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Regis Corporation (RGS) Q4 2024 Earnings Call Transcript

Aug. 28, 2024 7:33 PM ET | **Regis Corporation (RGS) Stock****SA Transcripts**

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Regis Corporation (NASDAQ:[RGS](#)) Q4 2024 Earnings Conference Call August 28, 2024 8:30 AM ET

Company Participants

Kersten Zupfer - Executive Vice President, Chief Financial Officer

Matthew Doctor - President and Chief Executive Officer

Conference Call Participants

Kersten Zupfer

Good morning, and thank you for joining the Regis Fourth Quarter and Full-Year 2024 Earnings Conference Call. I am your host, Kersten Zupfer, Executive Vice President and Chief Financial Officer. I am joined today by our President and Chief Executive Officer, Matthew Doctor. All participants are in a listen-only mode, and this conference is being recorded.

I would like to remind everyone that the language on forward-looking statements included in our earnings release and 8-K filing also apply to our comments made on the call today. These documents can be found on our website, www.regiscorp.com/investor-relations, along with the reconciliation of any non-GAAP financial measures mentioned on today's call with the corresponding GAAP measures.

With that, I will now turn the call over to Matt Doctor.

Matthew Doctor

Thank you, and good morning, everyone. I'm thrilled to be talking to you all today and to share perspectives on our next chapter here at Regis. This is my third fiscal year-end conference call as CEO, and I want to begin by reflecting on our recent achievements that have transformed the business to position it for growth.

This also marks the first time I am speaking since the conclusion of our strategic review process, which resulted in the refinancing of our debt with new lender partners, TCW and Midcap Financial. This is an outstanding result, which has reduced our indebtedness by more than \$80 million, saves us approximately \$7 million in cash interest annually and puts Regis back on solid financial foundation with right size leverage of approximately 4.5 times debt to adjusted EBITDA versus close to 8 times just two months ago.

This important milestone also has many other benefits, the first being the longer duration maturity extending from what was August 2025 to June of 2029. We have increased financial flexibility and can develop a capital allocation strategy to invest in the business and pursue growth initiatives that could not have been possible or contemplated otherwise. This removes a major distraction to our employees, franchisees and shareholders.

Importantly, management now has increased bandwidth to focus solely on the strategy and execution to grow the business itself alongside our franchisees. I can say with confidence that this is a new day and chapter for Regis in which we can finally operate as a true franchisor, as was intended all along when Regis set out on that journey to become fully franchised close to seven years ago. This is a major step for Regis and all of our stakeholders on our path to sustainable long-term growth and value creation.

Next, I want to reflect on the progress we've made during the past few years. First and foremost, we've stabilized the business and returned to profitability and strong adjusted EBITDA margins. We've gone from highly negative adjusted EBITDA in fiscal year '21 to roughly breakeven in fiscal year 2022 to \$21 million in fiscal '23 to \$26 million in fiscal 2024, with a full-year adjusted franchise EBITDA margin of 35%. The improvements were driven largely through stabilization of the business coming out of the pandemic combined with operational rigor around risk and expense management. We've done a lot of work rightsizing our G&A to match the company we have become, and this work has continued. We'll provide an update on our G&A efforts later during this call.

Second, during that period of stabilizing and returning to profitability, we further streamlined our focus and business model with an eye towards the future. The sale of our proprietary point-of-sale software system OpenSalon Pro to Zenoti further ensured that we were able to focus on our core salon business, established a long-term, sustainable technology partnership for our franchisees and provided cash proceeds that went towards deleveraging.

Third, the implementation of our NOL rights plan in January 2024 ensured that we can preserve our valuable net operating losses to offset taxable income, which proved to be valuable in our refinancing transaction, where the income from the debt forgiveness was tax-free and reflected in our results for the quarter with reported net income of over \$91 million. Along the journey, we've solidified the leadership team, adding complementary skill sets and franchise experience, all those leaders, who still form the foundation of leaders today.

And finally and importantly, we prioritized earning back trust and building relationships with our franchisees, who execute on our business day in and day out through increased dialogue and collaboration. Admittedly, we still have a lot more work to do here, as it is critical for us to continue to rally together to drive franchisee profitability and start getting more wins for their business.

While Regis Corporation is in a better state, our focus needs to be on driving our core salon business and ensuring that our franchisees are successful. Now all of these purposeful efforts culminated in a shareholder-friendly refinancing and our latest financial results, which represents major financial progress for this company.

Regis is now on its strongest financial footing in years, and I am proud of what we've accomplished, and I'm proud of the resilience and tenacity of the entire Regis team that they've shown along the way. I'd like to take a moment to acknowledge all of the employees, franchisees, vendor, lenders and shareholders for their dedication, passion, patience, work and faith shown in our team.

Let's now turn to our financial results. We continue to make strong progress on our key profitability metrics. Kersten will dive deeper into the fourth quarter and full-year results, but let me provide a few key highlights on the year. We achieved adjusted EBITDA of \$25.9 million versus \$21 million a year ago. This \$5 million improvement was driven by a continued focus on expense management, partially offset by lower revenue.

Our operating income of \$20.9 million improved \$12.1 million from \$8.8 million in fiscal year 2023. Our cash used in operations for the full-year was \$2 million, which improved from cash use of \$7.9 million in fiscal 2023. I'd like to highlight here that cash from operations in Q4 was positive \$5 million, a \$4.5 million improvement over the prior year's quarter.

And lastly, the refinancing resulted in a net gain of \$94.6 million, due to the extinguishment of our debt, which we were able to utilize our U.S. federal and state NOLs to offset the entire tax liability. While we're proud of the considerable progress made, we have more work to do. We continue to see significant net store closures as we move towards a smaller, albeit healthier salon network from a sales and profitability perspective.

We need to drive traffic and reverse a trend that has persisted over the last decade. Customer retention remains a major opportunity and stylist availability, while stable, is down over around one full-time employee per salon versus 4.5 years ago. These are the realities facing our business, which we must continue to work tirelessly to address.

Now with that said, I am encouraged by the many bright spots in our business and that for the first time since I've been CEO, we were able to go on the offensive and focused on growing the business with our full undivided focus. Speaking candidly, the last three years required a ton of blocking and tackling to fix issues in order to navigate the short-term. And we're excited to be able to take this opportunity to reset and taking a longer-term view and form of vision that is necessary to drive business transformation.

And as opposed to imparting my views for the sake of this call, I want to be very respectful of this process to ensure that, that vision is not only comprised of my thoughts, but utilizes the new data we now have access to, the recent surveys that reflect the voice of the customer and most importantly, is in collaboration with our franchisees, who are long-standing passionate partners to ensure buy-in.

While we continue to drive towards that bigger vision of what this all ladders up to, we are confident that our focused list of priorities comprises the right ingredients in addressing the challenges facing us in the current environment and forms an important foundational layer as we move towards the future.

And for the remainder of the call, I'd like to update you on the progress related to the Zenoti migration, the further work we've done on G&A management in our organization as well as what those priorities are for the year. I am proud to announce that as of the beginning of August, the Zenoti migration is complete and for the first time in years, Regis have now consolidated onto a single point-of-sale system and can finally utilize all of the scale benefits that come with this platform. This milestone solidifies Regis' execution readiness, as I have spoken about our CRM efforts for years.

However, the lack of a centralized system has been a major constraint to truly managing personalized marketing in the past. And while this marks the end of the migration journey, now is where the real work begins to utilize the data functionality to drive sales growth. Kersten will provide an update on what proceeds we are expecting from these migration efforts. And it is important to note that as opposed to under our previous credit agreement, where all proceeds were required to pay down our debt, we are no longer required to do so and are able to utilize these funds to invest in our business.

Regarding our organization and G&A. We took this new chapter as an opportunity to look hard at our organization over the last several months through the lens of what processes do we need to continue, what do we need to change, what do we need to stop and who is best suited to execute?

Earlier in this month of August, we culminated those efforts by: one, further rightsizing our organization to match our functions as franchisor; and two, ensuring we have the right people in the right roles. As a result of those moves, we have now gone back to a more brand-centric approach with multiple executive vice presidents now overseeing our core brands. We created new heads of brand roles under them, as well as newly created operational excellence roles to monitor and drive accountability and compliance. We will be investing further in systems and partners to aid in these efforts. As a result, we do have a net benefit to our G&A that Kersten will go into.

However, that in and of itself was not the goal. And I do want to take another opportunity in this forum to publicly recognize the difficulty of this decision as these reorgs are never easy. I want to thank those long-term dedicated employees, colleagues and friends for all of their contributions to Regis over the years. We would not have gotten to this point without them.

Turning to the focus areas for the future. We have significant opportunity to drive traffic back into our salons. We will look to do this by building loyalty to increase repeat visitation from existing guests and fill the funnel with new and lapsed guests as the primary drivers of sales and profitability growth for our franchisees.

Our priorities to address these goals fall into two main complementary buckets: increased operational rigor and a focused set of digital marketing initiatives. Regarding operational rigor: we must go back to basics and focus relentlessly on operational execution and foster a culture of excellence and accountability in our salons. We must do this in a targeted manner, as there is a lot that we can be doing, and quite frankly, we fall into that trap of trying to do too much in the past. And I'm trying to be extra cognizant of the changes that are being asked of our franchisees, especially just coming off of the recent point-of-sale conversion and the need to implement changes in a sustainable manner.

As we enter this new chapter as franchisor with singular focus, I've mentioned on prior calls that we were starting with our first major initiative of defining, monitoring and enforcing the components that we believe make for the proper end-to-end customer experience that we call excellence standards. Too many years have gone by without our finger on the pulse and eyes on salons, leading to the breeding of independent behaviors and an inability for us to take advantage of our size and our scale.

And while excellent standards cover the end-to-end operations, everything from salon preparation to service excellence, to how guests interact with us digitally before and after they enter our doors, where we will likely see the most immediate tangible benefits are in the facilities themselves, as the initial excellent site visits will largely be aimed at taking stock of how our fleet is showing up in addition to ensuring a consistent service menu offering.

We know how important it is to have clean great-looking salons for our customers and our stylists, especially in this highly personalized services business. Our salon image and service offering form a key element to perceive value and is the tone-setter of the experience. So we will aim to make the most inroads here to start, and over time, we will shift our efforts more towards further influencing the behaviors at the salon level. As I mentioned before, we will be starting the excellence visits in Supercuts this fall, and we'll ultimately be rolling this out to other brands as we move into calendar 2025.

The other main areas of focus for the year relates to our digital marketing efforts to drive increased customer retention and frequency, which are complementary to our operational efforts. We will start with tackling better retention of our existing guests, while also taking an initial step forward towards filling the funnel efforts by showing up better for potential new guests through search engine optimization.

To address frequency, we will leverage the fact that we are finally consolidated on a singular point-of-sale platform and utilize the personalized marketing functionality within Zenoti. The other major frequency effort is the launch of our Supercuts Rewards loyalty program and will be going live across the entire brand this fall. We are excited to take Supercuts Rewards from the initial pilot salons demonstrating 3.4% incremental traffic growth net of control to the whole system and consolidate on a singular national program for the first time versus the 400-plus independent programs that existed previously.

Ensuring that Supercuts Rewards is operationalized in our salons and driving adoption to a goal of 50% of sales through rewards members by the first-half of calendar 2025 is what we are rallying our efforts around. And based on the impact of this launch, we will explore rolling out loyalty programs to our other brands as well.

And while we have strong belief in the merits of these programs, we can't emphasize enough that the key to retaining and driving new guests starts first and foremost with the operational and service excellence I mentioned above. We will continue to report on our progress here and on our subsequent calls.

For those who have listened to our calls in the past, I also want to be clear that our efforts around stylist training, recruitment, retention, the notion of online booking and the merits of that and the broader marketing initiatives are not lost on us at all. These are, of course, ongoing efforts, but we want to be very intentional what we're highlighting here the current focus areas and acknowledge the real work required to move the needle on those items. And we will revisit how these fit into the broader long-term vision over time.

And putting this all together in a bit of an outlook for the year, while we've not provided any specific guidance historically, Kersten will be providing a bit more color on the elements of the key drivers of our business for the upcoming year.

From a high-level perspective, even with continued net closures and the softer sales, due to a combination of macro environment and the work that is required to be done in the business, we still believe that we are set up to continue to drive adjusted EBITDA growth in fiscal 2025, as well as increase our earnings per share and cash flow due to the refinancing.

Now before turning it over to Kersten, let me conclude by reiterating that this is an important moment of achievement for the company, but much work remains. Our efforts over the past three years have stabilized our finances and built a strong foundation. I am confident that we have the right team and the right franchise partners for the next stage, and I look forward to keeping you apprised of our continued progress.

And now I will turn the call over to Kersten for a detailed review of the Q4 and full year financials. Kersten?

Kersten Zupfer

Thanks, Matt. For this morning's call, I will review our fourth quarter and full-year results. In the fourth quarter and full year, we reported improved operating income, net income and earnings per share as well as improved adjusted EBITDA and cash from operations.

Reviewing the fourth quarter in more detail. Total fourth quarter revenues were \$49.4 million and declined \$6.3 million from the prior year. This revenue decline was expected and relates primarily to a reduction in franchise rental income and advertising fund revenue, which are a gross up of revenue and expense and have no impact on profitability.

Royalty and fee revenue of \$18.5 million, which represents our core business revenue, was down \$1.1 million versus the prior year fourth quarter due to the number of salon closures over the course of the last 12 months and a decrease in revenue related to terminated development agreements.

Another reflection of our revenue performance is system-wide same-store sales, which declined 1.3% in the quarter. We closed a net 149 locations, including three company-owned locations in the fourth quarter of fiscal year 2024.

We posted GAAP operating income of \$4.6 million in the fourth quarter, compared to \$3.6 million in the prior year quarter. The year-over-year increase in GAAP operating income of \$1 million was driven by a lower rent expense in the fourth quarter of fiscal year 2024, primarily related to franchise rent accruals in the fourth quarter of fiscal year 2023 that did not reoccur, partially offset by lower core business revenue. We continue to produce operating profit each quarter, and we expect that trend to continue.

We reported GAAP net income of \$91.2 million and diluted earnings per share of \$38.10 in the fourth quarter compared to a loss of \$4.8 million and diluted loss per share of \$2.07 a year ago. The majority of the improvement in the quarter was the result of the \$94.6 million net gain on the extinguishment of debt related to the debt refinance we executed in June. As it relates to the significant gain, the company utilized its U.S. federal and state NOLs to offset the entire tax liability related to the extinguishment of debt.

Now let's turn to our adjusted results, which we believe is a more representative view of the business. On an adjusted basis, fourth quarter consolidated EBITDA was \$7.4 million, compared to \$5.2 million in the prior year quarter. The \$2.2 million improvement was due primarily to lower rent expense of \$2 million, as previously discussed, the recognition of \$1.3 million of non-cash revenue related to a change in estimate for gift card breakage, partially offset by lower core franchise revenue.

Our core franchise business achieved adjusted EBITDA of \$6.1 million in the quarter, a \$600,000 increase, compared to \$5.5 million in the prior year quarter. This improvement is primarily due to lower rent expense, partially offset by lower core franchise revenue.

On an adjusted EBITDA basis, our company-owned segment reported \$1.3 million for the quarter, an improvement of \$1.6 million from the same quarter last year, primarily related to the recognition of non-cash revenue, resulting from a change in estimate for gift card breakage.

As of June 30, 2024, we had 17 company-owned locations and as of today, we have nine locations. During the three months ended June 30, we generated \$5 million of cash from operations, which is a \$4.5 million improvement from the prior three month period, primarily due to improved operating income and less cash used for working capital. With incentive compensation and other scheduled payments like insurance that get paid in the first quarter of our fiscal year 2025, cash generation may be challenged in Q1, but we do believe that we will generate cash in the second quarter and for the remainder of fiscal year 2025.

Moving to full-year results. Revenues for fiscal year 2024 were \$203 million, compared to \$233 million for the full-year fiscal 2023. Similar to the fourth quarter revenue decline, this decline was expected and relates primarily to a reduction in franchise rental income, advertising revenue and the wind down of our company-owned salons, as well as lower product sales to franchisees.

Royalties were also down due to fewer franchise locations, partially offset by system-wide same-store sales for our franchise locations of 60 basis points for the fiscal full-year. Full-year system-wide same-store sales improved 70 basis points in the year. We closed a net 455 locations, including 51 company-owned locations during fiscal year 2024.

We posted GAAP operating income of \$20.9 million in fiscal year 2024, compared to \$8.8 million in the prior year. The year-over-year increase in GAAP operating income of \$12.1 million was driven by lower rent expense, the recognition of \$1.3 million of noncash revenue related to a change in estimate for the gift card breakage and lower G&A, partially offset by lower core franchise revenue.

We reported GAAP net income of \$91.1 million and diluted earnings per share of \$38.34 in fiscal year 2024, compared to a loss of \$7.4 million and diluted loss per share of \$3.18 a year ago. The majority of the improvement was the result of a \$94.6 million net gain on the extinguishment of debt related to the debt refinance executed in June.

Adjusted EBITDA for the full-year was \$25.9 million, a \$4.9 million improvement, compared to \$21 million in fiscal year 2023. Adjusted EBITDA improved primarily due to our lower G&A expense, lower rent and recognition of the non-cash revenue related to the estimate for gift card breakage, partially offset by the \$1.1 million grant from North Carolina received last year. Adjusted G&A expense of \$45 million is down \$3.7 million due to lower compensation, legal and insurance expense and technical education spend efficiencies.

In fiscal year 2024, we used \$2 million of cash from operations, which is a \$5.9 million improvement from prior year. Excluding the \$1.1 million grant received from the State of North Carolina in fiscal year 2023, cash used in operations improved \$7 million due primarily to improved operating income and less cash used for working capital.

Turning to liquidity. Our new credit facility with TCW and Midcap Financial consists of \$105 million term loan and a \$25 million revolver. Due to the transition of our letters of credit to our new lenders, we were required to temporarily draw \$10.2 million on our line of credit to cash collateralize our letters of credit with our former lenders.

As of today, the amount drawn on our revolver is \$4.4 million, and our availability under the revolver is \$15.6 million. The draw and the reduction in availability relates to the company's letters of credit issued by our new lenders.

As a reminder, due to accounting standards, our balance sheet shows approximately \$300 million of operating lease liabilities related to liabilities associated with subleasing salons to our franchisees over the entire life of their respective leases. These liabilities are serviced by our franchisees and should not be factored in Regis' debt position. These liabilities have decreased approximately \$289 million over the last three years due to the reduction in salon count and also due to Regis moving off of franchise leases. Regis is solely responsible for lease liabilities for our corporate office space and the remaining company-owned salons, which amounts to \$9 million over the life of the leases.

As Matt mentioned, we wanted to give you some insight on key drivers of the business as we enter fiscal 2025. With the continued focus on our corporate G&A and the recent rightsizing of the organization, we expect our fiscal year 2025 G&A to be in the range of \$40 million to \$42 million and our run rate G&A to be closer to \$38 million to \$40 million.

The middle of the run rate range represents close to \$6 million of savings versus fiscal year 2024. While the \$38 million to \$40 million range represents additional investments in our business that offset savings to the extent we see opportunity to further invest in our initiatives, this range may change.

In addition to the G&A savings, we have now successfully subleased three of the four floors of our corporate office space. The sublease income of approximately \$1.2 million in fiscal year 2025 associated with the three subleases will be recorded in the other income line of our income statement.

As we've discussed on previous calls, we do expect further closure of unprofitable franchise locations. We believe that the number of salon closures will be in the same order of magnitude as fiscal year 2024, with the majority of the closures occurring in the third quarter of fiscal year 2025 as that is when many of the SmartStyle leases end.

From a cash perspective, we expect to receive additional Zenoti proceeds related to the completion of the migrations in the range of \$7 million to \$9 million. The largest driver in disparity between the originally contemplated earn-out and the realized proceeds is the fact that our franchise salon count is approximately 900 salons lower than two years ago. These proceeds will be received over the first three quarters of fiscal year 2025.

Under our new financing arrangement, as Matt mentioned, these proceeds will stay in the business and are not required to pay down debt, as they were under our previous financing arrangement.

To wrap up, we expect fiscal year 2025 adjusted EBITDA to increase and with our lower go-forward interest expense, net income and cash generation will also improve.

This concludes my prepared remarks. Please feel free to reach out to investorrelations@regiscorp.com to discuss any questions related to the business or quarterly results. I would like to thank you for your continued support and interest in Regis.

Question-and-Answer Session

End of Q&A

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