

REGIS CORP  
Form 10-Q  
May 06, 2008

**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, 2008

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 1-12725

**Regis Corporation**

(Exact name of registrant as specified in its charter)

**Minnesota**

(State or other jurisdiction of  
incorporation or organization)

**7201 Metro Boulevard, Edina, Minnesota**  
(Address of principal executive offices)

**41-0749934**

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

**55439**

(Zip Code)

**(952) 947-7777**

(Registrant's telephone number, including area code)

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N/A

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

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  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 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       Smaller reporting company   
(Do not check if a smaller reporting company)

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock as of May 5, 2008:

<b>Common Stock, \$.05 par value</b>	<b>43,008,944</b>
Class	Number of Shares

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REGIS CORPORATION

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## PART I - FINANCIAL INFORMATION

## Item 1. Condensed Consolidated Financial Information

**REGIS CORPORATION**  
**CONDENSED CONSOLIDATED BALANCE SHEET (Unaudited)**  
as of March 31, 2008 and June 30, 2007  
(In thousands, except share data)

	March 31, 2008	June 30, 2007
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 136,289	\$ 184,785
Receivables, net	41,972	67,773
Inventories	210,406	196,582
Deferred income taxes	12,778	18,775
Other current assets	47,489	57,149
Total current assets	448,934	525,064
Property and equipment, net	489,401	494,085
Goodwill	863,265	812,383
Other intangibles, net	144,841	213,452
Investment in affiliates	196,752	20,213
Other assets	93,292	66,917
Total assets	\$ 2,236,485	\$ 2,132,114
<b>LIABILITIES AND SHAREHOLDERS EQUITY</b>		
Current liabilities:		
Long-term debt, current portion	\$ 201,931	\$ 223,352
Accounts payable	67,012	74,532
Accrued expenses	205,830	240,748
Total current liabilities	474,773	538,632
Long-term debt and capital lease obligations	597,224	485,879
Other noncurrent liabilities	212,569	194,295
Total liabilities	1,284,566	1,218,806
Shareholders' equity:		
Common stock, \$0.05 par value; issued and outstanding 42,913,895 and 44,164,645 common shares at March 31, 2008 and June 30, 2007, respectively	2,145	2,209
Additional paid-in capital	143,801	178,029
Accumulated other comprehensive income	98,547	78,278
Retained earnings	707,426	654,792
Total shareholders' equity	951,919	913,308
Total liabilities and shareholders' equity	\$ 2,236,485	\$ 2,132,114

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



**REGIS CORPORATION**  
**CONDENSED CONSOLIDATED STATEMENT OF OPERATIONS (Unaudited)**  
**for the three months ended March 31, 2008 and 2007**  
**(In thousands, except per share data)**

	2008		2007
<b>Revenues:</b>			
Service	\$ 475,177	\$	449,548
Product	190,562		185,462
Royalties and fees	14,316		20,024
	680,055		655,034
<b>Operating expenses:</b>			
Cost of service	274,793		254,621
Cost of product	97,377		93,685
Site operating expenses	52,275		51,462
General and administrative	82,290		83,298
Rent	100,900		95,259
Depreciation and amortization	30,254		30,442
Goodwill impairment			23,000
Total operating expenses	637,889		631,767
Operating income	42,166		23,267
<b>Other income (expense):</b>			
Interest expense	(11,330)		(10,355)
Interest income and other, net	1,832		1,075
Income before income taxes and equity in income of affiliated companies	32,668		13,987
Income taxes	(14,338)		(8,659)
Equity in income of affiliated companies, net of income taxes	638		
Net income	\$ 18,968	\$	5,328
<b>Net income per share:</b>			
Basic	\$ 0.44	\$	0.12
Diluted	\$ 0.44	\$	0.12
<b>Weighted average common and common equivalent shares outstanding:</b>			
Basic	42,638		44,703
Diluted	43,025		45,564
Cash dividends declared per common share	\$ 0.04	\$	0.04

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

**REGIS CORPORATION**  
**CONDENSED CONSOLIDATED STATEMENT OF OPERATIONS (Unaudited)**  
**for the nine months ended March 31, 2008 and 2007**  
(In thousands, except per share data)

	2008	2007
<b>Revenues:</b>		
Service	\$ 1,392,763	\$ 1,324,445
Product	580,040	567,139
Royalties and fees	57,018	59,683
	2,029,821	1,951,267
<b>Operating expenses:</b>		
Cost of service	803,830	749,759
Cost of product	296,499	288,078
Site operating expenses	154,804	162,235
General and administrative	254,786	242,662
Rent	298,431	280,594
Depreciation and amortization	93,440	90,396
Goodwill impairment		23,000
Total operating expenses	1,901,790	1,836,724
Operating income	128,031	114,543
<b>Other income (expense):</b>		
Interest expense	(33,668)	(30,864)
Interest income and other, net	6,079	3,468
Income before income taxes and equity in income of affiliated companies	100,442	87,147
Income taxes	(39,009)	(31,852)
Equity in income of affiliated companies, net of income taxes	690	
Net income	\$ 62,123	\$ 55,295
<b>Net income per share:</b>		
Basic	\$ 1.43	\$ 1.23
Diluted	\$ 1.42	\$ 1.21
<b>Weighted average common and common equivalent shares outstanding:</b>		
Basic	43,303	44,807
Diluted	43,831	45,712
Cash dividends declared per common share	\$ 0.12	\$ 0.12

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

**REGIS CORPORATION**  
**CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS (Unaudited)**  
**for the nine months ended March 31, 2008 and 2007**  
(In thousands)

	2008	2007
Cash flows from operating activities:		
Net income	\$ 62,123	\$ 55,295
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	84,800	81,233
Amortization	8,640	9,163
Equity in income of affiliated companies	(690)	
Deferred income taxes	1,250	(462)
Goodwill impairment		23,000
Excess tax benefits from stock-based compensation plans	(1,335)	(4,135)
Stock-based compensation	4,998	3,505
Other noncash items affecting earnings	1,874	2,636
Changes in operating assets and liabilities:		
Receivables	(1,183)	(8,353)
Inventories	(3,740)	1,200
Other current assets	4,488	(20,327)
Other assets	13,949	1,673
Accounts payable	(6,032)	6,041
Accrued expenses	(1,453)	16,072
Other noncurrent liabilities	150	10,232
Net cash provided by operating activities	167,839	176,773
Cash flows from investing activities:		
Capital expenditures	(64,696)	(66,611)
Proceeds from sale of assets	21	223
Asset acquisitions, net of cash acquired and certain obligations assumed	(124,379)	(34,171)
Proceeds from loans and investments	10,000	5,250
Disbursements for loans and investments	(43,900)	(19,984)
Transfer of cash related to contribution of schools and European franchise salon operations	(14,570)	
Net investment hedge settlement		(8,897)
Net cash used in investing activities	(237,524)	(124,190)
Cash flows from financing activities:		
Borrowings on revolving credit facilities	6,883,917	5,015,956
Payments on revolving credit facilities	(6,863,630)	(4,976,950)
Proceeds from issuance of long-term debt	125,000	25,000
Repayments of long-term debt and capital lease obligations	(67,926)	(32,861)
Excess tax benefits from stock-based compensation plans	1,335	4,135
Other, primarily decrease in negative book cash balances	(7,343)	(4,976)
Repurchase of common stock	(49,956)	(41,298)
Proceeds from issuance of common stock	7,897	12,312
Dividends paid	(5,245)	(5,411)
Net cash provided by (used in) financing activities	24,049	(4,093)
Effect of exchange rate changes on cash and cash equivalents	(2,860)	2,288
(Decrease) increase in cash and cash equivalents	(48,496)	50,778
Cash and cash equivalents:		
Beginning of period	184,785	135,397
End of period	\$ 136,289	\$ 186,175



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



**REGIS CORPORATION**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL INFORMATION**  
**(Unaudited)**



**1. BASIS OF PRESENTATION OF UNAUDITED INTERIM CONDENSED CONSOLIDATED FINANCIAL INFORMATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:**

The unaudited interim Condensed Consolidated Financial Information of Regis Corporation (the Company) as of March 31, 2008 and for the three and nine months ended March 31, 2008 and 2007, reflect, in the opinion of management, all adjustments necessary to fairly state the consolidated financial position of the Company as of March 31, 2008 and the consolidated results of its operations and its cash flows for the interim periods. Adjustments consist only of normal recurring items, except for any discussed in the notes below. The results of operations and cash flows for any interim period are not necessarily indicative of results of operations and cash flows for the full year.

The Consolidated Balance Sheet data for June 30, 2007 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 Information should be read in conjunction with the Company's Annual Report on Form 10-K for the year ended June 30, 2007 and other documents filed or furnished with the Securities and Exchange Commission (SEC) during the current fiscal year.

The unaudited condensed financial information of the Company as of March 31, 2008 and for the three and nine month periods ended March 31, 2008 and 2007 included in this Form 10-Q, has been reviewed by PricewaterhouseCoopers LLP, an Independent Registered Public Accounting Firm. Their separate report dated May 6, 2008 appearing herein, states that they did not audit and they do not express an opinion on that unaudited financial information. Accordingly, the degree of reliance on their report on such information should be restricted in light of the limited nature of the review procedures applied. PricewaterhouseCoopers LLP is not subject to the liability provisions of Section 11 of the Securities Act of 1933 for their report on the unaudited financial information because that report is not a report or a part of the registration statement prepared or certified by PricewaterhouseCoopers LLP within the meaning of Sections 7 and 11 of the Act.

**Inventories:**

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

**Stock-Based Employee Compensation:**

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

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Total compensation expense related to share-based compensation plans was \$1.7 and \$5.0 million for the three and nine months ended March 31, 2008, respectively, and \$1.2 and \$3.5 million for the three and nine months ended March 31, 2007, respectively. A summary of outstanding and exercisable options as of March 31, 2008, and changes during the three and nine months ended March 31, 2008 is presented below:

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Options	Shares (In thousands)	Weighted- Average Exercise Price
Outstanding at July 1, 2007	2,193	\$ 22.97
Granted		
Exercised	(29)	24.42
Forfeited or expired	(39)	33.02
Outstanding at September 30, 2007	2,125	\$ 22.65
Granted		
Exercised	(410)	16.24
Forfeited or expired	(14)	35.41
Outstanding at December 31, 2007	1,701	\$ 24.08
Granted		
Exercised	(32)	17.30
Forfeited or expired	(11)	37.49
Outstanding at March 31, 2008	1,658	\$ 24.14
Exercisable at March 31, 2008	1,295	\$ 20.68

An additional 349,732 shares are expected to vest with a \$36.44 weighted average exercise price and a weighted average remaining contractual term of 7.7 years. The total intrinsic value of options exercised during the three and nine months ended March 31, 2008 was \$0.3 and \$6.6 million, respectively, and \$4.7 and \$15.9 million for the three and nine months ended March 31, 2007, respectively.

A summary of the nonvested restricted stock shares, RSUs and SARs outstanding as of March 31, 2008 and changes during the three and nine months ended March 31, 2008 is presented below:

	Restricted Stock Outstanding Shares/Units	Nonvested Weighted Average Grant Date Fair Value	SARs Outstanding Shares	Weighted Average Exercise Price
Balance, June 30, 2007	473,700	\$ 38.36	400,300	\$ 37.53
Granted				
Vested/Exercised	(301)	36.20		
Forfeited or expired	(11,150)	37.73	(9,950)	38.61
Balance, September 30, 2007	462,249	\$ 37.83	390,350	\$ 38.24
Granted				
Vested/Exercised				
Forfeited or expired			(1,500)	39.11
Balance, December 31, 2007	462,249	\$ 37.83	388,850	\$ 38.24
Granted				
Vested/Exercised				
Forfeited or expired				
Balance, March 31, 2008	462,249	\$ 37.83	388,850	\$ 38.24

The total unrecognized compensation cost related to unvested stock-based compensation arrangements was \$19.8 million at March 31, 2008 and the related weighted average period over which it is expected to be recognized is approximately 3.3 years.

**Recent Accounting Pronouncements:**

In September 2006, the FASB issued Statement of Financial Accounting Standard (SFAS) No. 157, *Fair Value Measures* (SFAS No. 157). SFAS No. 157 defines fair value, establishes a framework for measuring fair value and enhances disclosures about fair value measures required under other accounting pronouncements, but does not change existing guidance as to whether or not an instrument is carried at fair value. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007 (i.e., the Company's first quarter of fiscal year 2009). In February 2008, the FASB deferred SFAS No. 157's effective date for all non-financial assets and liabilities, except those items recognized or disclosed at fair value on an annual or more frequently recurring basis, until years beginning after November 15, 2008. The Company is currently evaluating the impact of SFAS No. 157 on its Consolidated Financial Statements.



In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* (SFAS No. 159). SFAS No. 159 permits companies to choose to measure many financial instruments and certain other items at fair value. The objective is to improve financial reporting by providing companies with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007. Companies are not allowed to adopt SFAS No. 159 on a retrospective basis unless they choose early adoption. The Company does not expect it will elect to adopt the provisions of SFAS No. 159.

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

In March 2008, the FASB issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities* (SFAS No. 161). SFAS No. 161 requires enhanced disclosures about how and why an entity uses derivative instruments, how derivative instruments and related hedge items are accounted for under SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, and its related interpretations, and how derivative instruments and related hedged items affect an entity's financial position, financial performance, and cash flows. SFAS No. 161 is effective for fiscal years beginning after November 15, 2008 (i.e. the Company's first quarter of fiscal year 2010). The Company intends to comply with the disclosure requirements upon adoption.

## 2. SHAREHOLDERS' EQUITY AND COMPREHENSIVE INCOME:

### Additional Paid-In Capital

The decrease in additional paid-in capital during the nine months ended March 31, 2008 was due to the following:

	(Dollars in thousands)
Balance, June 30, 2007	\$ 178,029
Exercise of stock options	7,874
Franchise stock incentive program	416
Tax benefit realized upon exercise of stock options	2,447
Stock-based compensation	4,998
FIN 48 adoption adjustment	(93)
Stock repurchase	(49,870)
<b>Balance, March 31, 2008</b>	<b>\$ 143,801</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 or foreign currency exposure and foreign currency translation charged or credited to the cumulative translation account within shareholders' equity. Comprehensive income for the three and nine months ended March 31, 2008 and 2007 was as follows:

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	For the Periods Ended March 31,			
	Three Months		Nine Months	
	2008	2007	2008	2007
	(Dollars in thousands)			
Net income	\$ 18,968	\$ 5,328	\$ 62,123	\$ 55,295
Other comprehensive income (loss):				
Changes in fair market value of financial instruments designated as cash flow hedges of interest rate exposure, net of taxes	(1,023)	(82)	(3,865)	(771)
Change in cumulative foreign currency translation, net of taxes	2,396	1,784	24,134	9,195
Total comprehensive income	\$ 20,341	\$ 7,030	\$ 82,392	\$ 63,719

**3. NET INCOME PER SHARE:**

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

	For the Periods Ended March 31,			
	Three Months		Nine Months	
	2008	2007	2008	2007
	(Shares in thousands)			
Weighted average shares for basic earnings per share	42,638	44,703	43,303	44,807
Effect of dilutive securities:				
Dilutive effect of stock-based compensation	280	812	421	856
Contingent shares issuable under contingent stock agreements (see Note 5)	107	49	107	49
Weighted average shares for diluted earnings per share	43,025	45,564	43,831	45,712
Anti-dilutive stock-based compensation shares excluded from the above computations:				
Stock options, SARs, restricted stock and RSUs	1,441	858	1,217	796

Restricted stock awards, including restricted stock units, of 462,249 shares for the three and nine months ended March 31, 2008 and 347,300 shares for the three and nine months ended March 31, 2007, were excluded from the computation of basic weighted average shares outstanding as such shares were not yet vested at these dates.

**4. GOODWILL AND OTHER INTANGIBLES:**

The table below contains details related to the Company's recorded goodwill as of March 31, 2008 and June 30, 2007:

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	Salons		Beauty	Hair Restoration	
	North America	International	Schools(1)	Centers	Consolidated
	(Dollars in thousands)				
Balance at June 30, 2007	\$ 570,161	\$ 46,487	\$ 60,934	\$ 134,801	\$ 812,383
Goodwill acquired	76,816	6,038		15,073	97,927
Impact of contribution of certain beauty schools (1)	13,829	13,071	(60,960)		(34,060)
Impact of contribution of European franchise salon operations (2)		(22,366)			(22,366)
Adjustment related to FIN 48				3,859	3,859
Translation rate adjustments	1,649	3,847	26		5,522
Balance at March 31, 2008	\$ 662,455	\$ 47,077	\$	\$ 153,733	\$ 863,265

(1) On August 1, 2007, the Company contributed its accredited cosmetology schools to Empire Education Group, Inc. The Company retained ownership of its one North American and four United Kingdom Vidal Sassoon schools. Subsequent to August 1, 2007 results of operations and assets for the Vidal Sassoon schools are included in the respective North American and International salon segments.

(2) On January 31, 2008 the Company merged its continental European franchise salon operations with the Franck Provost Salon Group (See Note 5).

Goodwill acquired includes adjustments to prior year acquisitions, primarily representing the finalization of purchase price allocations.

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

During the three months ended March 31, 2008 and 2007, the Company performed its annual goodwill impairment analysis on its reporting units. Based on the Company's testing no impairment of goodwill was recorded during the three months ended March 31, 2008. A \$23.0 million impairment charge was recorded during the three months ended March 31, 2007.

Related to the adoption of FIN 48, effective July 1, 2007 the Company recorded a \$3.9 million adjustment to goodwill to account for preacquisition tax positions at the Company's hair restoration centers segment.

The table below presents other intangible assets as of March 31, 2008 and June 30, 2007:

	March 31, 2008			June 30, 2007		
Cost	Accumulated Amortization (1)	Net	Cost	Accumulated Amortization (1)	Net	
(Dollars in thousands)						
Amortized intangible assets:						
Brand assets and trade names	\$ 84,464	\$ (7,229)	\$ 77,235	\$ 112,999	\$ (10,193)	\$ 102,806
Customer lists	51,317	(16,161)	35,156	48,744	(9,970)	38,774
Franchise agreements	21,919	(5,892)	16,027	27,149	(7,538)	19,611
Lease intangibles	14,983	(2,657)	12,326	13,933	(4,818)	9,115
Product license agreements				16,946	(2,944)	14,002
School-related licenses				25,428	(1,247)	24,181
	719	(608)	111	691	(644)	47

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Non-compete  
agreements

Other	7,800	(3,814)	3,986	7,728	(2,812)	4,916
	\$ 181,202	\$ (36,361)	\$ 144,841	\$ 253,618	\$ (40,166)	\$ 213,452

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

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:

	<b>Weighted Average Amortization Period (In years)</b>
Amortized intangible assets:	
Brand assets and trade names	38
Customer list	10
Franchise agreements	22
Lease intangibles	19
Product license agreements	30
Non-compete agreements	6
Other	9
<b>Total</b>	<b>26</b>

Total amortization expense related to amortizable intangible assets was approximately \$2.8 and \$3.0 million during the three months ended March 31, 2008 and 2007, and \$8.5 and \$8.7 million during the nine months ended March 31, 2008 and 2007. As of March 31, 2008, future estimated amortization expense related to amortizable intangible assets is estimated to be:

<b>Fiscal Year</b>	<b>(Dollars in thousands)</b>
2008 (Remainder: three-month period)	\$ 3,254
2009	12,386
2010	12,125
2011	11,959
2012	11,805

## 5. ACQUISITIONS, INVESTMENT IN AFFILIATES AND LOANS:

### *Acquisitions*

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

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

<b>Allocation of Purchase Prices</b>	<b>For the Nine Months Ended March 31,</b>	
	<b>2008</b>	<b>2007</b>
	<b>(Dollars in thousands)</b>	
Components of aggregate purchase prices:		
Cash	\$ 124,379	\$ 34,171
Note receivable applied to purchase price	10,000	
Liabilities assumed	2,602	559
	<b>\$ 136,981</b>	<b>\$ 34,730</b>

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Allocation of the purchase price:

Current assets	\$	15,184	\$	2,225
Property and equipment		20,414		5,298
Deferred income tax asset				1,043
Other noncurrent assets		1,210		52
Goodwill		97,927		24,256
Identifiable intangible assets		15,976		2,798
Accounts payable and accrued expenses		(12,330)		(150)
Deferred income tax liability				(436)
Other noncurrent liabilities		(1,400)		(356)
	\$	136,981	\$	34,730

For a certain acquisition the required purchase accounting adjustments, including the allocation of the purchase price based on the fair values of the assets acquired have been made based upon preliminary valuations, which are still in review and are subject to change. Based upon the Company's final valuation and review it may determine that certain tangible or intangible assets



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require revision. The Company anticipates that it will finalize the purchase price allocation within the fourth quarter of fiscal year 2008. Any adjustments to the purchase price allocation will be recorded as an increase or decrease in goodwill.

In a limited number of acquisitions, the Company guarantees that the 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 consideration 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. At March 31, 2008, one contingency of this type exists, which expires in June of 2008. Based on the March 31, 2008 market price, the Company would be required to provide an additional 106,707 shares with an aggregate market value on that date of \$2.9 million related to this acquisition contingency if the agreed upon time frame was assumed to have expired March 31, 2008. These contingently issuable shares have been included in the calculation of diluted earnings per share.

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

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

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

### *Investment in Affiliates and Loans*

The table below presents investments in affiliates as of March 31, 2008 and June 30, 2007:

	March 31, 2008	June 30, 2007
	(Dollars in thousands)	
Provalliance	\$ 112,276	\$
Empire Education Group, Inc.	73,011	
Intelligent Nutrients, LLC	6,592	8,114
Yamano Holdings	4,873	8,080

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PureBeauty/Beauty First				4,019
	\$	196,752	\$	20,213

*Investment in 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 minority 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 2,300 company-owned and franchise salons as of March 31, 2008.

The carrying value of the contributed European franchise salon operations approximated the estimated fair value of the Company's interest in Provalliance. The Company's net asset value in its European franchise salon operations as

of January 31, 2008 was recorded as an investment in Provalliance and no gain or loss was recognized on the date of the merger.

The merger agreement contains a right (Equity Put) to require the Company to purchase additional ownership interest in Provalliance between specified dates in 2010 to 2018. The acquisition price is determined based on the earnings before interest, taxes, depreciation and amortization of Provalliance for a trailing 12 month period which is intended to approximate fair value. The estimated fair value of this Equity Put has been included as a component of the Company's investment in Provalliance with a corresponding liability for the same amount. The merger agreement also contains an option (Equity Call) whereby the Company can acquire additional ownership interest in Provalliance between specific dates in 2018 to 2020 at an acquisition price determined consistent with the Equity Put.

The Company's investment in Provalliance is accounted for under the equity method of accounting. During the period from the date of the merger on January 31, 2008 to March 31, 2008, the Company recorded \$1.1 million of equity in income related to its investment in Provalliance. As of March 31, 2008, the identifiable intangible assets of Provalliance resulting from the merger and the Equity Put are based on preliminary estimates of fair value which are expected to be finalized by the Company or Provalliance during the Company's fourth quarter ending June 30, 2008. Any changes in the fair value of the Equity Put in future periods thereafter, will be recorded in the Company's consolidated statement of operations.

*Investment in 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 minority interest in EEG. This transaction leverages EEG's management expertise, while enabling the Company to maintain a vested interest in the beauty school industry. Once the integration of the Regis schools is complete, the Company expects to share in significant synergies and operating improvements. EEG operates 87 accredited cosmetology schools.

The carrying value of the contributed schools approximated the estimated fair value of the Company's interest in EEG, resulting in no gain or loss on the date of contribution. The Company's investment in EEG is accounted for under the equity method of accounting. Subsequent to August 1, 2007, the Company completed \$22.5 million of loans and advances to EEG, of which \$12.5 million was outstanding at March 31, 2008. In January 2008, the Company's effective ownership interest increased to 55.1 percent related to the buyout of EEG's minority interest shareholder. In connection with the buyout, the Company advanced EEG, an additional \$21.4 million, of which \$21.4 million was outstanding at March 31, 2008. The exposure to loss related to the Company's involvement with EEG is the carrying value of the investment and the outstanding loans.

The Company will continue to account for the investment in EEG under the equity method of accounting as Empire Beauty School retains majority voting interest and has full responsibility for managing EEG. During the three and nine months ended March 31, 2008 the Company recorded \$0.4 and \$0.8 million of interest income, respectively, related to the loans and advances. During the three and nine months ended March 31, 2008, the Company recorded less than \$0.1 million and \$0.7 million, respectively, of equity earnings related to its investment in EEG.

*Investment in Intelligent Nutrients*

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The Company holds a 49.0 percent interest in Intelligent Nutrients, LLC. The Company's ownership percentage decreased from 50.0 percent to 49.0 percent during the three months ended March 31, 2008 due to the issuance of additional shares by Intelligent Nutrients, LLC to the other investor. The Company is accounting for this investment under the equity method. Intelligent Nutrients, LLC currently carries a wide variety of organic, harmonically grown products, including dietary supplements, coffees, teas and aromatics. Additionally, a full line of professional hair care and personal care products is in development and is expected to be available in the summer of calendar year 2008. These products will be offered at the Company's corporate and franchise salons, and eventually in other independently owned salons. During the three and nine months ended March 31, 2008 the Company recorded losses of \$0.4 and \$1.0 million, respectively, net of \$0.2 and \$0.6 million, respectively, of tax benefit related to this equity investment.

### *Investment in Yamano Holdings*

In April 2007, the Company purchased exchangeable notes issued by Yamano Holding Corporation and a loan obligation of a Yamano Holdings subsidiary, Beauty Plaza Co. Ltd., for an aggregate amount of 1.3 billion JPY (\$11.9 million USD at March 31, 2008). A portion of the notes are exchangeable for approximately 14.8 percent of the outstanding shares of Beauty Takashi Co. Ltd., a subsidiary of Yamano Holdings. The exchangeable portion of

the notes is accounted for as a cost method investment. The notes, excluding the exchangeable portion are recorded in the condensed consolidated balance sheet as current assets and long-term assets of \$3.9 and \$3.1 million, respectively. The Company recorded less than \$0.1 million in interest income related to the exchangeable notes and loan obligation during the three and nine months ended March 31, 2008. In connection with the purchase of the exchangeable notes and loan obligation, the parties also entered into a business collaboration agreement with respect to their joint pursuit of opportunities relating to retail hair salons in Asia.

*Investment in Cameron Capital (PureBeauty and BeautyFirst)*

On February 20, 2008, the Company acquired the capital stock of Cameron Capital I, Inc. (CCI), a wholly-owned subsidiary of Cameron Capital Investments, Inc. CCI owns and operates PureBeauty and BeautyFirst salons. CCI is now accounted for as a wholly-owned subsidiary of the Company. Prior to the acquisition, the Company held a 19.9 percent interest in the voting common stock of CCI which was accounted for under the equity method of accounting and had \$10.0 million of long-term notes receivable under a credit agreement with the majority corporate investor in this privately held entity. The long-term notes receivable were incorporated as part of the purchase price of the acquisition. During the three and nine months ended March 31, 2008 the Company recorded losses of less than \$0.1 million related to this equity investment.

*Investment in Cool Cuts 4 Kids, Inc.*

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

**6. LITIGATION:**

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

**7. DERIVATIVE FINANCIAL INSTRUMENTS:**

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

In September 2007 the Company entered into several forward foreign currency contracts to hedge the U.S. Dollar value of future Chinese Yuan denominated payments to Chinese vendors. The foreign currency contracts totaled approximately 6.0 million Chinese Yuan or \$0.8 million U.S. dollars and have maturation dates between April 2008 and September 2008. The purpose of the forward contracts is to protect against adverse movements in the Chinese Yuan exchange rate. The contracts were designated and are effective as cash flow hedges of Chinese Yuan denominated foreign currency firm commitments. These cash flow hedges were recorded at fair value within other current assets in the Condensed Consolidated Balance Sheet, with a corresponding offset in other comprehensive income within shareholders' equity.

**8. INCOME TAXES:**

The reported effective income tax rate was 43.9 percent and 61.9 percent for the three months ended March 31, 2008 and 2007, respectively, and 38.9 percent and 36.5 percent for the nine months ended March 31, 2008 and 2007, respectively. The provision for income taxes differs from the amount of income tax determined by applying the applicable United States (U.S.) statutory rate to earnings before income taxes, as a result of the following:

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Tax Rate Reconciliation	For the Periods Ended March 31,			
	Three Months		Nine Months	
	2008	2007	2008	2007
U.S. statutory tax rate	35.0%	35.0%	35.0%	35.0%
Adjustments resulting from:				
State income taxes, net of federal income tax benefit	4.0	2.2	4.0	2.2
Foreign income taxes at other than U.S. rates	0.6	(8.9)	(1.6)	(3.1)
Work Opportunity Tax Credits and jobs tax credits, net	(1.7)	(8.7)	(1.8)	(3.9)
Repatriation costs	3.7		1.3	
Tax effect of goodwill impairment		42.6		6.2
Other, net	2.3	(0.3)	2.0	0.1
Effective income tax rate	43.9%	61.9%	38.9%	36.5%

The Company adopted the provisions of FIN 48 effective July 1, 2007. As a result of adoption, the Company recognized a \$20.7 million increase in the liability for unrecognized income tax benefits, including interest and penalties, which was accounted for through the following accounts (dollars in thousands):

Deferred income taxes	\$	10,128
Goodwill		6,094
Additional paid-in capital		237
Retained earnings		4,201
Total increase	\$	20,660

On July 1, 2007, the Company had gross unrecognized tax benefits of \$22.5 million, of which \$6.5 million would affect the effective tax rate if recognized.

The Company recognizes accrued interest and penalties related to unrecognized tax benefits as a component of income tax expense in its financial statements. As of the adoption date, the Company had accrued interest and penalties related to unrecognized tax benefits of \$7.2 million. This amount is not included in the gross unrecognized tax benefits noted above.

The Company files tax returns and pays tax primarily in the United States, Canada, the United Kingdom, and a number of countries in continental Europe as well as states, cities, and provinces within these jurisdictions. With few exceptions, tax years prior to June 30, 2004 are closed to audit. The Company, or its subsidiaries, is currently under audit by a number of states as well as Canada and the United Kingdom, and it is reasonably certain that some or all of these audits might be resolved within the next twelve months. Resolution of these audits could result in offsets to other balance sheet accounts, cash payments, and/or adjustments to the annual effective rate. The Company does not expect a significant increase or decrease in unrecognized tax benefits over the next 12 months. Between July 1, 2007 and March 31, 2008, there were no material changes to the Company's gross liability for unrecognized tax benefits.

## 9. SEGMENT INFORMATION:

As of March 31, 2008, the company owned, franchised, or held ownership interests in over 13,400 worldwide locations. The Company's locations consisted of 10,255 North American salons (located in the United States, Canada and Puerto Rico), 474 international salons, 90 hair

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restoration centers and approximately 2,630 locations in which the Company maintains an ownership interest. The Company operates its North American salon operations through five primary concepts: Regis Salons, MasterCuts, Trade Secret, SmartStyle and Strip Center 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 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 hair restoration centers are located in the United States and Canada.

On August 1, 2007, the Company contributed its accredited cosmetology schools to Empire Education Group, Inc. The results of operations for the month ended July 31, 2007 for the accredited cosmetology schools are reported in



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the North American salons segment. The Company retained ownership of its one North American and four United Kingdom Vidal Sassoon schools. Subsequent to August 1, 2007, results of operations for the Vidal Sassoon schools are included in the respective North American and International salon segments.

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

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

Total Assets by Segment	March 31, 2008		June 30, 2007	
	(Dollars in thousands)			
North American salons	\$	1,336,126	\$	1,070,776
International salons		231,839		210,629
Beauty schools				163,818
Hair restoration centers		281,587		262,295
Unallocated corporate		386,933		424,596
Consolidated	\$	2,236,485	\$	2,132,114

	For the Three Months Ended March 31, 2008(1)					Consolidated		
	North America	Salons International	Hair Restoration Centers	Unallocated Corporate				
					(Dollars in thousands)			
<b>Revenues:</b>								
Service	\$	422,208	\$	36,772	\$	16,197	\$	475,177
Product		157,328		15,853		17,381		190,562
Royalties and fees		9,930		3,348		1,038		14,316
		589,466		55,973		34,616		680,055
<b>Operating expenses:</b>								
Cost of service		245,562		20,405		8,826		274,793
Cost of product		83,729		8,672		4,976		97,377
Site operating expenses		47,431		3,611		1,233		52,275
General and administrative		34,680		7,543		8,018		32,049
Rent		85,473		12,991		1,923		513
Depreciation and amortization		21,469		2,223		2,627		3,935
Total operating expenses		518,344		55,445		27,603		36,497
Operating income (loss)		71,122		528		7,013		(36,497)
<b>Other income (expense):</b>								
Interest expense								(11,330)
Interest income and other, net								1,832
Income (loss) before income taxes and	\$	71,122	\$	528	\$	7,013	\$	(45,995)
								32,668

equity in income of  
affiliated companies

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(1) On August 1, 2007, the Company contributed its accredited cosmetology schools to Empire Education Group, Inc. The Company retained ownership of its one North American and four United Kingdom Vidal Sassoon schools. Results of operations for the Vidal Sassoon schools are included in the respective North American and International salon segments.

On January 31, 2008, the Company merged its continental European franchise salon operations with the Franck Provost Salon Group. For the three months ended March 31, 2008 the results of operations for the month ended January 31, 2008 are reported in the International salon segment.

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For the Three Months Ended March 31, 2007

	Salons		Hair		Unallocated	Consolidated
	North America	International	Beauty Schools	Restoration Centers	Corporate	
	(Dollars in thousands)					
<b>Revenues:</b>						
Service	\$ 379,903	\$ 34,856	\$ 20,459	\$ 14,330	\$	\$ 449,548
Product	150,356	16,794	2,582	15,730		185,462
Royalties and fees	9,383	9,342		1,299		20,024
	539,642	60,992	23,041	31,359		655,034
<b>Operating expenses:</b>						
Cost of service	220,079	18,922	8,035	7,585		254,621
Cost of product	77,323	10,151	1,485	4,726		93,685
Site operating expenses	43,302	2,792	4,050	1,318		51,462
General and administrative	29,507	11,218	2,357	7,226	32,990	83,298
Rent	79,119	11,662	2,348	1,626	504	95,259
Depreciation and amortization	20,736	2,191	852	2,432	4,231	30,442
Goodwill impairment(1)			23,000			23,000
Total operating expenses	470,066	56,936	42,127	24,913	37,725	631,767
Operating income (loss)	69,576	4,056	(19,086)	6,446	(37,725)	23,267
<b>Other income (expense):</b>						
Interest expense					(10,355)	(10,355)
Interest income and other, net					1,075	1,075
Income (loss) before income taxes and equity in income of affiliated companies	\$ 69,576	\$ 4,056	\$ (19,086)	\$ 6,446	\$ (47,005)	\$ 13,987

(1) During the three months ended March 31, 2007, the Company performed its annual impairment analysis on its reporting units. Based on the Company's testing, a \$23.0 million impairment charge was recorded during the three months ended March 31, 2007.

## For the Nine Months Ended March 31, 2008(1)

	Salons		Hair	Unallocated	
	North America	International	Restoration Centers	Corporate	Consolidated
	(Dollars in thousands)				
<b>Revenues:</b>					
Service	\$ 1,228,724	\$ 118,425	\$ 45,614	\$	\$ 1,392,763
Product	478,964	50,279	50,797		580,040
Royalties and fees	29,979	23,606	3,433		57,018
	1,737,667	192,310	99,844		2,029,821
<b>Operating expenses:</b>					
Cost of service	714,117	64,917	24,796		803,830
Cost of product	254,364	27,400	14,735		296,499
Site operating expenses	140,468	10,526	3,810		154,804
General and administrative	101,068	31,143	22,534	100,041	254,786
Rent	251,793	39,904	5,308	1,426	298,431
Depreciation and amortization	65,054	7,271	7,676	13,439	93,440
Total operating expenses	1,526,864	181,161	78,859	114,906	1,901,790
Operating income (loss)	210,803	11,149	20,985	(114,906)	128,031
<b>Other income (expense):</b>					
Interest expense				(33,668)	(33,668)
Interest income and other, net				6,079	6,079
Income (loss) before income taxes and equity in income of affiliated companies	\$ 210,803	\$ 11,149	\$ 20,985	\$ (142,495)	\$ 100,442

(1) On August 1, 2007, the Company contributed its accredited cosmetology schools to Empire Education Group, Inc. For the nine months ended March 31, 2008, the results of operations for the month ended July 31, 2007 for the accredited cosmetology schools are reported in the North American salons segment. The Company retained ownership of its one North American and four United Kingdom Vidal Sassoon schools. Subsequent to August 1, 2007 results of operations for the Vidal Sassoon schools are included in the respective North American and International salon segments.

On January 31, 2008, the Company merged its continental European franchise salon operations with the Franck Provost Salon Group. For the nine months ended March 31, 2008, the results of operations for the seven months ended January 31, 2008 are reported in the International salon segment.

## For the Nine Months Ended March 31, 2007

(Dollars in thousands)	Salons		Beauty Schools	Hair Restoration Centers	Unallocated Corporate	Consolidated
	North America	International				
<b>Revenues:</b>						
Service	\$ 1,123,263	\$ 103,780	\$ 57,565	\$ 39,837	\$	\$ 1,324,445
Product	467,520	46,154	6,817	46,648		567,139
Royalties and fees	28,678	27,302		3,703		59,683
	1,619,461	177,236	64,382	90,188		1,951,267
<b>Operating expenses:</b>						
Cost of service	648,314	55,518	24,255	21,672		749,759
Cost of product	241,618	28,026	4,413	14,021		288,078
Site operating expenses	138,146	7,867	12,596	3,626		162,235
General and administrative	88,897	32,944	7,520	20,045	93,256	242,662
Rent	233,704	33,768	6,825	4,898	1,399	280,594
Depreciation and amortization	61,506	6,256	2,493	7,156	12,985	90,396
Goodwill impairment(1)			23,000			23,000
Total operating expenses	1,412,185	164,379	81,102	71,418	107,640	1,836,724
Operating income	207,276	12,857	(16,720)	18,770	(107,640)	114,543
<b>Other income (expense):</b>						
Interest expense					(30,864)	(30,864)
Interest income and other, net					3,468	3,468
Income before income taxes and equity in income of affiliated companies	\$ 207,276	\$ 12,857	\$ (16,720)	\$ 18,770	\$ (135,036)	\$ 87,147

(1) During the three months ended March 31, 2007, the Company performed its annual impairment analysis on its reporting units. Based on the Company's testing, a \$23.0 million impairment charge was recorded during the nine months ended March 31, 2007.



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





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To the Shareholders and Directors of Regis Corporation:

We have reviewed the accompanying condensed consolidated balance sheet of Regis Corporation as of March 31, 2008 and the related condensed consolidated statements of operations for the three and nine month periods ended March 31, 2008 and 2007 and of cash flows for the nine month periods ended March 31, 2008 and 2007. This interim financial information is 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 reviews, we are not aware of any material modifications that should be made to the accompanying condensed consolidated interim financial information for it 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, 2007, 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 29, 2007, we expressed an unqualified opinion on those financial statements (our opinion contained an explanatory paragraph stating that the Company changed the manner in which it accounts for defined benefit arrangements effective June 30, 2007). In our opinion, the accompanying consolidated balance sheet information as of June 30, 2007, is fairly stated, in all material respects in relation to the consolidated balance sheet from which it has been derived.

As discussed in Note 8 to the Condensed Consolidated financial statements, Regis Corporation changed the manner in which it accounts for unrecognized income tax benefits effective July 1, 2007.

/s/ PricewaterhouseCoopers LLP

PRICEWATERHOUSECOOPERS LLP

Minneapolis, Minnesota  
May 6, 2008

**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 information 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**



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Regis Corporation (RGS) owns, franchises or holds ownership interests in beauty salons, hair restoration centers and educational institutions. As of March 31, 2008, we owned, franchised or held ownership interests in over 13,400 worldwide locations. Our locations consisted of 10,729 system wide North American and International salons, 90 hair restoration centers and approximately 2,630 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 10,255 salons, including 2,209 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 474 company-owned salons, located in the United Kingdom. Our hair restoration centers, operating under the trade name Hair Club for Men and Women, include 90 North American locations, including 35 franchise locations. During the nine months ended March 31, 2008, we had approximately 63,800 corporate employees worldwide.

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 March 31, 2008, we own a 55.1 percent minority interest in Empire Education Group, Inc. (EEG). Our investment in EEG is accounted for under the equity method as Empire Beauty School retains majority voting interest and has full responsibility for managing EEG. This transaction leverages EEG's management expertise, while enabling us to maintain a vested interest in the beauty school industry. Once the integration of the Regis schools is complete, we expect to share in significant synergies and operating improvements. The combined Empire Education Group, Inc. includes 87 accredited cosmetology schools with annual revenues of approximately \$130 million. Results of operations of the accredited beauty schools for the month ended July 31, 2007 are reported in the North American salons segment. The Company retained ownership of its one North American and four United Kingdom Vidal Sassoon schools. Subsequent to August 1, 2007 results of operations for the Vidal Sassoon schools are included in the respective North American and International salon segments.

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 minority interest in the newly formed entity, Provalliance. This transaction is expected to create significant growth opportunities for Europe's salon brands. The Provost Salon Group management structure has a proven platform to build and acquire company-owned stores as well as a strong franchise operating group that is positioned for expansion. Provalliance will operate over 2,300 company-owned and franchise salons.

Our growth strategy consists of two primary, but flexible, components. Through a combination of organic and acquisition growth, we seek to achieve our long-term objective of six to ten percent annual revenue growth. We anticipate that going forward, the mix of organic and acquisition growth will be roughly equal. However, depending on several factors, including the ability of our salon development program to keep pace with the availability of real estate for new construction, hair restoration lead generation, the availability of attractive acquisition candidates and same-store sales trends, this mix will vary from year to year. We believe achieving revenue growth of eight to ten percent, including same-store sales increases in excess of two percent, will allow us to increase annual earnings at a low-double-digit growth rate. We anticipate expanding our presence in North America.

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.

**Salon Business**



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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 anticipate expanding 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 Wal-Mart Supercenters. We believe that the availability of real estate will augment our ability to achieve the aforementioned long-term growth objectives. In fiscal 2008, our outlook for constructed salons is approximately 320 units, and we expect to add between 900 and 1,000 net locations through a combination of organic, acquisition and franchise growth. Capital expenditures in fiscal year 2008, excluding acquisition expenditures, are projected to be approximately \$100 million, which includes approximately \$50 million for salon maintenance.

Organic salon revenue growth is achieved through the combination of new salon construction and salon same-store sales increases. Each fiscal year, we anticipate building several hundred company-owned salons. We anticipate our franchisees will open several hundred salons as well. Older, unprofitable salons will be closed or relocated. Our long-term outlook for our salon business is for annual consolidated low single digit same-store sales increases. Based on current economic cycles (i.e., lengthening of customer visitation patterns), we project our annual fiscal year 2008 consolidated same-store sales increase to be 0.5 to 1.0 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 March 31, 2008, we acquired 7,812 salons, net of franchise buybacks. 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**





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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 business.

Our organic growth plans for hair restoration 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, 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 will be evaluated closely for additional growth opportunities.

### **CRITICAL ACCOUNTING POLICIES**

The Condensed Consolidated Financial Information is prepared in conformity with accounting principles generally accepted in the United States of America. In preparing the Condensed Consolidated Financial Information, 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 Information. 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 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 Information.

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, 2007 Annual Report on Form 10-K, as well as Note 1 to the Condensed Consolidated Financial Information 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, purchase price allocations, revenue recognition, the

cost of product used and sold, 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, 2007 Annual Report on Form 10-K. There were no significant changes in or application of our critical accounting policies during the three months ended March 31, 2008.

#### **OVERVIEW OF RESULTS FOR THE THREE MONTHS ENDED MARCH 31, 2008**

- Revenues increased 3.8 percent to \$680.1 million and consolidated same-store sales increased 1.4 percent during the three months ended March 31, 2008.
- The increase in operating income as a percentage of consolidated revenues during the three months ended March 31, 2008 was primarily due to the absence of a nonrecurring pre-tax, non-cash goodwill impairment charge for which the Company recorded a \$23.0 million impairment charge associated with the Company's accredited cosmetology schools during the three months ended March 31, 2007.
- During the three months ended March 31, 2008, we acquired 224 corporate locations, including 25 franchise location buybacks (none of which were hair restoration centers). We built 97 corporate locations and closed, converted or relocated 64 locations. Our franchisees constructed 26 locations and closed, sold back to us, converted or relocated 99 locations, and merged 1,587 locations with the Franck Provost Salon Group during the three months ended March 31, 2008. As of March 31, 2008, we had 8,520 company-owned locations, 2,209 franchise locations and 90 hair restoration centers (55 company-owned and 35 franchise locations).
- The effective income tax rate for the three months ended March 31, 2008 of 43.9 percent was negatively impacted by a tax charge associated with repatriating approximately \$30.0 million of cash previously considered to be indefinitely reinvested outside of the United States. The effective income tax rate of 61.9 percent for the three months ended March 31, 2007 was negatively impacted by a goodwill impairment charge, as the majority of the associated goodwill written off is not deductible for tax purposes. This was partially offset by Work Opportunity and Welfare-to-Work Tax Credits earned during the quarter.

#### **RESULTS OF OPERATIONS**

##### **Consolidated Results of Operations**

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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 March 31,			
	Three Months		Nine Months	
	2008	2007	2008	2007
Service revenues	69.9%	68.6%	68.6%	67.8%
Product revenues	28.0	28.3	28.6	29.1
Franchise royalties and fees	2.1	3.1	2.8	3.1
	100.0	100.0	100.0	100.0
<b>Operating expenses:</b>				
Cost of service (1)	57.8	56.6	57.7	56.6
Cost of product (2)	51.1	50.5	51.1	50.8
Site operating expenses	7.7	7.9	7.6	8.3
General and administrative	12.1	12.7	12.6	12.4
Rent	14.8	14.5	14.7	14.4
Depreciation and amortization	4.4	4.6	4.6	4.6
Goodwill impairment		3.5		1.2
Operating income	6.2	3.6	6.3	5.9
Income before income taxes and equity in income of affiliated companies	4.8	2.1	4.9	4.5
Net income	2.8	0.8	3.1	2.8



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

**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 fiscal year, consolidated revenues increased 3.8 percent to \$680.1 million during the three months ended March 31, 2008 and 4.0 percent to \$2,029.8 million during the nine months ended March 31, 2008. 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 within the table.

	For the Periods Ended March 31,			
	Three Months		Nine Months	
	2008	2007	2008	2007
	(Dollars in thousands)			
North American salons:				
Regis	\$ 130,184	\$ 126,137	\$ 386,532	\$ 373,872
MasterCuts	44,755	43,835	132,223	131,978
Trade Secret(1)	61,286	58,098	189,275	196,002
SmartStyle	130,476	119,284	374,759	343,086
Strip Center(1)	222,765	192,288	649,320	574,523
Other(2)			5,558	
Total North American Salons	589,466	539,642	1,737,667	1,619,461
International salons(1)(3)	55,973	60,992	192,310	177,236
Beauty schools(2)		23,041		64,382
Hair restoration centers(1)	34,616	31,359	99,844	90,188
Consolidated revenues	\$ 680,055	\$ 655,034	\$ 2,029,821	\$ 1,951,267
Percent change from prior year	3.8%	8.4%	4.0%	8.7%
Salon same-store sales increase (4)	1.4%	0.0%	0.5%	0.3%

The percent changes in consolidated revenues during the three and nine months ended March 31, 2008 and 2007, respectively, were driven by the following:

Percentage Increase (Decrease) in Revenues	For the Periods Ended March 31,			
	Three Months		Nine Months	
	2008	2007	2008	2007
Acquisitions (previous twelve months)	5.4%	4.4%	4.1%	5.2%
Organic growth	2.5	3.6	2.8	3.1
Foreign currency	1.0	0.9	1.2	0.9
Franchise revenues	(1.1)		(0.3)	
Closed salons(2)	(4.0)	(0.5)	(3.8)	(0.5)
	3.8%	8.4%	4.0%	8.7%



(1) Includes aggregate franchise royalties and fees of \$14.3 and \$20.0 million for the three months ended March 31, 2008 and 2007, respectively, and \$57.0 and \$59.7 million for the nine months ended March 31, 2008 and 2007, respectively. North American salon franchise royalties and fees represented 69.4 and 46.9 percent of total franchise revenues in the three months ended March 31, 2008 and 2007, respectively, and 52.6 and 48.1 percent of total franchise revenues in the nine months ended March 31, 2008 and 2007, respectively. The increase in North American salon franchise royalties and fees as a percent of total franchise revenues for the three and nine months ended March 31, 2008 is a result of the deconsolidation of the Company's European franchise salon operations.

(2) On August 1, 2007, the Company contributed its 51 accredited cosmetology schools to Empire Education Group, Inc. Accordingly, revenue growth was negatively impacted as a result of the deconsolidation. For the three and nine months ended March 31, 2007 the accredited cosmetology schools generated revenue of \$18.6 million and \$51.5 million, respectively, which represented 2.8 percent and 2.6 percent of consolidated revenues in the respective periods. For the nine months ended March 31, 2008, the results of operations for the month ended July 31, 2007 for the accredited cosmetology schools are reported in the North American salons segment. The Company retained ownership of its one North American and four United Kingdom Vidal Sassoon schools. Subsequent to August 1, 2007 results of operations for the Vidal Sassoon schools are included in the respective North American and International salon segments.

(3) On January 31, 2008, the Company deconsolidated the results of operations of its European franchise salon operations. Accordingly, revenue growth was negatively impacted as a result of the deconsolidation. For the three and nine months ended March 31, 2007 the European franchise salon operations generated revenue of \$14.2 million and \$42.2 million,



respectively, which represented 2.2 percent of consolidated revenues in the respective periods.

(4) Salon 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 and year-to-date salon 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 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 541 salons (including 108 franchise salon buybacks and six hair restoration centers) during the twelve months ended March 31, 2008. The organic growth was due to the construction of 339 company-owned salons during the twelve months ended March 31, 2008. We closed 300 salons (including 132 franchise salons) during the twelve months ended March 31, 2008.

During the three and nine months ended March 31, 2008 and 2007, 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 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.

During the twelve months ended March 31, 2007, we acquired 277 salons (including 90 franchise salon buybacks), two beauty schools, and two hair restoration centers (including one franchise buyback). The organic growth stemmed from the construction of 458 company-owned salons during the twelve months ended March 31, 2007. We closed 342 salons (including 160 franchise salons) during the twelve months ended March 31, 2007.

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 nine months ended March 31, 2008 and 2007 were as follows:

Periods Ended March 31,	Revenues	Increase Over Prior Fiscal Year	
		Dollar	Percentage
		(Dollars in thousands)	
<b>Three Months</b>			
2008	\$ 475,177	\$ 25,629	5.7%
2007	449,548	42,484	10.4
<b>Nine Months</b>			
2008	\$ 1,392,763	\$ 68,318	5.2%
2007	1,324,445	127,134	10.6

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The growth in service revenues during the three and nine months ended March 31, 2008 was driven primarily by acquisitions and new salon construction (a component of organic growth). Consolidated same-store service sales increased 3.3 and 1.8 percent during the three and nine months ended March 31, 2008, as compared to an increase of 1.0 percent for the three and nine months ended March 31, 2007. Growth was negatively impacted as a result of the deconsolidation of our 51 accredited cosmetology schools to Empire Education Group, Inc. on August 1, 2007 and our European franchise salon operations to Provalliance on January 31, 2008.

The growth in service revenues during the three and nine months ended March 31, 2007 was driven primarily by acquisitions and new salon construction (a component of organic growth). Consolidated same-store service sales increased 1.0 percent for the three and nine months ended March 31, 2007. Additionally, hair restoration service revenues contributed to the increases in consolidated service revenues for the three and nine months ended March 31, 2007 due to strong recurring and new customer revenues and increases in hair transplant management fees.

**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 nine months ended March 31, 2008 and 2007 were as follows:

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Periods Ended March 31,	Revenues	Increase Over Prior Fiscal Year	
		Dollar (Dollars in thousands)	Percentage
<b>Three Months</b>			
2008	\$ 190,562	\$ 5,100	2.7%
2007	185,462	7,555	4.2
<b>Nine Months</b>			
2008	\$ 580,040	\$ 12,901	2.3%
2007	567,139	27,372	5.1

Product revenues increased by \$5.1 million and \$12.9 million during the three and nine months ended March 31, 2008. Growth was not as robust as compared to the comparable prior periods due to negative same-store sales in our Trade Secret division. This decrease is a result of product diversion and increased appeal of mass hair care lines to the consumer. Consolidated same-store product sales decreased 3.3 and 2.7 percent during the three and nine months ended March 31, 2008 as compared to decreases of 2.3 and 1.3 percent during the comparable prior periods.

The growth in product revenues for the three and nine months ended March 31, 2007 was primarily due to acquisitions. Growth during the three and nine months ended March 31, 2007 was not as robust as compared to the three and nine months ended March 31, 2006 due to same-store product sales decreases of 2.3 percent and 1.3 percent during the three and nine months ended March 31, 2007, respectively.

**Royalties and Fees.** Total franchise revenues, which include royalties and fees, for the three and nine months ended March 31, 2008 and 2007 were as follows:

Periods Ended March 31,	Revenues	(Decrease) Increase Over Prior Fiscal Year	
		Dollar (Dollars in thousands)	Percentage
<b>Three Months</b>			
2008	\$ 14,316	\$ (5,708)	(2.9)%
2007	20,024	948	5.0
<b>Nine Months</b>			
2008	\$ 57,018	\$ (2,665)	(4.5)%
2007	59,683	1,862	3.2

Total franchise locations open at March 31, 2008 were 2,244, including 35 franchise hair restoration centers, as compared to 3,772, including 41 franchise hair restoration centers, at March 31, 2007. We purchased 108 of our franchise salons and six franchise hair restoration centers during the twelve months ended March 31, 2008, and acquired franchisors of product-focused salons which operated 93 franchise locations. We also merged our European franchise salon operations with the Franck Provost Salon Group, which drove the overall decrease in the number of franchise salons between periods. The decrease in consolidated franchise revenues during the three and nine months ended March 31, 2008 was primarily due to the decrease in the number of franchise salons, offset by the weakening of the United States dollar against the Canadian dollar and Euro as compared to the exchange rates for the comparable prior period.

Total franchise locations open at March 31, 2007 and 2006 were 3,772 (including 41 franchise hair restoration centers) and 3,781 (including 42 franchise hair restoration centers), respectively. We purchased 90 of our franchise salons during the twelve months ended March 31, 2007 compared to 161 during the twelve months ended March 31, 2006, which drove the overall decrease in the number of franchise salons between periods. The increase in consolidated franchise revenues during the three and nine months ended March 31, 2007 was primarily due to the weakening of the United States dollar against the Canadian dollar, British pound and Euro as compared to the exchange rates for the three and nine months ended March 31, 2006, partially offset by a decreased number of franchise salons.

**Gross Margin (Excluding Depreciation)**

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 nine months ended March 31, 2008 and 2007 was as follows:

Periods Ended March 31,	Gross Margin	Margin as % of Service and Product Revenues	Increase (Decrease) Over Prior Fiscal Year		
			Dollar (Dollars in thousands)	Percentage	Basis Point(1)
<b>Three Months</b>					
2008	\$ 293,569	44.1%	\$ 6,865	2.4%	(100)
2007	286,704	45.1	27,151	10.5	70
<b>Nine Months</b>					
2008	\$ 872,474	44.2%	\$ 18,727	2.2%	(90)
2007	853,747	45.1	75,279	9.7	30

(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.

**Service Margin (Excluding Depreciation).** Service margin for the three and nine months ended March 31, 2008 and 2007 was as follows:

Periods Ended March 31,	Service Margin	Margin as % of Service Revenues	Increase (Decrease) Over Prior Fiscal Year		
			Dollar (Dollars in thousands)	Percentage	Basis Point(1)
<b>Three Months</b>					
2008	\$ 200,384	42.2%	\$ 5,457	2.8%	(120)
2007	194,927	43.4	19,732	11.3	40
<b>Nine Months</b>					
2008	\$ 588,933	42.3%	\$ 14,247	2.5%	(110)
2007	574,686	43.4	58,041	11.2	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 decrease in service margin as a percent of service revenues during the three and nine months ended March 31, 2008 was primarily due to the absence of the beauty school segment service revenue from consolidated service revenues, which accounted for 70 of the total 120 basis point decrease. The decrease was also due to a change made during the first fiscal quarter as a result of refinements made to our inventory tracking systems. The refinements resulted in better tracking and accounting for retail products that our salon stylists transfer from retail shelves to the back bar for use in servicing customers. The cost of these products had historically been included as a component of our product gross margin, whereas they are now more appropriately included in our service margin. These retail-to-shop transfers amount to approximately \$1.0 million each quarter. For the three and nine months ended March 31, 2008, reclassification accounted for approximately 30 basis points of the total 120 and 110 basis point decrease, respectively, and had no impact on total gross margin. Also contributing to the basis point decrease was slightly higher payroll costs for recent salon acquisitions.

The basis point improvement in service margins as a percent of service revenues during the three and nine months ended March 31, 2007 was primarily due to improved same-store service sales for the three and nine months ended March 31, 2007 compared to the three and nine months ended March 31, 2006. The improvement was also due to the continued focus on management of salon payroll costs and increased hair restoration service revenues due to strong recurring and new customer revenues and increases in hair transplant management fees.

**Product Margin (Excluding Depreciation).** Product margin for the three and nine months ended March 31, 2008 and 2007 was as follows:

Periods Ended March 31,	Product Margin	Margin as % of Product Revenues	Increase (Decrease) Over Prior Fiscal Year		
			Dollar	Percentage	Basis Point(1)
(Dollars in thousands)					
<b>Three Months</b>					
2008	\$ 93,185	48.9%	\$ 1,408	1.5%	(60)
2007	91,777	49.5	7,419	8.8	210
<b>Nine Months</b>					
2008	\$ 283,541	48.9%	\$ 4,480	1.6%	(30)
2007	279,061	49.2	17,238	6.6	70

(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.

The basis point decrease in product margins as a percent of product revenues during the three and nine months ended March 31, 2008 was primarily due to a higher mix of retail promotional discounting, representing 90 basis points. The decrease was also due to recent salon acquisitions which have lower product margins (30 basis points), negative payroll leverage at our Trade Secret salons (25 basis points) and timing of donations (25 basis points). These items were offset by the deconsolidation of the beauty schools and European franchise salon operations (30 basis points) and the migration to a new, lower-cost product distribution model in the United Kingdom which includes shipping product from our United States distribution centers to the United Kingdom (45 basis points).

The basis point improvement in product margins as a percent of product revenues for the three and nine months ended March 31, 2007 was due to a reduction in retail promotional discounting as compared to the three and nine months ended March 31, 2006.

### 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 nine months ended March 31, 2008 and 2007 were as follows:

Periods Ended March 31,	Site Operating	Expense as % of Consolidated Revenues	Increase (Decrease) Over Prior Fiscal Year		
			Dollar	Percentage	Basis Point(1)
(Dollars in thousands)					
<b>Three Months</b>					
2008	\$ 52,275	7.7%	\$ 813	1.6%	(20)
2007	51,462	7.9	1,588	3.2	(40)
<b>Nine Months</b>					
2008	\$ 154,804	7.6%	\$ (7,431)	(4.6)%	(70)
2007	162,235	8.3	12,533	8.4	

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- (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 and nine months ended March 31, 2008 was primarily due to a reduction in current year workers' compensation expenses, as a result of successful safety and return-to-work programs implemented over the past few years. In addition, the absence of the beauty school segment site operating expenses from consolidated site operating expenses contributed to the basis point improvement.

The basis point improvement in site operating expenses as a percent of consolidated revenues for the three months ended March 31, 2007 was primarily due to a reduction in workers' compensation expenses as a result of implementing new safety and return-to-work programs over the recent years. Site operating expenses as a percent of consolidated revenues for the nine months ended March 31, 2007 were consistent with the nine months ended March 31, 2006.

### 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 nine months ended March 31, 2008 and 2007 were as follows:

Periods Ended March 31,	G&A	Expense as % of Consolidated Revenues	(Decrease) Increase Over Prior Fiscal Year		Basis Point(1)
			Dollar (Dollars in thousands)	Percentage	
<b>Three Months</b>					
2008	\$ 82,290	12.1%	\$ (1,008)	(1.2)%	(60)
2007	83,298	12.7	12,459	17.6	100
<b>Nine Months</b>					
2008	\$ 254,786	12.6%	\$ 12,124	5.0%	20
2007	242,662	12.4	26,581	12.3	40



- (1) Represents the basis point change in G&A as a percent of total consolidated revenues as compared to the corresponding

periods of the prior fiscal year.

The basis point improvement in G&A costs as a percent of consolidated revenues during the three months ended March 31, 2008 was primarily due to deconsolidation of the European franchise salon operations, partially offset by the payroll costs associated with the PureBeauty transaction. The basis point increase in G&A costs as a percent of consolidated revenues during the nine months ended March 31, 2008 was primarily due to increased professional fees related to investment transactions.

The basis point increase in G&A costs as a percent of consolidated revenues during the three months ended March 31, 2007 was primarily due to increases in certain benefit accruals related to deferred compensation and professional fees related to Deloitte Consulting LLP. The basis point increase in G&A costs as a percent of consolidated revenues during the nine months ended March 31, 2007 was due to the items stated above, offset by decreased international severance expenses.

**Rent**

Rent expense, which includes base and percentage rent, common area maintenance, and real estate taxes, for the three and nine months ended March 31, 2008 and 2007, was as follows:

Periods Ended March 31,	Rent	Expense as % of Consolidated Revenues	Increase Over Prior Fiscal Year		
			Dollar (Dollars in thousands)	Percentage	Basis Point(1)
<i>Three Months</i>					
2008	\$ 100,900	14.8%	\$ 5,641	5.9%	30
2007	95,259	14.5	8,083	9.3	10
<i>Nine Months</i>					
2008	\$ 298,431	14.7%	\$ 17,837	6.4%	30
2007	280,594	14.4	25,537	10.0	20

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- (1) Represents the basis point change in rent expense 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 for the three and nine months ended March 31, 2008 and 2007 was primarily due the deconsolidation of the schools and European franchise salon operations. Absent the impact of these deconsolidations, rent expense would have been flat period over period.

### Depreciation and Amortization

Depreciation and amortization expense (D&A) for the three and nine months ended March 31, 2008 and 2007 was as follows:

Periods Ended March 31,	D&A	Expense as % of Consolidated Revenues	(Decrease) Increase Over Prior Fiscal Year		Basis Point(1)
			Dollar	Percentage	
(Dollars in thousands)					
<b>Three Months</b>					
2008	\$ 30,254	4.4%	\$ (188)	0.6%	(20)
2007	30,442	4.6	2,381	8.5	
<b>Nine Months</b>					
2008	\$ 93,440	4.6%	\$ 3,044	3.4%	
2007	90,396	4.6	9,180	11.3	10

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

The basis point improvement in D&A as a percent of consolidated revenues during the three months ended March 31, 2008 was primarily due to a planned reduction in the number of new salons constructed during the current fiscal year. D&A as a percent of consolidated revenues during the nine months ended March 31, 2008 was consistent with the nine months ended March 31, 2007.

D&A as a percent of consolidated revenues during the three and nine months ended March 31, 2007 was consistent with the three and nine months ended March 31, 2006.

### **Interest**

Interest expense for the three and nine months ended March 31, 2008 and 2007 was as follows:

Periods Ended March 31,	Interest	Expense as % of Consolidated Revenues	Increase Over Prior Fiscal Year		Basis Point(1)
			Dollar (Dollars in thousands)	Percentage	
<b>Three Months</b>					
2008	\$ 11,330	1.7%	\$ 975	9.4%	10
2007	10,355	1.6	1,418	15.9	10
<b>Nine Months</b>					
2008	\$ 33,668	1.7%	\$ 2,804	9.1%	10
2007	30,864	1.6	5,003	19.3	20

(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 increase in interest expense as a percent of consolidated revenues during the three and nine months ended March 31, 2008 and was primarily due to increased debt levels used to fund customary acquisitions and investments and the repurchase of \$50.0 million of our outstanding common stock.

The basis point increase in interest expense as a percent of consolidated revenues during the three and nine months ended March 31, 2007 was primarily due to increased debt levels due to the Company's repurchase of \$41.3 million of our outstanding common stock, acquisitions and the timing of income tax payments during the nine months ended March 31, 2007.

#### 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, for the three and nine months ended March 31, 2008 and 2007, was as follows:

Periods Ended March 31,	Equity in Earnings	Earnings as % of Consolidated Revenues	Increase Over Prior Fiscal Year		Basis Point(1)
			Dollar (Dollars in thousands)	Percentage	
<b>Three Months</b>					
2008	\$ 638	0.1%	\$ 638	100.0%	10
2007					
<b>Nine Months</b>					
2008	\$ 690	%	\$ 690	100.0%	
2007					

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

On August 1, 2007, we contributed all of our accredited cosmetology schools to Empire Education Group, Inc (EEG) in exchange for a minority interest in EEG.

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On January 31, 2008, we merged our continental European franchise salon operations with the Franck Provost Salon Group in exchange for a minority interest in Provalliance.

This income relates to our equity investments in EEG, Provalliance, and other equity method investments as detailed in Note 5 to the Condensed Consolidated Financial Information.

### **Income Taxes**

Our reported effective income tax rate for the three and nine months ended March 31, 2008 and 2007 was as follows:

Periods Ended March 31,	Effective Income Tax Rate	Basis Point (Decrease) Increase
<b>Three Months</b>		
2008	43.9%	(1,800)
2007	61.9	2,450
<b>Nine Months</b>		
2008	38.9%	240
2007	36.5	90

The basis point improvement in our overall effective income tax rate for the three months ended March 31, 2008 was due to a nonrecurring pre-tax, non-cash goodwill impairment charge of \$23.0 million recorded during the three months ended March 31, 2007. The majority of the impairment charge was not deductible for tax purposes. The improvement for the three months ended March 31, 2008 was partially offset by a tax charge associated with repatriating approximately \$30.0 million in cash previously considered to be permanently reinvested outside of the United States as well as the impact of foreign tax credits and the effect of the retroactive reinstatement of the Work Opportunity and Welfare-to-Work tax credits in December 2006. The basis point increase in our overall effective income tax rate for the nine months ended March 31, 2008 was due to the same factors discussed for the three months ended March 31, 2008.

The basis point increase in our overall effective income tax rate for the three and nine months ended March 31, 2007 was due to the pre-tax, non-cash goodwill impairment charge of \$23.0 million recorded during the three months ended March 31, 2007. The majority of the impairment charge is not deductible for tax purposes. This was partially offset by the tax benefit received for the three months ended December 31, 2006 related to the retroactive reinstatement of the Work Opportunity and Welfare-to-Work Tax Credits in December 2006.

### Recent Accounting Pronouncements

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

### 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 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

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average foreign currency exchange rate between the current fiscal period and the corresponding period of the prior fiscal year. During the three and nine months ended March 31, 2008 and 2007, foreign currency translation had a favorable impact on consolidated revenues due to the strengthening of the Canadian dollar, British pound and Euro as compared to the comparable prior periods.

Favorable Impact of Foreign Currency Exchange Rate Fluctuations	Impact on Revenues		Impact on Income Before Income Taxes	
	March 31, 2008	March 31, 2007	March 31, 2008	March 31, 2007
<i>Three Months</i>				
Canadian dollar	\$	5,224		

(Dollars in thousands)