

Mossberg's Investor Digest

From the Editor...

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Headquartered in Minneapolis, 90-year-old, **Regis Corporation (NYSE: RGS)** employs more than 35,000 employees and is the largest provider of hair salon services in North America, nearly 10x larger than its nearest competitors. Last fiscal year (ending in June) 67 million haircuts/ stylings were performed at the Regis's 5,100 Company owned or 3,700 franchised locations in the United States, Canada, Puerto Rico and the UK.

After years of underperformance, the Company is undergoing significant strategic change, including the recent sale and re-franchise of 1,100 mall-based and international locations, which have been among the worst performing segments of the business. The Company is now focused on improving the performance of its value-segmented brands, growing its base of franchise locations, and growing profitability.

As the management continues to execute on its plan, our model indicates that there is \$1.00+ in earnings power for Regis in the next 2-3 years. Applying a mid's 20's multiple of earnings, yields a price 60% higher than current levels. Don't forget the CEO is well incentivized to achieve this level even earlier. Exiting fiscal 2018 (June), the bulk of the strategic changes will have been implemented and I expect that investors will begin bidding shares higher in anticipation of improving performance.

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Every month we hear ideas suggested from our large network of professional investors. Here are a few of the ideas we heard this month, but have not reviewed in detail...

Bluelinx Holdings Inc. (NYSE: BXC)– BlueLinX, is a leading distributor of building products in North America. Employing over 1,600 people, BlueLinX offers thousands of products from suppliers all over the world to service over 10,000 customers nationwide, including dealers, industrial manufacturers, manufactured housing producers and home improvement retailers. The Company operates its distribution business through a vast network of distribution centers located throughout the U.S.

Compass Diversified Holdings LLC (NYSE: CODI)- Compass Diversified Holdings LLC is a private equity firm specializing in acquisitions, buyouts, industry consolidation, recapitalization, and middle market investments. It seeks to invest in niche industrial or branded consumer companies, manufacturing, distribution, consumer products, and business services sectors. The firm prefers to invest in companies based in North America. It seeks to invest between \$100 million and \$500 million in transaction size between \$4 million and \$500 million in companies with cash flows between \$10 million and \$450 million, enterprise values between \$100 million and \$500 million, and an EBITDA between \$5 million and \$75 million.

Werner Enterprises, Inc. (Nasdaq: WERN)- Werner is a premier transportation and logistics company. Werner is among the five largest truckload carriers in the United States, with a diversified portfolio of transportation services that includes dedicated; medium-to-long-haul, regional and expedited van; and temperature-controlled. The Werner Logistics portfolio includes truck brokerage, freight management, intermodal, international, and final mile services.

Cinemark Holdings, Inc. (NYSE:CNK) – Cinemark holdings are a leader in the motion picture exhibition industry with 533 theatres and 5,957 screens in the U.S. and Latin America as of September 30, 2017. Their circuit is the third largest in the U.S. with 339 theatres and 4,562 screens in 41 states. They ranked either #1 or #2 by box office revenues in 22 of their top 30 U.S. markets as of 12/31/2016

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Best Idea Profile:

Regis Corporation (NYSE: RGS)

DESCRIPTION:

Headquartered in Minneapolis, 90-year-old, **Regis Corporation (NYSE: RGS)** employs more than 35,000 employees and is the largest provider of hair salon services in North America, nearly 10x larger than its nearest competitors. Last fiscal year (ending in June) 67 million haircuts/ stylings were performed at the Regis's 5,100 Company owned or 3,700 franchised locations in the United States, Canada, Puerto Rico and the UK.

After years of underperformance, the Company is undergoing significant strategic change, including the recent sale and re-franchise of 1,100 mall-based and international locations, which have been among the worst performing segments of the business. The Company is now focused on improving the performance of its value-segmented brands, growing its base of franchise locations, and growing profitability.

The Company's portfolio of salon concepts appeal to middle market customers and include:

- 1) 2,800 **Smart Style/Cost Cutter** salons, which are exclusively located in Walmart, and appeal to men, women and children. Less than 10% of these locations are franchised.
- 2) 2,600 **Supercuts** locations appeal to men, women and children. About two thirds of Supercuts locations are franchised.
- 3) 2,200 **Signature Style** locations, which include a variety of regional concepts that have been acquired by the company. About one third of these locations are franchised.
- 4) 860 **Regis & MasterCuts** locations, 100% of which have recently been sold and refranchised.
- 5) 250 international locations primarily in the UK, 100% of which have recently been sold and refranchised

Approximately 75% of revenue is derived from salon services (haircuts, color, styling etc.), 20% is derived from product sales (shampoo, gel, etc.) and the remaining 5% is from royalties and fees.

Regis Corporation (NYSE: RGS)

Investment Data (as of 12/29/17)

| | |
|--------------------------------|------------------|
| Recent Price | \$15.36 |
| 52-Week Range | \$9.02 - \$16.68 |
| Fiscal Year End | June |
| Dividend | N/A |
| Yield | N/A |
| Shares Outstanding | 46.6 M |
| Average Trading Volume (3 mos) | 175,000 |
| Market Capitalization | \$715 M |
| Cash | \$176 M |
| Long-term Debt | \$121 M |
| Enterprise Value (EV) | \$687 M |
| TTM Revenue | \$1.7 B |
| EV/ Revenue | 0.4x |
| FY19 EPS (consensus est.) | \$0.56 |
| P/E | 27.6x |
| 2017 EBITDA | \$91 M |
| EV/EBITDA | 7.5x |
| Book Value Per Share | \$20.78 |

In addition to its salons, the Company maintains a 55% ownership interest in Empire Education Group, one of the largest beauty schools in the country operating 89 accredited cosmetology schools in 21 states.

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KEY INVESTMENT CONSIDERATIONS:

Significant changes in leadership and governance

Targeting by activists since 2011, has led to significant change in the management team, board and corporate governance of the company. Change was certainly in order given the financial performance over the last several years. Since 2011, revenue levels have decreased by 22% and the company has accumulated \$280 million in net losses.

Board Changes – Since 2011, all seven of the company's board members have been replaced; and apart from newly appointed CEO, Hugh Sawyer, all are independent. Activist investor, Starboard Value (sold out of their position in 2014), nominated and placed three board members in 2011, one of which, David Williams remains on the board and is Chairman. Daniel Beltzman who owns Birch Run Capital (23% ownership interest in the company), was elected to the board in 2012.

Sale of underperforming assets – In 2012 the company sold its interest in The Hair Club for Men and Women for \$163.5 million and Provalliance (European salon business) for 80 million EUR. In November of this year, the company completed the sale and refranchise of its remaining European salons, as well as its mall based operations, which totaled about 1,100 salons.

A CEO who has been there and done that – Hugh Sawyer was named CEO in April of 2017, after previously serving as Managing Director of Huron Consulting Group. He supervised Huron's engagement with Regis for the six months prior to accepting the role. Mr. Sawyer held his first CEO role at the age of 34 when he was part of the team that led the LBO of BorgWarner, one of the largest LBOs of at that time. Since then he has served as CEO of eight companies. Sawyer has a 40-year career leading turnarounds, bankruptcies and merger and acquisitions for both public and private companies in many industries including several in service-intensive B2C businesses.

Alignment with creating shareholder value – In addition to his annual salary of \$950k, a sign on bonus of \$585,000, and an annual bonus potential of 115% of his base salary, Mr. Sayer received equity compensation of \$5 million (\$4 million stock appreciation rights and \$1 million of restricted stock units). However, the equity compensation only vests if the stock reaches \$22.50 per share before the second anniversary of his employment date, which represents a 110% increase in price from his start date. If it doesn't reach \$22.50 before his second anniversary, his equity comp is worthless. In other words, Mr. Sawyer stands to earn a bonus worth 5x his annual salary, but only if the stock more than doubles from his date of hire. That price represents more than 40% upside from current levels in less than 16 months.

A new management team – In just the first 6-8 months since taking over as CEO, the company has already replaced or repositioned most of its top management, which is indicative of the increased velocity of decision making. The Company created roles of President of Franchise and Vice President of Creative, as well as replaced the Chief Financial Officer, Chief Marketing Officer, Chief Human Resources Officer, Vice President of Walmart Relations and a General Counsel.

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KEY INVESTMENT CONSIDERATIONS:

Turn-around plan well under way

Sale of mall salons and UK operations – The company recently completed the sale and re-franchise of 250 UK locations as well as its 860 MasterCuts and Regis branded salons, which were primarily mall-based locations.

- **Eliminates significant losses** – These two businesses were declining at a significant rate and contributing significant losses to the company. According to the pro-forma reconciliation, revenue from these two businesses decreased 15% to \$380 million in the last fiscal year, and losses expanded from \$9.5 million to \$16.8 million. Just eliminating the losses will add \$0.25 per share to earnings.
- **Buyer will re-franchise the locations** – While there will be limited fees in the first three years, which improves the odds of the buyer's success with locations, the buyer is re-franchising these locations and will pay a tiered royalty structure giving room for upside should the locations be successfully turned around.
- **Reduces lease liability** – While there will be some residual exposure the location leases, the buyer has agreed to sublease the locations and Regis will no longer be a party to the individual leases when they are renewed by the buyer. Since the average lease term for loss-making mall based operations is less than 2 years, the residual liability will decrease over time.

Plan to improve efficiencies – Mr. Sawyer is leading a plan to help stabilize performance and establish a platform for longer term revenue and earnings growth. Our back of the envelope calculation assumes net margins improving to 4.5% of sales by 2020. While the company has not given any financial guidance, we believe our assumption is reasonable given historic profitability levels.

- Close or franchise unprofitable locations
- Removing layers of regional/ local managers
- Investment in technology, including online guest check-in, labor scheduling, and Point of Sale terminals that upgrade the guest and stylist experiences
- Reduce non-essential non-strategic G&A
- Improve the effectiveness of marketing by committing to digital advertising and expanding social media presence, including replacing the media agency

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Valuation

| | *2017 | 2018 | 2019 | 2020 |
|---------------------------------|--------------|--------------|--------------|--------------|
| Services | 997 | 947 | 947 | 947 |
| Service Growth | -2% | -5% | 0% | 0% |
| Product | 265 | 252 | 252 | 252 |
| Product Growth | | -5% | 0% | 0% |
| Royalties & Fees | 48 | 52 | 56 | 61 |
| | | 8% | 8% | 8% |
| Total Revenue | 1,310 | 1,251 | 1,255 | 1,260 |
| Total Operating Expenses | 1,276 | 1,209 | 1,190 | 1,176 |
| Operating Profit | 34 | 42 | 66 | 83 |
| Operating Margin | 2.6% | 3.4% | 5.2% | 6.6% |
| Pretax Income | 29 | 37 | 62 | 80 |
| Income Taxes | (9) | (13) | (20) | (25) |
| Net Income | 19.4 | 24.6 | 41.9 | 55.2 |
| Net Margin | | 2.0% | 3.3% | 4.4% |
| Shares (dilluted) | 47 | 47 | 47 | 47 |
| EPS | \$0.41 | \$0.52 | \$0.89 | \$1.17 |

*2017 operating income excludes \$18.8 million of adjustments to reflect one-time events.

In our back of the envelop calculation above, we use proforma numbers provided by the company following the sale of its UK and mall based salons and make the following assumptions for growth and improvement in profitability:

- **Revenue Growth** – We expect revenue will continue to decline in 2018 as management completes the first phases of its turn-around plan. In particular, we expect revenue from product and services will show the effect of closing and/or refranchising underperforming company-owned salons, and will only modestly be offset by an increase in franchise related revenue. Following 2018, we conservatively forecast revenue from company-owned stores will be relatively flat and franchise revenue will grow at a high-single digit pace of 8% per year.
- **Operating Expenses** – Since we are using the proforma numbers given by the company following the sale and refranchise of its mall based and UK Salons, the base run rate already reflects the removal of revenue and losses from those businesses. Our model shows four percentage points of improvement in operating margin, which we expect will come from higher gross margins, lower G&A costs, and a revenue mix shift to reflect a greater portion of franchise revenue, which are all derivative of management's turn-around plan.
- **Tax rate** – We use a 30% tax rate in our model, which is reflective of the most recent tax rate show in 1Q2018.
- **Shares Outstanding** – We assume no change in the share count.

As the management continues to execute on its plan, our model indicates that there is \$1.00+ in earnings power for Regis in the next 2-3 years. Applying a mid 20's multiple of earnings, yields a price 60% higher than current levels. Don't forget the CEO is well incentivized to achieve this level even earlier. Exiting fiscal 2018 (June), the bulk of the strategic changes will have been implemented and I expect that investors will be begin bidding shares higher in anticipation of improving performance.

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Mossberg's Investor Digest Idea Performance

The table below shows the relative change in the value of the ideas published since September 2015 and the Russell 2000. **Performance data quoted represents past performance and does not guarantee future results.** Current performance of ideas may be lower or higher than the performance quoted.

| Company | Pub. Date | Original Price | Recent Price | Change | Russell 2000 Change Since Pub. | Relative Perf. vs. Russell 2000 |
|---|-----------|----------------|--------------|----------------|--------------------------------|---------------------------------|
| Calloway Golf Company (NYSE: ELY). | 30-Sep-15 | \$8.39 | \$13.93 | 66.0% | 39.5% | 26.5% |
| New Gold (NYSE: NGD). | 31-Oct-15 | \$2.47 | \$3.28 | 32.8% | 32.2% | 0.6% |
| Townsquare Media (NYSE: TSQ) | 30-Nov-15 | \$11.43 | \$7.69 | -32.7% | 28.2% | -60.9% |
| Build-A-Bear Workshop (NYSE: BBW) | 31-Dec-15 | \$11.72 | \$9.25 | -21.1% | 35.2% | -56.3% |
| Dycom Industries, Inc (NYSE: DY) | 31-Jan-16 | \$62.18 | \$111.44 | 79.2% | 48.3% | 30.9% |
| Rackspace Hosting, Inc. (NYSE: RAX) | 29-Feb-16 | \$21.54 | \$32.00 | 48.6% | 48.5% | 0.0% |
| Kopin Corporation (Nasdaq:KOPN) | 31-Mar-16 | \$1.66 | \$3.21 | 93.4% | 37.8% | 55.5% |
| PAR Technology Group (NYSE: PAR) | 30-Apr-16 | \$6.39 | \$9.35 | 46.3% | 35.8% | 10.5% |
| Full House Resorts Inc. (Nasdaq: FLL) | 30-May-16 | \$1.60 | \$3.89 | 143.1% | 33.5% | 109.7% |
| Control4 Corporation (Nasdaq: CTRL) | 30-Jun-16 | \$7.99 | \$29.77 | 272.6% | 33.3% | 239.3% |
| KapStone Paper and Packaging Corporation (NYSE: KS) | 31-Jul-16 | \$14.28 | \$22.70 | 59.0% | 25.9% | 33.1% |
| Ampco-Pittsburgh Corp. (NYSE: AP) | 31-Aug-16 | \$11.12 | \$12.45 | 12.0% | 23.8% | -11.9% |
| Select Comfort Corporation (Nasdaq: SCSS) | 30-Sep-16 | \$22.51 | \$32.50 | 44.4% | 22.7% | 21.7% |
| Northwest Pipe Co. (NWPX) | 31-Oct-16 | \$13.16 | \$19.15 | 45.5% | 28.9% | 16.6% |
| Mitel Networks Corporation (Nasdaq: MITL) | 30-Nov-16 | \$7.25 | \$8.25 | 13.8% | 16.1% | -2.3% |
| Black Box Corporation (Nasdaq: BBOX) | 31-Dec-16 | \$15.25 | \$3.55 | -76.7% | 13.1% | -89.9% |
| RadNet, Inc. (Nasdaq: RDNT) | 31-Jan-17 | \$5.80 | \$10.10 | 74.1% | 12.8% | 61.4% |
| Guidance Software, Inc. (Nasdaq: GUID) | 28-Feb-17 | \$6.60 | \$7.10 | 7.6% | 10.7% | -3.2% |
| Calgon Carbon Corporation (NYSE: CCC) | 31-Mar-17 | \$14.25 | \$21.30 | 49.5% | 10.8% | 38.7% |
| LRAD Corporation (Nasdaq: LRAD) | 30-Apr-17 | \$1.51 | \$2.46 | 62.9% | 9.6% | 53.3% |
| Trecora Resources (NYSE: TREC) | 31-May-17 | \$10.65 | \$13.50 | 26.8% | 12.1% | 14.7% |
| EVINE Live Inc. (Nasdaq: EVLV) | 30-Jun-17 | \$1.00 | \$1.39 | 39.0% | 8.5% | 30.5% |
| LSI Industries Inc. (Nasdaq: LYTS) | 31-Jul-17 | \$8.38 | \$6.88 | -17.9% | 7.7% | -25.6% |
| Cooper Tire & Rubber Company (NYSE: CTB) | 31-Aug-17 | \$33.80 | \$35.35 | 4.6% | 9.3% | -4.7% |
| RealNetworks, Inc. (Nasdaq: RNWK) | 30-Sep-17 | \$4.78 | \$3.43 | -28.2% | 3.0% | -31.2% |
| NCI Building Systems, Inc. (NYSE: NCS) | 30-Oct-17 | \$15.65 | \$19.30 | 23.3% | 3.0% | 20.3% |
| TransAct Technologies, Inc. (Nasdaq: TACT) | 30-Nov-17 | \$13.60 | \$13.15 | -3.3% | -0.6% | -2.7% |
| | | | | Average | 39.4% | 21.8% |
| | | | | | | 17.6% |

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