 franchise hair restoration centers, at December 31, 2009. We purchased 49 of our franchise salons and one franchise hair restoration center during the twelve months ended December 31, 2010. The decrease in franchise locations was offset by the impact of the weakening of the United States dollar against the Canadian dollar.

Gross Margin (Excluding Depreciation and Amortization)

Edgar Filing: Marathon Petroleum Corp - Form 10-Q

Our cost of revenues primarily includes labor costs related to salon and hair restoration center employees, the cost of product used in providing services and the cost of products sold to customers and franchisees. The resulting gross margin for the three and six months ended December 31, 2011 and 2010 was as follows:

Periods Ended December 31,	Gross Margin	Margin as % of Service and Product Revenues	(Decrease) Increase Over Dollar Percentage	Increase Over Percentage	Prior Fiscal Year Basis Point(1)
(Dollars in thousands)					
<i>Three Months</i>					
2011	\$ 247,697	44.8%	\$ (3,435)	(1.4)%	30
2010	251,132	44.5	(3,432)	(1.3)	(50)
<i>Six Months</i>					
2011	\$ 500,324	45.0%	\$ (8,366)	(1.6)%	10
2010	508,690	44.9	(5,841)	(1.1)	60

(1) Represents the basis point change in gross margin as a percent of service and product revenues as compared to the corresponding periods of the prior fiscal year.

Table of Contents

Service Margin (Excluding Depreciation and Amortization). Service margin for the three and six months ended December 31, 2011 and 2010 was as follows:

Periods Ended December 31,	Service Margin	Margin as % of Service Revenues		Increase Over Prior Fiscal Year	
		(Decrease) Dollar	Percentage	(Decrease) Dollar	Percentage
(Dollars in thousands)					
Three Months					
2011	\$ 178,958	42.5%	\$ (2,276)	(1.3)%	40
2010	181,234	42.1	(5,079)	(2.7)	(70)
Six Months					
2011	\$ 364,647	42.7%	\$ (6,615)	(1.8)%	
2010	371,262	42.7	(8,360)	(2.2)	(20)

(1) Represents the basis point change in service margin as a percent of service revenues as compared to the corresponding periods of the prior fiscal year.

The basis point increase in service margin as a percent of service revenues during the three months ended December 31, 2011 was primarily due to increased productivity in our salons, lower commissions as a result of the implementation of leveraged pay plans for new stylists and a decrease in salon health insurance costs due to lower claims. Partially offsetting the increase was negative leverage on fixed payroll costs due to negative same-store service sales and an increase in payroll taxes as a result of states increasing unemployment taxes.

Service margin as a percent of service revenues during the six months ended December 31, 2011 was consistent with the comparable prior period. Lower commissions as a result of leveraged pay plans for new stylists and a decrease in salon health insurance costs due to lower claims were offset by an increase in payroll taxes as a result of states increasing unemployment taxes and negative leverage on fixed payroll costs due to negative same-store service sales.

The basis point decrease in service margin as a percent of service revenues during the three and six months ended December 31, 2010 was primarily due to an unexpected increase in salon payroll expense as staffing was increased in preparation for the holiday season and same-store sales declined during the period. In addition, the basis point decrease was due to a planned increase in payroll taxes as a result of states increasing unemployment tax rates.

Product Margin (Excluding Depreciation and Amortization). Product margin for the three and six months ended December 31, 2011 and 2010 was as follows:

Product	(Decrease) Increase Over Prior Fiscal Year
---------	--

Edgar Filing: Marathon Petroleum Corp - Form 10-Q

Periods Ended December 31,	Margin as % of Product Revenues				
	Margin	Dollar	Percentage	Basis Point(1)	
(Dollars in thousands)					
Three Months					
2011	\$ 68,739	52.0%	\$ (1,159)	(1.7)%	(20)
2010	69,898	52.2	1,647	2.4	
Six Months					
2011	\$ 135,677	52.4%	\$ (1,751)	(1.3)%	
2010	137,428	52.4	2,519	1.9	370

(1) Represents the basis point change in product margin as a percent of product revenues as compared to the corresponding periods of the prior fiscal year.

Product margin as a percent of product revenues during the three and six months ended December 31, 2011 was down 20 basis points and consistent, respectively, with the comparable prior period primarily due to a shift in sales mix to lower margin products and promotions in our North American segment, increases in freight-in costs due to higher fuel prices and an increase in the cost of hair systems in our Hair Restoration Centers segment. Partially offsetting the decrease was a reduction in commissions paid to new employees on retail product sales in our North American segment and an improvement in product margins in our International segment due to a shift in sales mix to higher margin products.

Product margin as a percent of product revenues during the three months ended December 31, 2010 was consistent with the comparable prior period. An improvement related to a reduction in commissions paid to new employees on retail product sales and increased product sales in our North American segment of higher-margin items such as the Company's private label lines was offset by an increase in sales of slightly lower profit margin appliances in our international segment.

Table of Contents

Product margin as a percent of product revenues during the six months ended December 31, 2010 improved due to the comparable prior period including \$20.0 million of product sold to the purchaser of Trade Secret at cost.

Site Operating Expenses

This expense category includes direct costs incurred by our salons and hair restoration centers such as on-site advertising, workers' compensation, insurance, utilities and janitorial costs. Site operating expenses for the three and six months ended December 31, 2011 and 2010 were as follows:

Periods Ended December 31,	Site Operating	Expense as % of Consolidated Revenues	Increase Over Prior Fiscal Year		
			(Decrease) Dollar	Percentage	Basis Point(1)
(Dollars in thousands)					
Three Months					
2011	\$ 48,425	8.6%	\$ (2,172)	(4.3)%	(20)
2010	50,597	8.8	4,188	9.0	70
Six Months					
2011	\$ 100,880	8.9%	\$ 1,274	1.3%	30
2010	99,606	8.6	521	0.5	20

(1) Represents the basis point change in site operating expenses as a percent of consolidated revenues as compared to the corresponding periods of the prior fiscal year.

The basis point improvement in site operating expenses as a percent of consolidated revenues during the three months ended December 31, 2011 was primarily due to a reduction in self insurance accruals and cost savings associated with inventory counts.

The basis point increase in site operating expenses as a percent of consolidated revenues during the six months ended December 31, 2011 was primarily due to planned increases in advertising expense related to promotional activity to increase customer trial and charges for salon internet connectivity, partially offset by a reduction in self insurance accruals and cost savings associated with inventory counts.

The basis point increase in site operating expenses as a percent of consolidated revenues during the three and six months ended December 31, 2010 was primarily due to a planned increase in advertising expense within a portion of the Company's Promenade salons, higher self insurance accruals and an increase in salon level telecommunications expenses related to the Company's internet in the salon initiative. The Company recorded an increase in self insurance accruals of \$0.5 million in the three months ended December 31, 2010, compared to a \$1.9 million reduction

Edgar Filing: Marathon Petroleum Corp - Form 10-Q

in the three months ended December 31, 2009. The basis point increase for the six months ended December 31, 2010 was partially offset by the prior year comparable period included \$3.6 million expense related to two legal claims on customer and employee matters.

General and Administrative

General and administrative (G&A) includes costs associated with our field supervision, salon training and promotions, product distribution centers and corporate offices (such as salaries and professional fees), including costs incurred to support franchise and hair restoration center operations. G&A expenses for the three and six months ended December 31, 2011 and 2010 were as follows:

Periods Ended December 31,	G&A	Expense as % of Consolidated Revenues (Decrease) Increase Over Prior Fiscal Year			
		Dollar	Percentage	Basis Point(1)	
(Dollars in thousands)					
Three Months					
2011	\$ 75,066	13.3%	\$ (782)	(1.0)%	10
2010	75,848	13.2	3,237	4.5	60
Six Months					
2011	\$ 153,745	13.6%	\$ 3,823	2.5%	60
2010	149,922	13.0	4,751	3.3	70

(1) Represents the basis point change in G&A as a percent of consolidated revenues as compared to the corresponding periods of the prior fiscal year.

Table of Contents

The basis point increase in G&A costs as a percent of consolidated revenues during the three and six months ended December 31, 2011 was primarily due to incremental costs associated with the Company's senior management restructuring and professional fees incurred in connection with the contested proxy, partially offset by a decline in travel expense that was a result of the implementation of portable technology for field staff and the prior period including expenditures associated with the Regis salon concept national salon managers meeting.

The basis point increase in G&A costs as a percent of consolidated revenues during the three and six months ended December 31, 2010 was primarily due to expenditures associated with the Regis salon concept re-imaging project and professional fees incurred related to the exploration of strategic alternatives.

Rent

Rent expense, which includes base and percentage rent, common area maintenance, and real estate taxes, for the three and six months ended December 31, 2011 and 2010, was as follows:

Periods Ended December 31,	Rent	Expense as % of Consolidated Revenues			
		Increase (Decrease) Dollar	Percentage	Increase (Decrease) Over Prior Fiscal Year Basis Point(1)	
(Dollars in thousands)					
Three Months					
2011	\$ 85,473	15.2%	\$ 238	0.3%	40
2010	85,235	14.8	(305)	(0.4)	(10)
Six Months					
2011	\$ 169,920	15.0%	\$ (423)	(0.2)%	20
2010	170,343	14.8	(1,047)	(0.6)	30

(1) Represents the basis point change in rent as a percent of consolidated revenues as compared to the corresponding periods of the prior fiscal year.

The basis point increase in rent expense as a percent of consolidated revenues during the three and six months ended December 31, 2011 was primarily due to negative leverage in this fixed cost category due to negative same-stores sales.

The basis point improvement in rent expense as a percent of consolidated revenues during the three months ended December 31, 2010 was primarily due to savings achieved from our store closure initiatives, partially offset by negative leverage in this fixed cost category due to negative same-stores sales.

The basis point increase in rent expense as a percent of consolidated revenues during the six months ended December 31, 2010 was primarily due to negative leverage in this fixed cost category due to negative same-store sales, partially offset by savings achieved from our salon closure initiatives.

Depreciation and Amortization

Depreciation and amortization expense (D&A) for the three and six months ended December 31, 2011 and 2010 was as follows:

Periods Ended December 31,	D&A	Expense as % of Consolidated Revenues				Increase (Decrease) Over Prior Fiscal Year Basis Point(1)
			Dollar	Percentage		
(Dollars in thousands)						
Three Months						
2011	\$ 31,695	5.6%	\$ 5,498	21.0%	100	
2010	26,197	4.6	(1,313)	(4.8)	(20)	
Six Months						
2011	\$ 65,801	5.8%	\$ 13,560	26.0%	130	
2010	52,241	4.5	(2,460)	(4.5)	(10)	

(1) Represents the basis point change in D&A as a percent of consolidated revenues as compared to the corresponding periods of the prior fiscal year.

The basis point increase in D&A as a percent of consolidated revenues during the three and six months ended December 31, 2011 was primarily due to accelerated depreciation expense resulting from the useful life adjustment of the Company's internally developed

Table of Contents

point-of-sale (POS) system. The accelerated depreciation was \$6.3 and \$15.0 million during the three and six months ended December 31, 2011, respectively. The Company expects to fully depreciate the net balance of the existing POS system, approximately \$2.0 million at December 31, 2011, during the three months ended March 31, 2012.

The basis point improvement in D&A as a percent of consolidated revenues during the three and six months ended December 31, 2010 was primarily due to a decrease in depreciation expense as a result of a reduction in salon construction, partially offset by negative leverage from the decrease in same-store sales.

Goodwill Impairment

Goodwill impairment charges for the three and six months ended December 31, 2011 and 2010 was as follows:

Periods Ended December 31,	Goodwill Impairment	Expense as % of Consolidated Revenues	Increase Over Prior Fiscal Year		
			Dollar	Percentage	Basis Point(1)
(Dollars in thousands)					
Three Months					
2011	\$ 78,426	13.9%	\$ 78,426	N/A	1,390
2010					
Six Months					
2011	\$ 78,426	6.9%	\$ 78,426	N/A	690
2010					

(1) Represents the basis point change in goodwill impairment as a percent of consolidated revenues as compared to the corresponding periods of the prior fiscal year.

During the three and six months ended December 31, 2011, the Company recorded \$78.4 million of goodwill impairment expense related to the Hair Restoration Centers reporting unit. Due to the impact of recent industry developments, including a slow down in revenue growth and increasing supply costs, the estimated fair value of the Hair Restoration Centers operations was less than the carrying value of this reporting unit's net assets, including goodwill. The \$78.4 million impairment charge was the excess of the carrying value of goodwill over the implied fair value of goodwill for the Hair Restoration Centers reporting unit.

Interest Expense

Edgar Filing: Marathon Petroleum Corp - Form 10-Q

Interest expense for the three and six months ended December 31, 2011 and 2010 was as follows:

Periods Ended December 31,	Interest	Expense as % of Consolidated Revenues	Decrease Over Prior Fiscal Year		
			Dollar	Percentage	Basis Point(1)
(Dollars in thousands)					
Three Months					
2011	\$ 7,203	1.3%	\$ (1,535)	(17.6)%	(20)
2010	8,738	1.5	(331)	(3.6)	(10)
Six Months					
2011	\$ 14,563	1.3%	\$ (3,098)	(17.5)%	(20)
2010	17,661	1.5	(18,724)	(51.5)	(160)

(1) Represents the basis point change in interest expense as a percent of consolidated revenues as compared to the corresponding periods of the prior fiscal year.

The basis point improvement in interest expense as a percent of consolidated revenues during the three and six months ended December 31, 2011 was primarily due to decreased debt levels as compared to the three and six months ended December 31, 2010, respectively.

The basis point improvement in interest expense as a percent of consolidated revenues during the three months ended December 31, 2010 was primarily due to decreased debt levels as compared to the three months ended December 31, 2009.

The basis point improvement in interest expense as a percent of consolidated revenues during the six months ended December 31, 2010 was due to the prior year comparable period including \$12.8 million of make-whole payments and \$5.2 million of interest rate settlement and other fees associated with the prepayment of private placement debt.

Table of Contents**Interest Income and Other, net**

Interest income and other, net for the three and six months ended December 31, 2011 and 2010 was as follows:

Periods Ended December 31,	Interest	Income as % of Consolidated Revenues				Increase (Decrease) Over Prior Fiscal Year Basis Point(1)
		Dollar	Percentage	Dollar	Percentage	
Three Months						
2011	\$ 2,659	0.5%	\$ 55	2.1%		
2010	2,604	0.5	1,193	84.5		30
Six Months						
2011	\$ 3,975	0.4%	\$ 594	17.6%		10
2010	3,381	0.3	(262)	(7.2)		

(1) Represents the basis point change in interest income and other, net as a percent of consolidated revenues as compared to the corresponding periods of the prior fiscal year.

Interest income and other, net as a percent of consolidated revenues during the three and six months ended December 31, 2011 was consistent and increased by ten basis points, respectively, with the comparable prior period. Foreign currency impact related to the Company's investment in MY Style and a favorable legal settlement during the three and six month periods ended December 31, 2011 were offset by the prior year comparable period including an interest payment of \$0.7 million on the note receivable with the purchaser of Trade Secret and lower fees received during the three and six month periods ended December 31, 2011 for warehousing services provided to the purchaser of Trade Secret.

The basis point improvement in interest income and other, net as a percent of consolidated revenues during the three months ended December 31, 2010 was primarily due to the quarterly interest payment of \$0.7 million on the note receivable with the purchaser of Trade Secret.

Interest income and other, net as a percent of consolidated revenues during the six months ended December 31, 2010 was consistent with prior year interest income and other, net as a percent of consolidated revenues.

Income Taxes

Edgar Filing: Marathon Petroleum Corp - Form 10-Q

Our reported effective income tax rate for the three and six months ended December 31, 2011 and 2010 was as follows:

Periods Ended December 31,	Effective Rate	Basis Point(1) Decrease
Three Months		
2011	(5.2)%	(3,710)
2010	31.9	(460)
Six Months		
2011	(1.2)%	(3,690)
2010	35.7	(250)

(1) Represents the basis point change in income tax (benefit) expense as a percent of (loss) income before income taxes and equity in income of affiliated companies as compared to the corresponding periods of the prior fiscal year.

The basis point decrease in our overall effective income tax rate for the three and six months ended December 31, 2011 was primarily due to a majority of the goodwill impairment charge being non-deductible for tax purposes. This resulted in the Company recording less of a tax benefit on the pre-tax loss during the three and six months ended December 31, 2011 than would otherwise be expected utilizing the Company's historical range of tax rates.

The basis point decrease in our overall effective income tax rate for the three and six months ended December 31, 2010 was due primarily to certain discrete items and a shift in the mix of worldwide income to lower taxing jurisdictions. The shift in the mix of worldwide income decreased the Company's income tax provision for the three and six months ended December 31, 2010 by \$0.7 million and decreased the effective income tax rate by 4.4 percent and 1.8 percent, respectively.

Table of Contents**Equity in Income of Affiliated Companies, Net of Income Taxes**

Equity in income of affiliates represents the income or loss generated by our equity investment in Empire Education Group, Inc., Provalliance, and other equity method investments. Equity in income of affiliated companies for the three and six months ended December 31, 2011 and 2010 was as follows:

Periods Ended December 31,	Equity in income	Increase Over Prior Fiscal Year	
		Dollar (Dollars in thousands)	Percentage
Three Months			
2011	\$ 5,281	\$ 2,161	69.3%
2010	3,120	463	17.4
Six Months			
2011	\$ 9,313	\$ 3,514	60.6%
2010	5,799	85	1.5

The increase in equity in income of affiliated companies during the three and six months ended December 31, 2011 was a result of an increase in the Company's share of Provalliance's net income over the comparable prior period due to the Company's 16.7 percent increase in ownership in March 2011.

The increase in equity in income of affiliated companies during the three and six months ended December 31, 2010 was a result of an increase in EEG's and Provalliance's net income over the comparable prior period.

Recent Accounting Pronouncements

Recent accounting pronouncements are discussed in Note 1 to the Condensed Consolidated Financial Statements.

Effects of Inflation

We compensate some of our salon employees with percentage commissions based on sales they generate, thereby enabling salon payroll expense as a percent of company-owned salon revenues to remain relatively constant. Accordingly, this provides us certain protection against inflationary increases, as payroll expense and related benefits (our major expense components) are variable costs of sales. In addition, we may increase pricing in our salons to offset any significant

Edgar Filing: Marathon Petroleum Corp - Form 10-Q

increases in wages. Therefore, we do not believe inflation has had a significant impact on the results of our operations.

Constant Currency Presentation

The presentation below demonstrates the effect of foreign currency exchange rate fluctuations from year to year. To present this information, current period results for entities reporting in currencies other than United States dollars are converted into United States dollars at the average exchange rates in effect during the corresponding period of the prior fiscal year, rather than the actual average exchange rates in effect during the current fiscal year. Therefore, the foreign currency impact is equal to current year results in local currencies multiplied by the change in the average foreign currency exchange rate between the current fiscal period and the corresponding period of the prior fiscal year. The impact of foreign currency exchange for the three and six months ended December 31, 2011 and 2010 were as follows:

Impact of Foreign Currency Exchange Rate Fluctuations	Impact on (Loss) Income			
	Impact on Revenue		Before Income Taxes	
	December	December	December	December
	31, 2011	31, 2010	31, 2011	31, 2010
	(Dollars in thousands)			
Three Months				
Canadian dollar	\$ 388	\$ 1,940	\$ 20	\$ 273
British pound	70	(1,235)	(13)	(34)
Euro	40	(203)	(10)	(59)
Total	\$ 498	\$ 502	\$ (3)	\$ 180
Six Months				
Canadian dollar	\$ 2,937	\$ 3,808	\$ 420	\$ 540
British pound	1,444	(3,309)	1	(154)
Euro	223	(438)	28	24
Total	\$ 4,604	\$ 61	\$ 449	\$ 410

Table of Contents**Results of Operations by Segment**

Based on our internal management structure, we report three segments: North American salons, international salons and hair restoration centers. Significant results of operations are discussed below with respect to each of these segments.

North American Salons

North American Salon Revenues. Total North American salon revenues for the three and six months ended December 31, 2011 and 2010 were as follows:

Periods Ended December 31,	Revenues	(Decrease) Increase Over Prior Fiscal Year		Same-Store Sales Decrease
		Dollar (Dollars in thousands)	Percentage	
Three Months				
2011	\$ 492,069	\$ (9,380)	(1.9)%	(2.9)%
2010	501,449	1,548	0.3	(1.4)
Six Months				
2011	\$ 989,926	\$ (18,456)	(1.8)%	(3.0)%
2010	1,008,382	(23,297)	(2.3)	(1.6)

The percentage (decreases) increase during the three and six months ended December 31, 2011 and 2010 were due to the following factors:

Percentage Increase (Decrease) in Revenues	For the Periods Ended December 31,			
	Three Months		Six Months	
	2011	2010	2011	2010
Acquisitions (previous twelve months)	0.8%	1.2%	1.1%	0.9%
Organic	(0.6)	0.1	(1.3)	(2.0)
Foreign currency	0.1	0.4	0.3	0.4
Closed salons	(2.2)	(1.4)	(1.9)	(1.6)
	(1.9)%	0.3%	(1.8)%	(2.3)%

We acquired 56 North American salons during the twelve months ended December 31, 2011, including 54 franchise buybacks. In addition, we closed 240 North American salons during the twelve months ended December 31, 2011. The organic decrease for the three months ended December 31, 2011 was primarily the result of same-store sales decrease of 2.9 percent, partially offset by the construction (net of relocations) of 114 company-owned salons during the twelve months ended December 31, 2011. The organic decrease for the six months ended December 31, 2011 was primarily due to the result of same-store sales decrease of 3.0 percent, partially offset by the construction (net of relocations) of 114 company-owned salons during the twelve months

Edgar Filing: Marathon Petroleum Corp - Form 10-Q

ended December 31, 2011. The same-store sales decrease for the three and six months ended December 31, 2011 were primarily the result of a decline in customer visitations and a decrease in average ticket. The foreign currency impact during the three and six months ended December 31, 2011 was driven by the weakening of the United States dollar against the Canadian dollar as compared to the prior period's exchange rate.

We acquired 76 North American salons during the twelve months ended December 31, 2010, including 49 franchise buybacks. The organic increase for the three months ended December 31, 2010 was primarily the result of the construction (net of relocations) of 84 company-owned salons during the twelve months ended December 31, 2010, partially offset by same-store sales decrease of 1.4 percent. The organic decrease for the six months ended December 31, 2010 was primarily due to the completion of an agreement to supply the purchaser of Trade Secret product at cost and same-store sales decrease of 1.6 percent, partially offset by the construction (net of relocations) of 84 company-owned salons during the twelve months ended December 31, 2010. The Company generated revenues of \$20.0 million for product sold to the purchaser of Trade Secret during the six months ended December 31, 2009. The foreign currency impact during the three and six months ended December 31, 2010 was driven by the weakening of the United States dollar against the Canadian dollar as compared to the prior period's exchange rate. We closed 182 company-owned salons during the twelve months ended December 31, 2010.

Table of Contents

North American Salon Operating Income. Operating income for the North American salons for the three and six months ended December 31, 2011 and 2010 was as follows:

[REDACTED]					
Three Months					
2011	\$ 57,341	11.7%	\$ 4,354	8.2%	110
2010	52,987	10.6	(7,820)	(12.9)	(160)
Six Months					
2011	\$ 114,288	11.5%	\$ (1,545)	(1.3)%	
2010	115,833	11.5	(7,593)	(6.2)	(50)

(1) Represents the basis point change in North American salon operating income as a percent of North American salon revenues as compared to the corresponding periods of the prior fiscal year.

The basis point improvement in North American salon operating income as a percent of North American salon revenues for the three months ended December 31, 2011 was primarily due to increased productivity in our salons, lower commissions as a result of the implementation of leveraged pay plans for new stylists, strong operational payroll control, a reduction in travel expense due to the implementation of new portable technology for field staff, cost savings associated with inventory counts, the prior period including expenditures associated with the Regis salon concept national salon managers meeting and a reduction in self insurance accruals. Partially offsetting the improvement was \$0.8 million of accelerated depreciation expense recorded as a result of an adjustment to the useful life of the Company's internally developed point-of-sale system, an increase in sales of slightly lower profit margin products, and negative leverage from a decrease in same-store sales.

North American operating income as a percent of North American salon revenues for the six months ended December 31, 2011 was consistent with the six months ended December 31, 2010.

The improvement in commissions expense as a result of the leveraged pay plans for new stylists and a reduction in travel expense was offset by \$2.0 million of accelerated depreciation expense recorded as a result of an adjustment to the useful life of the Company's internally developed point-of-sale system and negative leverage from a decrease in same-store sales.

The basis point decrease in North American salon operating income as a percent of North American salon revenues for the three and six months ended December 31, 2010 was primarily due to an unexpected increase in salon payroll expense as staffing was increased in preparation for the holiday season and same-store sales declined during the period, a planned increase in advertising expenditures for the Promenade and Regis salon concepts, and an increase in salon level telecommunications expense related to the Company's internet in the salon initiative. Also contributing to the decrease was an unfavorable adjustment in self insurance accruals compared

Edgar Filing: Marathon Petroleum Corp - Form 10-Q

to a favorable adjustment in the comparable prior period. Partially offsetting the basis point decrease was improvement in retail product margin as a result of a reduction in commissions paid to new employees on retail product sales and an increase in sales of higher margin categories. In addition, for the six months ended December 31, 2010, the basis point decrease was partially offset by the completion of the agreement to supply the purchaser of Trade Secret product at cost.

International Salons

International Salon Revenues. Total international salon revenues for the three and six months ended December 31, 2011 and 2010 were as follows:

International Salon Revenues						
Three Months						
2011	\$	34,069	\$	(3,008)	(8.1)%	(10.1)%
2010		37,077		(3,269)	(8.1)	(3.1)
Six Months						
2011	\$	67,558	\$	(4,577)	(6.3)%	(9.8)%
2010		72,135		(7,010)	(8.9)	(2.4)

Table of Contents

The percentage decreases during the three and six months ended December 31, 2011 and 2010 were due to the following factors:

Percentage Increase (Decrease) in Revenues	For the Periods Ended December 31,			
	Three Months		Six Months	
	2011	2010	2011	2010
Acquisitions (previous twelve months)				
Organic	(6.8)	(1.5)	(6.8)	1.0
Foreign currency	0.3	(3.6)	2.3	(4.7)
Closed salons	(1.6)	(3.0)	(1.8)	(5.2)
	(8.1)%	(8.1)%	(6.3)%	(8.9)%

We did not acquire any international salons during the twelve months ended December 31, 2011. The organic decrease for the three months ended December 31, 2011 was primarily the result of the same-store sales decrease of 10.1 percent. The organic decrease for the six months ended December 31, 2011 was primarily the result of same-store sales decrease of 9.8 percent. Partially offsetting the same-store sales decreases was the construction (net of relocations) of 16 company-owned salons during the twelve months ended December 31, 2011. The foreign currency impact during the three and six months ended December 31, 2011 was driven by the weakening of the United States dollar against the British pound and the Euro as compared to the comparable prior period. We closed 13 company-owned salons during the twelve months ended December 31, 2011.

We did not acquire any international salons during the twelve months ended December 31, 2010. The organic decrease for the three months ended December 31, 2010 was primarily the result of the same-store sales decrease of 3.1 percent. The increase in organic for the six months ended December 31, 2010 was primarily the result of the rebranding of certain salons that had previously been operating under a different salon concept, partially offset by the same-store sales decrease of 2.4 percent. The foreign currency impact during the three and six months ended December 31, 2010 was driven by the strengthening of the United States dollar against the British pound and the Euro as compared to the comparable prior period. We closed 27 company-owned salons during the twelve months ended December 31, 2010.

International Salon Operating Income. Operating income for the international salons for the three and six months ended December 31, 2011 and 2010 was as follows:

Periods Ended December 31,	Operating Income	Operating Income as % of Total Revenues	(Decrease) Increase Over Prior Fiscal Year		
			Dollar	Percentage	Basis Point(1)
(Dollars in thousands)					
Three Months					
2011	\$ 206	0.6%	\$ (1,375)	(87.0)%	(370)
2010	1,581	4.3	(330)	(17.3)	(40)
Six Months					
2011	\$ 756	1.1%	\$ (3,011)	(79.9)%	(410)

Edgar Filing: Marathon Petroleum Corp - Form 10-Q

2010	3,767	5.2	2,985	381.7	420
------	-------	-----	-------	-------	-----

(1) Represents the basis point change in international salon operating income as a percent of international salon revenues as compared to the corresponding periods of the prior fiscal year.

The basis point decrease in international salon operating income as a percent of international salon revenues for the three and six months ended December 31, 2011 was primarily due to negative leverage on fixed costs due to a decrease in same-store sales, partially offset by an improvement in product margins due to a shift in sales mix to higher margin products.

The basis point decrease in international salon operating income as a percent of international salon revenues during the three months ended December 31, 2010 was primarily due to a decline in product margins from mix play, as a larger than expected percentage of our product sales came from lower-margin products. Partially offsetting the basis point decrease was leverage improvement in the fixed cost categories as a result of the Company's fiscal year 2010 implementation to close underperforming salons.

The basis point improvement in international salon operating income as a percent of international salon revenues during the six months ended December 31, 2010 was primarily due to \$3.6 million of lease termination costs recognized during the six months ended December 31, 2009 associated with the Company's planned closure of underperforming salons.

Table of Contents**Hair Restoration Centers**

Hair Restoration Revenues. Total hair restoration revenues for the three and six months ended December 31, 2011 and 2010 were as follows:

Periods Ended December 31,	Revenues	Increase Over Prior Fiscal Year		Same-Store Sales Increase
		Dollar (Dollars in thousands)	Percentage	
Three Months				
2011	\$ 37,140	\$ 1,294	3.6%	1.7%
2010	35,846	728	2.1	0.8
Six Months				
2011	\$ 74,543	\$ 2,443	3.4%	1.5%
2010	72,100	2,009	2.9	1.2

The percentage increases (decreases) during the three and six months ended December 31, 2011 and 2010, were due to the following factors:

Percentage Increase (Decrease) in Revenues	For the Periods Ended December 31,			
	Three Months		Six Months	
	2011	2010	2011	2010
Acquisitions (previous twelve months)	2.3%	0.8%	2.0%	0.4%
Organic	2.1	0.5	1.8	1.6
Franchise revenues	(0.8)	0.8	(0.4)	0.9
	3.6%	2.1%	3.4%	2.9%

We acquired three hair restoration centers through franchise buyback during the twelve months ended December 31, 2011. The increase in organic was primarily due to same-store sales increases of 1.7 and 1.5 percent during the three and six months ended December 31, 2011 and four new corporate locations that were constructed during the twelve months ended December 31, 2011.

We acquired one hair restoration center through franchise buyback during the twelve months ended December 31, 2010. The increase in organic was primarily due to same-store sales increases of 0.8 and 1.2 percent during the three and six months ended December 31, 2010 and one new corporate location that was constructed during the twelve months ended December 31, 2010.

Hair Restoration Operating (Loss) Income. Operating (loss) income for our hair restoration centers for the three and six months ended December 31, 2011 and 2010 was as follows:

Periods Ended December 31,	Operating (Loss) Income	Operating Total Revenues	Income as % of		
			(Decrease) Dollar	Increase Over Prior Fiscal Year Percentage	Prior Fiscal Year Basis Point(1)
(Dollars in thousands)					
Three Months					
2011	\$ (73,553)	(198.0)%	\$ (78,685)	(1,533.2)%	(21,230)
2010	5,132	14.3	(40)	(0.8)	(40)
Six Months					
2011	\$ (69,485)	(93.2)%	\$ (80,822)	(712.9)%	(10,890)
2010	11,337	15.7	578	5.4	30

(1) Represents the basis point change in hair restoration operating (loss) income as a percent of hair restoration revenues as compared to the corresponding periods of the prior fiscal year.

The basis point decrease in hair restoration operating loss as a percent of hair restoration revenues during the three and six months ended December 31, 2011 was primarily due to the \$78.4 million goodwill impairment of the Hair Restoration Centers and an increase in the cost of hair systems. Also contributing to the basis point decrease in hair restoration operating loss as a percent of hair restoration revenues during the six months ended December 31, 2011 were lower service margins due primarily to increased labor costs associated with new and acquired locations.

Table of Contents

The basis point decrease in hair restoration operating income as a percent of hair restoration revenues during the three months ended December 31, 2010 is primarily due to an increase in health insurance expense and in the cost of hair systems. The basis point increase in hair restoration operating income as a percent of hair restoration revenues during the six months ended December 31, 2010 is primarily due to a benefit related to a favorable ruling on a state sales tax issue, partially offset by the increase in health insurance expense and in the cost of hair systems.

Unallocated Corporate

Unallocated Corporate Operating Loss. Unallocated corporate operating expenses include salaries, stock-based compensation, professional fees, rent, depreciation and other expenses that are not allocated. Unallocated corporate operating losses were as follows:

Periods Ended December 31,	Operating Loss	Increase (Decrease) Over Prior Fiscal Year	
		Dollar	Percentage
(Dollars in thousands)			
Three Months			
2011	\$ (45,611)	\$ 8,775	23.8%
2010	(36,836)	1,009	2.8
Six Months			
2011	\$ (94,104)	\$ 19,465	26.1%
2010	(74,639)	(8)	(0.0)

The increase in unallocated corporate operating loss during the three and six months ended December 31, 2011 as compared to the three and six months ended December 31, 2010 was primarily due to \$5.4 and \$12.8 million, respectively, of accelerated depreciation expense recorded as a result of an adjustment to the useful life of the Company's internally developed point-of-sale system, incremental costs associated with the Company's senior management restructuring, and professional fees resulting from the contested proxy.

The increase in unallocated corporate operating loss during the three months ended December 31, 2010 as compared to the three months ended December 31, 2009 was primarily due to professional fees incurred related to the exploration of strategic alternatives.

Unallocated corporate operating loss during the six months ended December 31, 2010 was consistent with the six months ended December 31, 2009. The increase in professional fees incurred related to the exploration of strategic alternatives during the six months ended December 31, 2010 was offset by a decrease in distribution costs, the result of shipping less inventory to our corporate salons and under a warehouse services agreement with the purchaser of Trade Secret.

LIQUIDITY AND CAPITAL RESOURCES**Overview**

We continue to maintain a strong balance sheet to support system growth and financial flexibility. Our debt to capitalization ratio, calculated as total debt as a percentage of total debt and shareholders' equity at fiscal quarter end, was as follows:

Periods Ended	Debt to Capitalization	Basis Point Increase (Decrease) (1)
December 31, 2011	23.4%	10
June 30, 2011	23.3	(700)

(1) Represents the basis point change in total debt as a percent of total debt and shareholders' equity as compared to prior fiscal year end (June 30).

The increase in the debt to capitalization ratio as of December 31, 2011 compared to June 30, 2011 was primarily due to a decrease in shareholders' equity from the non-cash goodwill impairment charge related to the Hair Restoration Centers reporting unit and foreign currency translation adjustments due to the weakening of the United States dollar against the Canadian dollar and British Pound.

The basis point improvement in the debt to capitalization ratio as of June 30, 2011 compared to June 30, 2010 was primarily due to the repayment of an \$85.0 million term loan during fiscal year 2011, partially offset by foreign currency translation adjustments due to the weakening of the United States dollar against the Canadian dollar and British Pound.

Table of Contents

Total assets at December 31, 2011 and June 30, 2011 were as follows:

	December 31, 2011	June 30, 2011	\$ Decrease Over Prior Period(1)	% Decrease Over Prior Period(1)
			(Dollars in thousands)	
Total Assets	\$ 1,696,961	\$ 1,805,753	\$ (108,792)	(6.0)%

(1) Change as compared to prior fiscal year end (June 30).

During the six months ended December 31, 2011, total assets decreased primarily as a result of the non-cash goodwill impairment charge related to the Hair Restoration Centers reporting unit and the accelerated depreciation expense recorded as a result of an adjustment to the useful life of the Company's internally developed POS system.

Total shareholders' equity at December 31, 2011 and June 30, 2011 was as follows:

	December 31, 2011	June 30, 2011	\$ Decrease Over Prior Period(1)	% Decrease Over Prior Period(1)
			(Dollars in thousands)	
Shareholders' Equity	\$ 960,357	\$ 1,032,619	\$ (72,262)	(7.0)%

(1) Change as compared to prior fiscal year end (June 30).

During the six months ended December 31, 2011, equity decreased primarily as a result of the non-cash goodwill impairment charge related to the Hair Restoration Centers reporting unit and foreign currency translation adjustments due to the weakening of the United States dollar against the Canadian dollar and British Pound.

Cash Flows*Operating Activities*

Net cash provided by operating activities was \$61.9 and \$102.8 million during the six months ended December 31, 2011 and 2010, respectively, and was the result of the following:

Operating Cash Flows	For the Six Months Ended December 31,	
	2011	2010
	(Dollars in thousands)	
Net (loss) income	\$ (49,090)	\$ 32,825
Depreciation and amortization	65,801	52,241
Equity in income of affiliated companies	(9,313)	(5,799)
Dividends received from affiliated companies	606	5,853
Deferred income taxes	(7,245)	628
Goodwill impairment	78,426	
Receivables	(4,861)	(4,592)
Inventories	(20,382)	(5,627)
Income tax receivable	4,996	21,575
Other current assets	2,662	6,672
Other assets	(2,708)	(7,899)
Accounts payable and accrued expenses	5,176	(10,562)
Other non-current liabilities	(9,743)	8,700
Other	7,622	8,818
	\$ 61,947	\$ 102,833

During the six months ended December 31, 2011, cash provided by operating activities was less than the corresponding period of the prior fiscal year primarily due to a higher level of inventory purchased, a shortfall in cash earnings in the current year, and a large income tax refund and dividends received from EEG and Provalliance in the prior year comparable period.

Table of Contents

Investing Activities

Net cash used in investing activities was \$42.9 and \$38.8 million during the six months ended December 31, 2011 and 2010, respectively, and was the result of the following:

Investing Cash Flows	For the Six Months Ended December 31,	
	2011	2010
	(Dollars in thousands)	
Capital expenditures for remodels or other additions	\$ (17,814)	\$ (16,438)
Capital expenditures for the corporate office (including all technology-related expenditures)	(15,829)	(9,917)
Capital expenditures for new salon construction	(9,336)	(4,308)
Proceeds from sale of assets	371	19
Business and salon acquisitions	(2,225)	(8,106)
Proceeds from loans and investments	1,956	15,000
Disbursements for loans and investments	(15,000)	(15,000)
	\$ (42,877)	\$ (38,750)

During the six months ended December 31, 2011, cash used in investing activities was greater than the corresponding period of the prior fiscal year primarily due to an increase in capital expenditures for a new POS system and new salon construction partially offset by a decrease in the amount of cash paid for acquisitions.

The company-owned constructed and acquired locations (excluding franchise buybacks) consisted of the following number of locations in each concept:

	For the Six Months Ended December 31, 2011		For the Six Months Ended December 31, 2010	
	Constructed	Acquired	Constructed	Acquired
Regis	4		7	9
MasterCuts	6		3	
SmartStyle	32		45	
Supercuts	26	1	7	
Promenade	20		12	17
International	12		7	
	100	1	81	26

Financing Activities

Net cash used in financing activities was \$28.9 and \$46.4 million during the six months ended December 31, 2011 and 2010, respectively, was the result of the following:

Financing Cash Flows	For the Six Months Ended December 31,	
	2011	2010
	(Dollars in thousands)	
Net payments on revolving credit facilities	\$	\$
Net payments of long-term debt	(21,990)	(42,592)
Proceeds from the issuance of common stock, net of underwriting discount		691
Excess tax benefits from stock-based compensation plans		67
Dividends paid	(6,952)	(4,599)
	\$ (28,942)	\$ (46,433)

During the six months ended December 31, 2011, cash used in financing activities was less than the corresponding period of the prior fiscal year primarily due to a decrease in scheduled long-term debt payments, partially offset by an increase in dividends paid.

Table of Contents

Acquisitions

Acquisitions of \$2.2 million during the six months ended December 31, 2011 consisted of eight franchise buybacks and one acquired corporate salon. On July 1, 2011, the Company acquired a 60.0 percent ownership interest in Roosters MGC International LLC (Roosters), consisting of 31 franchise salons.

Acquisitions of \$8.1 million during the six months ended December 31, 2010 consisted of 33 franchise buybacks and 26 acquired corporate salons.

Contractual Obligations and Commercial Commitments

As a part of our salon development program, we continue to negotiate and enter into leases and commitments for the acquisition of equipment and leasehold improvements related to future salon locations, and continue to enter into transactions to acquire established hair care salons and businesses. In connection with the sale of Trade Secret, the Company maintains a guarantee of approximately 30 salons operated by the purchaser of Trade Secret. The Company has determined the exposure to the risk of loss on the guarantee of the operating leases to be immaterial to the financial statements.

Sources of Liquidity

Funds generated by operating activities, available cash and cash equivalents, and our revolving credit facility are our most significant sources of liquidity. We believe our sources of liquidity will be sufficient to sustain operations and to finance anticipated growth opportunities and strategic initiatives. We also anticipate access to long-term financing. However, in the event our liquidity is insufficient and we are not able to access long-term financing, we may be required to limit our growth opportunities. There can be no assurance that we will continue to generate cash flows at or above current levels.

We have a \$400.0 million five-year senior unsecured revolving credit facility with a syndicate of banks that expires in June 2016. As of December 31, 2011, the Company had no outstanding borrowings under the facility. Additionally, the Company had outstanding standby letters of credit under the facility of \$26.0 million at December 31, 2011, primarily related to its self insurance program. Unused available credit under the facility at December 31, 2011 was \$374.0 million.

Edgar Filing: Marathon Petroleum Corp - Form 10-Q

Our ability to access our revolving credit facility is subject to our compliance with the terms and conditions of such facility, including minimum net worth and other covenants and requirements. At December 31, 2011, we were in compliance with all covenants and other requirements of our credit agreement and senior notes.

See Note 9 of the Notes to Condensed Consolidated Financial Statements included in this Quarterly Report on Form 10-Q for the quarter ended December 31, 2011 and Note 8 of the Notes to Consolidated Financial Statements included in our Annual Report on Form 10-K for the fiscal year ended June 30, 2011, for additional information regarding our financing arrangements.

Dividends

We paid dividends of \$0.12 and \$0.08 per share during the six months ended December 31, 2011 and 2010, respectively. On January 25, 2012, our Board of Directors declared a \$0.06 per share quarterly dividend payable February 22, 2012 to shareholders of record on February 8, 2012.

SAFE HARBOR PROVISIONS UNDER THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995

This Quarterly Report on Form 10-Q, as well as information included in, or incorporated by reference from, future filings by the Company with the Securities and Exchange Commission and information contained in written material, press releases and oral statements issued by or on behalf of the Company contains or may contain forward-looking statements within the meaning of the federal securities laws, including statements concerning anticipated future events and expectations that are not historical facts. These forward-looking statements are made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. The forward-looking statements in this document reflect management's best judgment at the time they are made, but all such statements are subject to numerous risks and uncertainties, which could cause actual results to differ materially from those expressed in or implied by the statements herein. Such forward-looking statements are often identified herein by use of words including, but not limited to, may, believe, project, forecast, expect, estimate, anticipate, and plan. In addition, the following factors could affect the Company's actual results and cause such results to differ materially from those expressed in forward-looking statements. These factors include the impact of management and organizational changes; competition within the personal hair care industry, which remains strong, both domestically and internationally, price sensitivity; changes in economic conditions; changes in consumer tastes and fashion trends; the ability of the Company to implement its planned spending and cost reduction plan and to continue to maintain compliance with financial covenants

Table of Contents

in its credit agreements; labor and benefit costs; legal claims; risk inherent to international development (including currency fluctuations); the continued ability of the Company and its franchisees to obtain suitable locations and financing for new salon development and to maintain satisfactory relationships with landlords and other licensors with respect to existing locations; governmental initiatives such as minimum wage rates, taxes and possible franchise legislation; the ability of the Company to successfully identify, acquire and integrate salons that support its growth objectives; the ability of the Company to maintain satisfactory relationships with suppliers; or other factors not listed above. The ability of the Company to meet its expected revenue target is dependent on salon acquisitions, new salon construction and same-store sales performance, all of which are affected by many of the aforementioned risks. Additional information concerning potential factors that could affect future financial results is set forth in the Company's Annual Report on Form 10-K for the year ended June 30, 2011. We undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

However, your attention is directed to any further disclosures made in our subsequent annual and periodic reports filed or furnished with the SEC on Forms 10-K, 10-Q and 8-K and Proxy Statements on Schedule 14A.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

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 notes receivable with certain affiliated companies and, to a lesser extent, changes in the Canadian dollar exchange rate. 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.

The Company has established an interest rate management policy that attempts to minimize its overall cost of debt, while taking into consideration the earnings implications associated with the volatility of short-term interest rates. On occasion, the Company uses interest rate swaps to further mitigate the risk associated with changing interest rates and to maintain its desired balances of fixed and floating rate debt. The Company is currently assessing the amount of fixed and variable rate debt. The Company had outstanding fixed rate debt balances of \$292.9 and \$313.4 million at December 31, 2011 and June 30, 2011, respectively.

For additional information, including a tabular presentation of the Company's debt obligations and derivative financial instruments, refer to Part II, Item 7A, "Quantitative and Qualitative Disclosures About Market Risk," in the Company's June 30, 2011 Annual Report on Form 10-K. Other than the information included above, there have been no material changes to the Company's market risk and hedging activities during the three and six months ended December 31, 2011.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

The Company maintains disclosure controls and procedures that are designed to ensure that information required to be disclosed in its Exchange Act reports is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms, and that such information is accumulated and communicated to management, including the chief executive officer and chief financial officer, as appropriate, to allow timely decisions regarding required disclosure.

Our Disclosure Committee, consisting of certain members of management, assists in this evaluation. The Disclosure Committee meets on a quarterly basis and more often if necessary.

With the participation of management, the Company's chief executive officer and chief financial officer evaluated the effectiveness of the design and operation of the Company's disclosure controls and procedures (as defined in Rules 13a-5(e) and 15d-15(e) promulgated under the Exchange Act) at the conclusion of the period ended December 31, 2011. Based upon this evaluation, the chief executive officer and chief financial officer concluded that the Company's disclosure controls and procedures were effective.

Changes in Internal Controls

Based on management's most recent evaluation of the Company's internal control over financial reporting, management determined that there were no changes in the Company's internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting that occurred during the Company's most recent fiscal quarter.

Table of Contents

PART II OTHER INFORMATION

Item 1. Legal Proceedings

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 consumer and wage and hour violations. In addition, the Company is a nominal defendant, and nine current and former directors and officers of the Company are named defendants, in a shareholder derivative action in Minnesota state court. The derivative shareholder alleges that the individual defendants breached their fiduciary duties to the Company in connection with their approval of certain executive compensation arrangements and certain related party transactions. Litigation is inherently unpredictable and the outcome of these matters cannot presently be determined. Although the actions are being vigorously defended, the Company 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.

Item 1A. Risk Factors

Changes in the general economic environment may impact our business and results of operations.

Changes to the United States, Canadian, United Kingdom, Asian and other European economies have an impact on our business. General economic factors that are beyond our control, such as interest rates, recession, inflation, deflation, tax rates and policy, energy costs, unemployment trends, and other matters that influence consumer confidence and spending, may impact our business. In particular, visitation patterns to our salons and hair restoration centers can be adversely impacted by increases in unemployment rates and decreases in discretionary income levels.

If we continue to have negative same-store sales our business and results of operations may be affected.

Our success depends, in part, upon our ability to improve sales, as well as both gross margins and operating margins. Comparable same-store sales are affected by average ticket and same-store customer visits. A variety of factors affect same-store customer visits, including fashion trends, competition, current economic conditions, changes in our product assortment, the success of marketing programs and weather conditions. These factors may cause our comparable same-store sales results to differ materially from prior periods and from our expectations. Our comparable same-store sales results for the three and six months ended December 31, 2011 declined 3.0 and

3.1 percent, respectively, compared to the three and six months ended December 31, 2010. We impaired \$78.4 million of goodwill associated with our Hair Restoration Centers reporting unit during the three months ended December 31, 2011, \$74.1 million of goodwill associated with our Promenade salon concept during fiscal year 2011 and \$35.3 million of goodwill associated with our Regis salon concept during fiscal year 2010. We also impaired \$41.7 million of goodwill associated with our salon concepts in the United Kingdom during fiscal year 2009. If negative same-store sales continue and we are unable to offset the impact with operational savings, our financial results may be further affected. We may be required to take additional impairment charges and to impair certain long-lived assets and goodwill and such impairments could be material to our consolidated balance sheet and results of operations. The concepts that have the highest likelihood of impairment are Promenade, Regis, and Hair Restoration Centers.

If we are unable to improve our comparable same-store sales on a long-term basis or offset the impact with operational savings, our financial results may be affected. Furthermore, continued declines in same-store sales performance may cause us to be in default of certain covenants in our financing arrangements.

The Board of Directors is engaged in a strategic review of non-core assets and a search for a new chief executive officer that may impact our business and results of operations.

In January 2012, Randy L. Pearce informed the Company of his intention to retire as President and as a member of the Board of Directors effective June 30, 2012, the end of the Company's current fiscal year. As previously disclosed, Paul D. Finkelstein will step down as Chief Executive Officer of the Company in February 2012. The Board of Directors has formed a Search Committee of independent directors to begin the search for a new chief executive officer. In the interim, Mr. Pearce will perform the functions of principal executive officer in his role as President.

Our strategic review of non-core assets and the chief executive officer search may adversely affect our financial condition and operating results or impose other risk, such as the following:

- Disruption of our business or distraction of our employees and management;
- Difficulty recruiting, hiring, motivating and retaining talented and skilled personnel, including a chief executive officer;
- Increased stock price volatility;
- Difficulty in establishing, maintaining or negotiating business or strategic relationships or transactions; and
- Increased advisory fees.

Table of Contents

Failure to control cost may adversely affect our operating results.

We must continue to control our expense structure. Failure to manage our cost of product, labor and benefit rates, advertising and marketing expenses, operating lease costs, other store expenses or indirect spending could delay or prevent us from achieving increased profitability or otherwise adversely affect our operating results.

Changes in our key relationships may adversely affect our operating results.

We maintain key relationships with certain companies, including Walmart. Termination or modification of any of these relationships, including Walmart, could significantly reduce our revenues and have a material and adverse impact on our business, our operating results and our ability to grow.

Changes in fashion trends may impact our revenue.

Changes in consumer tastes and fashion trends can have an impact on our financial performance. For example, trends in wearing longer hair may reduce the number of visits to, and therefore, sales at our salons.

Changes in regulatory and statutory laws may result in increased costs to our business.

With approximately 12,800 locations and 54,000 employees worldwide, our financial results can be adversely impacted by regulatory or statutory changes in laws. Due to the number of people we employ, laws that increase minimum wage rates or increase costs to provide employee benefits may result in additional costs to our company. Compliance with new, complex and changing laws may cause our expenses to increase. In addition, any non-compliance with these laws could result in fines, product recalls and enforcement actions or otherwise restrict our ability to market certain products, which could adversely affect our business, financial condition and results of operations. We are also subject to laws that affect the franchisor-franchisee relationship.

If we are not able to successfully compete in our business segments, our financial results may be affected.

Edgar Filing: Marathon Petroleum Corp - Form 10-Q

Competition on a market by market basis remains strong. Therefore, our ability to raise prices in certain markets can be adversely impacted by this competition. If we are not able to raise prices, our ability to grow same-store sales and increase our revenue and earnings may be impaired.

If our joint ventures are unsuccessful our financial results may be affected.

We have entered into joint venture arrangements with other companies in the hair salon and beauty school businesses in order to maintain and expand our operations in the United States, Asia and continental Europe. If our joint venture partners are unwilling or unable to devote their financial resources or marketing and operational capabilities to our joint venture businesses, or if any of our joint ventures are terminated, we may not be able to realize anticipated revenues and profits in the countries where our joint ventures operate and our business could be materially adversely affected. If our joint venture arrangements are not successful, we may have a limited ability to terminate or modify these arrangements. If any of our joint ventures are terminated, there can be no assurance that we will be able to attract new joint venture partners to continue the activities of the terminated joint venture or to operate independently in the countries in which the terminated joint venture conducted business.

During fiscal year 2011, we recorded an impairment of \$9.2 million related to our investment in MY Style. During fiscal year 2009, we recorded impairments of \$25.7 million and \$7.8 million (\$4.8 million net of tax) related to our investment in Provalliance and investment in and loans to Intelligent Nutrients, LLC, respectively. Due to economic and other factors, we may be required to take additional impairment charges related to our investments and such impairments could be material to our consolidated balance sheet and results of operations. In addition, our joint venture partners may be required to take impairment charges related to long-lived assets and goodwill, and our share of such impairment charges could be material to our consolidated balance sheet and results of operations. Our share of our investment's goodwill balances as of June 30, 2011 is \$102.1 million.

We are subject to default risk on our accounts and notes receivable.

We have outstanding accounts and notes receivable subject to collectability. If the counterparties are unable to repay the amounts due or if payment becomes unlikely our results of operations would be adversely affected. For example, in fiscal year 2011 the Company recorded a \$31.2 million valuation reserve on the note receivable from the purchaser of Trade Secret to reflect the net realizable value.

Table of Contents

Changes in manufacturers' choice of distribution channels may negatively affect our revenues.

The retail products that we sell are licensed to be carried exclusively by professional salons. The products we purchase for sale in our salons are purchased pursuant to purchase orders, as opposed to long-term contracts and generally can be terminated by the producer without much advance notice. Should the various product manufacturers decide to utilize other distribution channels, such as large discount retailers, it could negatively impact the revenue earned from product sales.

Changes to interest rates and foreign currency exchange rates may impact our results from operations.

Changes in interest rates will have an impact on our expected results from operations. Currently, we manage the risk related to fluctuations in interest rates through the use of variable rate debt instruments and other financial instruments.

We rely heavily on our management information systems. If our systems fail to perform adequately or if we experience an interruption in their operation, our results of operations may be affected.

The efficient operation of our business is dependent on our management information systems. We rely heavily on our management information systems to collect daily sales information and customer demographics, generate payroll information, monitor salon performance, manage salon staffing and payroll costs, inventory control and other functions. The failure of our management information systems to perform as we anticipate, or to meet the continuously evolving needs of our business, could disrupt our business and may adversely affect our operating results.

The Company is in the process of implementing a new point-of-sale system in our salons. Failure to effectively implement the point-of-sale system may adversely affect our operating results.

If we fail to protect the security of personal information about our customers, we could be subject to costly government enforcement actions or private litigation and our reputation could suffer.

The nature of our business involves processing, transmission and storage of personal information about our customers. If we experience a data security breach, we could be exposed to government enforcement actions and private litigation. In addition, our customers could lose confidence in our ability to protect their personal information, which could cause them to stop visiting our salons altogether. Such events could lead to lost future sales and adversely affect our results of

operations.

Certain of the terms and provisions of the convertible notes we issued in July 2009 may adversely affect our financial condition and operating results and impose other risks.

In July 2009, we issued \$172.5 million aggregate principal amount of our 5.0 percent convertible senior notes due 2014 in a public offering. Certain terms of the notes we issued may adversely affect our financial condition and operating results or impose other risks, such as the following:

- Holders of notes may convert their notes into shares of our common stock, which may dilute the ownership interest of our shareholders,
- If we elect to settle all or a portion of the conversion obligation exercised by holders of the notes through the payment of cash, it could adversely affect our liquidity,
- Holders of notes may require us to purchase their notes upon certain fundamental changes, and any failure by us to purchase the notes in such event would result in an event of default with respect to the notes,
- The fundamental change provisions contained in the notes may delay or prevent a takeover attempt of the Company that might otherwise be beneficial to our investors,
- The accounting method for convertible debt securities that may be settled in cash require us to include both the current period's amortization of the debt discount and the instrument's coupon interest as interest expense, which will decrease our financial results,
- Our ability to pay principal and interest on the notes depends on our future operating performance and any failure by us to make scheduled payments could allow the note holders to declare all outstanding principal and interest to be due and payable, result in termination of other debt commitments and foreclosure proceedings by other lenders, or force us into bankruptcy or liquidation, and

Table of Contents

- The debt obligations represented by the notes may limit our ability to obtain additional financing, require us to dedicate a substantial portion of our cash flow from operations to pay our debt, limit our ability to adjust rapidly to changing market conditions and increase our vulnerability to downturns in general economic conditions in our business.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

The Company did not repurchase any of its common stock through its share repurchase program during the three months ended December 31, 2011.

Item 6. Exhibits

- Exhibit 15 Letter Re: Unaudited Interim Financial Information.
- Exhibit 31.1 Chief Executive Officer of Regis Corporation: Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- Exhibit 31.2 Senior Vice President and Chief Financial Officer of Regis Corporation: Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- Exhibit 32.1 Chief Executive Officer of Regis Corporation: Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- Exhibit 32.2 Senior Vice President and Chief Financial Officer of Regis Corporation: Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- Exhibit 101.INS XBRL Instance Document
(*)
- Exhibit 101.SCH XBRL Taxonomy Extension Schema
(*)
- Exhibit 101.CAL XBRL Taxonomy Extension Calculation Linkbase
(*)
- Exhibit 101.LAB XBRL Taxonomy Extension Label Linkbase
(*)
- Exhibit 101.PRE XBRL Taxonomy Extension Presentation Linkbase
(*)
- Exhibit 101.DEF XBRL Taxonomy Extension Definition Linkbase
(*)

(*)

Edgar Filing: Marathon Petroleum Corp - Form 10-Q

The XBRL related information in Exhibit 101 to this Quarterly Report on Form 10-Q shall not be deemed filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, or otherwise subject to liability of that section and shall not be incorporated by reference into any filing or other document pursuant to the Securities Act of 1933, as amended, except as shall be expressly set forth by specific reference in such filing or document.

Table of Contents

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

REGIS CORPORATION

Date: February 6, 2012

By: /s/ Brent A. Moen
Brent A. Moen
Senior Vice President and Chief
Financial Officer

Signing on behalf of the registrant
and as principal
accounting officer