

REGIS CORP
Form 10-Q
May 10, 2007

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2007

OR

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

For the transition period from to

Commission file number 0-11230

Regis Corporation

(Exact name of registrant as specified in its charter)

Minnesota

(State or other jurisdiction of
incorporation or organization)

41-0749934

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

7201 Metro Boulevard, Edina, Minnesota

(Address of principal executive offices)

55439

(Zip Code)

(952) 947-7777

(Registrant's telephone number, including area code)

N/A

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

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes **x** No **o**

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Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ☒

Accelerated filer ☐

Non-accelerated filer ☐

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 3, 2007:

Common Stock, \$.05 par value

Class

44,303,673

Number of Shares

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, 2007 and June 30, 2006
(In thousands, except share data)

	March 31, 2007	June 30, 2006
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 186,175	\$ 135,397
Receivables, net	71,684	62,558
Inventories	195,892	193,999
Deferred income taxes	17,993	16,224
Other current assets	60,835	33,588
Total current assets	532,579	441,766
Property and equipment, net	490,196	483,764
Goodwill	781,175	778,228
Other intangibles, net	213,649	216,831
Other assets	66,368	61,475
Total assets	\$ 2,083,967	\$ 1,982,064
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Long-term debt, current portion	\$ 177,090	\$ 101,912
Accounts payable	71,508	70,807
Accrued expenses	241,983	230,236
Total current liabilities	490,581	402,955
Long-term debt	490,942	520,357
Other noncurrent liabilities	192,067	187,345
Total liabilities	1,173,590	1,110,657
Commitments and contingencies		
Shareholders' equity:		
Preferred stock, authorized 250,000 shares at March 31, 2007 and June 30, 2006		
Common stock, \$.05 par value; issued and outstanding 44,925,706 and 45,303,459 common shares at March 31, 2007 and June 30, 2006, respectively	2,247	2,266
Additional paid-in capital	212,963	232,284
Accumulated other comprehensive income	66,490	58,066
Retained earnings	628,677	578,791
Total shareholders' equity	910,377	871,407
Total liabilities and shareholders' equity	\$ 2,083,967	\$ 1,982,064

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, 2007 and 2006
(In thousands, except per share data)

	2007	2006
Revenues:		
Service	\$ 449,548	\$ 407,064
Product	185,462	177,907
Royalties and fees	20,024	19,076
	655,034	604,047
Operating expenses:		
Cost of service	254,621	231,869
Cost of product	93,685	93,549
Site operating expenses	51,462	49,874
General and administrative	83,298	70,839
Rent	95,259	87,176
Depreciation and amortization	30,442	28,061
Goodwill impairment	23,000	
Terminated acquisition expenses		5,687
Total operating expenses	631,767	567,055
Operating income	23,267	36,992
Other income (expense):		
Interest	(10,355)	(8,937)
Other, net	1,075	1,633
Income before income taxes	13,987	29,688
Income taxes	(8,659)	(11,094)
Net income	\$ 5,328	\$ 18,594
Net income per share:		
Basic	\$ 0.12	\$ 0.41
Diluted	\$ 0.12	\$ 0.40
Weighted average common and common equivalent shares outstanding:		
Basic	44,703	45,366
Diluted	45,564	46,602
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, 2007 and 2006
(In thousands, except per share data)

	2007	2006
Revenues:		
Service	\$ 1,324,445	\$ 1,197,311
Product	567,139	539,767
Royalties and fees	59,683	57,821
	1,951,267	1,794,899
Operating expenses:		
Cost of service	749,759	680,666
Cost of product	288,078	277,944
Site operating expenses	162,235	149,702
General and administrative	242,662	216,081
Rent	280,594	255,057
Depreciation and amortization	90,396	81,216
Goodwill impairment	23,000	
Terminated acquisition expenses		5,687
Total operating expenses	1,836,724	1,666,353
Operating income	114,543	128,546
Other income (expense):		
Interest	(30,864)	(25,861)
Other, net	3,468	3,002
Income before income taxes	87,147	105,687
Income taxes	(31,852)	(37,624)
Net income	\$ 55,295	\$ 68,063
Net income per share:		
Basic	\$ 1.23	\$ 1.51
Diluted	\$ 1.21	\$ 1.47
Weighted average common and common equivalent shares outstanding:		
Basic	44,807	45,149
Diluted	45,712	46,460
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, 2007 and 2006
(In thousands)

	2007	2006
Cash flows from operating activities:		
Net income	\$ 55,295	\$ 68,063
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	81,233	72,463
Amortization	9,163	8,753
Deferred income taxes	(462)	) 3,824
Goodwill impairment	23,000	
Excess tax benefits from stock-based compensation plans	(4,135)	) (3,644)
Stock-based compensation	3,505	3,906
Other noncash items affecting earnings	2,636	282
Changes in operating assets and liabilities:		
Receivables	(8,353)	) (2,245)
Inventories	1,200	(11,142)
Other current assets	(20,327)	) (1,843)
Other assets	1,673	(953)
Accounts payable	6,041	8,032
Accrued expenses	16,072	19,203
Other noncurrent liabilities	10,232	13,818
Net cash provided by operating activities	176,773	178,517
Cash flows from investing activities:		
Capital expenditures	(66,611)	) (93,149)
Proceeds from sale of assets	223	640
Purchase of salon, school and hair restoration center net assets, net of cash acquired	(34,171)	) (93,760)
Proceeds from loans and investments	5,250	
Disbursements for loans and investments	(19,984))
Net investment hedge settlement	(8,897))
Net cash used in investing activities	(124,190)	) (186,269)
Cash flows from financing activities:		
Borrowings on revolving credit facilities	5,015,956	2,152,230
Payments on revolving credit facilities	(4,976,950)	) (2,119,980)
Proceeds from issuance of long-term debt	25,000	3,075
Repayments of long-term debt	(32,861)	) (19,559)
Excess tax benefits from stock-based compensation plans	4,135	3,644
Other, primarily decrease in negative book cash balances	(4,976)	) (2,055)
Repurchase of common stock	(41,298))
Proceeds from issuance of common stock	12,312	10,528
Dividends paid	(5,411)	) (5,435)
Net cash (used in) provided by financing activities	(4,093)	) 22,448
Effect of exchange rate changes on cash and cash equivalents	2,288	(624)
Increase in cash and cash equivalents	50,778	14,072
Cash and cash equivalents:		
Beginning of period	135,397	102,718
End of period	\$ 186,175	\$ 116,790

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, 2007 and for the three and nine months ended March 31, 2007 and 2006, reflect, in the opinion of management, all adjustments necessary to fairly state the consolidated financial position of the Company as of March 31, 2007 and the consolidated results of its operations and its cash flows for the interim periods presented. 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, 2006 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, 2006 and other documents filed or furnished with the Securities and Exchange Commission (SEC) during the current fiscal year.

With respect to the unaudited condensed financial information of the Company for the three and nine month periods ended March 31, 2007 and 2006 included in this Form 10-Q, PricewaterhouseCoopers LLP reported that they have applied limited procedures in accordance with professional standards for a review of such information. However, their separate report dated May 10, 2007 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. Inventories are stated at the lower of cost or market with cost determined on a weighted average basis. 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. 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. These stock-based awards expire within ten years from the grant date. The Company utilizes the lattice (binomial) option-pricing model to estimate the fair value of options at their grant date and recognizes compensation expense for these awards on a straight-line basis over the five-year vesting period. Awards granted do not contain acceleration of vesting terms for retirement eligible recipients.

A summary of outstanding and exercisable options as of March 31, 2007, and changes during the three and nine months ended March 31, 2007 is presented below:

Options	Shares (in thousands)	Weighted- Average Exercise Price
Outstanding at July 1, 2006	2,908	\$ 20.59
Granted		
Exercised	(236)	16.25
Cancelled	(9)	38.02
Outstanding at September 30, 2006	2,663	\$ 20.89
Granted		
Exercised	(302)	16.62
Cancelled	(2)	28.60
Outstanding at December 31, 2006	2,359	\$ 21.44
Granted		
Exercised	(192)	17.41
Cancelled	(5)	36.37
Outstanding at March 31, 2007	2,162	\$ 21.76
Exercisable at March 31, 2007	1,737	\$ 18.72

An additional 411,529 shares are expected to vest with a \$34.13 weighted average exercise price and a weighted average remaining contractual term of 7.5 years. The total intrinsic value of options exercised during the nine months ended March 31, 2007 and 2006, was \$15.9 and \$14.1 million, respectively.

As of March 31, 2007, 182,300 unvested restricted stock shares with a weighted average grant-date fair value of \$36.95 were outstanding, of which 192,855 were outstanding at June 30, 2006. Additionally, 165,000 restricted stock units with a weighted average grant-date fair value of \$40.99 were granted during the three months ended March 31, 2007. These restricted stock units were unvested as of March 31, 2007.

As of March 31, 2007, 219,350 SARS with a weighted average grant-date fair value of \$37.23 were outstanding, of which 231,250 were outstanding at June 30, 2006.

The Company's primary employee stock-based compensation grant occurs during the fourth quarter. The total unrecognized compensation cost related to stock-based compensation arrangements was \$16.8 million at March 31, 2007 and the related weighted average period over which it is expected to be recognized is approximately 3.8 years.

Recent Accounting Pronouncements:

On July 13, 2006, the Financial Accounting Standards Board (FASB) issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes - An Interpretation of FASB Statement No. 109 (FIN 48)*. FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with FASB Statement No. 109, *Accounting for Income Taxes*. FIN 48 also prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. The new FASB standard provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. The provisions of FIN 48 are effective for fiscal years beginning after December 15, 2006 (i.e., the Company's first quarter of fiscal year 2008), and the provisions are to be applied to all tax positions upon initial adoption of this standard. Only tax positions that meet the more-likely-than-not recognition threshold at the effective date may be recognized or continue to be recognized upon adoption of FIN 48. The cumulative effect of applying the provisions of FIN 48 must be reported as an adjustment to the opening balance of retained earnings for that fiscal year. The Company is currently evaluating the impact of FIN 48 on its Consolidated Financial Statements.

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 beginning of the Company's fiscal year 2009). The Company is currently evaluating the impact of SFAS No. 157 on its Consolidated Financial Statements.

In September 2006, the FASB issued SFAS No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans* (SFAS No. 158). SFAS No. 158 amends SFAS No. 87, *Employers' Accounting for Pensions* (SFAS No. 87), SFAS No. 88, *Employers' Accounting for Settlements and Curtailments of Defined Benefit Plans and for Termination Benefits* (SFAS No. 88), SFAS No. 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions* (SFAS No. 106) and SFAS No. 132(R), *Employers' Disclosures about Pensions and Other Postretirement Benefits* (SFAS No. 132(R)). SFAS No. 158 requires balance sheet recognition of the funded status for all pension and postretirement benefit plans as of the end of the Company's current fiscal year (i.e., in the Company's fiscal year 2007 Annual Report on Form 10-K). The impact of initial adjustment will be recorded as an adjustment of the ending balance of accumulated other comprehensive income. Subsequent changes in funded status will be recognized as a component of other comprehensive income to the extent they have not yet been recognized as a component of net periodic benefit cost pursuant to SFAS No. 87, SFAS No. 88 or SFAS No. 106. The Company has unfunded deferred compensation contracts covering key executives based on their accomplishments within the Company which will be subject to the provisions of SFAS No. 158. The Company intends to fund its future obligations under these contracts through company-owned life insurance policies on the participants. The Company is currently evaluating the impact of SFAS No. 158 on its Consolidated Financial Statements.

2. SHAREHOLDERS' EQUITY AND COMPREHENSIVE INCOME:

Additional Paid-In Capital

The decrease in additional paid-in capital during the nine months ended March 31, 2007 was due to the following:

(Dollars in thousands)	
Balance, June 30, 2006	\$ 232,284
Exercise of stock options	12,276
Franchise stock incentive program	233
Tax benefit realized upon exercise of stock options	5,907
Stock-based compensation	3,505
Stock repurchase	(41,242)
Balance, March 31, 2007	\$ 212,963

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, 2007 and 2006 was as follows:

Components of Comprehensive Income (Dollars in thousands)	For the Periods Ended March 31,		Nine Months	
	Three Months 2007	2006	2007	2006
Net income	\$ 5,328	\$ 18,594	\$ 55,295	\$ 68,063
Other comprehensive income (loss):				
Changes in fair market value of financial instruments designated as cash flow hedges of interest rate exposure, net of taxes	(82)	922	(771)	924
Change in cumulative foreign currency translation, net of taxes	1,784	1,229	9,195	349
Total comprehensive income	\$ 7,030	\$ 20,745	\$ 63,719	\$ 69,336

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:

(Shares in thousands)	For the Periods Ended March 31,			
	Three Months		Nine Months	
	2007	2006	2007	2006
Weighted average shares for basic earnings per share	44,703	45,366	44,807	45,149
Effect of dilutive securities:				
Dilutive effect of stock-based compensation	812	1,061	856	1,136
Contingent shares issuable under contingent stock agreements	49	175	49	175
Weighted average shares for diluted earnings per share	45,564	46,602	45,712	46,460
Anti-dilutive stock-based compensation shares excluded from the above computations:				
Stock options, SARs, restricted stock and restricted stock units	858	330	796	444

Restricted stock awards, including restricted stock units, of 347,300 and 139,400 shares as of March 31, 2007 and 2006, respectively, 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 our recorded goodwill as of March 31, 2007 and June 30, 2006:

(Dollars in thousands)	Salons North America	International	Beauty Schools	Hair Restoration Centers	Consolidated
Balance at June 30, 2006	\$ 520,314	\$ 41,224	\$ 81,886	\$ 134,804	\$ 778,228
Goodwill acquired	20,723	1,592	1,777	149	24,241
Translation rate adjustments	(1,388)	2,872	222		1,706
Impairment			(23,000)		(23,000)
Balance at March 31, 2007	\$ 539,649	\$ 45,688	\$ 60,885	\$ 134,953	\$ 781,175

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, 2007 and 2006, the Company performed its annual goodwill 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. No impairment of goodwill was recorded during the three months ended March 31, 2006.

The recent performance challenges and necessary investments in information technology platforms and management that are required to effectively operate the Company's beauty schools led the Company to exploring strategic alternatives pertaining to its beauty school operating segment. Subsequent to the quarter end, the Company entered into an agreement to merge its 51 accredited cosmetology schools into Empire Education Group, Inc., creating the largest beauty school operator in North America. This transaction leverages Empire Education Group, Inc.'s management expertise, while enabling the Company to maintain a vested interest in the beauty school industry. The terms of the transaction indicated that the estimated fair value of the accredited cosmetology schools was less than

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the current carrying value of this reporting unit's net assets, including goodwill. Thus, a \$23.0 million pre-tax, non-cash impairment loss was recorded during the quarter ended March 31, 2007.

The table below presents details of our other intangible assets as of March 31, 2007 and June 30, 2006:

	March 31, 2007			June 30, 2006		
(Dollars in thousands)	Cost	Accumulated Amortization	Net	Cost	Accumulated Amortization	Net
Amortized intangible assets:						
Brand assets and trade names	\$ 111,552	\$ (9,344)	\$ 102,208	\$ 110,087	\$ (7,019)	\$ 103,068
Customer list	48,743	(9,970)	38,773	48,743	(7,598)	41,145
Franchise agreements	26,682	(6,997)	19,685	24,907	(5,967)	18,940
Product license agreements	16,760	(2,774)	13,986	15,784	(2,221)	13,563
School-related licenses	25,428	(1,088)	24,340	24,818	(613)	24,205
Non-compete agreements	664	(611)	53	674	(603)	71
Other	20,446	(5,842)	14,604	19,325	(3,486)	15,839
	\$ 250,275	\$ (36,626)	\$ 213,649	\$ 244,338	\$ (27,507)	\$ 216,831

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 three to 40 years). The Company follows the straight-line method of amortization, which approximates the economic benefit obtained in that reporting period by the Company from the intangible asset. The weighted average amortization periods, in total and by major intangible asset class, are as follows:

	Weighted Average Amortization Period (in years)
Amortized intangible assets:	
Brand assets and trade names	39
Customer list	10
Franchise agreements	21
Product license agreements	30
School-related licenses	40
Non-compete agreements	6
Other	19
Total	29

Total amortization expense related to amortizable intangible assets was approximately \$3.0 and \$2.8 million during the three months ended March 31, 2007 and 2006, respectively, and \$8.7 and \$8.3 million during the nine months ended March 31, 2007 and 2006, respectively. As of March 31, 2007, future estimated amortization expense related to amortizable intangible assets is estimated to be:

(Dollars in thousands)

Fiscal Year

Remainder of 2007	\$ 2,915
2008	11,544
2009	11,280
2010	11,074
2011	10,902

5. ACQUISITIONS, LOANS AND INVESTMENTS:*Acquisitions*

During the nine months ended March 31, 2007 and 2006, the Company made numerous acquisitions and the purchase prices have been allocated to assets acquired and liabilities assumed based on their estimated fair values at the dates of acquisition. 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 three and nine months ended March 31, 2007 and 2006 and the allocation of the purchase prices were as follows:

(Dollars in thousands)	Allocation of Purchase Prices For the Periods Ended March 31,			
	Three Months 2007	2006	Nine Months 2007	2006
Components of aggregate purchase prices:				
Cash	\$ 8,829	\$ 52,335	\$ 34,171	\$ 93,760
Liabilities assumed	(286)	1,010	559	1,044
	\$ 8,543	\$ 53,345	\$ 34,730	\$ 94,804
Allocation of the purchase price:				
Current assets	261	8,915	\$ 2,225	\$ 12,368
Property and equipment	1,524	6,017	5,298	10,796
Deferred income tax asset			1,043	
Other noncurrent assets	43		52	1
Goodwill	6,383	42,892	24,256	74,794
Identifiable intangible assets	754	8,835	2,798	15,344
Accounts payable and accrued expenses	(66)	(11,362)	(150)	(16,314)
Deferred income tax liability		(1,952)	(436)	(2,185)
Other noncurrent liabilities	(356)		(356)	
	\$ 8,543	\$ 53,345	\$ 34,730	\$ 94,804

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

Residual goodwill further represents the Company's opportunity to strategically combine the acquired business with the Company's existing structure to serve a greater number of customers through its expansion strategies. In the acquisitions of international salons, beauty schools 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 and certain beauty school 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 Hair Club, is not deductible for tax purposes due to the acquisition structure of the transaction.

During the nine months ended March 31, 2007 and 2006, the Company purchased salon operations 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.

Loans and Investments

During the three months ended September 30, 2006, the Company invested \$5.3 million in the preferred stock of a privately held entity. This investment was recorded within other assets in the Condensed Consolidated Balance Sheet and as an investing activity within the Condensed Consolidated Statement of Cash Flows. During the three months ended December 31, 2006, the preferred stock was redeemed for the original investment amount of \$5.3 million. The Company received \$93.0 thousand of preferred dividends from this investment prior to its redemption.

The Company holds a 19.9 percent interest in the voting common stock of another privately held entity. The Company is accounting for this investment under the equity method. During the three and nine months ended March 31, 2007, the Company recorded a loss of \$0.6 and \$1.1 million, respectively related to this equity investment. As of March 31, 2007 and June 30, 2006, the Company had \$10.0 and \$6.0 million of current and long-term notes receivable, respectively, outstanding under a credit agreement with the entity that is the majority corporate investor in this investment. The notes receivable are included within other current assets at March 31, 2007 and in other assets at June 30, 2006 in the Condensed Consolidated Balance Sheet and as investing activities within the Condensed Consolidated Statement of Cash Flows. Refer to Note 3 to the Consolidated Financial Statements contained in Part II, Item 8 of the June 30, 2006 Annual Report on Form 10-K for additional details.

In October 2006, the Company invested \$9.9 million to form a new limited liability company called Intelligent Nutrients, LLC. The Company holds a 50 percent interest in the newly formed LLC. 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 later in calendar year 2007. 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, 2007, the Company recorded a loss of \$0.6 and \$1.2 million, respectively, related to this equity investment.

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. Estimated recorded reserve amounts are not significant; however, 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:

During September 2006, the Company's cross-currency swap (which had a notional amount of \$21.3 million and hedged a portion of the Company's net investment in its foreign operations) was settled, resulting in a cash outlay of \$8.9 million. This cash outlay was recorded within investing activities within the Condensed Consolidated Statement of Cash Flows. Approximately \$0.1 million of tax-effected gain related to this derivative was charged to the cumulative translation adjustment account during the nine months ended March 31, 2007. The cumulative tax-effected net loss recorded in accumulated other comprehensive income (AOCI) related to the cross-currency swap was \$7.9 million at March 31, 2007. This amount will remain deferred within AOCI indefinitely, as the event which would trigger its release from AOCI and recognition in earnings is the sale or liquidation of the Company's international operations that the cross-currency swap hedged. The Company currently has no intent to sell or liquidate this portion of its business operations.

On January 3, 2007, the Company terminated its Canadian forward foreign currency contracts having a \$14.5 million notional amount. The termination resulted in a deferred gain of \$0.4 million which is recorded in AOCI in the Condensed Consolidated Balance Sheet, as the contracts hedged currency risk associated with a portion of the monthly forecasted intercompany foreign-currency-denominated transactions stemming from the forecasted monthly product shipments from the Company's subsidiaries located in the United States to its Canadian subsidiaries. The

deferred gain will be recorded into income through May 31, 2009 as the forecasted foreign currency transactions are recognized in earnings.

8. INCOME TAXES:

The reported effective income tax rate was 61.9 percent and 37.4 percent for the three months ended March 31, 2007 and 2006, respectively, and 36.5 percent and 35.6 percent for the nine months ended March 31, 2007 and 2006, 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:

Tax Rate Reconciliation	For the Periods Ended March 31,			
	Three Months		Nine Months	
	2007	2006	2007	2006
Statutory tax rate	35.0 %	35.0 %	35.0 %	35.0 %
Adjustments resulting from:				
State income taxes	1.1	2.4	1.8	2.1
Foreign income taxes at other than U.S. rates	(7.1)	(0.5)	(2.5)	(1.4)
WOTC and jobs tax credits, net	(7.9)		(3.9)	(0.7)
Tax effect of goodwill impairment	37.6		6.0	
All other non-deductible book-tax differences, net	3.2	0.5	0.1	0.6
Effective income tax rate	61.9 %	37.4 %	36.5 %	35.6 %

In December 2006, President Bush signed the Tax Relief and Health Care Act of 2006 into law. This Act retroactively reinstated the Work Opportunity and Welfare-to-Work Tax Credits for a two year period beginning January 1, 2006. In accordance with generally accepted accounting principles, the financial impact of the tax credits earned during the entire calendar year is required to be reflected in the Company's tax rate for the quarter in which the Act was signed into law, which was the Company's quarter ended December 31, 2006.

The effective income tax rate for the three and nine months ended March 31, 2007 was adversely impacted by 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 goodwill impairment charge is not deductible for tax purposes.

9. SUBSEQUENT EVENTS:

On April 18, 2007, the Company entered into a Contribution Agreement with Empire Beauty School Inc. Pursuant to the Agreement, Regis and Empire Beauty School Inc. will each contribute their respective cosmetology school businesses, as defined in the Agreement, to a newly formed company, Empire Education Group, Inc. Upon completion of the transaction, Regis will own a 49 percent minority interest in Empire Education Group, Inc. Empire's management team will operate and manage the combined business. The transaction is expected to close July 1, 2007, subject to regulatory and accreditation approvals. In conjunction with the transaction, Regis and Empire Beauty School Inc. entered into a Consulting Agreement effective April 18, 2007 through the close of the transaction. The consulting services covered under the Consulting Agreement include, among other things, a review of Regis' business operations. The five Vidal Sassoon Academies are not part of this transaction.

In April 2007, the Company acquired exchangeable notes issued by Yamano Holding Corporation and a loan obligation of a Yamano Holdings subsidiary, Beauty Plaza Co. Ltd., for \$11.3 million. The notes are exchangeable for approximately 14.7% of the outstanding shares of Beauty Takashi Co. Ltd., a subsidiary of Yamano Holdings. 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.

10. SEGMENT INFORMATION:

The Company operates or franchises 9,585 North American salons (located in the United States, Canada and Puerto

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Rico), 2,042 international salons, 56 beauty schools and 90 hair restoration centers. 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 beauty schools are located in the United States and the United Kingdom. The Company's hair restoration centers are located in the United States and Canada.

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

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

(Dollars in thousands)	Total Assets		
	As of		
	March 31, 2007	June 30, 2006	
North American salons	\$ 1,137,346	\$ 1,030,720	
International salons	199,413	184,296	
Beauty schools	163,887	177,295	
Hair restoration centers	258,860	259,739	
Unallocated corporate	324,461	330,014	
Consolidated	\$ 2,083,967	\$ 1,982,064	

For the Three Months Ended March 31, 2007						
(Dollars in thousands)	Salons North America	International	Beauty Schools	Hair Restoration Centers	Unallocated Corporate	Consolidated
Revenues:						
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
Operating expenses:						
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			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
Other income (expense):						
Interest					(10,355)	(10,355)
Other, net					1,075	1,075
Income (loss) before income taxes	\$ 69,576	\$ 4,056	\$ (19,086)	\$ 6,446	\$ (47,005)	\$ 13,987

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For the Three Months Ended March 31, 2006

(Dollars in thousands)	Salons North America	International	Beauty Schools	Hair Restoration Centers	Unallocated Corporate	Consolidated
Revenues:						
Service	\$ 348,125	\$ 30,253	\$ 16,591	\$ 12,095	\$	\$ 407,064
Product	148,351	13,350	1,542	14,664		177,907
Royalties and fees	9,549	8,243		1,284		19,076
	506,025	51,846	18,133	28,043		604,047
Operating expenses:						
Cost of service	201,395	16,395	7,131	6,948		231,869
Cost of product	80,018	7,784	1,413	4,334		93,549
Site operating expenses	43,599	2,433	2,677	1,165		49,874
General and administrative	26,888	9,713	2,136	6,052	26,050	70,839
Rent	73,391	9,987	1,905	1,624	269	87,176
Depreciation and amortization	19,504	1,930	682	2,381	3,564	28,061
Terminated acquisition expenses					5,687	5,687
Total operating expenses	444,795	48,242	15,944	22,504	35,570	567,055
Operating income	61,230	3,604	2,189	5,539	(35,570)	36,992
Other income (expense):						
Interest					(8,937)	(8,937)
Other, net					1,633	1,633
Income before income taxes	\$ 61,230	\$ 3,604	\$ 2,189	\$ 5,539	\$ (42,874)	\$ 29,688

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For the Nine Months Ended March 31, 2007

(Dollars in thousands)	Salons North America	International	Beauty Schools	Hair Restoration Centers	Unallocated Corporate	Consolidated
Revenues:						
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
Operating expenses:						
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			23,000			23,000
Total operating expenses	1,412,185	164,379	81,102	71,418	107,640	1,836,724
Operating income (loss)	207,276	12,857	(16,720)	18,770	(107,640)	114,543
Other income (expense):						
Interest					(30,864)	(30,864)
Other, net					3,468	3,468
Income (loss) before income taxes	\$ 207,276	\$ 12,857	\$ (16,720)	\$ 18,770	\$ (135,036)	\$ 87,147

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For the Nine Months Ended March 31, 2006

(Dollars in thousands)	Salons North America	International	Beauty Schools	Hair Restoration Centers	Unallocated Corporate	Consolidated
Revenues:						
Service	\$ 1,027,661	\$ 93,216	\$ 42,348	\$ 34,086	\$	\$ 1,197,311
Product	454,277	38,383	4,014	43,093		539,767
Royalties and fees	29,213	24,814		3,794		57,821
	1,511,151	156,413	46,362	80,973		1,794,899
Operating expenses:						
Cost of service	594,059	50,096	16,899	19,612		680,666
Cost of product	238,364	23,234	3,314	13,032		277,944
Site operating expenses	133,211	6,850	6,337	3,304		149,702
General and administrative	79,769	30,379	5,828	17,214	82,891	216,081
Rent	215,049	29,660	4,848	4,538	962	255,057
Depreciation and amortization	56,711	5,729	1,825	6,912	10,039	81,216
Terminated acquisition expenses					5,687	5,687
Total operating expenses	1,317,163	145,948	39,051	64,612	99,579	1,666,353
Operating income	193,988	10,465	7,311	16,361	(99,579)	128,546
Other income (expense):						
Interest					(25,861)	(25,861)
Other, net					3,002	3,002
Income before income taxes	\$ 193,988	\$ 10,465	\$ 7,311	\$ 16,361	\$ (122,438)	\$ 105,687

REVIEW REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Shareholders and Directors of Regis Corporation:

We have reviewed the accompanying condensed consolidated balance sheet of Regis Corporation as of March 31, 2007 and the related condensed consolidated statements of operations for the three and nine month periods ended March 31, 2007 and 2006 and of cash flows for the nine month periods ended March 31, 2007 and 2006. 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 to financial data and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board (United States), the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our reviews, we are not aware of any material modifications that should be made to the accompanying condensed consolidated interim financial 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, 2006, 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 September 8, 2006, which contained an explanatory paragraph indicating the Company changed its method of accounting for share-based payments as of July 1, 2005, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying consolidated balance sheet as of June 30, 2006, is fairly stated in all material respects in relation to the consolidated balance sheet from which it has been derived.

/s/ PricewaterhouseCoopers LLP

PRICEWATERHOUSECOOPERS LLP

Minneapolis, Minnesota
May 10, 2007

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

Regis Corporation (RGS) owns or franchises beauty salons, hair restoration centers and educational establishments. As of March 31, 2007, our worldwide operations included 11,627 system wide North American and international salons, 90 hair restoration centers and 56 beauty schools. Our salon concepts offer generally similar products and services and serve mass market consumers. Our salon operations are organized to be managed based on geographical location. Our North American salon operations include 9,585 salons, including 2,165 franchise salons, operating in the United States, Canada and Puerto Rico primarily under the trade names of Regis Salons, MasterCuts, Trade Secret, SmartStyle, Supercuts and Cost Cutters. Our international salon operations include 2,042 salons, including 1,566 franchise salons, located throughout Europe, primarily in the United Kingdom, France, Italy and Spain. Our beauty schools are managed in aggregate, regardless of geographical location, and include 52 locations in the United States and four locations in the United Kingdom. Our hair restoration centers are located in the United States and Canada. During the nine months ended March 31, 2007, we had approximately 61,000 corporate employees worldwide.

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 eight to 12 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, student enrollment, 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 12 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. Impacted by long hair fashions, during the past two fiscal years we have not been able to realize the same-store sales growth required to leverage some of our fixed cost categories, therefore resulting in less than double digit annual earnings growth. We anticipate expanding our presence in both North America and Europe. In April 2007, Regis entered the Asian market through an investment in a privately held Japanese company.

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

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. In addition, 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 2007, we expect constructed salons to be between 400 to 450 units. In addition, we still expect to add between 500 and 700 net locations through a combination of organic, acquisition and franchise growth.

Our long-term outlook anticipates that we will add between 800 to 1,000 net locations each year through a combination of organic, acquisition and franchise growth. 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 fashion and economic cycles (i.e., longer hairstyles and lengthening of customer visitation patterns), we project our annual fiscal year 2007 consolidated same-store sales increase to be in a range of flat to one 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, 2007, we acquired 7,400 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

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.

Beauty School Business

On April 18, 2007, the Company entered into a Contribution Agreement with Empire Beauty School Inc. Regis and Empire Beauty School Inc. will each contribute their respective cosmetology school businesses to a newly formed company, Empire Education Group, Inc. Upon completion of the transaction, Regis will own a 49 percent minority interest in Empire Education Group, Inc. Empire's management team will operate and manage the combined business. The transaction is expected to close July 1, 2007, subject to regulatory and accreditation approvals. Upon closing of the transaction, we expect to account for our investment in the new Empire Education Group, Inc. under the equity method.

In order to maximize the enormous potential of the beauty school division, it would be necessary to invest heavily in information technology platforms and management. We believe merging with Empire is the most efficient and accretive way for us to achieve our goals. This transaction leverages Empire Education Group, Inc.'s management expertise, while enabling the Company to maintain a vested interest in the beauty school industry. The consolidated new Empire Education Group, Inc. will own 88 accredited cosmetology schools with revenues of approximately \$130 million annually and will be overseen by the current Empire management team.

We will be able to add significant value to the venture with our strong education and marketing programs coupled with the ancillary benefits that the Vidal Sassoon Academies (which are not part of this transaction) and Horst Rechelbacher (the founder of Aveda and a beauty industry icon) will provide. In addition, we will have double the number of qualified graduates who will have placement opportunities at our Regis operated salons.

We recorded a \$23.0 million pre-tax, non-cash goodwill impairment charge as a result of the transaction. We expect the integration of the Regis schools into Empire Education Group, Inc. to take several months and that there will be significant integration costs, which will result in the transaction reducing earnings in fiscal year 2008. Once the integration is complete, we will share in significant synergies and operating improvements. Long-term, it is our belief this transaction should be very accretive and our expectations will be to add significantly more shareholder value than the impairment charge.

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, 2006 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, 2006 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, 2007.

OVERVIEW OF RESULTS FOR THE THREE MONTHS ENDED MARCH 31, 2007

- Revenues increased 8.4 percent to \$655.0 million and consolidated same-store sales were flat during the three months ended March 31, 2007. Same-store service sales continue to be modest due to the current customer visitation patterns stemming from a fashion trend towards longer hairstyles.
- The decrease in operating income as a percentage of consolidated revenues during the three months ended March 31, 2007 was primarily due to the pre-tax, non-cash goodwill impairment charge of \$23.0 million associated with the Company's accredited cosmetology schools. In accordance with the terms of the Contribution Agreement entered into on April 18, 2007, these schools will be contributed into a newly formed company, Empire Education Group, Inc. on July 1, 2007.
- During the quarter, we acquired 45 corporate locations (including 37 franchise location buybacks). We built 123 corporate locations and closed or relocated 53 locations, for a net increase of 115 locations. Our franchisees constructed 53 locations and closed, sold back to us or relocated 108 locations, for a net decrease of 55 franchise locations during the quarter. As of March 31, 2007, we had 7,896 company-owned salons, 3,731 franchise salons, 56 beauty schools and 90 hair restoration centers (49 company-owned and 41 franchise locations).
- Total debt at the end of the quarter was \$668.0 million and our debt-to-capitalization ratio, calculated as total debt as a percentage of total debt and shareholders' equity at fiscal quarter end, increased 60 basis points to 42.3 percent as compared to June 30, 2006.
- The effective income tax rate was adversely affected by the 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.
- Site operating expenses were impacted by a reduction in workers' compensation expenses as a result of implementing new safety and return-to-work programs over the recent years.

RESULTS OF OPERATIONS

Consolidated Results of Operations

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

Results of Operations as a Percent of Revenues

	For the Periods Ended March 31,				Nine Months			
	Three Months							
	2007		2006		2007		2006	
Service revenues	68.6	%	67.3	%	67.8	%	66.7	%
Product revenues	28.3		29.5		29.1		30.1	
Royalties and fees	3.1		3.2		3.1		3.2	
	100.0		100.0		100.0		100.0	
Operating expenses:								
Cost of service (1)	56.6		57.0		56.6		56.8	
Cost of product (2)	50.5		52.6		50.8		51.5	
Site operating expenses	7.9		8.3		8.3		8.3	
General and administrative	12.7		11.7		12.4		12.0	
Rent	14.5		14.4		14.4		14.2	