REGIS CORP
Form 10-Q
January 29, 2019

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

FORM 10-Q
(Mark One)
x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended December 31, 2018
OR
¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to
Commission file number 1-12725
Regis Corporation
(Exact name of registrant as specified in its charter)

Minnesota	41-0749934
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
7201 Metro Boulevard, Edina, Minnesota	55439
(Address of principal executive offices)	(Zip Code)

(952) 947-7777
(Registrant's telephone number, including area code)
N/A
(Former name, former address and former fiscal year, if changed since last report)
Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to be submit and post such files). Yes x No ¨

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

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

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

Exchange Act. ¨

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

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

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

REGIS CORPORATION

INDEX

PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

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

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

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

REGIS CORPORATION
CONDENSED CONSOLIDATED STATEMENT OF OPERATIONS (Unaudited)
For The Three and Six Months Ended December 31, 2018 and 2017
(Dollars and shares in thousands, except per share data amounts)

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

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

(1) Total is a recalculation; line items calculated individually may not sum to total due to rounding.

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

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

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

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

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

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

____

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

REGIS CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

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

The unaudited interim Condensed Consolidated Financial Statements of Regis Corporation (the "Company") as of December 31, 2018 and for the three and six months ended December 31, 2018 and 2017, reflect, in the opinion of management, all adjustments necessary to fairly state the consolidated financial position of the Company as of December 31, 2018 and its consolidated results of operations, comprehensive income and cash flows for the interim periods. Adjustments consist only of normal recurring items, except for any discussed in the notes below. The results of operations and cash flows for any interim period are not necessarily indicative of results of operations and cash flows for the full year.

The accompanying interim unaudited condensed consolidated financial statements have been prepared by the Company pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). Accordingly, they do not include all disclosures required by accounting principles generally accepted in the United States of America (GAAP). The unaudited interim Condensed Consolidated Financial Statements should be read in conjunction with the Company’s Annual Report on Form 10-K for the year ended June 30, 2018 and other documents filed or furnished with the SEC during the current fiscal year.

Goodwill:

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

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

If the triggering event analysis indicates the fair value of the Company-owned reporting unit has potentially fallen below more than the 24% headroom, we may be required to perform an updated impairment assessment which may result in a non-cash impairment charge to reduce the carrying value of goodwill.

Assessing goodwill for impairment requires management to make assumptions and to apply judgment, including forecasting future sales and expenses, and selecting appropriate discount rates, which can be affected by economic conditions and other factors that can be difficult to predict. The Company does not believe there is a reasonable likelihood that there will be a material change in the estimates or assumptions it uses to calculate impairment losses of goodwill. However, if actual results are not consistent with the estimates and assumptions used in the calculations, or if there are significant changes to the Company's planned strategy for company-owned salons, the Company may be exposed to future impairment losses that could be material.

Accounting Standards Recently Adopted by the Company:

Revenue from Contracts with Customers

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

Restricted Cash

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

Statement of Cash Flows

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

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

Leases

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

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

2. REVENUE RECOGNITION:

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

Revenue Recognition and Deferred Revenue:

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

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

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

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

Revenue recognized over time:

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

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

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

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

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

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

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

10

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

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

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

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

		Adjustments for new revenue recognition guidance				
	Previously Reported	Franchise Fees	Advertising Funds	Gift Card Breakage	Taxes	Adjusted
ASSETS						
Current assets:						
Cash and cash equivalents	$ 110,399	$ —	$ —	$ —	$ —	$ 110,399
Receivables, net	52,430	—	—	—	—	52,430
Inventories	79,363	—	—	—	—	79,363
Other current assets	47,867	—	—	—	—	47,867
Total current assets	290,059	—	—	—	—	290,059
Property and equipment, net	105,860	—	—	—	—	105,860
Goodwill	412,643	—	—	—	—	412,643
Other intangibles, net	10,557	—	—	—	—	10,557
Other assets	37,616	—	—	—	—	37,616
Total assets	$ 856,735	$ —	$ —	$ —	$ —	$ 856,735
LIABILITIES AND SHAREHOLDERS' EQUITY						
Current liabilities:						
Accounts payable	$ 57,738	$ —	$ —	$ —	$ —	$ 57,738
Accrued expenses	97,630	3,030	—	56	—	100,716
Total current liabilities	155,368	3,030	—	56	—	158,454
Long-term debt	90,000	—	—	—	—	90,000
Other noncurrent liabilities	107,875	18,346	—	—	(4,378)	121,843
Total liabilities	353,243	21,376	—	56	(4,378)	370,297
Commitments and contingencies (Note 7)						
Shareholders' equity:		0				
Common stock	2,263	—	—	—	—	2,263
Additional paid-in capital	194,436	—	—	—	—	194,436
Accumulated other comprehensive income	9,568	88	—	—	—	9,656
Retained earnings	297,225	(21,464)	—	(56)	4,378	280,083
Total shareholders' equity	503,492	(21,376)	—	(56)	4,378	486,438
Total liabilities and shareholders' equity	$ 856,735	$ —	$ —	$ —	$ —	$ 856,735

12

CONDENSED CONSOLIDATED STATEMENT OF OPERATIONS (Unaudited)
For The Three Months Ended December 31, 2017
(Dollars and shares in thousands, except per share data amounts)

		Adjustments for new revenue recognition guidance				
	Previously Reported	Franchise Fees	Advertising Funds	Gift Card Breakage	Taxes	Adjusted
Revenues:						
Service	$223,214	$—	$ —	$ 64	$—	$223,278
Product	71,816	—	—	16	—	71,832
Royalties and fees	13,485	(1,225)	6,479	—	—	18,739
	308,515	(1,225)	6,479	80	—	313,849
Operating expenses:						
Cost of service	134,850	—	—	—	—	134,850
Cost of product	39,864	—	—	—	—	39,864
Site operating expenses	32,119	—	6,479	—	—	38,598
General and administrative	48,592	—	—	—	—	48,592
Rent	65,473	—	—	—	—	65,473
Depreciation and amortization	24,951	—	—	—	—	24,951
Total operating expenses	345,849	—	6,479	—	—	352,328
Operating income	(37,334)	(1,225)	—	80	—	(38,479)
Other (expense) income:						
Interest expense	(2,169)	—	—	—	—	(2,169)
Gain from sale of salon assets to franchisees, net	(104)	—	—	—	—	(104)
Interest income and other, net	2,466	—	—	(447)	—	2,019
Income from continuing operations before income taxes	(37,141)	(1,225)	—	(367)	—	(38,733)
Income tax expense	76,462	—	—	—	4,363	80,825
Income from continuing operations	39,321	(1,225)	—	(367)	4,363	42,092
Loss from discontinued operations, net of taxes	(6,601)	—	—	—	—	(6,601)
Net loss	$32,720	$(1,225)	$ —	$ (367)	$4,363	$35,491
Net loss per share:						
Basic:						
Income from continuing operations	$0.84	$(0.03)	$ 0.00	$ (0.01)	$0.09	$0.90
Loss from discontinued operations	(0.14)	0.00	0.00	0.00	0.00	(0.14)
Net loss per share, basic (1)	$0.70	$(0.03)	$ 0.00	$ (0.01)	$0.09	$0.76
Diluted:						
Income from continuing operations	$0.83	$(0.03)	$ 0.00	$ (0.01)	$0.09	$0.89
Loss from discontinued operations	(0.14)	0.00	0.00	0.00	0.00	(0.14)
Net loss per share, diluted (1)	$0.69	$(0.03)	$ 0.00	$ (0.01)	$0.09	$0.75

Weighted average common and common equivalent shares outstanding:						
Basic	46,821	46,821	46,821	46,821	46,821	46,821
Diluted	47,314	47,314	47,314	47,314	47,314	47,314

(1)Total is a recalculation; line items calculated individually may not sum to total due to rounding.

CONDENSED CONSOLIDATED STATEMENT OF OPERATIONS (Unaudited)
For The Six Months Ended December 31, 2017
(Dollars and shares in thousands, except per share data amounts)

		Adjustments for new revenue recognition guidance				
	Previously Reported	Franchise Fees	Advertising Funds	Gift Card Breakage	Taxes	Adjusted
Revenues:						
Service	$458,773	$—	$ —	$ 135	$—	$458,908
Product	132,756	—	—	34	—	132,790
Royalties and fees	26,859	(2,449)	13,205	—	—	37,615
	618,388	(2,449)	13,205	169	—	629,313
Operating expenses:						
Cost of service	274,686	—	—	—	—	274,686
Cost of product	70,026	—	—	—	—	70,026
Site operating expenses	65,422	—	13,205	—	—	78,627
General and administrative	83,758	—	—	—	—	83,758
Rent	107,889	—	—	—	—	107,889
Depreciation and amortization	37,206	—	—	—	—	37,206
Total operating expenses	638,987	—	13,205	—	—	652,192
Operating income	(20,599)	(2,449)	—	169	—	(22,879)
Other (expense) income:						
Interest expense	(4,307)	—	—	—	—	(4,307)
Gain from sale of salon assets to franchisees, net	18	—	—	—	—	18
Interest income and other, net	3,371	—	—	(932)	—	2,439
Income from continuing operations before income taxes	(21,517)	(2,449)	—	(763)	—	(24,729)
Income tax expense	71,630	—	—	—	3,636	75,266
Income from continuing operations	50,113	(2,449)	—	(763)	3,636	50,537
Loss from discontinued operations, net of taxes	(40,368)	—	—	—	—	(40,368)
Net loss	$9,745	$(2,449)	$ —	$ (763)	$3,636	$10,169
Net loss per share:						
Basic:						
Income from continuing operations	$1.07	$(0.05)	$ 0.00	$ (0.02)	$0.08	$1.08
Loss from discontinued operations	(0.86)	0.00	0.00	0.00	0.00	(0.86)
Net loss per share, basic (1)	$0.21	$(0.05)	$ 0.00	$ (0.02)	$0.08	$0.22
Diluted:						
Income from continuing operations	$1.07	$(0.05)	$ 0.00	$ (0.02)	$0.08	$1.07
Loss from discontinued operations	(0.86)	0.00	0.00	0.00	0.00	(0.86)
Net loss per share, diluted (1)	$0.21	$(0.05)	$ 0.00	$ (0.02)	$0.08	$0.22

Weighted average common and common equivalent shares outstanding:						
Basic	46,719	46,719	46,719	46,719	46,719	46,719
Diluted	47,053	47,053	47,053	47,053	47,053	47,053

(1)Total is a recalculation; line items calculated individually may not sum to total due to rounding.

3. DISCONTINUED OPERATIONS:

In October 2017, the Company sold substantially all of its mall-based salon business in North America, representing 858 salons, and substantially all of its International segment, representing approximately 250 salons in the UK, to The Beautiful Group ("TBG"), an affiliate of Regent, a private equity firm based in Los Angeles, California, who operates these locations as franchise locations.

As part of the sale of the mall-based business, TBG agreed to pay for the value of certain inventory, prepaid rent and assumed specific liabilities, including lease liabilities. In March 2018, the Company entered into discussions with TBG regarding a waiver of working capital and prepaid rent payments associated with the original transaction and the financing of certain receivables to assist TBG with its cash flow and operational needs. Based on the status of these discussions as of March 31, 2018, the Company fully reserved for the working capital and prepaid rent amount of $11.7 million. In August 2018, the Company entered into promissory notes for approximately $11.7 million in working capital receivables and $8.0 million in accounts receivables, a majority of which was for inventory purchases. All notes have a maturity date of August 2, 2020. Under the working capital notes, if no default has occurred under such notes and certain other conditions are met, such notes will be forgiven as of the maturity date and will be exchanged for a three-year contingent payment right that is payable to us upon the occurrence of certain TBG monetization events. Should the Company need to record reserves against its current and future receivables from TBG these reserves would be recorded within general and administrative expenses.

For the International segment, the Company entered into a share purchase agreement with TBG for minimal consideration.

The Company classified the results of its mall-based business and its International segment as discontinued operations for all periods presented in the Condensed Consolidated Statement of Operations. In connection with the sale of the mall-based business and the International segment, the Company performed an impairment assessment of the asset groups. The Company recognized net impairment charges within discontinued operations based on the difference between the expected sale prices and the carrying value of the asset groups.

The following summarizes the results of our discontinued operations for the periods presented:

	For the Three Months Ended December 31,		For the Six Months Ended December 31,	
	2018	2017	2018	2017
	(Dollars in thousands)		(Dollars in thousands)	
Revenues	$—	$7,773	$—	$101,140
Loss from discontinued operations, before income taxes	(750)	(10,073)	(1,086)	(43,840)
Income tax benefit on discontinued operations	6,863	3,472	6,935	3,472
Income (loss) from discontinued operations, net of income taxes	$6,113	$(6,601)	$5,849	$(40,368)

For the three months ended December 31, 2018, the $6.1 million income from discontinued operations includes $6.9 million of income tax benefits recognized in the quarter with respect to the wind-down of the transaction, partly offset by $0.8 million of actuarial insurance accrual adjustments associated with the transaction. For the six months ended December 31, 2018, the $5.8 million income from discontinued operations includes $6.9 million of income tax benefits associated with the wind-down and transfer of legal entities related to discontinued operations, partly offset by professional fees and actuarial insurance accrual adjustments associated with the transaction.

For the three months ended December 31, 2017, included within the $6.6 million loss from discontinued operations were $4.8 million of asset impairment charges, $1.1 million of loss from operations and $4.2 million of professional fees associated with the transaction, partly offset by a $3.5 million income tax benefit generated due to federal tax legislation enacted during the three months ended December 31, 2017. For the six months ended December 31, 2017, included within the $40.4 million loss from discontinued operations were $29.1 million of asset impairment charges, $6.2 million of cumulative foreign currency translation adjustment associated with the Company's liquidation of substantially all foreign entities with British pound denominated currencies, $2.8 million of loss from operations and $5.8 million of professional fees associated with the transaction, partly offset by a $3.5 million income tax benefit.

Other than the items presented in the Consolidated Statement of Cash Flows, there were no other significant non-cash operating activities or any significant non-cash investing activities related to discontinued operations for the three and six months ended December 31, 2018 and 2017.

The Company utilized the consolidation of variable interest entities guidance to determine whether or not TBG was a variable interest entity (VIE), and if so, whether the Company was the primary beneficiary of TBG. As of December 31, 2018, the Company concluded that TBG is a VIE, based on the fact that the equity investment at risk in TBG is not sufficient. The Company determined that it is not the primary beneficiary of TBG based on its exposure to the expected losses of TBG and as it is not the variable interest holder that is most closely associated within the relationship and the significance of the activities of TBG. The exposure to loss related to the Company's involvement with TBG is the carrying value of the amounts due from TBG of $16.4 million as of December 31, 2018 and the guarantee of the operating leases.

4. EARNINGS PER SHARE:

The Company’s basic earnings per share is calculated as net income divided by weighted average common shares outstanding, excluding unvested outstanding RSAs, RSUs and PSUs. The Company’s diluted earnings per share is calculated as net income divided by weighted average common shares and common share equivalents outstanding, which includes shares issued under the Company’s stock-based compensation plans. Stock-based awards with exercise prices greater than the average market price of the Company’s common stock are excluded from the computation of diluted earnings per share.

For the three months ended December 31, 2018, 859,598 common stock equivalents of dilutive common stock were included in the diluted earnings per share calculations due to the net income from continuing operations. For the six months ended December 31, 2018, 903,107 common stock equivalents of dilutive common stock were excluded in the diluted earnings per share calculations due to the net loss from continuing operations. For the three and six months ended December 31, 2017, 492,889 and 334,062, respectively, common stock equivalents of dilutive common stock were included in the diluted earnings per share calculations due to the net income from continuing operations.

The computation of weighted average shares outstanding, assuming dilution, excluded 734,526 and 2,373,110 of stock-based awards during the three months ended December 31, 2018 and 2017, respectively, and 520,348 and 1,199,042 of stock-based awards during the six months ended December 31, 2018 and 2017, respectively, as they were not dilutive under the treasury stock method.

5. SHAREHOLDERS’ EQUITY:

Stock-Based Employee Compensation:

During the three and six months ended December 31, 2018, the Company granted various equity awards including restricted stock units (RSUs) and performance-based restricted stock units (PSUs).

A summary of equity awards granted is as follows:

	For the Three Months Ended December 31, 2018	For the Six Months Ended December 31, 2018
Restricted stock units	1,437	338,859
Performance-based restricted stock units	3,506	733,688

The RSUs granted to employees vest in equal amounts over a three-year period subsequent to the grant date, cliff vest after a three-year period or cliff vest after a five-year period subsequent to the grant date.

The PSUs granted to employees have a three year performance period ending June 30, 2021 linked to the Company's stock price reaching a specified volume weighted average closing price for a 50 day period that ends on June 30, 2021. The PSUs granted to certain executives include an additional two year service period after the performance period. Of the total PSUs granted, 52,590 PSUs have a maximum vesting percentage of 200% based on the level of performance achieved for the respective award, while the remaining PSUs have a maximum vesting percentage of 100%.

Total compensation cost for stock-based payment arrangements totaling $2.2 and $2.6 million for the three months ended December 31, 2018 and 2017, respectively, and $4.6 million for the six months ended December 31, 2018 and 2017, respectively, was recorded within general and administrative expense on the unaudited Condensed Consolidated Statement of Operations.

Additional Paid-In Capital:

The $65.5 million decrease in additional paid-in capital during the six months ended December 31, 2018 was primarily due to $68.1 million of common stock repurchases and $2.0 million of other stock-based compensation activity, primarily shares forfeited for withholdings on vestings, partly offset by $4.6 million of stock-based compensation.

During the three and six months ended December 31, 2018, the Company repurchased 2.9 million and 4.0 million shares, respectively, for $48.9 million and $68.3 million, respectively, under a previously approved stock repurchase program. At December 31, 2018, $167.0 million remains outstanding under the approved stock repurchase program.

6. INCOME TAXES:

A summary of income tax (expense) benefit and corresponding effective tax rates is as follows:

	For the Three Months Ended December 31,		For the Six Months Ended December 31,	
	2018	2017	2018	2017
	(Dollars in thousands)			
Income tax (expense) benefit	$(454)	$80,825	$260	$75,266
Effective tax rate	52.1 %	208.7 %	85.0 %	304.4 %

On December 22, 2017, the U.S. government enacted comprehensive tax legislation commonly referred to as the Tax Cuts and Jobs Act (the “Tax Act”). The Company applied the guidance under SEC Staff Accounting Bulletin No. 118 which allowed for a measurement period up to one year after the December 22, 2017 enactment date of the Tax Act to complete the accounting requirements. The Company recorded a provisional net tax benefit of $68.1 million in continuing operations through fiscal year 2018. During the three and six months ended December 31, 2018, the Company made no adjustments to previously recorded provisional amounts related to the Tax Act and is now complete with its accounting.

The Company is no longer subject to IRS examinations for years before 2013. Furthermore, with limited exceptions, the Company is no longer subject to state and international income tax examinations by tax authorities for years before 2012.

7. COMMITMENTS AND CONTINGENCIES:

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

17

8. CASH, CASH EQUIVALENTS AND RESTRICTED CASH:

The table below reconciles the cash and cash equivalents balances and restricted cash balances, recorded in other current assets from the unaudited Condensed Consolidated Balance Sheet to the amount of cash, cash equivalents and restricted cash reported on the unaudited Condensed Consolidated Statement of Cash flows:

	December 31, 2018	June 30, 2018
	(Dollars in thousands)	
Cash and cash equivalents	$96,954	$110,399
Restricted cash, included in Other current assets (1)	23,512	38,375
Total cash, cash equivalents and restricted cash	$120,466	$148,774

(1) Restricted cash within Other current assets primarily relates to consolidated advertising cooperatives funds which can only be used to settle obligations of the respective cooperatives and contractual obligations to collateralize the Company's self-insurance programs.

9. GOODWILL AND OTHER INTANGIBLES:

The table below contains details related to the Company's goodwill:

	Company-owned	Franchise	Consolidated
	(Dollars in thousands)		
Goodwill, net at June 30, 2018	$184,788	$227,855	$412,643
Translation rate adjustments	(337)	(936)	(1,273)
Derecognition related to sale of salon assets to franchisees (1)	(17,596)	—	(17,596)
Goodwill, net at December 31, 2018	$166,855	$226,919	$393,774

(1) Goodwill is derecognized for salons sold to franchisees with positive cash flows. The amount of goodwill derecognized is determined by a fraction (the numerator of which is the trailing-twelve months EBITDA of the salon being sold and the denominator of which is the estimated annualized EBITDA of the Company-owned reporting unit) that is applied to the total goodwill balance of the Company-owned reporting unit.

The table below presents other intangible assets:

	December 31, 2018			June 30, 2018		
	Cost (1)	Accumulated Amortization (1)	Net	Cost (1)	Accumulated Amortization (1)	Net
	(Dollars in thousands)					
Amortized intangible assets:						
Brand assets and trade names	$7,910	$(4,274)	$3,636	$8,128	$(4,260)	$3,868
Franchise agreements	9,562	(7,717)	1,845	9,763	(7,712)	2,051
Lease intangibles	13,967	(10,096)	3,871	13,997	(9,770)	4,227
Other	1,945	(1,561)	384	1,983	(1,572)	411
	$33,384	$(23,648)	$9,736	$33,871	$(23,314)	$10,557

(1) The change in the gross carrying value and accumulated amortization of other intangible assets is impacted by foreign currency.

18

10. FINANCING ARRANGEMENTS:

The Company’s long-term debt consists of the following:

	Maturity Date	Interest Rate	December 31, 2018	June 30, 2018
	(Fiscal Year)		(Dollars in thousands)	
Revolving credit facility	2023	3.77%	$ 90,000	$ 90,000

Revolving Credit Facility

As of December 31, 2018 and June 30, 2018, the Company has $90.0 million of outstanding borrowings under a $295.0 million revolving credit facility. At December 31, 2018 and June 30, 2018, the Company has outstanding standby letters of credit under the revolving credit facility of $23.0 million and $1.5 million, respectively, primarily related to the Company's self-insurance program. The unused available credit under the facility was $182.0 million and $203.5 million, respectively. Amounts outstanding under the revolving credit facility are due at maturity in March 2023.

The Company’s long-term lease liability consists of the following: