

REGIS CORP  
Form 10-Q/A  
May 20, 2005

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549**

**FORM 10-Q/A**

**(Amendment No. 1)**

(Mark One)

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

For the quarterly period ended September 30, 2004

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 011230

**Regis Corporation**

(Exact name of registrant as specified in its charter)

Minnesota

41-0749934

(State or other jurisdiction of incorporation or organization)

(I.R.S. Employer Identification No.)

7201 Metro Boulevard, Edina, Minnesota

55439

(Address of principal executive offices)

(Zip Code)

(952)947-7777

(Registrant's telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

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Yes  No

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

Yes  No

Indicate the number of shares outstanding of each of the issuer's classes of common stock as of October 22, 2004:

Common Stock, \$.05 par value

44,355,557

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Class

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Number of Shares

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EXPLANATORY NOTE

The Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2004 was filed with the SEC on October 29, 2004 (the Original Filing). The Company is filing this Amendment No. 1 to its Quarterly Report on Form 10-Q for the quarter ended September 30, 2004 (Form 10-Q/A) to reflect restatements of its Condensed Consolidated Balance Sheets at September 30, 2004 and June 30, 2004, and its Condensed Consolidated Statement of Operations and Condensed Consolidated Statement of Cash Flows for the quarters ended September 30, 2004 and 2003, and the related notes thereto, as discussed below. For a more detailed description of these restatements, see

Restatement of Financial Statements in Note 2 of the Notes to the Condensed Consolidated Financial Statements included in Item 1, Financial Statements, of this Form 10-Q/A. Information presented in the section entitled Item 2, Management's Discussion and Analysis of Financial Condition and Results of Operations has also been revised, as applicable, for the effects of the restatement of financial data.

During the third quarter of its fiscal year ending June 30, 2005 (fiscal year 2005), Regis Corporation (the Company) became aware that a number of retailers and restaurant operators had disclosed in their filings with the Securities and Exchange Commission (SEC) that they were reassessing their accounting related to leases and that some companies had restated their financial statements to reflect changes in their accounting for leases. In light of these disclosures and restatements, the Company conducted a review of its lease accounting policies and practices.

In its lease accounting review, the Company examined its leases to determine the appropriate lease term for each lease under generally accepted accounting principles (GAAP). Typically, the Company's operating leases do not require rental payments to begin until the salon is opened. The leased space is sometimes made available to the Company prior to the commencement of salon operations in order to allow time for installing normal leasehold improvements and equipment necessary to operate a salon. The Company historically began to recognize rental expense on a straight-line basis at the earlier of the commencement of operations or the commencement of rental payments. However, the Company did not include the rent holiday period in its straight-line rent calculation. A rent holiday is considered to be any period where the lessee has the right to control the use of the leased property but no rental payments are required under the lease during that period. FASB Technical Bulletin (FTB) 85-3, Accounting for Operating Leases with Scheduled Rent Increases, requires rent holiday periods in an operating lease to be recognized by the lessee on a straight-line basis over the lease term, which includes any rent holiday period.

Based on the review of the Company's accounting for operating leases, the Company determined that it would be appropriate to restate certain of its prior financial statements to appropriately account for rent holiday periods. On April 13, 2005, the Company determined that its previously filed financial statements included in its Annual Report on Form 10-K for fiscal year 2004 (ended June 30, 2004) and its previously filed financial statements included in its Quarterly Reports on Form 10-Q for the first two quarters of fiscal year 2005 should be restated. The restatement to appropriately account for rent holidays had no impact on the overall cash flows of the Company's business. The Company has completed its lease accounting review and has reflected all of the necessary adjustments in its restated Condensed Consolidated Financial Statements.

This Form 10-Q/A sets forth the content of the Original Filing in its entirety, with changes to Items 1, 2, and 4 of Part I and Item 6 of Part II of the Original Filing amended, in each case, solely as a result of, and to reflect, the restatement. No other information in the Original Filing has been amended in this Form 10-Q/A. Pursuant to the rules of the SEC, Item 6 of Part II of the Original Filing has been amended to contain the awareness letter of the Company's independent registered public accountants and currently-dated certifications from the Company's Chief Executive Officer (CEO) and Chief Financial Officer (CFO), as required by Sections 302 and 906 of the Sarbanes-Oxley Act of 2002. The awareness letter of the Company's independent registered public accountant is attached to this Form 10-Q/A as Exhibit 15. The certifications of the Company's CEO and CFO are attached to this form 10-Q/A as Exhibits 31.1, 31.2, 32.1 and 32.2.

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Except for the foregoing amended information, this Form 10-Q/A continues to describe conditions as of the date of the Original Filing, and the Company has not updated the disclosures contained herein to reflect events that have occurred subsequent to that date. Other events occurring after the date of the Original Filing or other information necessary to reflect subsequent events have been disclosed in reports filed with the SEC subsequent to the Original Filing or in the Company's amended Quarterly Report on Form 10-Q/A for the quarterly period ended December 31, 2004, which is filed concurrently with the filing of this Form 10-Q/A, and any other reports filed with the SEC subsequent to the date of this filing.

The Company has not amended and does not intend to amend its previously-filed Annual Reports on Form 10-K or Quarterly Reports on Form 10-Q for the periods affected by the restatement that ended prior to June 30, 2004. For this reason, the Consolidated Financial Statements, reports of independent accountants and related financial information for the affected periods contained in such reports should no longer be relied upon.

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### REGIS CORPORATION

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Signature

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Letter Re: Unaudited Interim Financial Information

Certificatin Pursuant to Section 302

Certificatin Pursuant to Section 302

Certificatin Pursuant to Section 906

Certificatin Pursuant to Section 906

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**PART I FINANCIAL INFORMATION**  
**Item 1. Condensed Consolidated Financial Statements**

**REGIS CORPORATION**

**CONDENSED CONSOLIDATED BALANCE SHEET (Unaudited)**  
**as of September 30, 2004 and June 30, 2004**  
**(Dollars in thousands, except per share amounts)**

	<b>September 30, 2004</b>	<b>June 30, 2004</b>
	(as restated, see Note 2)	(as restated, see Note 2)
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 82,416	\$ 73,567
Receivables, net	36,065	35,033
Inventories	177,237	161,304
Deferred income taxes	14,405	15,285
Other current assets	21,416	28,253
Total current assets	331,539	313,442
Property and equipment, net	389,937	381,903
Goodwill	469,034	457,140
Other intangibles, net	79,658	79,174
Other assets	42,976	40,200
Total assets	\$ 1,313,144	\$ 1,271,859
<b>LIABILITIES AND SHAREHOLDERS EQUITY</b>		
Current liabilities:		
Long-term debt, current portion	\$ 9,051	\$ 19,128
Accounts payable	59,862	53,112
Accrued expenses	120,975	129,721
Total current liabilities	189,888	201,961
Long-term debt	300,100	282,015
Other noncurrent liabilities	111,135	105,863
Total liabilities	601,123	589,839
Commitments and contingencies		
Shareholders' equity:		

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Preferred stock, authorized 250,000 shares at September 30, 2004 and June 30, 2004

Common stock, \$.05 par value; issued and outstanding 44,349,357 and 44,283,949 common shares at September 30, 2004 and June 30, 2004, respectively

	2,217	2,214
Additional paid-in capital	222,109	220,204
Accumulated other comprehensive income	45,289	40,615
Retained earnings	442,406	418,987

Total shareholders equity	712,021	682,020
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Total liabilities and shareholders equity	\$ 1,313,144	\$ 1,271,859
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The accompanying notes are an integral part of the unaudited Condensed Consolidated Financial Statements.



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**CONDENSED CONSOLIDATED STATEMENT OF OPERATIONS (Unaudited)**  
**for the three months ended September 30, 2004 and 2003**  
**(Dollars in thousands, except per share amounts)**

	<b>2004</b>	<b>2003</b>
	(as restated, see Note 2)	(as restated, see Note 2)
Revenues:		
Company-owned salons:		
Service	\$ 333,874	\$ 300,037
Product	139,800	131,592
	473,674	431,629
Franchise revenues:		
Royalties and fees	18,668	18,109
Product sales	7,824	7,937
	26,492	26,046
School revenues	6,056	3,046
	506,222	460,721
Operating expenses:		
Company-owned salons:		
Cost of service	190,595	169,395
Cost of product	71,393	68,247
Direct salon	42,306	38,148
Rent	71,996	63,286
Depreciation	16,119	14,543
	392,409	353,619
Franchise direct costs, including product and equipment	13,946	13,671
General and administrative	48,838	45,505
School direct costs	4,606	1,979
Depreciation and amortization	3,676	3,083
Total operating expenses	463,475	417,857
Operating income	42,747	42,864

Other income (expense):		
Interest	(4,308)	(4,368)
Other, net	677	340
Income before income taxes	39,116	38,836
Income taxes	(13,924)	(14,187)
Net income	\$ 25,192	\$ 24,649
Net income per share:		
Basic	\$ 0.57	\$ 0.56
Diluted	\$ 0.54	\$ 0.54
Weighted average common and common equivalent shares outstanding:		
Basic	44,322	43,637
Diluted	46,293	45,596
Cash dividends declared per common share	\$ 0.04	\$ 0.03

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

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**CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS (Unaudited)**  
**for the three months ended September 30, 2004 and 2003**  
**(Dollars in thousands)**

	<b>2004</b>	<b>2003</b>
	(as restated, see Note 2)	(as restated, see Note 2)
Cash flows from operating activities:		
Net income	\$ 25,192	\$ 24,649
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	18,928	16,924
Amortization	867	891
Deferred income taxes	1,223	2,094
Other	(168)	(273)
Changes in operating assets and liabilities:		
Receivables	(407)	(1,411)
Inventories	(15,474)	(1,114)
Other current assets	6,930	1,645
Other assets	(1,843)	(1,988)
Accounts payable	2,825	4,002
Accrued expenses	(7,423)	3,310
Other noncurrent liabilities	4,728	3,850
Net cash provided by operating activities	35,378	52,579
Cash flows from investing activities:		
Capital expenditures	(21,905)	(15,980)
Proceeds from sale of assets	220	217
Purchases of salon net assets, net of cash acquired	(11,801)	(25,360)
Net cash used in investing activities	(33,486)	(41,123)
Cash flows from financing activities:		
Borrowings on revolving credit facilities	443,150	223,515
Payments on revolving credit facilities	(426,526)	(207,815)
Repayment of long-term debt	(11,888)	(15,171)
Other, primarily decrease in negative book cash balances	2,136	(4,813)
Dividends paid	(1,772)	(1,309)
Repurchase of common stock		(2,990)
Proceeds from issuance of common stock	1,311	2,978
Net cash provided by (used in) financing activities	6,411	(5,605)

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Effect of exchange rate changes on cash and cash equivalents	546	723
Increase in cash and cash equivalents	8,849	6,574
Cash and cash equivalents:		
Beginning of period	73,567	55,454
End of period	\$ 82,416	\$ 62,028

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

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**REGIS CORPORATION**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(Unaudited)**

**1. BASIS OF PRESENTATION OF UNAUDITED INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS:**

The unaudited interim Condensed Consolidated Financial Information of Regis Corporation (the Company) as of September 30, 2004 and for the three months ended September 30, 2004 and 2003, reflect, in the opinion of management, all adjustments (all of which are normal and recurring in nature) necessary to fairly state the consolidated financial position of the Company as of September 30, 2004 and the consolidated results of its operations and its cash flows for the interim periods. The results of operations and cash flows for any interim period are not necessarily indicative of results of operations and cash flows for the full year.

The Consolidated Balance Sheet data for June 30, 2004 was derived from audited Consolidated Financial Statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America (GAAP). The unaudited interim Condensed Consolidated Financial Statements should be read in conjunction with the Company's Annual Report on Form 10-K/A for the year ended June 30, 2004 and other documents filed with the Securities and Exchange Commission (SEC) during the current fiscal year.

With respect to the unaudited condensed financial information of the Company for the three month periods ended September 30, 2004 and 2003 included in this Form 10-Q/A, PricewaterhouseCoopers LLP reported that they have applied limited procedures in accordance with professional standards for a review of such information. However, their separate report dated October 27, 2004 appearing herein, states that they did not audit and they do not express an opinion on that unaudited financial information. Accordingly, the degree of reliance on their report on such information should be restricted in light of the limited nature of the review procedures applied. PricewaterhouseCoopers LLP is not subject to the liability provisions of Section 11 of the Securities Act of 1933 for their report on the unaudited financial information because that report is not a report or a part of the registration statement prepared or certified by PricewaterhouseCoopers LLP within the meaning of Sections 7 and 11 of the Act.

**Cost of Product Used and Sold:**

Product costs are determined by applying estimated gross profit margins to service and product revenues, which are based on historical factors including product pricing trends and estimated shrinkage. In addition, the estimated gross profit margin is adjusted based on the results of physical inventory counts performed at least semi-annually. Significant changes in product costs, volumes or shrinkage could have a material impact on the Company's gross margin.

**Property and Equipment:**

Property and equipment are carried at cost, less accumulated depreciation and amortization. Depreciation and amortization of property and equipment are computed on the straight-line method over estimated useful asset lives (30 to 39 years for buildings and improvements and five to ten years for equipment, furniture, software and leasehold improvements). Leasehold improvements are amortized over the shorter of their estimated useful lives or the related lease term, generally ten years. For leases with renewal periods at the Company's option, management may determine at the inception of the lease that renewal is reasonably assured if failure to exercise a renewal option imposes an economic penalty to the Company. In such cases, the Company will include the

renewal option period along with the original stated lease period in the determination of appropriate estimated useful lives.

The Company capitalizes both internal and external costs of developing or obtaining computer software for internal use. Costs incurred to develop internal-use software during the application development stage are capitalized, while data conversion, training and maintenance costs associated with internal-use software are expensed as incurred. Amortization expense related to capitalized software is determined based on an estimated useful life of five or seven years.

Expenditures for maintenance and repairs and minor renewals and betterments which do not improve or extend the life of the respective assets are expensed. All other expenditures for renewals and betterments are capitalized. The assets and related depreciation and amortization accounts are adjusted for property retirements and disposals with the resulting gain or loss included in operations. Fully depreciated/amortized assets remain in the accounts until retired from service.

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**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (cont.)  
(Unaudited)**

**Deferred Rent and Rent Expense:**

The Company leases most salon, beauty school and hair restoration center locations under operating leases. Most lease agreements contain tenant improvement allowances funded by landlord incentives, rent holidays, rent escalation clauses and/or contingent rent provisions. Accounting principles generally accepted in the United States of America require rent expense to be recognized on a straight-line basis over the lease term. The difference between the rent due under the stated periods of the lease compared to that of the straight-line basis is recorded as deferred rent within other noncurrent liabilities in the Condensed Consolidated Balance Sheet.

For purposes of recognizing incentives and minimum rental expenses on a straight-line basis over the terms of the leases, the Company uses the date that it obtains the legal right to use and control the leased space to begin amortization, which is generally when the Company enters the space and begins to make improvements in preparation of intended use of the leased space.

For tenant improvement allowances funded by landlord incentives and rent holidays, the Company records a deferred rent liability in other noncurrent liabilities on the Condensed Consolidated Balance Sheet and amortizes the deferred rent as a reduction to rent expense on the Condensed Consolidated Statements of Operations over the term of the lease (including one renewal option period if renewal is reasonably assured based on the imposition of an economic penalty for failure to exercise the renewal option).

Certain lease agreements contain rent escalation clauses which provide for scheduled rent increases during the lease term or for rental payments commencing at a date other than the date of initial occupancy. Such stepped rent expense is recorded in the Condensed Consolidated Statements of Operations on a straight-line basis over the lease term (including one renewal option period if renewal is reasonably assured based on the imposition of an economic penalty for failure to exercise the renewal option).

Certain leases provide for contingent rents, which are determined as a percentage of revenues in excess of specified levels. The Company records a contingent rent liability in accrued expenses on the Condensed Consolidated Balance Sheet, along with the corresponding rent expense in the Condensed Consolidated Statement of Operations, when specified levels have been achieved or when management determines that achieving the specified levels during the fiscal year is probable.

**Reclassifications:**

Certain prior period amounts have been reclassified to conform to the current year presentation. These reclassifications had no effect on net income or shareholders' equity as previously presented.

**Stock-Based Employee Compensation Plans:**

At September 30, 2004, the Company had the 2004 Long Term Incentive Plan (2004 Plan), the 2000 Stock Option Plan and the 1991 Stock Option Plan. The 2004 Plan was approved by the Company's Board of Directors in May of 2004 and received shareholder approval on October 28, 2004. In June 2004 (prior to shareholder approval), 72,500 shares of restricted stock and 110,750 stock appreciation rights (SARs) were awarded under the 2004 Plan, pending shareholder approval. No stock options have been granted under the 2004 Plan. Since the 2004 Plan did not receive shareholder approval until after September 30, 2004, no compensation expense was recognized during the first quarter of fiscal year 2005. The Company had outstanding stock options under the 1991 Plan, although the Plan terminated in 2001.

Prior to July 1, 2003, the Company accounted for these plans using the intrinsic value method under the recognition and measurement principles of Accounting Principles Board (APB) Opinion No. 25, Accounting for Stock Issued to Employees (APB No. 25) and related Interpretations and applies FAS No. 123, Accounting for Stock-Based Compensation (FAS No. 123), as amended by FAS No. 148, Accounting for Stock-Based Compensation Transition and Disclosure (FAS No. 148), for disclosure purposes only. The FAS No. 123 disclosures include pro forma net income and earnings per share as if the fair value-based method of accounting had been used. Under the provisions of APB No. 25, no stock-based employee compensation cost is reflected in net income, as all options granted under those plans had an exercise price equal to the market value of the underlying stock on the date of grant.



**Table of Contents****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (cont.)  
(Unaudited)**

Effective July 1, 2003, the Company adopted the fair value recognition provisions of FAS No. 123 using the prospective transition method. Under the prospective method of adoption, compensation cost is recognized related to options granted, modified or settled after the beginning of the fiscal year in which the fair value method is first adopted. Under this approach, fiscal year 2005 and 2004 compensation expense is less than it would have been had the fair value recognition provisions of FAS No. 123 been applied from its original effective date because the fair value of the options vesting during the year which were granted prior to fiscal year 2004 are not recognized in the Consolidated Statement of Operations. Options granted in fiscal years prior to the adoption of the fair value recognition provisions will continue to be accounted for under APB Opinion No. 25. The adoption of the fair value recognition provisions increased the Company's first quarter fiscal year 2005 compensation expense by approximately \$80,000, and is expected to increase total fiscal year 2005 compensation expense by approximately \$1.4 million.

The Company's pro forma net income and pro forma earnings per share for the quarters ended September 30, 2004 and 2003 was as follows:

(Dollars in thousands)	<b>For the Three Months Ended September 30,</b>	
	<b>2004</b>	<b>2003</b>
Net income, as reported (as restated, see Note 2)	\$ 25,192	\$ 24,649
Add: Stock-based employee compensation expense included in reported net income, net of related tax effects	50	
Deduct: Total stock-based employee compensation expense determined under fair value based methods for all awards, net of related tax effects	(1,570)	(1,677)
Pro forma net income (as restated, see Note 2)	\$ 23,672	\$ 22,972
Earnings per share:		
Basic as reported (as restated, see Note 2)	\$ 0.57	\$ 0.56
Basic pro forma (as restated, see Note 2)	\$ 0.53	\$ 0.53
Diluted as reported (as restated, see Note 2)	\$ 0.54	\$ 0.54
Diluted pro forma (as restated, see Note 2)	\$ 0.51	\$ 0.51

The fair value of options was calculated utilizing the Black-Scholes option-pricing model and the following key weighted average assumptions:

	<b>2004</b>	<b>2003</b>
Risk-free interest rate	4.16%	2.89%
Expected life in years	5.5	7.25
Expected volatility	30.0%	42.00%
Expected dividend yield	0.37%	0.45%

**2. RESTATEMENT OF FINANCIAL STATEMENTS:**

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During the third quarter of its fiscal year ending June 30, 2005 (fiscal year 2005), the Company became aware that a number of retailers and restaurant operators had disclosed in their filings with the SEC that they were reassessing their accounting related to leases and that some companies had restated their financial statements to reflect changes in their accounting for leases. In light of these disclosures and restatements, the Company conducted a review of its lease accounting policies and practices.

**Table of Contents****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (cont.)  
(Unaudited)**

In its lease accounting review, the Company examined its real estate leases to determine the appropriate lease term for each lease under GAAP. Typically, the Company's operating leases do not require rental payments to begin until the salon is opened. The leased space is sometimes made available to the Company prior to the commencement of salon operations in order to allow time for installing normal leasehold improvements and equipment necessary to operate a salon. The Company historically began to recognize rental expense on a straight-line basis at the earlier of the commencement of operations or the commencement of rental payments. However, the Company did not previously include the rent holiday period in its straight-line rent calculation. A rent holiday is considered to be any period where the lessee has the right to control the use of the leased property but no rental payments are required under the lease during that period. FASB Technical Bulletin (FTB) 85-3,

Accounting for Operating Leases with Scheduled Rent Increases, requires rent holiday periods in an operating lease to be recognized by the lessee on a straight-line basis over the lease term, which includes any rent holiday period.

Based on the review of the Company's accounting for operating leases, the Company concluded that its previously reported rent expense amounts needed to be restated to reflect rent holidays on a straight-line basis over the appropriately defined lease term. This correction generally results in an increase of the total amount of rent expense recorded each fiscal year, with a corresponding adjustment to the deferred rent liability (within other noncurrent liabilities on the Condensed Consolidated Balance Sheet). The adjustment to lease expense is tax effected, which causes adjustments to income tax expense within the Condensed Consolidated Statement of Operations, as well as deferred income taxes (within other noncurrent liabilities) in the Condensed Consolidated Balance Sheet.

The Company restated its previously issued financial statements, including those in the Company's 2004 Annual Report on Form 10-K for the fiscal year ended June 30, 2004 and those in the Company's Quarterly Reports on Form 10-Q for the quarters ended September 30, 2004 and December 31, 2004. The restatement did not have any effect on the Company's previously reported consolidated revenues or cash flow from operations. Following is a summary of the effects of the lease accounting corrections on the Company's Condensed Consolidated Statements of Operations for the three months ended September 30, 2004 and 2003:

**Condensed Consolidated Statement of Operations  
For the Three Months Ended September 30,  
2004**

	As			As		
	Previously Reported	Adjustment	As Restated	Previously Reported	Adjustment	As Restated
(Dollars in thousands)						
Rent	\$ 71,537	\$ 459	\$ 71,996	\$ 62,819	\$ 467	\$ 63,286
Operating income	43,206	(459)	42,747	43,331	(467)	42,864
Income before income taxes	39,575	(459)	39,116	39,303	(467)	38,836
Income taxes	(14,096)	172	(13,924)	(14,345)	158	(14,187)
Net income	25,479	(287)	25,192	24,958	(309)	24,649
Net income per share basic	\$ 0.57	\$	\$ 0.57	\$ 0.57	\$ (0.01)	\$ 0.56
Net income per share diluted	\$ 0.55	\$ (0.01)	\$ 0.54	\$ 0.55	\$ (0.01)	\$ 0.54

Following is a summary of the effects of the lease accounting corrections on the Company's Condensed Consolidated Balance Sheet as of September 30, 2004 and June 30, 2004:

**Condensed Consolidated Balance Sheet**

	September 30, 2004			June 30, 2004		
	As Previously Reported	Adjustment	As Restated	As Previously Reported	Adjustment	As Restated
(Dollars in thousands)						
Other noncurrent liabilities	\$ 105,288	\$ 5,847	\$ 111,135	\$ 100,322	\$ 5,541	\$ 105,863
Total liabilities	595,276	5,847	601,123	584,298	5,541	589,839
Accumulated other comprehensive income	45,335	(46)	45,289	40,642	(27)	40,615
Retained earnings	448,207	(5,801)	442,406	424,501	(5,514)	418,987
Total shareholders' equity	717,868	(5,847)	712,021	687,561	(5,541)	682,020

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(Unaudited)****3. SHAREHOLDERS' EQUITY AND COMPREHENSIVE INCOME:****Additional Paid-In Capital**

The increase in additional paid-in capital during the first quarter of fiscal year 2005 was due to the following:

(Dollars in thousands)	<b>Increase</b>
Exercise of stock options	\$ 1,308
Tax benefit realized upon exercise of stock options	517
Stock option compensation	80
	<b>\$ 1,905</b>

**Comprehensive Income**

Components of comprehensive income for the Company include net income, changes in fair market value of financial instruments designated as hedges of interest rate exposures and changes in foreign currency translation, including the impact of the cross-currency swap, recorded in the cumulative translation account within shareholders' equity. Comprehensive income for the three months ended September 30, 2004 and 2003 were as follows:

	<b>For the Three Months Ended September 30,</b>	
	(Dollars in thousands)	
	<b>2004</b>	<b>2003</b>
Net income (as restated, see Note 2)	\$ 25,192	\$ 24,649
Other comprehensive income (loss):		
Changes in fair market value of financial instruments designated as cash flow hedges of interest rate exposure, net of taxes	(1)	45
Change in cumulative foreign currency translation (as restated, see Note 2)	4,675	1,051
Total comprehensive income (as restated, see Note 2)	\$ 29,866	\$ 25,745

**4. NET INCOME PER SHARE:**

Stock options covering 109,805 and 345 shares were excluded from the shares used in the computation of diluted earnings per share for the three months ended September 30, 2004 and 2003, respectively, since they were anti-dilutive.

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

	<b>For the Three Months Ended September,</b>	
	<b>2004</b>	<b>2003</b>
Weighted average shares for basic earnings per share	44,321,992	43,636,503
Effect of dilutive securities:		
Dilutive effect of stock options	1,902,960	1,889,281
Contingent shares issuable under contingent stock agreements (see Note 6)	68,431	70,033
Weighted average shares for diluted earnings per share	46,293,383	45,595,817

**Table of Contents****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (cont.)  
(Unaudited)****5. SEGMENT INFORMATION:**

The Company operates or franchises 8,236 North American salons (located in the United States, Canada and Puerto Rico), 2,015 international salons and 11 beauty career schools. The Company operates its North American salon operations through five primary concepts: Regis Salons, MasterCuts, Trade Secret, SmartStyle and Strip Center salons. Each of the concepts offer similar products and services, concentrates on the mass-market consumer marketplace and has consistent distribution channels. All of the salons within the North American salon concepts are located in high traffic, retail shopping locations that attract mass-market consumers, and the individual salons generally display similar economic characteristics. The salons share interdependencies and a common support base. The Company's international salon operations, which are primarily in Europe, are located in malls, leading department stores, mass merchants and high-street locations. The Company's beauty career schools are located in the United States and the United Kingdom.

Based on the way the Company manages its business, it has presented its North American salons, international salons and beauty career schools as three reportable operating segments. Prior to the current fiscal quarter, the Company had two reportable operating segments: North American and international operations. Salons and beauty career schools were included within each of these reportable operating segments due to the way in which the Company managed its business at that time. Management began reviewing the operations of the beauty career schools separately from the salon operations during fiscal year 2005 in anticipation of further expansion into the beauty career school business. Segment information for the first quarter of fiscal year 2004 has been reclassified to conform to the current year presentation.

Summarized financial information concerning the Company's reportable operating segments is shown in the following table:

	<b>For the Three Months Ended September 30,</b>	
	(Dollars in thousands)	
	<b>2004</b>	<b>2003</b>
Total revenues:		
North American salons	\$ 448,428	\$ 414,533
International salons	51,738	43,142
Beauty career schools	6,056	3,046
Total	\$ 506,222	\$ 460,721
Income before income taxes:		
North American salons (as restated, see Note 2)	\$ 83,248	\$ 82,587
International salons	9,853	7,093
Beauty career schools	1,264	1,012
Corporate*	(55,249)	(51,856)
Total (as restated, see Note 2)	\$ 39,116	\$ 38,836

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\* primarily general and administrative, corporate depreciation and amortization, and net interest expense  
Total revenues associated with salon operations in the United States represent 95.3 and 95.8 percent of the amounts set forth above as North American salon revenues for the three months ended September 30, 2004 and 2003, respectively. Total income before income taxes associated with salon operations in the United States represent 95.2 and 96.3 percent of the amounts set forth above as North American salon income before income taxes for the three months ended September 30, 2004 and 2003, respectively.

## **6. ACQUISITIONS:**

During the quarters ended September 30, 2004 and 2003, the Company made numerous 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.



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**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (cont.)**  
**(Unaudited)**

Based upon purchase price allocations, which may have components representing preliminary allocations with respect to recent acquisitions, the components of the aggregate purchase prices of the acquisitions made during the three months ended September 30, 2004 and 2003, and the allocation of the purchase prices, were as follows:

	<b>Three Months Ended</b>	
	<b>September 30,</b>	
	(Dollars in thousands)	
	<b>2004</b>	<b>2003</b>
Components of aggregate purchase prices:		
Cash	\$ 11,801	\$ 25,360
Allocation of the purchase price:		
Net tangible assets acquired	\$ 2,425	\$ 3,477
Identifiable intangible assets	90	174
Goodwill	9,286	21,709
	\$ 11,801	\$ 25,360

In a limited number of acquisitions, the Company has guaranteed that stock issued in conjunction with the acquisition will reach a certain market price. If the stock should not reach this price during an agreed-upon time frame (typically three years from the date of acquisition), the Company is obligated to issue additional shares to the sellers. Once the agreed-upon stock price is met or exceeded for a period of five consecutive days, the contingency is met and the Company is no longer liable. Based on the September 30, 2004 market price, the Company would be required to provide an additional 68,431 shares related to these acquisition contingencies if the agreed-upon time frames were all assumed to have expired September 30, 2004. These contingently issuable shares have been included in the calculation of diluted earnings per share for the three months ended September 30, 2004.

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 (driven by word-of-mouth referrals), service quality and price point competitiveness. These attributes represent the going concern value of the salon. While the value of the acquired customer base is the primary driver of any potential acquisition's cash flows (which determines the purchase price), it is neither known nor identifiable at the time of the acquisition. The cash flow history of a salon primarily results from repeat walk-in customers driven by the existing personal relationship between the customer and the stylist(s). Under FAS No. 141, Business Combinations, a customer base does not meet the criteria for recognition apart from goodwill. As such, this portion of the purchase price is captured within goodwill and should not be attributed to any other contractual arrangement. Because we are acquiring the going concern value of the salon, driven primarily by the manner in which the salon has been operated and the existing walk-in customer base's relationship with the stylist(s), the value being acquired is subsumed into goodwill in accordance with FAS No. 141.

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 beauty schools, the residual goodwill primarily represents the growth prospects that are not captured as part of acquired tangible or identified intangible assets. Generally the goodwill recognized in the North American salon transactions is expected to be fully deductible for tax purposes and the goodwill recognized in the international salon transactions is non-deductible for tax purposes. Goodwill generated in certain acquisitions is generally not deductible for tax purposes due to the acquisition structure of the transaction.

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**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (cont.)  
(Unaudited)**

**7. SUBSEQUENT EVENT:**

On October 4, 2004, President Bush signed an Act into law that included a provision reinstating the Work Opportunity and Welfare-to-Work Credits. The reinstatement is retroactive to December 31, 2003 and the credits will be available through December 31, 2005.

For interim reporting purposes, the Company determines the best estimate of its annual effective tax rate and applies this rate in calculating income taxes on a year-to-date basis. Any immediate impact resulting from a change in tax law is recognized in the interim period in which the law change is enacted. Since the credits were reinstated after September 30, 2004, they were not factored into the Company's calculation of the estimated annual effective tax rate in the first quarter ended September 30. The Company will remeasure its annual estimated tax rate in the second quarter, with consideration given to the reinstated tax credit for the full fiscal year. The resulting catch-up adjustment will also be recognized in the second quarter. The Company expects this change in tax law to result in a catch-up adjustment of approximately \$0.3 million in the quarter ended December 31, 2004; the expected annual impact is approximately \$0.9 million for fiscal year 2005.

Additionally, President Bush signed into law the American Jobs Creation Act of 2004. The Company is in the process of evaluating this legislation and believes that certain provisions of the Act may have a favorable impact on the Company in the future. The Act has no immediate impact on the Company's tax position.

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**REVIEW REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Shareholders and Directors of Regis Corporation:

We have reviewed the accompanying restated condensed consolidated balance sheet of Regis Corporation as of September 30, 2004 and the related restated condensed consolidated statements of operations and of cash flows for the three month periods ended September 30, 2004 and 2003. 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 to financial data 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 reviews, 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, 2004, and the related consolidated statements of operations, of changes in shareholders' equity and of cash flows for the year then ended (not presented herein), and in our report dated August 24, 2004, except for Note 2, as to which the date is May 9, 2005, which contained explanatory paragraphs indicating (i) the Company changed its method of accounting for equity-based compensation arrangements to begin expensing new awards as of July 1, 2003 and (ii) the Company restated its financial statements as of June 30, 2004 and 2003 and for the three years ended June 30, 2004 to account for rent holidays on a straight-line basis, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the accompanying consolidated balance sheet information as of June 30, 2004, is fairly stated, in all material respects in relation to the consolidated balance sheet from which it has been derived.

As discussed in Note 2 to the accompanying condensed consolidated interim financial statements, the company restated its prior year financial statements for the three month periods ended September 30, 2004 and 2003.

/s/ PricewaterhouseCoopers LLP

PRICEWATERHOUSECOOPERS LLP

Minneapolis, Minnesota

October 27, 2004, except for Note 2, as to  
which the date is May 17, 2005

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**Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

**RESTATEMENT OF FINANCIAL STATEMENTS**

During our quarter ending March 31, 2005 (third quarter of fiscal year 2005), we became aware that a number of retailers and restaurant operators had disclosed in their filings with the SEC that they were reassessing their accounting related to leases and that some companies had restated their financial statements to reflect changes in their accounting for leases. In light of these disclosures and restatements, we conducted a review of our lease accounting policies and practices.

In our lease accounting review, we examined our leases to determine the appropriate lease term for each lease under GAAP. Typically, our operating leases do not require rental payments to begin until the salon is opened. The leased space is sometimes made available to us prior to the commencement of salon operations in order to allow time for installing normal leasehold improvements and equipment necessary to operate a salon. We historically began to recognize rental expense on a straight-line basis at the earlier of the commencement of operations or the commencement of rental payments. However, we did not include the rent holiday period in our straight-line rent calculation. A rent holiday is considered to be any period where the lessee has the right to control the use of the leased property but no rental payments are required under the lease during that period. FASB Technical Bulletin (FTB) 85-3, Accounting for Operating Leases with Scheduled Rent Increases, requires rent holiday periods in an operating lease to be recognized by the lessee on a straight-line basis over the lease term, which includes any rent holiday period. Therefore, we restated our financial statements for fiscal years 2004, 2003 and 2002 to appropriately account for rent holiday periods. The restatement to appropriately account for rent holidays had no impact on our consolidated revenues or cash flows from operations.

Based on the review of our accounting for operating leases, we have restated our previously issued financial statements in our Annual Report on Form 10-K for the fiscal year ended June 30, 2004, as well as those in our Quarterly Reports on Form 10-Q for the quarters ended September 30, 2004 and December 31, 2004. We filed a Form 10-K/A with restated Consolidated Financial Statements, and are filing a Form 10-Q/A for each of these interim reporting periods with restated Condensed Consolidated Financial Information.

See Note 2 to the Condensed Consolidated Financial Statements for a summary of the effect of this change on our Condensed Consolidated Balance Sheet as of September 30, 2004 and June 30, 2004 and the Condensed Consolidated Statement of Operations for the three month periods ended September 30, 2004 and 2003.

**MANAGEMENT'S OVERVIEW**

Regis Corporation, based in Minneapolis, Minnesota, is an owner, operator and franchisor of hair and retail product salons and beauty career schools. Our worldwide operations include 10,251 system-wide North American and international salons and 11 beauty career schools at September 30, 2004. Each of our salon concepts has generally similar products and services and serves mass-market consumers. Our salon operations are organized to be managed based on geographical location. Our North American salon operation includes 8,236 salons, including 2,303 franchise salons, operating in the United States, Canada and Puerto Rico primarily under the trade names of Regis Salons, MasterCuts, Trade Secret, SmartStyle, Supercuts and Cost Cutters. Our international salon operations include 2,015 salons, including 1,599 franchise salons, located throughout Europe, primarily in the United Kingdom, France, Italy and Spain. Our beauty career schools are managed in aggregate, regardless of geographical location, and include seven locations in the United States and four locations in the United Kingdom. During the first quarter of fiscal year 2005, we had an average of approximately 54,000 corporate employees worldwide.

Our growth strategy consists of two primary, but flexible, building blocks. Through a combination of organic and acquisition growth, we seek to achieve our long-term objective of 10-to-14 percent annual revenue growth. We anticipate that going forward, the mix of organic and acquisition growth to be roughly equal. However, depending on several factors, including the availability of appropriate real estate, availability of salons for sale and same-store sales trends, this mix will vary from year-to-year. We believe achieving revenue growth of 10-to-14 percent will allow us to increase annual earnings at a low-to-mid teen percent growth rate.

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Organic revenue growth is achieved through the combination of new salon construction and same-store sales increases. Each fiscal year, we anticipate building several hundred corporate salons. We anticipate our franchisees will open several hundred salons as well. Although not a significant factor, older, unprofitable salons will be closed or relocated. Our long-term outlook is for annual consolidated low single-digit same-store sales increases. Based on current fashion and economic cycles, we project our annual fiscal year 2005 consolidated same-store sales increase to be at the low end of our long-term outlook range.

Historically, acquisitions have varied in size from as small as one salon to over one-thousand salons. The median acquisition size is approximately 10 salons. From fiscal year 1994 to fiscal year 2004, we completed nearly 300 acquisitions, adding over 7,400 salons. We anticipate adding several hundred corporate salons each year from acquisitions. Some of these acquisitions may include buying salons from our franchisees.

We execute our growth strategy by focusing on real estate. Our real estate strategy is dependent on adding salons in convenient locations with good visibility, strong customer traffic and appropriate trade demographics. Our various salon and product concepts are now operating in a wide range of retailing environments. We believe that the availability of real estate will augment our ability to achieve the aforementioned long-term growth objectives. We anticipate that we will add approximately 1,000 salons each year through a combination of organic, acquisition and franchise growth.

The conceptual strength of our business is in the fundamental similarity of our salon concepts that allow flexibility and multiple salon concept placement in shopping centers and neighborhoods, and broad customer mix. Each concept is targeted at the middle market customer, however each attracts a slightly different demographic. We anticipate expanding all of our salon concepts. In addition, we anticipate testing and developing new salon concepts to complement our existing concepts.

We have begun acquiring and are exploring the possibility of building beauty career schools. The beauty career school business is highly profitable, and often participates in governmental programs designed to encourage education. We believe there is an opportunity to place graduates in our various salon concepts which may provide us with another competitive advantage. Similar to the salon industry, the beauty career school business is highly fragmented. As a result, we believe there is an opportunity to consolidate this industry. Expanding this business would allow us to add incremental revenue without cannibalizing our existing salon business. Primarily through acquisition, we believe beauty career schools could contribute over \$100 million in annual revenue in five years.

Additionally, we desire to enter the Asian market within the next five years.

For a discussion of our near-term expectations, please refer to the Investor Information section of our website at [www.regiscorp.com](http://www.regiscorp.com).

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

**Table of Contents****Results of Operations**

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

	<b>For the Three Months Ended September 30,</b>	
	<b>2004</b>	<b>2003</b>
Company-owned service revenues (1)	70.5%	69.5%
Company-owned product revenues (1)	29.5	30.5
Franchise revenues	5.2	5.7
School revenues	1.2	0.7
Company-owned operations:		
Profit margins on service (2)	42.9	43.5
Profit margins on product (3)	48.9	48.1
Direct salon expenses (1)	8.9	8.8
Rent (1) (as restated, see Note 2)	15.2	14.7
Depreciation (1)	3.4	3.4
Franchise direct costs, including product and equipment (4)	52.6	52.5
General and administrative	9.6	9.9
School direct costs (5)	76.1	65.0
Depreciation and amortization	0.8	0.7
Operating income (as restated, see Note 2)	8.4	9.3
Income before income taxes (as restated, see Note 2)	7.7	8.4
Net income (as restated, see Note 2)	5.0	5.4

- (1) Computed as a percent of company-owned salon revenues.
- (2) Computed as a percent of company-owned salon service revenues.
- (3) Computed as a percent of company-owned salon product revenues.
- (4) Computed as a percent of franchise revenues.
- (5) Computed as a percent of school revenues.



**Table of Contents****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. 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, 2004 Annual Report on Form 10-K/A. We believe the accounting policies related to the valuation of goodwill, the valuation and estimated useful lives of long-lived assets, purchase price allocations, revenue recognition, the cost of product used and sold, self-insurance accruals, 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 our June 30, 2004 Annual Report on Form 10-K/A. No changes have been made to these policies since June 30, 2004.

**RESULTS OF OPERATIONS****Revenues**

Consolidated revenues include revenues of company-owned salons, beauty career school revenues, franchise royalties, franchise fees and product and equipment sales to franchisees. During the first quarter of fiscal year 2005, consolidated revenues increased 9.9 percent to \$506.2 million as compared to the corresponding period of the prior fiscal year. The following chart details our consolidated revenues by concept:

(Dollars in thousands)	<b>For the Three Months Ended</b>	
	<b>2004</b>	<b>September 30, 2003</b>
Revenues:		
North American salons:		
Regis Salons	\$ 116,457	\$ 117,955
MasterCuts	42,519	43,546
Trade Secret*	61,461	58,941
SmartStyle	82,283	68,447
Strip Center Salons*	145,708	125,644
Total North American Salons	448,428	414,533
International salons*	51,738	43,142
Beauty career schools	6,056	3,046
Consolidated revenues	\$ 506,222	\$ 460,721
Percent change from prior year	9.9%	15.4%
Same-store sales increase	0.9%	2.6%

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\* Includes aggregate franchise royalties, franchise fees and product and equipment sales to franchisees of \$26.5 and \$26.0 million for the three months ended September 30, 2004 and 2003, respectively. North American franchise revenues represented 61.2 and 65.6 percent of total franchise revenues in the first quarter of fiscal year 2005 and 2004, respectively.

Same-store sales increases or decreases 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 same-store sales increases are the sum of the same-store sales increases computed on a daily basis. Relocated salons are 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 order to help determine the increase in revenue attributable to its organic growth (new salon construction and same-store sales growth) versus growth from acquisitions.

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The 9.9 percent increase in consolidated revenues during the first quarter of fiscal year 2005 was driven by the following:

<b>Percentage Increase (Decrease) in Revenues For the Three Months Ended September 30, 2004</b>	
Acquisitions (previous twelve months)	5.4%
Organic growth (salons)	4.0
Foreign currency	1.3
Franchise revenues	(0.1)
Closed salons	(0.7)
	9.9%

We acquired 379 company-owned salons during the twelve months ended September 30, 2004, including 169 franchise buybacks. The organic growth stemmed from the construction of 479 company-owned salons during the twelve months ended September 30, 2004, as well as consolidated same-store sales increases. During the first quarter of fiscal year 2005, the foreign currency impact was driven by the weakening of the United States dollar against the British pound, Euro and Canadian dollar as compared to the prior period's exchange rates. 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 fiscal year and the prior fiscal year.

**North American Salon Revenues.** Total North American salon revenues were as follows:

(Dollars in thousands)	Increase Over Prior Fiscal Year			Same-Store Sales Increase
	Revenues	Dollar	Percentage	
<b>Quarter Ended September 30,</b>				
2004	\$ 448,428	\$ 33,895	8.2%	0.5%
2003	414,533	51,086	14.1	2.4

The percentage increase during the first quarter of fiscal year 2005 was due to the following factors:

<b>Percentage Increase (Decrease) in Revenues For the Three Months Ended September 30, 2004</b>	
Acquisitions (previous twelve months)	5.3%
Organic growth	3.3
Foreign currency	0.2
Franchise revenues	(0.2)
Closed salons	(0.4)
	8.2%

We acquired 351 company-owned North American salons during the twelve months ended September 30, 2004, including 169 franchise buybacks. The organic growth stemmed from the construction of 451 company-owned salons in North America during the twelve months ended September 30, 2004, as well as North American same-store sales increases. Revenues were negatively impacted during the first quarter of fiscal year 2005 by the hurricanes in the southeast United States, which caused nearly 650 of our company-owned salons to be closed for at least one day, as well as reduced customer visits to salons. The foreign currency impact during the first quarter of fiscal years 2005 was driven by the weakening of the United States dollar against the Canadian dollar as compared to the prior period's exchange rate.

**International Salon Revenues.** Total international salon revenues were as follows:

(Dollars in thousands)	Revenues	Increase Over Prior Fiscal Year		Same-Store Sales Increase
		Dollar	Percentage	
<b>Quarter Ended September 30,</b>				
2004	\$ 51,738	\$ 8,596	19.9%	5.6%
2003	43,142	7,366	20.6	5.3

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The percentage increase during the first quarter of fiscal year 2005 was due to the following factors:

	<b>Percentage Increase (Decrease) in Revenues For the Three Months Ended September 30, 2004</b>
Acquisitions (previous twelve months)	1.0%
Organic growth	10.3
Foreign currency	11.2
Franchise revenues	1.4
Closed salons	(4.0)
	19.9%

We acquired 28 company-owned international salons, primarily located in France and the United Kingdom, during the twelve months ended September 30, 2004. The organic growth stemmed from the construction of 28 company-owned salons in the United Kingdom during the twelve months ended September 30, 2004, as well as international same-store sales increases. International same-store product sales increased 14.7 and 32.3 percent during the first quarter of fiscal year 2005 and 2004, respectively, benefiting from our continuing improvement in assessing the merchandising demands of our international customers. The foreign currency impact during the first quarter of fiscal year 2005 was driven by the weakening of the United States dollar against the British pound and the Euro as compared to the prior period's exchange rates.

**School Revenues.** Total revenues earned by beauty career schools were as follows:

<b>(Dollars in thousands) Quarter Ended September 30,</b>	<b>Increase Over Prior Fiscal Year</b>		
	<b>Revenues</b>	<b>Dollar</b>	<b>Percentage</b>
2004	\$ 6,056	\$ 3,010	98.8%
2003	3,046	N/A <sup>a</sup>	N/A <sup>a</sup>

a. We did not own or operate any beauty career schools until December of 2002.

The percentage increase during the first quarter of fiscal year 2005 was due to the following factors:

	<b>Percentage Increase (Decrease) in Revenues For the Three Months Ended September 30, 2004</b>
Acquisitions (previous twelve months)	87.8%
Organic growth	5.3
Foreign currency	5.7
	98.8%

We acquired six Blaine Beauty Career Schools during the fourth quarter of fiscal year 2004. The organic growth stemmed from increased tuition earned by the existing beauty career schools during the three months ended September 30, 2004 due to increased attendance. The foreign currency impact during the first quarter of fiscal year 2005 was driven by the weakening of the United States dollar against the British pound as compared to the prior period's exchange rate.

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**Consolidated Revenues.** North American salon and international salon revenues are primarily comprised of company-owned service and product revenues, as well as franchise revenues from franchise fees and royalties, and product and equipment sales to franchisees. School revenues are primarily comprised of tuition; fluctuations in school revenues are discussed above. Fluctuations in the three salon revenue categories were as follows:

**Service Revenues.** Service revenues were as follows:

(Dollars in thousands)	Revenues	Increase Over Prior Fiscal Year		Same-Store Sales Increase
		Dollar	Percentage	
<b>Quarter Ended September 30,</b>				
2004	\$ 333,874	\$ 33,837	11.3%	1.0%
2003	300,037	36,961	14.0	0.4

The growth in service revenues in the first quarter of fiscal year 2005 was driven by acquisitions and organic growth (new salon construction and same-store sales growth). Service revenues were negatively impacted during the first quarter of fiscal year 2005 by the hurricanes in the southeast United States, as discussed above in conjunction with North American salon revenues.

**Product Revenues.** Product revenues were as follows:

(Dollars in thousands)	Revenues	Increase Over Prior Fiscal Year		Same-Store Sales Increase
		Dollar	Percentage	
<b>Quarter Ended September 30,</b>				
2004	\$ 139,800	\$ 8,208	6.2%	0.6%
2003	131,592	21,299	19.3	7.9

Product revenues were also negatively impacted by the hurricanes during the first quarter of fiscal year 2004, as discussed above.

**Franchise Revenues.** Total franchise revenues, which include royalties, franchise fees and our product and equipment sales to franchisees, were as follows:

(Dollars in thousands)	Revenues	Increase (Decrease) Over Prior Fiscal Year		Percentage
		Dollar	Percentage	
<b>Quarter Ended September 30,</b>				
2004: Royalties	\$ 17,719	\$ 571	3.3%	
Franchise fees	949	(13)	(1.4)	
Franchise product sales	7,824	(112)	(1.4)	
Total franchise revenues	\$ 26,492	\$ 446	1.7%	
2003: Royalties	\$ 17,148	\$ 1,454	9.3%	
Franchise fees	962	(463)	(32.5)	

Franchise product sales	7,936	(799)	(9.2)
Total franchise revenues	\$ 26,046	\$ 192	0.7%

Total franchise salons open at September 30, 2004 and 2003 were 3,902 and 3,999, respectively. We purchased 169 of our franchise salons during the twelve months ended September 30, 2004, which was one of the drivers of the overall decrease in the number of franchise salons between periods. Of total consolidated franchise revenues, North American franchise revenues represented 61.2 and 65.6 percent in the first quarters of fiscal year 2005 and 2004, respectively.

The increase in total consolidated franchise revenues during the first quarter of fiscal year 2005 was due to favorable foreign currency fluctuations, which caused franchise revenues to increase 2.9 percent. Exclusive of the effect of this favorable currency fluctuation, consolidated franchise revenues decreased 1.2 percent, primarily due to our purchase of 169 franchise salons during the past twelve months.

Royalties increased 3.5 percent during the first quarter of fiscal year 2005 due to favorable foreign currency fluctuations. Exclusive of the effect of this favorable currency fluctuation, royalties decreased 0.2 percent.



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Franchise fees decreased during the first quarter of fiscal year 2005 primarily due to the timing of franchise development, particularly with regard to the international franchise salons. The 1.4 percent decrease in franchise fees was net of a favorable impact of approximately 1.3 percent related to foreign currency exchange rate fluctuations.

Sales of product and equipment to franchise salons decreased during the first quarter of fiscal year 2005 primarily due to our purchase of 169 franchise salons during the past twelve months. The franchise product revenues contributed by these salons were replaced by company-owned salon product revenues. Further, lower international franchise salon counts as compared to the prior fiscal year (1,599 and 1,632 international franchise salons were open at September 30, 2004 and 2003, respectively) contributed to the decrease in franchise product revenues. The 1.4 percent decrease is net of a 1.8 percent favorable impact related to foreign currency exchange rate fluctuations.

**Cost of Revenue**

**Total company-owned salon gross margin.** Our cost of salon revenues includes salon based labor costs, the cost of product to provide services for company-owned salons and the cost of products sold to salon customers. The resulting gross margin for the first quarter of fiscal years 2005 and 2004 was as follows:

(Dollars in thousands)	Margin as % of		Increase (Decrease) Over Prior Fiscal		
	Total Margin	Company-owned Salon Revenues	Dollar	Percentage	Basis Point*
Quarter Ended					
September 30, 2004	\$ 211,686	44.7	\$ 17,699	9.1%	(20)
2003	193,987	44.9	\$ 24,918	14.7	(40)

\* Represents the basis point change in total margin as a percent of company-owned salon revenues as compared to the corresponding period of the prior fiscal year.

**Company-owned salon service margin.** Service margin for the first quarter of fiscal year 2005 and 2004 was as follows:

(Dollars in thousands)	Margin as % of Company-		Increase (Decrease) Over Prior		
	Service Margin	Owned Salon Service Revenues	Dollar	Percentage	Basis Point*
Quarter Ended					
September 30, 2004	\$ 143,279	42.9	\$ 12,637	9.7%	(60)
2003	130,642	43.5	15,194	13.2	(40)

\* Represents the basis point change in service margin as a percent of company-owned salon service revenues as compared to the corresponding period of the prior fiscal year.