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Financial Analysis and Valuation of Regis Corporation.

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Regis Corporation

RGS / NYSE

Initiating Coverage

Investment Rating: **Underperform**

PRICE: USD 20.22 S&P 500: 3,066.91 DIJA:27,347.36 RUSSELL 2000: 1,589.33

- Regis is currently transitioning from owning to franchising their salons.
- In a heavily fragmented and weak industry, Regis will face heavy competition for the upcoming years.

Valuation	2019 A	2020 E	2021 E
EPS	-0.34	1.03	1.46
P/E	N/A (Neg EPS)	21.09	16.33
P/CFPS	0.02	0.09	
P/BVPS	2.26	1.83	
EV/EBITDA	28.2	14.01	

Market and Trading Information

Equity Market Cap (USD):	718,780,560	52-Week Range (USD): 14.50 – 23.27
Enterprise Value (USD)(M):	1,692	12-Month Stock Return: 19.29%
Shares Outstanding (M):	35.55	Dividend / Capital Gain Yields: 19.29%
Estimated Float (M):	21.83	12-Month Russell 2000 Return: 18.04%
3-mo Avg. Daily Volume (M):	1.17	Beta: 0.82

Company Quick View:

Location: 7201 Metro Blvd Minneapolis, MN 55439

Industry: Miscellaneous Personal Services, SIC 7229 / All Other Personal Services, NAICS 812990

Description: Regis is a hair salon operator and franchisor located in Minneapolis, Minnesota and is the largest hair salon chain in the world. Operating over eight-thousand salons under twenty-six concepts such as Supercuts, SmartStyle, and Cost Cutters.

Key Products & Services: Regis offers hair care services including cutting, styling, and coloring. In addition, Regis also sells hair care products through their salons.

Website <http://www.regiscorp.com>

Analyst: Joshua Lammers

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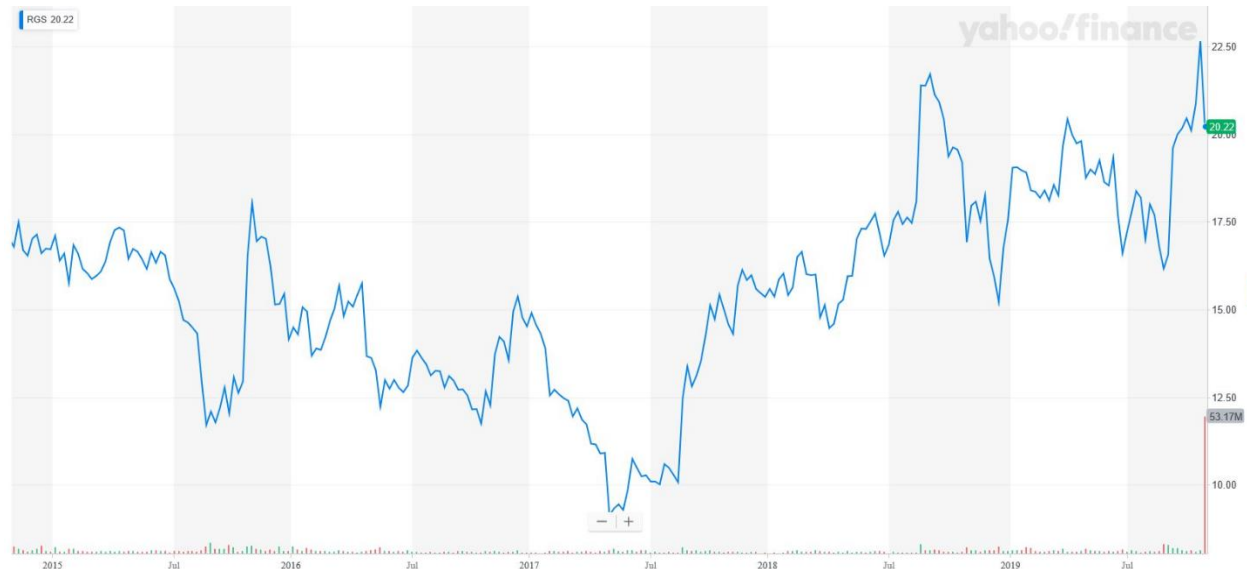


Table 1: 5-year Stock Price Performance

Source: Marketwatch.com October 31, 2019

On October 31, 2019 the stock closed at USD 20.22, depicting a rocky upward trend as seen in table 1. As of October 31, 2019 Regis, has seen a 12-month total return of 19.29%. The 5-year stock return of Regis is 22.25% averaging to 4.5% a year. Ulta Beauty, a competitor of Regis, has seen a return over the 12-month period of -5.99%. The poor performance is a peculiar trend for Ulta as the company had been performing steadily and positively over previous years. This has been the opposite for Regis seeing mixed to poor performance in previous years, but positive as of late, implying the tides may be changing in favor of Regis in comparison to competitors. Unfortunately, most close competitors to Regis, such as Great Clips and Sports Clips are all privately held companies making stock performance comparisons unavailable. As such, the pool of comparable companies in this regard is small and may skew industry comparisons regarding the stock performance of Regis.

The price behavior of Regis can be attributed to long-term struggling performance, a changing market, a recent restructuring, and a change to becoming a franchisor only. Table 1 shows performance was declining from 2015 into mid-2017, falling below USD 10. However, during quarter 4 of 2017, Regis stock saw a rebound following the company's announced plans of restructuring and change in portfolio focus. From there on, the company would see inconsistent performance with minor rises and falls until a large spike then fall in late 2018. Onwards the company has followed a trend of the stock fall or rising in a spike movement almost quarterly, given the company has been going through numerous major changes and a restructuring in the last few years. Regis has seen inconsistent performance throughout past quarters and as such the stock has been as well. Having finished restructuring and established priority on being a franchisor, Regis hopes to become stable and see healthy growth in future years.

INVESTMENT DECISION SUMMARY

I forecast the intrinsic value of Regis Corp. at USD 16.83 per share. From the analysis of Regis, the stock is overvalued, primarily due to an overly optimistic turnaround and sales of company owned salons. The company has been promising higher profitability since finishing restructuring in 2018. However, performance has not been indicative of this. This aside, as the company continues the conversion into being only a franchisor, gross margins are expected to improve and future revenue growth through royalties hold potential. Despite this, the estimated price per share of Regis is below the market value USD 20.22 as of October 31, 2019.

COMPANY DESCRIPTION

Holding ownership or franchises in 7,145 locations, Regis is the largest owner and operator of salon chain's in the world. These salons are operated under twenty-six concept salons, primarily concentrating on either the value or premium segments and providing geographic coverage over most of the Northern Americas. Of salon interests, 3,951 are franchised salons, 3,108 are company-owned salons, and 86 are non-controlling interests of less than 100%.

Based in Edina, Minnesota, Regis was founded in 1922 by Paul Kunin under the name Kunin Beauty Salon. Paul's children Diana and Myron Kunin later purchased the business from him in 1954. Myron bought his sister's share in the business and renamed it Regis in 1958. Regis went to public ownership in 1983, returned to private ownership in 1988, and returned to public ownership in 1991.

Situated in the salon industry, Regis offers hair and beauty services to consumers through their twenty-six concept salons. Most Regis concept salons such as SmartStyle, Supercuts, MasterCuts, and Signature Style occupy the value economic sector targeting families as their customer base. However, a few Regis salon concepts target the Premium economic sector such as Sassoon. Regis also provides cosmetology education under the Sassoon Academies name.

Regis is currently undergoing a multiyear strategic and operational transformation to stabilize the company and provide a platform for long term growth and objectives. Upon recent completion of their portfolio restructuring, downsizing their number of company owned salons, increasing franchise owned salons, and shifting segment emphasis to value, Regis has advanced their short-term strategy to continue stabilizing the company and now diversify the company's salon portfolio, looking towards alternatives to mall-based salons and continued growth of their franchise portfolio.

In emphasizing their focus on maximizing shareholder value and expansion of their franchise portfolio, in August 2019, Regis reached the decision to transition fully their company owned salons to a franchise platform. With this, the multiyear strategic and operational transformation has put the company on path to become a capital-light

franchisor platform, thereby eliminating non-essential costs and investing in enhancing franchisor capabilities.

As of June 30, 2019, 56% of salons operated by Regis are franchises (Regis Corporation (Form 10-K), 2019), rising by 5.1% from the previous year. Despite this, most of the revenue generated by the company comes from company owned salons (85.63% in fiscal 2019). Revenue streams are broken down into 70.12% from salon services of company owned salons, 21.10% from hair product sales, and 8.77% from franchise fees and royalties. Hair product sales are comprised of sales at company owned salons and sales of product to franchised salons.

Due to the hair salon industry having low market share concentration, Regis faces heaviest salon competition from small businesses and value chains such as Great Clips, Fantastic Sams, and Sport Clips, which compete against Regis in the value category. Its closest competitor in terms of size is Ulta Beauty having interests in 1,163 hair salons/retail stores. Ulta Beauty is focused in premium hair services and beauty products.

MANAGEMENT AND CORPORATE GOVERNANCE

Serving the vision and direction of Regis, there are ten key executives under Regis: David Williams, Hugh Sawyer, Andrew Lacko, Eric Bakken, Chad Kapadia, Jim Lain, Amanda Rusin, James Townsend, Shawn Moren, and Laura Alexander. David Williams has served as a director and Board Chairman since 2011, with a total compensation of USD 284,985. Hugh Sawyer joined Regis in 2017, serving as President, Chief Executive Officer, and as a Director; with a total compensation of USD 8,427,057 (In 2019 USD 950,000 Salary and USD 6,588,878 Stock Awards). Andrew Lacko has served as Executive Vice President and Chief Financial Officer since 2017 with a total compensation of USD 1,996,106. Erick Bakken was appointed Executive Vice President in 2013, with a total compensation of USD 2,393,756. A recent addition, Chad Kapadia has served as Executive Vice President and Chief Technology Officer since June 2018. Jim Lain has served as Executive Vice President and Chief Operating Officer since 2013, with a compensation of USD 1,617,852. Another recent addition, Amanda Rusin has served as Senior Vice President and General Counsel and Secretary since January 2018. James Townsend has served as Executive Vice President and Chief Marketing Officer since April 2019. Shawn Moren has served as Senior Vice President and Chief Human Resources Officer since 2017. Lastly, Laura Alexander was appointed Senior Vice President of Merchandise since June 2018.

Recently implemented in 2019, Regis employs an unusual incentive plan meant to encourage executives to invest personally in the company. The company discontinued automatic annual equity grants, replacing them with a single and larger initial equity grant. The grant is offset over a five-year period with no additional grants during the

period. Said grants require significant performance and cliff vesting criteria to be achieved by management. In addition, Regis also implemented a matching share program where senior executives are encouraged to buy shares. If held for five years and incentive targets are met, executives receive a company match of shares. The company claims to set difficult stretch goals where two of the three corporate goals of the company failed to meet goals, and thusly were not paid out for in 2019.

Regis's Board of Directors, composed of eight members, has six males and two females. The Board members are as follows: David Williams, Hugh Sawyer, Daniel Beltzman, Virginia Gambale, David Grissen, Mark Light, Micheal Merriman, and M. Ann Rhoades. All directors stand for election every year and may be eligible for re-election. In addition, all directors, except the Regis President and CEO Hugh Sawyer and Daniel Beltzman are independent.

As of October 4, 2019 Regis, has an ISS Governance QualityScore of 1. The scoring breaks down into Audit: 1, Board: 1, Shareholder Rights: 1, and Compensation: 2. The corporate governance scores are provided by the proxy advisory firm Institutional Shareholder Services (ISS). A score of 1 indicates lower governance risk whereas a 10 indicates a higher governance risk.

Accounting Quality

PricewaterhouseCoopers LLP has served as the auditor of Regis since at least 1990 (Exact year could not be determined by the firm). As of June 30, 2019, and June 30, 2018, the consolidated financial statements were given an unqualified opinion.

In 2019 the Regis did change the way it accounts for revenues from contracts with customers. Previously, the company recognized initial franchise fees in full upon a franchised salon opening. Adopting new FASB guidance recognition of revenue from franchise fees are deferred until the salon is opened and is then recognized over the term of the franchise agreement. The company used the full retrospective transition method to adjust prior reporting periods to reflect the adoption of the new policy.

Quality of Earnings for the fiscal year of 2019 was -1.21 and averaged -2.54 for the previous fiscal five years (2018 – 2014). The Quality of Earnings is low for Regis, primarily due to three factors that are negative net income, large amounts of depreciation, and the company selling company owned salons to franchisees for a gain on the sale.

SHAREHOLDER ANALYSIS

As of October 31, 2019, there are approximately 10,000 shareholders of Regis stock and 35.55 million shares outstanding. Shareholders of Regis stock are predominately institutional investors, holding 94.35% of Regis Stock. Of institutional owners, 44.39% are mutual fund holders and 49.96% other institutional holders (CNNMoney, 2019). Of their fiscal year-to-date, Regis has repurchased 8.6 million shares for USD 154.4 million.

From October 28, 2018 to October 31, 2019, several of the ten Regis executives have participated in insider transactions at Regis. Of the transactions, most have been the sales of stock, with two purchases. Sales of stock were done by Jim Lain, Andrew Lacko, Kersten Zupfer, Chad Kapadia, Shawn Moren, Amanda Rusin, Laura Alexander, and Eric Bakken. The individual transactions of stock sold by each executive all totaled to less than USD 100,000, except for Jim Lain, Eric Bakken, and Kersten Zupfer who sold 49,352, 24,138 and 5,836 shares at total transaction values of USD 878.7K, USD 484.1K and USD 103.1K respectively. Jim Lain still holds 155,554 shares and Eric Bakken 220,474. There has also been a significant amount of stock rewards from October 28, 2018 to October 31, 2019 granted by the executive incentive program. In this period, there have been 202,882 shares awarded to company executives.

Table 2 shows the five largest owners of Regis stock and recent quarterly transactions (All are institutional). The dominant owner is Birch Run Capital Advisors LP, an employee owned hedge fund sponsor. A co-founder and general partner of Birch Run is Daniel Beltzman, who is also a board member of Regis as a director. Table 3 shows the largest mutual fund investors in Regis stock and recent quarterly transactions.

Top Other Institutional Holders of Regis Corp

Stockholder	Stake	Shares Owned	Total Value (USD)	Shares Bought/Sold	Total Change
Birch Run Capital Advisors LP	29.55%	10,655,170	215,447,537	0	0.00%
BlackRock Fund Advisors	11.50%	4,163,594	84,187,871	-138,109	-3.21%
Dimensional Fund Advisors LP	9.22%	3,325,382	67,239,224	-229,157	-6.45%
The Vanguard Group, Inc.	8.38%	3,021,243	61,089,533	-30,562	-1.00%
Cramer Rosenthal McGlynn LLC	7.95%	2,866,275	57,956,081	+90,884	+3.27%

Table 2

Source: Money.CNN

Data as of October 31, 2019

Top Mutual Fund Holders of Regis Corp

Stockholder	Stake	Shares Owned	Total Value (USD)	Shares Bought/Sold	Total Change
iShares Core S&P Small Cap ETF	4.12%	1,484,240	30,011,333	-2,112	-0.14%
DFA US Small Cap Value Portfolio	2.97%	1,070,670	21,648,947	-96,498	-8.27%
CRM Small Cap Value Fund	2.67%	961,232	19,436,111	+58,335	+6.46%
Brown Advisory Small Cap Fundamental Value Fund	2.58%	930,741	18,819,583	+81,124	+9.55%
Vanguard Total Stock Market Index Fund	2.19%	788,372	15,940,882	+3,384	+0.43%

Table 3

Source: Money.CNN

Data as of October 31, 2019

INDUSTRY ANALYSIS

Regis is a mature company operating in the Miscellaneous Personal Services (Hair Salon) industry; their SIC is 7299 and NAICS 812990. Due to heavy industry fragmentation and low entry barriers, Regis faces numerous sources of competition from small independent salons to major chains. With traditional salons on the decline and value and luxury salons on steady rise, Regis will need to adapt their appropriate salon concepts to capture on current trends in order to remain competitive.

Regis is an operator of franchise and company owned hair salons throughout North America. The company serves a diverse customer base through their twenty-six salon concepts, most focusing on value or premium services. The major focus of Regis is currently the value segment, prioritizing families and consumers looking for affordable hair services. Each salon concept under Regis provides hair cutting and styling (basic styling at minimum) services, but more premium concepts may provide additional styling services such as perms, coloring, and highlights. In addition to hair services, hair care products are sold at the salon concepts. While not the primary offering of the salons, the hair care products still generate a considerable portion of revenue; making up 21.1% of revenue in 2019 (Regis Corporation (Form 10-K), 2019).

Despite a currently healthy economy, the salon industry is weak and is experiencing low growth with only a 2.4% annual growth from 2013-2018 per industry analyst firm IBIS World (IBIS). In addition to this, the industry has shifted heavily in consumer tastes and salon formats. Women are now more likely to opt for cheaper hair services at value-oriented salons, and more men have gone to male-centered salons such as Sport Clips.

Regarding salon formats, traditional salons and mall chains have seen a heavy decline, while value-oriented salons and high-end salon suites have risen considerably.

Given the salon industry is heavily fragmented, there are a high number of competitors. Recent trends show that the industry is becoming less fragmented with the rapid rise of salon chains such as Great Clips and Sport Clips. This can also be attributed to the decline of traditional salons that are small businesses operating few to only one location. Competition is concentrated mostly in either the value or premium/specialty segments, being highly competitive in both and is expected to continue being so in the future. Regis has chosen to target the value segment, giving their value-oriented salon concepts highest priority for revenue and growth. Being the largest chain in the industry, Regis expects to leverage their size to be competitive and attract franchisees; ensuring stable long-term growth.

Unique to the value segment, the larger competing salon chains are almost entirely franchise only with no company-owned stores. The barriers of entry are low to start a salon, making it easy to start a low-cost salon and enter competition with other salons. As the value-segment operates on lower margins than the premium segment, the low barriers have led to many competitors fighting over a small amount of revenue. With this, the larger salon chains opt to take advantage of the low entry barriers and offer their brand as a franchise. With a low initial investment allowed by low entry barriers and the thriving value segment, franchisees can quickly be attracted. This has allowed for rapid growth of chains such as Great Clips, opening 567 salons in the past three years (Entrepreneur.com Website, 2019). Taking note of this trend, Regis is recasting itself as a franchisor quickly converting company-owned salons into franchised ones. As of fiscal 2019 (June 30), 56.0 percent of salons operated by Regis are franchises, a 5.1 percent rise compared to the previous year. The repositioning is in early stages and poses some risk to Regis as continued success will depend on the independently operated franchisees.

Regarding the premium salon segment, there has been a considerable increase in large high-end salons referred to as salon suites. With the decline of traditional salons and mall chains, there is an increasing divergence between value and premium salons in the market. This has been problematic for the premium salon concepts of Regis. The premium concepts operated by Regis are often mall-based and occupy the lower end of the premium segment, with none catering to niche markets of care hair. Matching poorly to demands and the competitive landscape, the premium concepts have performed lackluster leading Regis to lean away from the premium sector. This can be seen with a focused growth of value-oriented salons and Regis recently selling most of

their mall-based salons to the equity firm Regent, LP in 2017. The deal included 858 North American Regis salons and 250 international salons.

Three key identifiers in the industry explain the lackluster performance in the premium segment:

- The premium segment has moved upscale and more niche.
- High competition in salon retail from online competitors and mass retail chains like Amazon and Ulta.
- Poor performance of malls in the United States.

With more women opting for value-oriented salons, the lower end of premium salons has suffered. However, with a healthy economy, high-end salon suites have fared considerably well. Specialty and niche salons such as blow-out bars that only perform styling services have also increased in popularity. As the premium Regis salon concepts are on the lower end of the premium segment and have little niche appeal, competitiveness has suffered. In addition, salon retail of selling hair care products was a strong revenue source for premium salons. Now with the emergence of online retailers and mass retail chains such as Amazon (Online) and Ulta (Mass Retail), product sales have waned heavily for salons. Lastly, malls overall have been trending on a consistent decline. As many Regis premium concepts were mall-based, they have declined in tandem. Instead of appropriating current premium salons to meet changing premium sector trends, Regis is culling them as mentioned earlier for the more lucrative value segment.

Customer loyalty is tied with the stylists serving said customers, making it critical to attract and retain capable stylists to ensure return customers. Due to high industry fragmentation and numerous salon operators, the labor market for stylists is competitive. This can lead to hiring and retention difficulties for Regis and is a current issue for Regis in some markets. In addition, cosmetology schools have seen declining enrollment, meaning less trained stylists will be entering the industry, making hiring issues even more difficult for operators in the future.

PEER ANALYSIS

In a heavily fragmented industry, Regis faces competition from numerous fronts against their North American locations. Aside competition from independently owned local salons, Regis also has chain salon competitors such as Ulta Beauty, Great Clips, Sport Clips, and Fantastic Sams. Of the chain competitors, Sport Clips is a direct competitor capturing the male demographic. Nationwide in the United States, Sport Clips is a barbershop chain specializing in haircuts for men. At 1,800 locations, Sport Clips is far smaller than Regis is, but remain a primary competitor by focusing entirely on the male demographic whereas only two Regis Salon concepts concentrate on men.

Headquartered in Minneapolis, Minnesota, close to Regis's Headquarters, is a major competitor: Great Clips. Like Regis, Great Clips has a location coverage encompassing North America nationwide. Unlike Regis, Great Clips is a private company and only a salon franchise, not operating company owned salons (Regis is currently transitioning to be a franchise-only company). Great Clips salons are stripped-down salons focusing on lean operating costs. This is done to allow for lower-priced services, making them appealing to families. Operating over 4,300 salons, Great Clips is heavily outnumbered by Regis's 7,145 interests. However, Regis still faces intense competition against Great Clips in capturing family demographics. Regis targets multiple demographics through their salon concepts, while Great Clips focuses primarily on families.

The smallest competitor to Regis, Fantastic Sams is a salon chain with 995 franchises throughout the United States and Canada. With most locations scattered along the eastern portion of the United States. Like Sport Clips and Great Clips, the company is owned privately and only a franchisor. Also, like Great Clips, Fantastic Sams is focused primarily on families. While the smallest of major competitors, the prominence of Fantastic Sams in the eastern United States pose stiff competition for Regis on this front.

Competing against Regis in premium salon services is Ulta Beauty. At a current market capitalization of USD 15 Billion, Ulta Beauty has a considerably larger capitalization than Regis (USD 729 Million). Still, despite the difference Ulta Beauty is a primary competitor to Regis. Ulta Beauty operates primarily as a chain of beauty stores, a majority of which are in the East Coast region and the remaining spread across the United States. All stores are company-owned and provide cosmetics, fragrances, skin care products, hair care products, and salon services with each store being equipped with a salon. While focused primarily on beauty products, the premium salon services provided at Ulta Beauty locations compete against the premium salon concepts of Regis.

Peer Analysis Relevant Comparisons

Company	Ticker Symbol	Sales (USD)	Market Cap (USD)	PE Ratio	EV/EBITDA	Debt/Assets	ROA	ROE
Regis Corp.	RGS	1,069M	739.940M	17.89	28.2	0.50	-0.04%	-4.96%
Ulta Beauty	ULTA	6,716M	15.149B	18.88	14.14	0.43	14.39%	38.30%

Table 4

Source: Finance.yahoo.com October 31, 2019

M = Millions

B = Billions

HISTORICAL FINANCIAL ANALYSIS

To overview the performance of Regis in regards of productivity, liquidity, financial risk, and profitability ratios, I will compare the financial ratios of competitor Ulta Beauty against those of Regis to provide insight on the performance of Regis in the salon industry. While not an ideal comparison as Ulta focuses more on beauty products than salon services, Ulta is the closest peer that is public. Primary competitors such as Sport Clips and Great Clips are private and do not release financial records.

Table 5 shows that Regis has seen a steady decline in sales with a decrease of 28.24% in 2018 and another large decrease of 12% in 2019. Ulta Beauty, however, has experienced considerable growth year-over-year exceeding 20% from 2015-2018. While still healthy, growth did slow down by about 7% in 2019 declining from 21.2% in 2018 to 14.1% in 2019. Regarding the heavy decline in sales of Regis, the company has been closing many underperforming salons and converting many others to franchises. Given that Regis is becoming a franchisor-only company, the conversions to franchises will continue in the future. With the closing of salons and conversions to franchises, a decline in sales is expected and will likely continue until franchise conversions end. The table also shows that Regis has consistently maintained a higher operating working capital turnover than Ulta, generating a higher amount of sales per dollar of working capital used.

Productivity Ratio Analysis

Productivity Ratios	2019	2018	2017	2016	2015
Regis Growth in Sales % (Revenue)	-12%	-28.2%	-5.5%	-2.5%	-2.9%
Ulta Growth in Sales % (Revenue)	14.1%	21.2%	23.7%	21.1%	21.4%
Regis Operating Working Capital Turnover	11.37	8.28	8.23	10.10	7.92
Ulta Operating Working Capital Turnover	6.16	6.32	4.97	4.62	4.44

Table 5

Regarding liquidity, Regis appears acceptably liquid but much less liquid than Ulta. The declining current ratios of both Regis and Ulta is of concern as both companies are showing a trend of becoming less liquid. In comparing quick ratios, Regis does appear to be faring better than Ulta in the previous three years. While previously hovering around a quick ratio of 1.5, in 2019 the quick ratio of Regis declined from 1.48 to 1.16. The fall in liquidity has been the largest dip in recent years. Although concerning, liquidity is higher than that of Ulta who has had a lower quick ratio than Regis for the past five years, surprising as Ulta would be expected to have a rising quick ratio due to their rising sales and higher amount of inventory and Regis declining as their sales have been declining. The results though, have shown to be the opposite, a good sign for Regis.

Liquidity Ratio Analysis

Liquidity Ratios	2019	2018	2017	2016	2015
Regis Current Ratio	1.83	2.04	2.27	1.99	2.19
Ulta Current Ratio	2.32	2.64	2.90	3.47	3.45
Regis Quick Ratio	1.16	1.48	1.52	1.25	1.53
Ulta Quick Ratio	0.85	0.93	1.12	1.55	1.83

Table 6

Both companies have low to average leverage ratios with total financial debt averaging around 0.14 for Regis and being nonexistent for Ulta. In addition, with no long-term financial debt Ulta has no interest expense to cover. Interest coverage is problematic for Regis being unable to cover interest in 2019 and 2017. Regardless, the overall leverage of the companies is fairly close. Although, the total debt to equity ratio of Regis did rise considerably from 2018 (0.66) to 2019 (1.00). This may be due to 2018 being a usual year as 2017 and 2016 were both 0.93, close to the 2019 ratio of 1.00.

Leverage Ratio Analysis

Leverage Ratios	2019	2018	2017	2016	2015
Regis Total Debt-to-Equity Ratio	1.00	0.66	0.93	0.93	0.65
Ulta Total Debt-to-Equity Ratio	0.75	0.64	0.65	0.55	0.59
Regis Total Debt-to-Assets Ratio	0.50	0.40	0.48	0.48	0.45
Ulta Total Debt-to-Assets Ratio	0.43	0.39	0.39	0.35	0.37
Regis Total Financial Debt over Invested Capital Ratio	0.15	0.13	0.15	0.14	0.13
Ulta Total Financial Debt over Invested Capital Ratio	0.00	0.00	0.00	0.00	0.00
Regis Times Interest Earned	0.00	0.07	0.00	3.46	0.41
Ulta Times Interest Earned	INF	INF	INF	INF	INF

Table 7

Despite high gross profit margins, profitability ratios are overall far lower for Regis than Ulta. While the gross profit margin of Regis has grown to an impressive 45.16% in 2019, this has not translated to positive performance in other profitability ratios with a negative operating profit margin, net margin, and ROIC in 2019. Lower profitability margins can be attributed to high sales, general and administrative expenses (SGA) consuming 42.08% of revenue in 2019 and has increased by 4.65% since 2015 at 37.43%. SGA expenses have been decreasing year-over-year however, sales have fallen at a more aggressive rate causing SGA expenses to grow proportionally. In comparison, Ulta has a considerably lower 2019 gross profit margin of 35.87%. Yet profitability margins far exceed with a consistently growing net margin reaching 10.25% in 2019. With higher operating profitability and ROIC Ulta is adding value whereas Regis is destroying value due to poor operating profitability and ROIC.

Profitability Ratio Analysis

Profitability Ratios	2019	2018	2017	2016	2015
Regis Gross Profit Margin	45.16%	43.17%	39.95%	40.92%	41.33%
Ulta Gross Profit Margin	35.87%	35.63%	35.99%	35.28%	35.07%
Regis Operating Profit Margin	-0.03%	0.02%	-0.07%	0.98%	0.19%
Ulta Operating Profit Margin	12.72%	13.35%	13.49%	12.90%	12.66%
Regis Net Margin	-1.33%	0.72%	-0.95%	-0.63%	-1.84%
Ulta Net Margin	10.25%	9.44%	8.44%	8.15%	7.93%
Regis ROIC Ratio	-2.05%	-9.86%	0.62%	1.50%	1.89%
Ulta ROIC Ratio	30.90%	26.59%	25.18%	20.22%	20.12%

Table 8

PROSPECTIVE FINANCIAL ANALYSIS

I expect the next five years to be difficult and crucial for Regis. Recently completing their restructure and shifting company focus to being only a franchisor have put the company in a state of some uncertainty. As the company is continuing to convert company-owned salons into franchised salons, I expect revenue generation from salon services to decline as well as overall revenue. The company will instead be generating more royalty income from the conversion. Royalty revenue is also typically less than revenue generated from the salons, which will also be reason for decline. However, as the company will no longer be paying for the operating expenses of the franchised salons, operating expenses for the company will decline.

Concerning the salons, the company has focused attention to the value segment. I expect Regis will see a slow increase in revenue from company-owned and franchised salons in this segment over the next five years. As the company continues to expand into this segment, revenue will increase. However, the company will continue to face its current difficulties in this segment, due to aggressive competition from competitors such as Great Clips and Sport Clips, which have been growing faster in this segment. In addition, I expect Regis concept salons that are not oriented towards the value segment to decline in future years.

I expect hair dyeing service revenue to decline into the next few years due to the increasing trend of older demographics opting to retain their graying hair color instead of dyeing. With the increasing trend of salons that only provide hair styling services, I expect hair styling revenue to decline for Regis due to these more appealing competitors. In my opinion, Hair product sales will decline for Regis due to demographics shifting towards online retailers instead. With an ever-growing population, revenue from hair cutting services will increase indefinitely.

WACC was calculated by subtracting one by the target percent financed with long-term debt (18%) then multiplying the result by the cost of equity (11.20%). Then adding the

multiple of target percent financed with long-term debt (18%) and after-tax cost of long-term debt (5.58%) an estimated WACC of 10.19% was obtained.

Target percent financed with long-term debt of 18% was chosen based on historical liquidity of the company being in this range. Cost of equity was determined by multiplying the beta (0.82) by the market risk premium (10%), then adding the result to the risk-free rate (3%). After-tax cost of long-term debt was determined by subtracting one by the tax rate (21%) then multiplying by cost of long-term debt (7.06%). Cost of long-term debt was calculated by adding the spread for bond rating (4.06%) and the risk-free rate (3%).

The net income of Regis is projected to increase from USD -14 Million in 2019 to USD 38 Million in 2020, increasing slowly from there on. In 2019 Regis had a ROIC value of -2.1%, I forecast this to increase to 8.3% in 2020 and see slow percent growth onwards. While the WACC and ROIC value of Regis appear to be improving compared to previous years, ROIC is still considerably less than the WACC and is expected to be so in future years.

As Regis continues to convert company-owned salons into franchised ones as part of their strategy to be only a franchisor. Cost of goods sold (COGS) is expected to decline as Regis will no longer be required to pay the costs of the owned salons increasing gross margins. With the shift to be a franchisor, company costs and expenses will shift from COGS to sales, general, and administrative expenses (SGA). SGA expenses are a concern for the profitability of Regis as SGA expenses have consistently grown year-over-year proportional to generated revenue (SGA/Sales) rising from 36.76% in 2016 to 42.08% in 2019. A sensitivity analysis is provided below in table 9 showing the sensitivity of Regis to fluctuations in SGA/Sales and beta.

Sensitivity Analysis

Current: USD 20.22

		Beta				
		0.42	0.62	0.82	1.02	1.22
SGA/Sales	34.20%	\$ 37.61	\$ 29.41	\$ 24.00	\$ 20.17	\$ 17.34
	36.20%	\$ 31.82	\$ 24.76	\$ 20.84	\$ 16.83	\$ 14.39
	38.20%	\$ 26.03	\$ 20.12	\$ 16.22	\$ 13.48	\$ 11.44
	40.20%	\$ 20.23	\$ 15.47	\$ 12.33	\$ 10.13	\$ 8.50
	42.20%	\$ 14.44	\$ 10.82	\$ 8.45	\$ 6.78	\$ 5.55

Table 9

Green: Undervalued

Orange: Hold

Red: Overvalued

VALUATION AND INVESTMENT DECISION

From above projections that define the size and timing of the free cash flows, I estimate the price for Regis at the closing date of October 31, 2019 to be USD 16.83. This share price is below the market close price of USD 20.22 for the same date, a USD 3.39 or 18.3% difference. I use a Corporate Valuation Model based on discounting expected Free Cash Flows at the Weighted Average Cost of Capital. I obtained the last five years of financial statements from Mergent Online. The latest audited information for Regis is June 30, 2019.

In comparing my estimate of the stock price of USD 16.83 to the market close price of USD 20.22 on October 31, 2019, the stock is overvalued. Because of this, I recommend an “underperform” recommendation for Regis’ stock, due to the 18.3% difference not in favor of Regis. As noticed in the stock performance section, the stock value of Regis has a history of spiking then falling, with the company currently being in a spike.

Using the relative valuation method in estimating share price of Regis when compared to Ulta Beauty, Regis is overvalued and considered a sell in three categories that are EV/EBITDA, Market to Book, and EV/Sales. While the valuation method recommends a sell, Regis and Ulta Beauty differ greatly as Regis is a salon chain franchisor and Ulta a cosmetics retailer that also provides salon services. In addition, Ulta primary targets the female demographic whereas Regis is oriented towards families. Despite being the closest comparable competitor to Regis, the vast differences of the companies greatly diminish the usefulness of relative valuation and is not relied on in this analysis. See table 10 on the following page for data.

Relative Valuation

Multiple	Ulta	Regis	PPS	Valuation	Decision
EV/EBITDA	14.14	28.2	13.11	Overvalued	Sell
Market/Book	1.1	2.0	11.11	Overvalued	Sell
EV/Sales	0.4	0.87	12.03	Overvalued	Sell

Table 10

The projected forecast of the price per share of Regis is expected to increase in future years. Rising to USD 19.83 in June 30, 2021, just short of the current market price per share. A possible reason for the overvaluation of Regis is due to overconfidence in the turnaround of the company. The company currently has been building excitement from a recent restructure and massive shifts in strategy (Focus on being a franchisor only). The potential prospects the company presents itself to have may be overexaggerated. As excitement dies down, the stock price may cool down as well to a value closer to my estimate.

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<u>Regis: Historical Financial Ratios</u>	<u>2019</u>	<u>2018</u>	<u>2017</u>	<u>2016</u>	<u>2015</u>	<u>2014</u>	<u>2013</u>
Productivity Ratios							
Growth in sales	-12%	-28%	-6%	-3%	-3%	-6%	N/A
Receivables turnover	35.47	23.16	72.07	72.53	74.59	73.33	61.06
Inventory turnover	13.83	15.30	13.86	13.34	14.29	13.80	14.46
Operating working capital turnover	13.18	9.07	8.87	11.07	8.71	4.72	7.75
Net fixed asset turnover	2.26	2.15	2.76	2.75	2.67	2.53	2.54
Total asset turnover	1.49	1.36	1.62	1.67	1.53	1.30	1.48
Invested capital turnover	1.93	1.74	2.11	2.20	2.04	1.65	1.91
Liquidity Ratios							
Current ratio	1.64	1.87	2.08	1.83	1.98	1.59	1.23
Quick ratio	1.04	1.36	1.39	1.15	1.38	1.24	0.86
Cash ratio	0.56	0.72	0.98	0.76	0.98	0.99	0.53
Short-term investments over invested capital	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Operating Cycle	36.69	39.62	31.41	32.39	30.44	31.43	31.22
Cash Cycle	20.46	22.26	19.31	20.18	17.87	18.22	19.27
Financial Risk (Leverage) Ratios							
Total debt-to-equity ratio	1.00	0.66	0.93	0.93	0.81	0.92	0.59
Total debt-to-equity ratio (excluding deferred taxes)	0.95	0.60	0.73	0.75	0.67	0.81	0.58
Total financial debt-to-equity ratio	0.30	0.22	0.28	0.28	0.24	0.29	0.26
Interest coverage ratio (accounting-based)	-0.06	0.03	-0.14	1.89	0.35	0.04	0.33
Interest coverage ratio (cash-based)	6.87	3.78	6.18	8.01	7.03	3.69	1.10
Total debt-to-assets ratio	0.50	0.40	0.48	0.48	0.45	0.48	0.37
Total financial debt over invested capital	0.15	0.13	0.15	0.14	0.13	0.15	0.16
Long-term financial debt over invested capital	0.19	0.17	0.19	0.19	0.17	0.04	0.04

Regis: Historical Financial Ratios

	<u>2019</u>	<u>2018</u>	<u>2017</u>	<u>2016</u>	<u>2015</u>	<u>2014</u>	<u>2013</u>
Profitability/Valuation Ratios							
Gross profit margin	45.16%	43.17%	39.95%	40.92%	41.33%	41.20%	39.48%
EBITDA margin	3.08%	3.27%	3.18%	4.17%	3.91%	4.35%	2.06%
Operating profit margin	-0.03%	0.02%	-0.07%	0.98%	0.19%	0.05%	0.61%
NOPAT margin	-1.36%	-6.64%	0.30%	0.77%	1.20%	1.44%	1.82%
Earnings before taxes margin	-0.32%	-0.29%	-0.41%	-2.28%	-0.46%	-1.29%	0.10%
Net margin	-1.33%	0.72%	-0.95%	-0.63%	-1.84%	-5.33%	1.45%
Return on Assets	-0.04%	0.03%	-0.12%	1.64%	0.29%	0.07%	0.90%
Net investment rate	558.79%	78.84%	-181.54%	-630.44%	-1158.87%	320.34%	1707.82%
Dividend payout ratio	0.00%	0.00%	0.00%	0.00%	0.00%	6.74%	-46.95%
ROIC	-2.09%	-10.04%	0.63%	1.54%	1.92%	2.58%	N/A

Regis Corp.*In millions of USD*

Income Statement	6/30/2017	6/30/2018	6/30/2019	6/30/2020	6/30/2021	6/30/2022	6/30/2023	6/30/2024
Sales	1691.888	1214.074	1069.039	994.206	939.525	901.944	874.886	857.388
Costs of goods sold (COGS)	1015.902	689.977	586.230	544.825	496.069	458.188	435.693	420.120
Sales, general and administrative expense (SGA)	622.229	484.390	449.851	379.787	358.899	344.543	334.206	327.522
Depreciation	54.961	39.433	33.261	20.292	19.176	18.409	17.856	17.499
Operating profit	(1.204)	0.274	(0.303)	49.303	65.382	80.805	87.130	92.246
Interest expense	8.703	10.492	4.795	7.522	8.018	8.017	7.963	7.896
Interest income	3.072	6.670	1.729	0.044	2.092	4.432	7.002	9.671
Nonoperating income (Expense)	(0.034)	0.000	0.000	0.000	0.000	0.000	0.000	0.000
Earnings before taxes (EBT)	(6.869)	(3.548)	(3.369)	41.825	59.456	77.219	86.170	94.021
Tax expense	9.271	(65.434)	(0.325)	4.015	5.708	7.413	8.272	9.026
Net income before extraordinary items	(16.140)	61.886	(3.044)	37.810	53.748	69.806	77.897	84.995
After-tax extraordinary income (Expense)	0.000	(53.185)	(11.182)	0.000	0.000	0.000	0.000	0.000
Net income (NI)	(16.140)	8.701	(14.226)	37.810	53.748	69.806	77.897	84.995
Dividends-- preferred	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000
Dividends-- common	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000
Additions to RE	(16.140)	8.701	(14.226)	37.810	53.748	69.806	77.897	84.995
Balance Sheet	6/30/2017	6/30/2018	6/30/2019	6/30/2020	6/30/2021	6/30/2022	6/30/2023	6/30/2024
Assets								
Cash	172.396	110.399	70.141	59.652	56.371	54.117	52.493	51.443
Inventory	122.104	79.363	77.322	70.589	66.706	64.038	62.117	60.875
Accounts receivable	23.475	52.430	30.143	27.838	26.307	25.254	24.497	24.007
Other short-term operating assets	50.874	46.994	31.765	32.809	31.004	29.764	28.871	28.294
Short-term investments	1.298	0.873	1.451	69.732	147.718	233.409	322.360	414.072
Total current assets	370.147	290.059	210.822	260.619	328.107	406.582	490.338	578.690
Net plant, property, & equipment (PPE)	146.994	105.860	78.090	64.623	61.069	58.626	56.868	55.730
Other long-term operating assets	465.560	458.139	394.694	367.061	346.873	332.998	323.008	316.548
Long-term investments	63.726	37.616	34.170	25.253	23.864	22.909	22.222	21.778
Total assets	1046.427	891.674	717.776	717.556	759.912	821.116	892.435	972.746

Note 1: 2018 after-tax extraordinary expense of \$53.185 million was due to loss from discontinued operations, primarily asset impairment charges (\$43.0 million).

Liabilities and Equity

Accounts payable (AP)	56.049	57.738	47.532	45.733	43.218	41.489	40.245	39.440
Accruals	107.137	84.739	67.816	67.606	63.888	61.332	59.492	58.302
Other operating current liabilities	14.876	12.891	12.935	9.942	9.395	9.019	8.749	8.574
All short-term debt	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000
Total current liabilities	178.062	155.368	128.283	123.282	116.501	111.841	108.486	106.316
Long-term debt	154.703	119.229	106.537	113.569	113.562	112.783	111.839	110.798
Deferred taxes	108.119	32.229	17.924	19.387	18.321	17.588	17.060	16.719
Preferred stock	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000
Other long-term liabilities	62.383	46.417	105.848	64.325	60.787	58.356	56.605	55.473
Total liabilities	503.267	353.243	358.592	320.563	309.171	300.568	293.990	289.306
Par plus PIC Less treasury (and other adjustments)	655.551	642.121	477.100	477.100	477.100	477.100	477.100	477.100
Retained earnings (RE)	(112.391)	(103.690)	(117.916)	(80.106)	(26.359)	43.447	121.345	206.340
Total common equity	543.160	538.431	359.184	396.994	450.741	520.547	598.445	683.440
Total liabilities and equity	1046.427	891.674	717.776	717.556	759.912	821.116	892.435	972.746

Regis Corp.*In millions of USD***Statement of Cash Flows****Operating Activities**

	6/30/2017	6/30/2018	6/30/2019	6/30/2020	6/30/2021	6/30/2022	6/30/2023	6/30/2024
Net income	(16.140)	8.701	(14.226)	37.810	53.748	69.806	77.897	84.995
Depreciation	54.961	39.433	33.261	20.292	19.176	18.409	17.856	17.499
Change in deferred tax	7.950	(75.890)	(14.305)	1.463	(1.066)	(0.733)	(0.528)	(0.341)

Change in inventory	12.108	42.741	2.041	6.733	3.882	2.668	1.921	1.242
Change in accounts receivable	1.216	(28.955)	22.287	2.305	1.531	1.052	0.758	0.490
Change in other short-term operating assets	(0.008)	3.880	15.229	(1.044)	1.804	1.240	0.893	0.577
Change in accounts payable	(3.835)	1.689	(10.206)	(1.799)	(2.515)	(1.729)	(1.245)	(0.805)
Change in accruals	(12.735)	(22.398)	(16.923)	(0.210)	(3.718)	(2.556)	(1.840)	(1.190)
Change in other current liabilities	(0.683)	(1.985)	0.044	(2.993)	(0.547)	(0.376)	(0.271)	(0.175)
Net cash from operating activities	42.834	(32.784)	17.202	62.558	72.295	87.783	95.443	102.293

Investing Activities

Investment in PPE	(18.634)	1.701	(5.491)	(6.825)	(15.621)	(15.966)	(16.098)	(16.362)
Investment in other long-term operating assets	1.957	7.421	63.445	27.633	20.188	13.875	9.990	6.460
Net cash from investing activities	(16.677)	9.122	57.954	20.808	4.567	(2.091)	(6.108)	(9.902)

Financing Activities

Change in short-term investments	(0.399)	0.425	(0.578)	(68.281)	(77.986)	(85.691)	(88.951)	(91.712)
Change in long-term investments	(0.878)	26.110	3.446	8.917	1.389	0.955	0.687	0.444
Change in short-term debt	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000
Change in long-term debt	(0.097)	(35.474)	(12.692)	7.032	(0.007)	(0.778)	(0.944)	(1.042)
Preferred dividends	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000
Change in preferred stock	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000
Change in other long-term liabilities	(4.693)	(15.966)	59.431	(41.523)	(3.538)	(2.431)	(1.751)	(1.132)
Change in common stock (Par + PIC)	4.960	(13.430)	(165.021)	0.000	0.000	0.000	0.000	0.000
Common dividends	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000
Net cash from financing activities	(1.107)	(38.335)	(115.414)	(93.854)	(80.142)	(87.947)	(90.958)	(93.441)

Net cash flow	25.050	(61.997)	(40.258)	(10.489)	(3.281)	(2.255)	(1.623)	(1.050)
Starting cash	147.346	172.396	110.399	70.141	59.652	56.371	54.117	52.493
Ending cash	172.396	110.399	70.141	59.652	56.371	54.117	52.493	51.443

