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Via EDGAR

September 27, 2007

Securities and Exchange Commission
100 F Street, N.E.
Mailstop 3561
Washington, D.C. 20549

Attention: H. Christopher Owings
Scott Anderegg

Re: Ulta Salon, Cosmetics & Fragrance, Inc. — Amendment No. 2
Registration Statement on Form S-1
File No. 333-144405

Ladies and Gentlemen:

On behalf of Ulta Salon, Cosmetics & Fragrance, Inc., a Delaware corporation (the "Company"), we hereby transmit for filing under the Securities Act of 1933, as amended, Amendment No. 2 (the "Amendment") to the Company's Registration Statement on Form S-1 (the "Registration Statement"), including certain exhibits. The Company supplementally advises the staff (the "Staff") of the Securities and Exchange Commission (the "Commission") that it plans to file an application for confidential treatment with respect to a certain exhibit to the Registration Statement with the Secretary of the Commission concurrently with the Amendment. Courtesy copies of this letter and the Amendment (specifically marked to show changes thereto) are being submitted to the Staff by hand delivery.

The Amendment reflects the responses of the Company to comments received from the Staff in a letter from H. Christopher Owings, dated September 14, 2007 (the "Comment Letter"). Where we have revised the disclosure in the Registration Statement in response to the Staff's comments, we have noted the applicable page number of the Amendment next to the comment. In addition, certain marked copies of the Amendment provided to the Staff have been marked with the number of the response next to the corresponding text of the Amendment.

General

1. **We note your response to comment 1 in our letter dated August 3, 2007. As discussed with counsel, please ensure that you provide a price range in your next amendment.**

Response: In response to the Staff's comment, we have provided a price range in the Amendment.

Front Cover of Prospectus

2. **We note your response to comment 4 in our letter dated August 3, 2007. Please revise your disclosure to remove the names of the joint book-running managers from the front cover page. You may include this information on the back cover of the prospectus.**

Response: We supplementally advise the Staff that J.P. Morgan Securities Inc. and Wachovia Capital Markets, LLC, the two underwriters identified as joint book-running managers in the response to prior comment 4, are managing underwriters of the offering, as are Thomas Weisel Partners LLC, Cowen and Company, LLC and Piper Jaffray & Co. As such, we respectfully submit that Item 501(b)(8)(i) of Regulation S-K requires that each of J.P. Morgan Securities Inc., Wachovia Capital Markets, LLC, Thomas Weisel Partners LLC, Cowen and Company, LLC and Piper Jaffray & Co. be listed on the outside front cover page.

Prospectus Summary, page 1

3. **We note your response to comment 6 in our letter dated August 3, 2007 and we re-issue it in part. We note your chart supporting your assertion that you are "the largest beauty retailer that provides one-stop shopping for prestige, mass and salon products and services in the United States" and your statement that you "offer the widest selection of categories across prestige and mass cosmetics, fragrances, haircare, skincare, bath and body products and salon styling tools." In this regard, please provide us with copies of your source data cited in footnote 1. In addition, please explain to us the meaning of footnote 2. Please also explain by what measure you are referencing when you state that you are the largest.**

Response: In response to the Staff's comment, we have updated the chart supporting our assertion that the Company is "the largest beauty retailer that provides one-stop shopping for prestige, mass and salon products and services in the United States" and the statement that the Company "offer[s] the widest selection of categories across prestige and mass cosmetics, fragrances, haircare, skincare, bath and body products and salon styling tools." The updated chart and copies of the source data cited in footnotes to the chart are provided in Annex B hereto.

In response to the Staff's request for an explanation of footnote 2 in the above-referenced chart, we supplementally advise the Staff that Sally Beauty Holdings is comprised of two divisions — Sally Beauty Supply (a retailer) and Beauty System Group, or BSG (a distributor). For comparison purposes, we have only included Sally Beauty Supply information in the chart.

We also supplementally advise the Staff that we believe we are the largest U.S. retailer to offer products across all of the categories referenced above as measured by sales.

We also note your revised disclosure concerning the assertion that you "pioneered our unique combination of beauty superstore and specialty store attributes." In this regard, please disclose whether this information is based upon management's belief, industry data, reports/articles or any other source. If the statement is based upon management's belief, please indicate that this is the case and include an explanation for the basis of such belief. See also, "We provide affordable indulgence to our customers..." and "We provide our customers with a timely escape..."

Response: In response to the Staff's comment, we have revised the disclosure. Please see pages 1, 2, 33, 55 and 56.

We further note your revised disclosure concerning the number salons in the United States. Please provide us with a copy of the report or study by Professional Consultants & Resources. Please also provide us support for your references to the "significant changes" that have occurred to the $75 billion beauty industry.

Response: In response to the Staff's comment, we have deleted the references to 230,000 salons and to the study by Professional Consultants & Resources on pages 60 and 69, because a copy of such study is not available on a cost-effective basis. In addition, we supplementally provide in the bulleted language below the support describing the "significant changes" that have occurred in the $75 billion beauty industry which is further discussed in greater detail in the "Our Market" section of the Registration Statement on pages 60 — 63.

- Department stores, which have traditionally been the primary distribution channel for prestige beauty products, have been meaningfully affected by changing consumer preferences and industry consolidation over the past decade. From 2000 to 2006, these changes have resulted in declines in the beauty retail market share of department stores from 18% to 15% while the specialty retail channel has increased its share of the beauty retail market from 7% to 9%, according to Kline & Company (a copy of its study is included in the backup materials in Annex D hereto).

- Women, and particularly women in younger generations, tend to find department stores intimidating, high-pressured and a hindrance to a multi-brand shopping experience and, as such, are choosing to shop elsewhere for their beauty care needs. According to NPD, 55% of women aged 18 to 24 and 40% of women aged 18 to 64 shop in specialty stores. In addition, a recent NPD study (a copy of which is included in the backup materials in Annex D hereto) found that nine out of ten women who shop at specialty retailers for beauty products do so because they can touch, feel and smell the products.

- There has been an increase in the number of manufacturers of prestige beauty brands pursuing new distribution channels outside of the department store channel. Examples of these alternative distribution channels include specialty retail stores, spas and salons, direct response television (i.e., home shopping and infomercials) and the Internet. In addition, many manufacturers of smaller prestige brands are selling their products through these non-traditional channels due to the high fixed costs associated with marketing through most department stores and to capitalize on consumers' growing propensity to shop elsewhere.
- Historically, beauty manufacturers have distributed their products through distinct channels—department stores for prestige products, drug stores and mass merchandisers for mass products, and salons and authorized retail outlets for professional hair care products. Women are increasingly shopping across retail channels for their beauty products (as opposed to shopping in just one channel), and they tend to purchase both prestige and mass beauty products. We attribute this trend to a number of factors, including the growing availability of prestige brands outside of department stores and increased innovation in mass products.

4. We note your response to comment 8 in our letter dated August 3, 2007. We further note the revision that you have made to the prospectus summary. However, your disclosure continues to contain repetitive disclosures. For example, we note that your disclosure "Our competitive strengths" on page 2 contains disclosures that are identical to your disclosure on page 54. Accordingly, revise the summary to highlight each item of key information one time, and include a more complete description of each item only once in the body of your prospectus.

Response: In response to the Staff's comment, we have revised the disclosure. Please see page 2.

Risk Factors, page 9

Any significant interruption in the operations of our distribution and order fulfillment infrastructure could disrupt our ability to deliver our merchandise..., page 11

5. We note your response to comment 11 in our letter dated August 3, 2007. Your subheading does not fully describe the risk disclosed in the text. The risk you describe appears to be that you are dependent on only one distribution center and if that one distribution center experiences any significant interruption it would significantly reduce your ability to supply your stores with your products which in

turn would likely reduce your revenues. Please revise your risk factor subheading to reflect this risk.

Response: In response to the Staff's comment, we have revised the disclosure. Please see page 11.

We as well as our vendors are subject to laws and regulations that could require us to modify our current business practices..., page 15

6. **We note your response to comment 14 in our letter dated August 3, 2007. Please revise to tailor this risk to your company. As drafted you have included risk that could apply to nearly any issuer in your industry and even to other industries, like local zoning and land use restrictions and risk that are more specific to your operations, like California's "Proposition 65" and FDA and FTC regulations. This comment also refers to the risk entitled "If we fail to maintain the value of our brand..."**

   Response: In response to the Staff's comment, we have revised the disclosure. Please see pages 15 - 16. In addition, in response to the Staff's comment, we have deleted the risk entitled "If we fail to maintain the value of our brand . . ."

Management's discussion and analysis of financial condition and results of operations, page 32

7. **We note your response to comment 20 in our letter dated August 3, 2007. We note your discussion of trends in your industry and your plans to take advantage of those trends. Please expand your discussion to also include known risks, challenges or uncertainties that will have, or are reasonably likely to have, a material impact on your revenues, income, or your liquidity.**

   Response: In response to the Staff's comment, we have revised the disclosure. Please see pages 34 - 35.

Growth Strategy, page 55

8. **We note your response to comment 37 in our letter dated August 3, 2007. We continue to believe that, without additional support, your indication that you will be able to expand to 1,000 retail stores over the next 10 years is inappropriate. The support you have provided for this statement would appear to provide support for your ability to identify new locations, however, you do not speak to any other aspect**

of this goal, such as the ability to finance such expansions. Please revise to provide additional support.

Response: In response to the Staff's comment, we have revised the disclosure. Please see pages 58 - 59.

Our Market, page 57

9. **We note your response to comment 38 in our letter dated August 3, 2007. We reissue our prior comment in part. We note your submission of the referenced studies published by Kline & Company, and IBIS World Inc., a survey by American Express, and articles citing studies by NPD and Professional Consultants & Resources. We were unable to verify some of the statements attributable to these materials. We could not verify all the statements because you did not provide us a means to cross reference statements in the prospectus with the studies. Please provide copies of these studies to us, appropriately marked in a manner that cross references the support materials with your statements in your prospectus.**

Response: In response to the Staff's comment, we have marked the prospectus and copies of the studies published by Kline & Company, and IBIS World Inc., the survey by American Express, and articles citing studies by NPD to cross reference certain statements attributable to these materials. Marked copies of the source data together with an index are provided in Annex D hereto.

Compensation discussion and analysis, page 73

10. **We note your response to comment 43 in our letter dated August 3, 2007. Please expand your discussion to explain the components of the benchmark that was utilized, such as the items of compensation you have benchmarked. Please also discuss the generally and retail industry surveys that you utilized. Please also explain in terms that an average investor could understand what a binominal option valuation model is and its role in awarding compensation.**

Response: In response to the Staff's comment, we have revised the *Philosophy and overview of compensation* section to more specifically address the issues raised. Specifically, we have revised our discussion of the Compensation Committee's use of compensation consultant services to benchmark total cash compensation (salary and bonus) to the marketplace. The Compensation Committee did not consider separate components or compensation items in their review. Instead, as noted in the discussion, the Compensation Committee looked at overall compensation levels in the marketplace and increased the compensation of our executives in a commensurate manner. Please see pages 77 - 78.

We also have revised our description of the general and retail industry surveys to specifically identify the surveys used. We have deleted the reference to the binomial option valuation model, as such model has not in fact been used for making any grants to date. Please see page 78.

11. We note your response to comment 44 in our letter dated August 3, 2007. Please elaborate upon how the annual report of individual executive performance prepared by Ms. Kirby assists the Compensation Committee in determining appropriate individual compensation. Summarize the data that is provided in the annual report.

Response: In response to the Staff's comment, we have revised the *Philosophy and overview of compensation* section to more specifically describe the data contained in the annual report prepared by Ms. Kirby to assist the Compensation Committee in determining appropriate executive compensation. Please see page 78.

Summary Compensation Table, page 77

12. We note your response to comment 47 in our letter dated August 3, 2007. You include a "$" at the top in the year column. Please delete the "$" in this column.

Response: In response to the Staff's comment, we have deleted the "$" within the referenced column. Please see page 82.

Review and approval of related party transactions, name 87

13. We note your response to comment 49 in our letter dated August 3, 2007. We reissue our prior comment in part. Please revise yours discussion to indicate how you will determine whether a board member is "interested" in the transaction and what constitutes a "material economic interest." Similarly, indicate what types of transactions, if not all, will be subject to this approval process.

Response: In response to the Staff's comment, we have revised the disclosure. Please see pages 96 - 97.

<u>Financial Statements</u>

14. Please revise to update the unaudited interim financial statements to include the 26 weeks ended August 4, 2007 in accordance with Rule 3-12 of Regulation S-X.

<u>Response</u>: In response to the Staff's comment, we have updated the unaudited interim financial statements to include the period as of and for the 26 weeks ended August 4, 2007, where appropriate. Please see pages F-3, F-5, F-7, F-10 and related notes to the consolidated financial statements.

15. We note your responses to comments 51 and 57 in our letter dated August 3, 2007. Both of these comments require additional disclosure and or supplemental information related to the initial offering price of the common shares. We may have additional comment when the IPO price is available. Please update the information in Annex C to include grants subsequent to our initial comment letter.

<u>Response</u>: In response to the Staff's prior comment 51, we have added pro forma disclosure of the offering and pro forma earnings per share for the latest year and the six months ended August 4, 2007. Please see pages F-3, F-5 and F-12. We supplementally advise the Staff that we understand that the Staff may have additional comments in connection with this information.

In addition, we respectfully submit that the analysis of our response to prior comment 57 is not dependent on the price range.

We supplementally advise the Staff that we have updated the information included in<u>Annex C</u> for options granted subsequent to the initial comment letter.

In order to assist the Staff in its analysis with respect to our option grants, we are supplementally providing the Staff with the following discussion regarding the Company's valuation methodology and option grants during the 12-month period prior to filing its Registration Statement on Form S-1 on July 6, 2007. The discussion includes the methodologies used to determine the fair market value of the Company's common stock for purposes of determining the exercise price of the Company's stock options, and the events that have impacted the Company's valuation during the relevant time period. All share and per share amounts reflected hereafter are presented on a pre-split basis.

The Company has a history of issuing stock option grants to employees, directors, and others dating back to 1993 under various stock option plans as described in our Registration Statement. In accordance with our stock option plans, the Board of Directors is responsible for determining the fair market value of our common stock. To assist the Board of Directors, the Company has obtained independent third-party valuations of the fair market value of its common stock from the same nationally recognized appraisal firm on a regular basis since 2000.

The following table summarizes options granted during the twelve-month period prior to the filing of our initial Registration Statement (all numbers are shown on a pre-split basis):

Employee Option Grants July 2006 - July 2007

Grant Date	Options Granted	Option Strike Price	Underlying Share Fair Value
10/24/2006	755,000	$ 5.80	$ 5.80
12/20/2006	120,000	5.80	5.80
2/28/2007	58,000	7.52	7.52
5/15/2007	70,000	7.89	7.89
7/18/2007	388,000	9.99	9.99
7/18/2007	500,000(1)	9.99	9.99
7/18/2007	500,000(1)	16.00	9.99

(1) - Represents a grant to our Chief Executive Officer of 500,000 options at the current fair market value and 500,000 options at a price as determined by the Compensation Committee and the Board of Directors.

Valuation Methodology

As mentioned above, the Company has obtained valuation reports from the same nationally recognized third-party appraisal firm on a regular basis since 2000. For the twelve-month period prior to filing our initial Registration Statement, the Company obtained contemporaneous valuations to coincide with option grant approvals, which occurred during our regularly scheduled Board meetings.

The methodology for estimating the fair market value of the Company's common stock utilized by the third-party appraisal firm follows the guidance set forth in the AICPA's Practice Aid, Valuation of Privately-Held-Company Equity Securities Issued as Compensation. The third-party appraisal firm estimated the Company's enterprise value using both the market and income approaches. The Company's historical operating performance and projected Earnings Before Interest and Taxes (EBIT) and Earnings Before Interest, Taxes, Depreciation and Amortization (EBITDA) assumptions were consistently applied in both approaches.

The market approach uses direct comparisons of comparable publicly traded companies and the valuation of their equity securities to estimate the fair value of the common shares of privately issued securities. In determining a market-based estimate of our enterprise value, the third-party appraisal firm assessed our financial performance against a comparable set of high-growth specialty retailers. The firm developed a range of valuation multiples based on the historical and projected EBIT / EBITDA and the actual market-based enterprise valuations. This range of valuation multiples was then applied to representative levels of the Company's EBIT / EBITDA to derive an estimated market-based enterprise value. The multiples applied were consistent over the twelve-month period.

The income approach converts future economic benefits into a present value. The third-party appraisal firm used the discounted cash flow method which measured our forecasted future unlevered free cash flows based on our five year plan projections. The analysis included a sensitivity analysis surrounding the discount rate and the terminal enterprise valuation multiple applied to the cash flow forecast. The discount rates and terminal enterprise valuation multiples applied were consistent over the twelve-month period.

The following table summarizes the valuation results as provided by the third-party appraisal firm during the twelve-month period prior to filing our initial Registration Statement:

	October 16, 2006	February 12, 2007	April 30, 2007	July 7, 2007
		(in millions)		
Enterprise value from operations(1)	$ 692.6	$ 820.0	$ 827.3	$ 982.6
Adjusted enterprise value(2)	$ 574.2	$ 701.0	$ 693.5	$ 855.7
Private company liquidity discount	15.0%	10.0%	5.0%	2.5%
Net aggregate value	$ 488.1	$ 630.9	$ 658.8	$ 834.2
Diluted shares outstanding(3)	84.2	83.9	83.5	83.5
Per share value	$ 5.80	$ 7.52	$ 7.89	$ 9.99

(1) — Enterprise value from operations represents the midpoint of the market and income approach derived enterprise value estimates.

(2) — Adjusted enterprise value is defined as enterprise value from operations, adjusted for non-operating assets and liabilities, debt, accrued dividends, liquidation value of the non-convertible Series III preferred stock, and assumed option proceeds.

(3) — Includes outstanding common and preferred shares, and dilutive options.

Valuation Driver Milestones

The increases in fair market value of the Company's common stock during this 12-month period are attributed to a mix of the following:

Continued strong increases in financial performance as measured by EBITDA as included in the market valuation approach.

Decrease of the private company liquidity discount from 15.0% to 2.5% over the period to align the private company common stock fair market value to a planned 2007 IPO event.

Revisions to our rolling five year plan and the passage of time resulting in older periods being removed and replaced with higher performing periods due to the Company's forward looking growth plans. As the Company continues to achieve its growth targets, the income approach continues to reflect increases in enterprise value as determined by projected cash flows and the expected future terminal value.

Third-Party Stock Sales

In February 2007, the Company reacquired 146,348 and 214,077 of its outstanding Series I and Series II preferred stock, respectively, from BCI Growth III, L.P. (BCI), a sophisticated investor and shareholder of the Company for over 10 years. The purchase price of $5.00 per share (pre-split) was the negotiated price determined at arms length between the Company and BCI. We believe this transaction supports the Board of Directors common stock value of $5.80 applied to the October and December, 2006 option grants.

Midpoint Common Stock Value (Pre-Split)

We began to seriously consider an initial public offering in early Spring 2007 after the close of fiscal 2006. The Board of Directors approved the selection of a banking group in April 2007 and we filed our initial Registration Statement on July 6, 2007. The initial pricing provided by our two lead bank teams in September 2007 on a pre-split basis reflected a midpoint of the range of $9.48, which reflects a customary IPO discount. The prospectus cover price range of $14.00 — $16.00 reflects a reverse stock split ratio of 0.6320-for-1 from the pre-split range of $8.85 to $10.11.

Conclusion

Based on the information provided above, we believe the stock options granted during the twelve-month period prior to filing our initial Registration Statement were properly valued by the Board of Directors in all material respects. We also believe that we have taken the necessary steps, including obtaining contemporaneous independent valuations, to properly assess the fair market value of our common stock during the preceding 12-month period prior to the Company's filing of an initial Registration Statement.

* * * *

LATHAM&WATKINS LLP

If you have any questions regarding the foregoing responses or the enclosed Amendment or need additional information, please do not hesitate to contact me at (312) 876-7680 or Seth Diehl at (312) 876-7634.

Very truly yours,

/s/ Christopher D. Lueking

Christopher D. Lueking
of LATHAM & WATKINS LLP

Enclosures

cc: Gregg R. Bodnar
Robert Guttman, Esq.
Seth Diehl

ANNEX A

Marked Amendment No. 2 to the Registration Statement on Form S-1

(attached)

ANNEX B

Supporting Chart and Back-Up for
"Largest Beauty Retailer"

(attached)

Index

Specialty Retailer	Estimated sales	# of U.S. stores	U.S. debut	# of states	Average store size (square feet)	Category			
						Mass Products	Prestige products	Salon products	Salon services
ULTA	**$755[1]**	**207**	**1990**	**26**	**10,000**	✓	✓	✓	✓
Sally Beauty Supply[2]	1,419[1]	2,196	1964	48	1,700	✓	✓	✓[3]	
Bath & Body Works	1,304	1,540	1990	48	2,300	✓	✓		
The Body Shop	957[1]	322	1989	N/A	850	✓			
Sephora	850	183	1998	36	4,500		✓		
Trade Secret	253[1]	633	1982	49	1,200	✓		✓	✓
L'Occitane	296[1, 4]	148	1996	29	350	✓	✓		
Beautyfirst	100	77	1983	18	2,000		✓	✓	✓
Beauty Brands	65	50	1995	11	6,500	✓		✓	✓
Harmon	46	39	~1980	3	6,850	✓			
Ricky's	30	20	1988	2	N/A	✓			
H_2O	29	11	1989	5	1,100		✓		
Fresh	13	11	1991	4	625		✓		

Source: Company filings, company websites, Capital IQ, Factiva, Lexis/Nexis
[1] Latest actual annual sales figure
[2] Does not include BSG division
[3] Only available to customers presenting their salon professional license card
[4] Number has changed since last filing

ULTA

Ulta Salon, Cosmetics & Fragrance, Inc.
Consolidated statements of income

	Year ended			Three months ended	
(Dollars in thousands, except per share data)	January 29, 2005	January 28, 2006	February 3, 2007	April 29, 2006	May 5, 2007
				(unaudited)	
Net sales	$ 491,152	$ 579,075	$ 755,113	$ 159,468	$ 194,113
Cost of sales	346,585	404,794	519,929	108,813	134,600
Gross profit	144,567	174,281	235,184	50,655	59,513
Selling, general, and administrative expenses	121,999	140,145	188,000	41,316	47,982
Pre-opening expenses	4,072	4,712	7,096	826	1,656
Operating income	18,496	29,424	40,088	8,513	9,875
Interest expense	2,835	2,951	3,314	742	996
Income before income taxes	15,661	26,473	36,774	7,771	8,879
Income tax expense	6,201	10,504	14,231	3,071	3,560
Net income	$ 9,460	$ 15,969	$ 22,543	$ 4,700	$ 5,319
Less preferred stock dividends	11,692	12,922	14,584	3,450	3,744
Net income (loss) available to common stockholders	$ (2,232)	$ 3,047	$ 7,959	$ 1,250	$ 1,575
Net income (loss) per common share:					
Basic	$ (0.44)	$ 0.47	$ 0.87	$ 0.18	$ 0.14
Diluted	$ (0.44)	$ 0.21	$ 0.29	$ 0.06	$ 0.07
Basic weighted average number of shares of common stock outstanding	5,032,612	6,478,217	9,130,697	6,960,640	11,368,805
Diluted weighted average number of shares of common stock outstanding	5,032,612	76,297,969	79,026,350	76,617,578	80,652,941

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Key Operating Metrics

SALLY

The following table sets forth, for the periods indicated, information concerning key measures we rely on to gauge our operating performance (dollars in thousands):

	Year Ended September 30,		
	2006	2005	2004
Net sales:			
Sally Beauty Supply	$\boxed{\$1,419,332}$	$1,358,899	$1,296,057
Beauty Systems Group	953,768	895,408	801,610
	$2,373,100	$2,254,307	$2,097,667
Gross Profit	$1,086,771	$1,027,000	$ 950,853
Gross profit margin	45.8%	45.6%	45.3%
Selling, general and administrative expenses	$ 822,695	$ 789,447	$ 711,208
Operating earnings:			
Sally Beauty Supply	$ 188,786	$ 168,663	$ 151,811
Beauty Systems Group	66,928	55,584	70,895
Segment operating profit	255,714	224,247	222,706
Unallocated sales based service fee	(28,852)	(27,615)	(26,051)
Stock option expense	(5,186)	—	—
Non-cash charge related to Alberto-Culver's conversion to one class of common stock	—	(4,051)	(27,036)
Transaction expenses	(41,475)	—	—
	$ 180,201	$ 192,581	$ 169,619
Segment operating profit margin:			
Sally Beauty Supply	13.3%	12.4%	11.7%
Beauty Systems Group	7.0%	6.2%	8.8%
Consolidated operating profit margin	7.6%	8.5%	8.1%
Number of stores at end-of-period (including franchises):			
Sally Beauty Supply	2,511	2,419	2,355
Beauty Systems Group	828	822	692
	3,339	3,241	3,047
Comparable store sales growth(1)			
Sally Beauty Supply	2.4%	2.4%	3.8%
Beauty Systems Group	4.1%	(0.6)%	8.5%
Consolidated	2.8%	1.8%	4.6%

(1) Comparable stores are defined as company-owned stores that have been open for at least 14 months as of the last day of a month.

Description of Revenues and Expenses

Net Sales. Our net sales consist primarily of the following:

- *Sally Beauty Supply.* Sally Beauty Supply generates net sales primarily by selling products through its stores to both professional and retail customers. Various factors influence Sally Beauty Supply's net sales including local competition, product assortment and availability, price, hours of operation and marketing and promotional activity. Sally Beauty Supply's product assortment and sales are not seasonal in nature.
- *Beauty Systems Group.* BSG generates net sales by selling products to salon professionals and independent stylists through company-owned and franchised stores as well as through its network of professional distributor sales consultants. Various factors influence BSG's net sales, including product breadth and

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BODY SHOP

€ millions 2006	Sales	Operating profit	Operational assets [1]	Operational liabilities [2]	Investments in tangible and intangible assets	Depreciation and provisions
Professional Products	2,125.9	443.0	1,756.1	544.0	68.3	62.3
Consumer Products	7,903.5	1,421.3	5,394.4	2,162.0	379.9	341.8
Luxury Products	3,773.1	775.9	2,559.5	1,075.3	151.1	126.1
Active Cosmetics	1,127.9	220.8	785.2	281.8	30.4	33.4
Other Cosmetics	81.1	−0.8	22.4	29.2	0.7	2.9
Cosmetics divisions total	15,011.4	2,860.2	10,517.7	4,092.4	630.4	566.5
Non-allocated		−437.0	333.1	506.6	59.7	46.6
Cosmetics branch	15,011.4	2,423.2	10,850.8	4,599.0	690.0	613.0
The Body Shop branch [3]	435.0	58.3	1,371.0	65.2	47.3	28.5
Dermatology branch	343.7	59.4	342.5	74.5	19.7	24.5
Group	15,790.1	2,540.9	12,564.3	4,738.7	757.1	666.0

€ millions 2005	Sales	Operating profit	Operational assets [1]	Operational liabilities [2]	Investments in tangible and intangible assets	Depreciation and provisions
Professional Products	2,060.9	405.8	1,802.5	554.7	64.1	63.2
Consumer Products	7,499.4	1,290.4	5,460.7	2,064.5	369.5	321.9
Luxury Products	3,582.4	723.5	2,570.0	1,053.7	143.5	131.8
Active Cosmetics	985.9	187.0	719.8	247.6	22.4	31.5
Other Cosmetics	86.2	1.9	27.0	34.2	1.6	4.0
Cosmetics divisions total	14,214.7	2,608.6	10,580.0	3,954.8	601.2	552.3
Non-allocated		−396.4	326.3	549.4	57.3	46.2
Cosmetics branch	14,214.7	2,212.2	10,906.3	4,504.2	658.4	598.5
Dermatology branch	317.8	53.8	359.1	73.6	15.5	26.7
Group	14,532.5	2,266.0	11,265.5	4,577.8	673.9	625.3

€ millions 2004	Sales	Operating profit	Operational assets [1]	Operational liabilities [2]	Investments in tangible and intangible assets	Depreciation and provisions
Professional Products	1,920.4	365.4	1,654.1	523.1	77.9	57.1
Consumer Products	7,050.1	1,186.6	4,876.1	1,887.5	332.1	270.5
Luxury Products	3,449.6	693.6	2,361.9	1,026.9	116.0	123.4
Active Cosmetics	840.9	156.8	512.2	210.5	37.5	19.2
Other Cosmetics	86.8	4.0	29.5	37.7	3.6	7.3
Cosmetics divisions total	13,347.9	2,406.3	9,433.7	3,685.7	567.1	477.4
Non-allocated		−368.0	298.5	588.7	74.4	48.2
Cosmetics branch	13,347.9	2,038.3	9,732.2	4,274.3	641.4	525.6
Dermatology branch	293.4	50.6	333.6	66.4	31.5	19.9
Group	13,641.3	2,088.9	10,065.8	4,340.7	672.9	545.6

(1) Operational assets include goodwill, intangible and tangible assets, trade accounts receivable, inventories, samples, and point-of-sales advertising recorded in advance.
(2) Operational liabilities include provisions for liabilities and charges (excluding provisions for tax and restructuring), provisions for employee retirement obligation, trade accounts payable, social accounts payable and creditors.
(3) 2006 data for The Body Shop relate only to second half of the year 2006. Sales for full year 2006 would have amounted to €733.4 million.

assumes exchange rate of 1.304

Operational assets and operational liabilities can be reconciled to the 2006, 2005 and 2004 balance sheets as follows:

€ millions	2006	2005	2004		2006	2005	2004
Operational assets	12,564.3	11,265.5	10,065.8	Operational liabilities	4,738.7	4,577.8	4,340.7
Non-current financial assets	10,250.5	10,757.1	8,542.4	Shareholders' equity	14,624.2	14,657.2	11,825.4
				Non-current borrowings and loans	1,892.4	428.2	713.0
Deferred tax assets	429.8	424.8	427.9	Provision for liabilities and charges	138.9	113.1	107.4
				Current borrowings and loans	2,218.0	2,452.1	1,431.2
Other current assets	757.2	775.5	772.8	Deferred tax liabilities	512.6	914.7	1,322.2
Cash and cash equivalent	781.2	663.2	576.2	Other current liabilities	658.4	743.0	645.3
Non-allocated assets	12,218.7	12,620.6	10,319.4	Non-allocated liabilities	20,044.3	19,308.4	16,044.5
Total Assets	24,783.0	23,886.1	20,385.2	Total Liabilities	24,783.0	23,886.1	20,385.2

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TRADE SECRET

Consolidated Revenues

Consolidated revenues primarily include revenues of company-owned salons, product and equipment sales to franchisees, beauty schools revenues, hair restoration center revenues, and franchise royalties and fees. As compared to the prior fiscal year, consolidated revenues increased 8.1 percent to $2.6 billion during fiscal year 2007 and 10.8 percent to $2.4 billion during fiscal year 2006. The following table details our consolidated revenues by concept. All service revenues, product revenues (which include product and equipment sales to franchisees), and franchise royalties and fees are included within their respective concept within the table.

	For the Periods Ended June 30,		
	2007	2006	2005
	(Dollars in thousands)		
North American salons:			
Regis	$ 498,577	$ 481,760	$ 475,736
MasterCuts	174,287	174,674	172,792
Trade Secret(1)	253,250	262,862	252,934
SmartStyle	462,321	413,907	351,741
Strip Center(1)	776,995	703,345	621,008
Total North American Salons	2,165,430	2,036,548	1,874,211
International salons(1)	253,430	220,662	226,784
Beauty schools	85,627	63,952	33,911
Hair restoration centers(1)(3)	122,101	109,702	59,388
Consolidated revenues	$ 2,626,588	$ 2,430,864	$ 2,194,294
Percent change from prior year	8.1 %	10.8 %	14.1 %
Salon same-store sales increase(2)	0.2 %	0.4 %	0.9 %

(1) Includes aggregate franchise royalties and fees of $80.5, $77.9, and $79.5 million in fiscal years 2007, 2006, and 2005, respectively. North American salon franchise royalties and fees represented 48.2, 50.4, and 50.6 percent of total franchise revenues in fiscal years 2007, 2006, and 2005, respectively.

(2) Same-store sales increases or decreases are calculated on a daily basis as the total change in sales for company-owned locations which were open on a specific day of the week during the current period and the corresponding prior period. Annual same-store sales increases are the sum of the same-store sales increases computed on a daily basis. Relocated locations are included in same-store sales as they are considered to have been open in the prior period. International same-store sales are calculated in local currencies so that foreign currency fluctuations do not impact the calculation. We began including hair restoration centers in same-store sales calculations beginning with the third fiscal quarter of 2007, as we did not own or operate any hair restoration centers until December 2004. Management believes that same-store sales, a component of organic growth, are useful in order to help determine the increase in salon revenues attributable to its organic growth (new salon construction and same-store sales growth) versus growth from acquisitions.

(3) We did not own or operate any hair restoration centers until December 2004.

L'OCCITANE

CNBC EUROPEAN BUSINESS

SOAP OPERA

December 2005

L'Occitane has come from nowhere to 600 outlets in 60 countries in under a decade. The secret? An international strategy from day one. By HELEN DUNNE

EVERY 90 SECONDS SHOPPERS IN LOCATIONS AS DIVERSE as Ljubljana in Slovenia, Auckland in New Zealand or Bangkok in Thailand buy a silver tube of L'Occitane shea butter hand cream pro- duced in a factory based in the beautiful Haute Provence region of France. And each week this best-selling product gains new fans as L'Occitane, the high-street chain that started life 29 years ago as a Provence-based market stall selling rosemary essential oil, opens another store.

In September 2005 alone, the company opened new stores in Ireland, Russia, Macau, the Czech Republic and two in Japan, giving it almost 600 outlets in 60 countries to sell its natural fragrances, skincare and bodycare range. But the global ambitions of this privately owned company are far from sated. A listing on the Paris stock exchange is likely early next year, further overseas partners are being sought to facilitate the drive into virgin countries and territories, and new products are constantly in development.

UK managing director Kit Braden says: "We are not like most companies. We've done things differently. Most companies start very strongly in their home markets before expanding overseas. We were global from the very start."

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The “very start” that Braden refers to is 1996 when he and three other businessmen bought a majority shareholding in L’Occitane from its founder, Olivier Baussan, for an undisclosed sum. Baussan remains instrumental in sourcing ingredients and developing new products.

“Olivier is a romantic, a dreamer, who grew up in Provence and loves the area,” explains Braden. “He felt there was an abundance of nice things and wanted to capture the spirit of the region in a bottle. He learned some of the old-fashioned skills, such as distilling essential oils and making soap, and perfumed soap with natural perfumes.”

But Baussan’s skill in transforming locally grown lavender and verbena into body lotions and fragrances did not extend to running a business. In 1996 L’Occitane had two shops and outlets in department stores but turned over just €9m a year. Turnover today is growing at an annual compound rate of 25%, and in the year ending in March 2005 stood at €229m. converted at 1.292 = $296mm

Braden, who previously owned a packaging company, was looking for a business to develop along with several contemporaries. “We wanted something with a core range and a brand. The ethics of the brand were also important to us.” L’Occitane ticked all the boxes. Its products are 100% natural and never tested on animals.

However, Braden felt that the department store outlets diminished L’Occitane’s brand. “There was no clear policy,” he explains. “The brand was interpreted differently in every country. We had to build a cohesive brand and define it. We had to take control.”

“The brand was interpreted differently in every country. We had to build a cohesive brand and define it. We had to take control”

The shareholders closed the outlets. “We opened our first shop on Madison Avenue within weeks of taking over,” recalls Braden. “We made the decision that we would only open shops on A1 pitches. Also, because L’Occitane is a relatively small-ticket shop, we needed somewhere with a lot of people passing.”

For example, L’Occitane is on London’s prestigious, busy Regent Street but has avoided fashionable Bond Street. “You would have to sell a lot of €4 bars of soap to make that work,” explains Braden. An average-size L’Occitane store conducts 2,000 transactions a week.

THE SHAREHOLDERS WERE CONVINCED THAT THE SHOPS’ look would be vital to L’Occitane’s success, and today a L’Occitane on the high street in Kazakhstan is identical to a branch in Dubai. “We were trying to bring the good things of the Mediterranean into a rainy high street in February or a cold New York in January,” says Braden. “L’Occitane is a very sensual range, so we needed a store which excited all the senses. We used warm colours. The shops smell of fragrances.

We create an atmosphere, and you can't do that in a department store. We are not a white, clinical brand. We are a warm brand." He adds: "The assistants are trained well. We don't sell products over a counter. We want customers to wander around, to touch products. We are a tactile brand." Most of L'Occitane's packaging also in- cludes a Braille description of the product. The strategy appears to have worked. "We have done moderately well," admits Braden, "but none of the shareholders has taken a dividend from the company, and everything we have made has been ploughed back."
The four do not intend to cash in at flotation. "We only plan to float a minority of the company. Quite a lot of our employees are shareholders, and this is an opportunity for them to make some money."

If Braden and his contemporaries were driven by financial gain, they could have sold out to a myriad of multinational cosmetic companies. "Just about everybody has approached us, but we are not for sale," he says emphatically. "We only buy ingredients when we know where they come from. We would lose that sort of control. If we wrapped into a bigger business, it would be difficult to keep our sense of identity."
Its ethical stance would also be at risk. L'Occitane's shopping bags, for example, are made from recycled algae removed from Venetian canals under a programme to combat pollution. The company is also the largest employer in Manosque, France, where its factory is located, and supports traditional production methods.

The development of its range of Shea Butter products, which derive from karite nuts in the Burkina Faso region of Africa, illustrates its philosophy. "The shea tree grows slowly, but nobody is allowed to cut, beat or shake it so they must wait for the nuts to fall. The nuts then belong to the women of the tribe," explains Braden. "We run a co-operative with women from three villages. They are paid before the crop and we give guarantees on the amount of product we will take."

L'Occitane's global operations are run from six distribution centres based in London, Paris, New York, Hong Kong, Brazil and Tokyo but much of its overseas expansion has been driven by partnerships. Language difficulties in Estonia, Russia and Turkey, and import licence problems in other countries, such as Japan, made it more vi- able for L'Occitane to work with local businessmen. "We see a place and find a partner. We choose people who are enthusiastic about the brand," he explains. "We have to be convinced that they can do it before we offer them licences."

Natural charm: L'Occitane founder Olivier Baussan

L'Occitane's Japanese partner has more than 30 stores, and annual turnover in the country is growing at 50%, but his 8 predecessor struggled and the company revoked his licence. "It was an incredibly brave decision to take it back," recalls Braden. "But now our brand recognition is extremely strong in Japan. We are thrilled that L'Occitane works there; after all, Boots failed in Japan."

Partners provide all the financing for their stores, and agree to sell only L'Occitane products. "We sell them all their stock at wholesale prices, and set them performance criteria that they must achieve but they then keep the money they make," explains Braden. "We couldn't get on without them, and they couldn't get on without us. Basically, we want them to succeed."

« STYLE: DECEMBER 2005
SUCCESS IN LARGE MEASURES »

This feature is in: Fashion & Leisure

September 2007

FOOTNOTE 2

ITEM 1. BUSINESS

Introduction

We are the largest distributor of professional beauty supplies in the United States based on store count. We operate primarily through two business units, Sally Beauty Supply and Beauty Systems Group, which we refer to as BSG. Through Sally Beauty Supply and BSG, we operated a multi-channel platform of 3,169 stores and supplied 170 franchised stores in North America as well as selected European countries and Japan, as of September 30, 2006. As of September 30, 2006, Sally Beauty Supply owned and operated 2,181 stores in the United States and 2,511 stores worldwide and BSG operated 658 company-owned stores and supplied 170 franchised stores. Within BSG, we also have one of the largest networks of professional distributor sales consultants in North America, with approximately 1,200 professional distributor sales consultants who sell directly to salons and salon professionals. We provide our customers with a wide variety of leading third-party branded and private/control label professional beauty supplies, including hair care products, styling appliances, skin and nail care products and other beauty items. Sally Beauty Supply stores target retail consumers and salon professionals, while BSG exclusively targets salons and salon professionals. Over 90% of our net sales were in the U.S. and Canada for each of the last three fiscal years. For the year ended September 30, 2006 our net sales were $2,373.1 million.

Sally Beauty Supply began as a single store in New Orleans in 1964 and was purchased in 1969 by our former parent company, Alberto-Culver Company, or Alberto-Culver. BSG became a subsidiary of Alberto-Culver in 1985. On November 16, 2006, we separated from Alberto-Culver and became an independent company traded on the New York Stock Exchange. Our separation from Alberto-Culver and its consumer products-focused business was pursuant to an investment agreement, dated as of June 19, 2006, as amended, among us, Alberto-Culver, CDRS Acquisition LLC and others. We were formed as a Delaware corporation in June of 2006 in connection with this transaction to be the ultimate parent of Sally Beauty Supply and BSG and other subsidiaries following the separation. When we refer to Alberto-Culver, we mean Alberto-Culver Company prior to the separation or the company from which we separated, which is currently a separate public company, as the context requires.

In connection with the separation from Alberto-Culver, CDRS Acquisition LLC, or CDRS, and CD&R Parallel Fund VII, L.P., which we refer to as Parallel Fund and which we refer to together with CDRS as the CDR investors, invested an aggregate of $575 million in cash equity, representing ownership subsequent to the separation of approximately 48% of the outstanding shares of our common stock on an undiluted basis. CDRS, which owns approximately 47.7% of the outstanding shares of our common stock on an undiluted basis, is a Delaware limited liability company organized by Clayton, Dubilier & Rice Fund VII, L.P., a private investment fund managed by Clayton, Dubilier & Rice, Inc. Also in connection with the separation from Alberto-Culver, certain of our subsidiaries incurred approximately $1.85 billion of indebtedness, as more fully described below.

Professional Beauty Supply Industry

We operate primarily within the large and growing U.S. professional beauty supply industry. Potential growth in the industry is expected to be driven by demographic and fashion trends, which we expect will lead to increased usage of hair color, hair-loss prevention products and hair styling products.

The professional beauty supply industry serves end-users through four channels: full-service exclusive distribution, open-line distribution, direct and mega-salon stores.

Full Service/Exclusive

This channel exclusively serves salons and salon professionals and distributes "professional-only" products for use and re-sale to consumers in salons. Many brands are distributed through arrangements with suppliers by geographic territory. BSG is a leading full-service distributor in the U.S.

Open-Line

This channel serves retail consumers and salon professionals through retail stores. This channel is served by a large number of localized retailers and distributors, with only a few having a regional presence and significant market share. We believe that Sally Beauty Supply is the only open-line distributor in the U.S. with a national network of retail stores.

Direct

This channel focuses on direct sales to salons and salon professionals by large manufacturers. This is the dominant form of distribution in Europe, but represents a small channel in the U.S. due to the highly fragmented nature of the U.S. market, which tends to make direct distribution cost prohibitive for manufacturers.

Mega-Salon Stores

In this channel, large-format salons are supplied directly by manufacturers due to their large scale.

Key Future Industry Trends

We believe the following key industry trends and characteristics will influence our business, going forward:

High Level of Customer Fragmentation

The U.S. salon market is highly fragmented with over 230,000 salons. Given the fragmented and small-scale nature of the salon industry, we believe that salon operators will continue to depend on full service/exclusive distributors and open-line channels for a majority of their beauty supply purchases.

Growth in Booth Renting

Many professional stylists are individual operators who rent booth space from salons, which we refer to as "booth renters," and are responsible for purchasing their own supplies. Over time, the number of booth renters has significantly increased as a percentage of total salon professionals, and we expect this trend to continue. Given their smaller individual purchases and relative capital constraints, booth renters are likely to be dependent on frequent trips to professional beauty supply stores, like those that BSG and Sally Beauty Supply operate.

Frequent Re-Stocking Needs

Salon professionals primarily rely on just-in-time inventory due to capital constraints and a lack of warehouse and shelf space at salons. These factors are key to driving demand for conveniently located professional beauty supply stores.

Continuing Consolidation

There is continuing consolidation among professional beauty product distributors and among professional beauty supply manufacturers. We believe that suppliers are increasingly likely to focus on larger distributors and retailers with broader scale and a retail footprint. We also believe that we are well positioned to capitalize on this trend as well as to participate in the ongoing consolidation at the distributor / retail level. However, changes often occur in our relationships with suppliers that positively or negatively affect the net sales and operating profits of each business segment. Consolidation among suppliers could exacerbate the effects of these relationship changes and could increase pricing pressures. See "Risk Factors—We depend upon manufacturers who may be unable to provide products of adequate quality or who may be unwilling to continue to supply products to us."

Favorable Demographic and Consumer Trends

The aging baby-boomer population is expected to drive future growth in professional beauty supply sales through increased usage of hair color and hair-loss products. Additionally, continuously changing fashion-related trends that drive new hair styles are expected to result in continued demand for hair styling products.

Business Segments, Geographic Area Information and Seasonality

We operate two business segments: (1) Sally Beauty Supply, a domestic and international open-line distributor of professional beauty supplies offering professional beauty supplies to both retail consumers and salon professionals, and (2) BSG, a full-service beauty supply distributor offering professional brands directly to salons and salon professionals through our own sales force and professional-only stores, many in exclusive geographical territories in North America. BSG also franchises beauty supply outlets in the United States and Mexico, and supplies sub-distributors in Europe. Sales of Sally Beauty Supply accounted for approximately 60%, 60% and 62% of the company's consolidated net sales for the years ended September 30, 2006, 2005 and 2004, respectively. BSG accounted for approximately 40%, 40% and 38% of the company's consolidated net sales for the years ended September 30, 2006, 2005 and 2004, respectively.

Financial information about business segments and geographic area information is incorporated herein by reference to the "Business Segments and Geographic Area Information" note 18 of the "Notes to the Consolidated Financial Statements" in "Item 8—Financial Statements and Supplementary Data" of this report.

Neither the sales or product assortment for Sally Beauty Supply or BSG are seasonal in nature.

Sally Beauty Supply

Sally Beauty Supply is the largest open-line distributor of professional beauty supplies in the U.S. based on store count. It carries an extensive selection of professional beauty products, ranging between 5,400 and 7,400 stock keeping units ("SKUs") of beauty products, including hair care, nail care, beauty sundries and appliances. It targets retail consumers and salon professionals. We believe that Sally Beauty Supply has differentiated itself from its competitors through its attractive customer value proposition, attractive pricing, extensive selection of leading third-party branded and private label products, broad ethnic product selection, excellent product knowledge of its sales associates and convenient store locations.

Store Design and Operations

Sally Beauty Supply stores are designed to create an appealing shopping environment that embraces the retail consumer and salon professional and highlights its extensive product offering. Sally Beauty Supply stores average 1,700 square feet in size and are located primarily in strip shopping centers. Generally, Sally Beauty Supply stores follow a consistent format, allowing customers familiarity between Sally Beauty Supply locations.

Sally Beauty Supply stores are segmented into distinctive areas arranged by product type with signs allowing its customers to easily navigate through its stores. Sally Beauty Supply seeks to stimulate cross-selling and impulse buying through strategic product placement and use the front of the store to highlight new products and key promotional items.

Merchandise

Sally Beauty Supply stores carry a broad selection of branded and private label beauty supplies. Sally Beauty Supply manages each category by product and by SKU and uses centrally developed planoguides to maintain a consistent merchandise presentation across its store base. Through its information systems, Sally Beauty Supply actively monitors each store's category performance, allowing maintenance of consistently high levels of in-stock merchandise. We believe Sally Beauty Supply's tailored merchandise strategy enables it to meet local demands and helps drive traffic in its stores. Additionally, its information systems track and automatically replenish inventory levels, generally on a weekly basis.

Sally Beauty Supply offers a comprehensive ethnic product selection with specific appeal to the African-American markets. Its ethnic product offerings are tailored by store based on market demographics and category performance. For example, sales to the African-American markets represent approximately 11% of net sales in Sally Beauty Supply's U.S. stores. We believe the breadth of selection of ethnic products available in Sally Beauty Supply Stores is unique and differentiates its stores from its competition. Sally Beauty Supply also positions itself to be competitive in price, but not a discount leader.

Sally Beauty Supply's pricing strategy is differentiated by customer segment. Professional salon customers are generally entitled to a price lower than that received by retail customers. Sally Beauty Supply does offer discounts to retail customers through its customer loyalty program.

Leading Third-Party Branded Products

Sally Beauty Supply offers an extensive selection of hair care products, nail care products, beauty sundries and appliances from leading third-party brands such as Clairol, L'Oreal, Revlon and Conair. We believe that carrying a broad selection of the latest premier branded merchandise is critical to maintaining long-term relationships with our valued customers. The merchandise Sally Beauty Supply carries includes products from one or more of the leading manufacturers in each category. Sally Beauty Supply's objective is not only to carry leading brands, but also to carry a full range of branded and private label products within each category. As hair trends continue to evolve, we expect to offer the changing professional beauty product assortment necessary to meet the needs of retail consumers and salon professionals.

Private Label Products

Sally Beauty Supply offers a broad range of private label and controlled label products, which we generally refer to collectively as private label products, unless the context requires otherwise. Private label products are brands for which we own the trademark and in some instances the formula. Controlled label products are brands that are owned by the manufacturer for which we have been granted sole distribution rights. Private label products, including controlled label products, provide customers with an attractive alternative to higher-priced leading third-party brands. Private label products accounted for approximately 37% of Sally Beauty Supply's net sales as of September 30, 2006. Generally, the private label brands have higher gross margins than the leading third-party branded products and we believe this area offers significant potential growth. Sally Beauty Supply maintains private label products in a number of categories including hair care, appliances and salon products. Sally Beauty Supply actively promotes its private label brands through in-store promotions and monthly flyers. We believe our customers perceive these private label products to be comparable in quality and name recognition to leading third-party branded products.

The following table sets forth the approximate percentage of Sally Beauty Supply's sales by merchandise category:

	Year Ended September 30, 2006
Hair care	21.1%
Hair color	20.1%
Skin and nail care	16.1%
Electrical appliances	14.3%
Brushes, cutlery and accessories	13.4%
Ethnic products	10.7%
Other beauty items	4.3%
Total	100.0%

Marketing and Advertising

Sally Beauty Supply's marketing program is designed to promote its extensive selection of brand name products at competitive prices. The program is currently centered on multi-page, color flyers highlighting promotional products. Separate flyers are created and tailored to Sally Beauty Supply's retail customers and salon professionals. These flyers, which are available in Sally Beauty Supply stores, are also mailed to loyalty program customers and salon professionals on a monthly basis and are supplemented by e-mail newsletters. Additionally, a Sally Beauty magazine that provides customers with beauty trends and product information is sold in Sally Beauty Supply stores.

Sally Beauty Supply's customer loyalty and marketing programs allow Sally Beauty Supply to collect point-of-sale customer data and increase our understanding of customers' needs. The Sally Beauty Club is a loyalty program for customers who are not salon professionals. Beauty Club members, after paying a small annual fee to join, receive a special, discounted price on almost every non-sale item. Members are also eligible for a special Beauty Club e-mail newsletter that contains additional savings, beauty tips, new product information and coupons. Beauty Club customers are rewarded with additional discounts as their store spending increases. The ProCard is a marketing program for salon professionals. ProCard members receive discounts on all beauty products sold at Sally Beauty Supply stores. We believe these programs are highly effective in developing and maintaining customer relationships.

Store Locations

Sally Beauty Supply selects geographic markets and store sites on the basis of demographic information, quality and nature of neighboring tenants, store visibility and location accessibility. Sally Beauty Supply seeks to locate stores primarily in strip malls, which are occupied by other high traffic retailers including grocery stores, mass merchants and home centers.

Sally Beauty Supply balances its store expansion between new and existing markets. In its existing markets, Sally Beauty Supply adds stores as necessary to provide additional coverage. In new markets, Sally Beauty Supply generally seeks to expand in geographically contiguous areas to leverage its experience. We believe that Sally Beauty Supply's knowledge of local markets is an important part of its success.

The following table provides a history of Sally Beauty Supply store openings since the beginning of fiscal year 2002:

	Year Ended September 30,				
	2006	2005	2004	2003	2002
Stores open at beginning of period	2,419	2,355	2,272	2,177	2,112
Net store openings during period	92	62	83	95	64
Stores acquired during period	—	2	—	—	1
Stores open at end of period	2,511	2,419	2,355	2,272	2,177

Beauty Systems Group

We believe that BSG is the largest full-service distributor of professional beauty supplies in the U.S. As of September 30, 2006, BSG operated 658 company-owned stores, supplied 170 franchised stores and had a sales force of approximately 1,200 professional distributor sales consultants selling exclusively to salons and salon professionals in 43 U.S. states and portions of Canada, Mexico and certain European countries.

Store Design and Operations

BSG stores are designed to create a professional shopping environment that embraces the salon professional and highlights its extensive product offering. Company-owned BSG stores average 2,800 square feet and are located primarily in secondary strip shopping centers. BSG store layout is designed to provide optimal variety and options to the salon professional. Stores are segmented into distinctive areas arranged by product type with certain areas

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dedicated to leading third-party brands; such as Matrix, Redken, Paul Mitchell, Graham Webb, Rusk and TIGI. The selection of these varies by territory.

Professional Distributor Sales Consultants

BSG has a network of approximately 1,200 professional distributor sales consultants, which exclusively serve salons and salon professionals.

The number of consultants in the BSG network has increased since fiscal 2002, as set forth in the following table:

	Year Ended September 30,				
	2006	2005	2004	2003	2002
Professional distributor sales consultants	1,192	1,244	1,167	989	930

In order to provide a knowledgeable consultant team, BSG actively recruits professional cosmetologists and individuals with sales experience, as we believe that new consultants with either broad knowledge about the products or direct sales experience will be more successful.

BSG provides extensive training to new consultants beginning with an intensive one-week training program, followed by an extensive, continuing program of media-based training, delivered through audio, video and web-based e-learning. The program is designed to develop product knowledge as well as techniques on how best to serve salon professionals. In addition to selling professional beauty products, these sales consultants offer in-store training for professionals and owners in areas such as new styles, techniques and business practices.

An important component of consultants' compensation is sales commissions. BSG's commission system is designed to drive sales and focus consultants on selling products that are best suited to individual salons and salon professionals. We believe our emphasis on recruitment, training, and sales-based compensation results in a sales force that distinguishes itself from other full service/exclusive-channel distributors.

The following tables sets forth the approximate percentage of BSG sales attributable by channel:

	Year Ended September 30, 2006
Company-owned retail stores	47.5%
Professional distributor sales consultants	37.2%
Franchise stores	15.3%
Total	100.0%

Merchandise

BSG stores carry a broad selection of branded beauty supplies, ranging between 3,700 and 9,500 SKUs of beauty products, including hair care products, nail care, appliances and other beauty items from leading third-party brands. Some products are available in bulk packaging for higher volume salon needs. Through BSG's information systems, each store's product performance is actively monitored, allowing maintenance of an optimal merchandise mix. Additionally, BSG's information systems track and automatically replenish inventory levels on a weekly basis, enabling BSG to maintain high levels of product in stock. Although BSG positions itself to be competitive on price, its primary focus is to provide a comprehensive selection of branded products to the salon professional. Many BSG products are sold under exclusive arrangements with suppliers, whereby BSG is designated the sole distributor for a specific brand name within certain geographic territories. We believe that carrying a broad selection of the latest premier branded merchandise is critical to maintaining relationships with our valued professional customers.

The following table sets forth the approximate percentage of sales attributable by merchandise category:

	Year Ended September 30, 2006
Hair care	36.7%
Hair color	23.6%
Promotional items	19.1%
Skin and nail care	8.3%
Electrical appliances	5.6%
Brushes, cutlery and accessories	3.5%
Other beauty items	2.2%
Ethnic products	1.0%
Total	100.0%

Marketing and Advertising

BSG's marketing program is designed to promote its extensive selection of brand name products at competitive prices. BSG distributes at its stores and mails to its salon and salon professional customers, multi-page color flyers that highlight promotional products. Some BSG stores also host monthly manufacturer-sponsored classes for customers. These classes are held at BSG stores and led by manufacturer-employed educators. Salon professionals, after paying a small fee to attend, are educated on new products and beauty trends. We believe these classes increase brand awareness and drive sales in BSG stores.

Store Locations

BSG stores are primarily located in secondary strip shopping centers. Although BSG stores are located in visible and convenient locations, salon professionals are less sensitive about store location than Sally Beauty Supply customers.

The following table provides a history of BSG store openings since the beginning of fiscal year 2002:

	Year Ended September 30,				
	2006	2005	2004	2003	2002
Stores open at beginning of period	822	692	543	535	316
Net store openings during period	6	37	26	8	24
Stores acquired during period	—	93	123	—	195
Stores open at end of period					

ANNEX C

Schedule of Option Grants

PRE-SPLIT

Grant Date	Strike Price	Options Granted
2/26/2004	$ 1.65	628,029
5/18/2004	1.65	254,000
6/21/2004	1.65	550,000
7/15/2004	1.65	235,000
10/26/2004	1.65	406,000
		2,073,029
7/19/2005	2.10	1,115,815
10/25/2005	2.10	197,000
		1,312,815
4/26/2006	2.60	1,230,000
10/24/2006	5.80	755,000
12/20/2006	5.80	120,000
		2,105,000
2/28/2007	7.52	58,000
5/15/2007	7.89	70,000
7/18/2007	9.99	888,000
7/18/2007	16.00	500,000
		1,516,000

POST-SPLIT

Grant Date	Strike Price	Options Granted
2/26/2004	$ 2.61	396,914
5/18/2004	2.61	160,528
6/21/2004	2.61	347,600
7/15/2004	2.61	148,520
10/26/2004	2.61	256,592
		1,310,154
7/19/2005	3.32	705,195
10/25/2005	3.32	124,504
		829,699
4/26/2006	4.11	777,360
10/24/2006	9.18	477,160
12/20/2006	9.18	75,840
		1,330,360
2/28/2007	11.90	36,656
5/15/2007	12.48	44,240
7/18/2007	15.81	561,216
7/18/2007	25.32	316,000
		958,112

ANNEX D

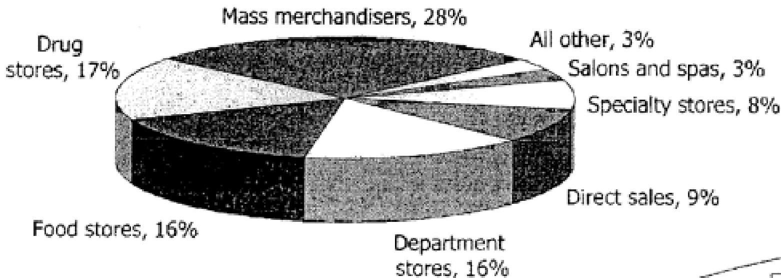
Market Studies and Surveys
(Marked, with Index)

(attached)

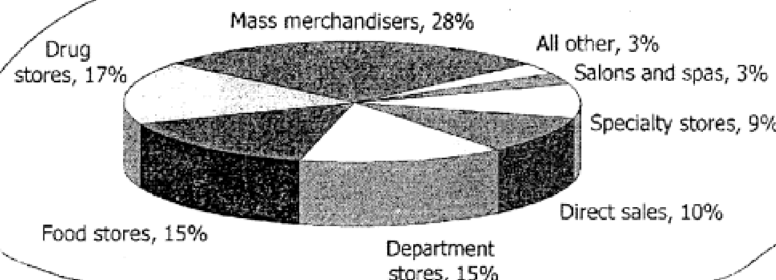
S-1 page #	Relevant data	Annex D page #
Page 60	**Market size**	
	$35 bn beauty products industry - Kline & Co.	Page 1
	$40 bn salon services industry - IBISWorld	Page 18
	Changes in consumer shopping preferences	
	2000 - Kline & Co.	Page 3
	2006 - Kline & Co.	Page 1
Page 61	**Changes in consumer shopping preferences**	
	2000 - Kline & Co.	Page 3
	2006 - Kline & Co.	Page 1
	Specialty retailers	
	NPD reference from WWD	Page 54
	Reasons to shop at specialty stores	
	NPD	Page 48
Page 62	**Generation X**	
	American Express	Page 11
	Generation Y	
	U.S. Census	Page 49
Page 69	**Changes in consumer shopping preferences**	
	2000 - Kline & Co.	Page 3
	2006 - Kline & Co.	Page 1

U.S. SALES OF COSMETICS AND TOILETRIES BY RETAIL CHANNEL, 2005 AND 2006

2005 **Total: $33.6 billion**



2006 **Total: $34.7 billion**



*

Kline

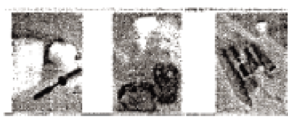
IN PROGRESS

Beauty Retailing USA 2006

Revitalization and Recovery

Kline's seventh-edition report on the dynamic retailing environment for cosmetics and toiletries. Issues and challenges to be addressed include:

- What will be the impact of the divestiture of May Co.?
- Estée Lauder's Beauty Bank: Is Coach the next frontier?
- Is Wal-Mart scaling back in beauty?
- Are Skincare Centers the solution for CVS?
- Will Sephora put J.C. Penney on the map again?



Kline

www.klinegroup.com

Beauty Retailing USA 2006

The U.S. market for cosmetics and toiletries registered a 3.5% sales gain in 2005, the largest increase in the last five years. Several factors contributed to this healthy performance, ranging from heightened demand for anti-aging products to renewed innovation in previously stale categories.

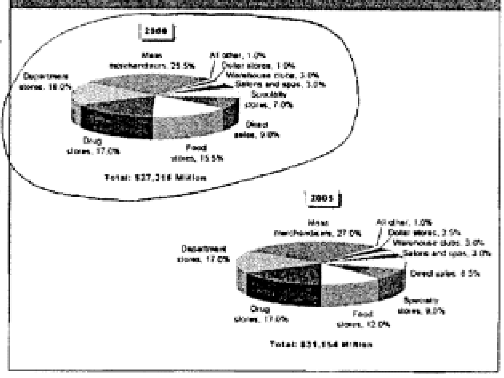
While some channels such as department stores and food stores have lost share, as shown in Figure 1, mass merchandisers continue to make inroads by carrying pricier brands and attempting to cater to a more affluent customer.

The specialty store channel got a boost early in the year with the announcement of L'Oréal's purchase of The Body Shop. And many marketers are waiting to see what impact Federated Department Stores' acquisition of its rival May Department Stores will have on the industry.

For many marketers, the key to successful retailing is diversification into new channels. An example of this is the emergence of professional skin care brands in drug stores. For years, premium-priced brands such as La Roche-Posay have been sold mainly by medical care providers, but outlets like CVS Skincare Centers are changing this.

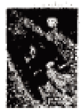
Figure 1

U.S. SALES OF COSMETICS AND TOILETRIES BY RETAIL CHANNEL, 2000 AND 2005



Beauty Retailing USA 2006 will provide subscribers with insights into retailing challenges and opportunities that have contributed to the overall gains made in this mature market. The report will analyze the latest developments, including the impact of J.C. Penney's new partnership with Sephora and other mergers, acquisitions, and joint ventures.

As in previous editions, it will analyze the major purchase channels, product categories, and retailers in the U.S. market, providing an accurate, detailed examination of the competitive landscape for cosmetic and toiletry products at the retail level.



Report Outline

1. INTRODUCTION
2. EXECUTIVE SUMMARY
3. PURCHASE CHANNELS

   A review of all purchase channels for cosmetics and toiletries, with detailed descriptions and analysis for each channel shown in Table 1. Each profile includes the following:

   - Channel developments
   - Sales and analysis by subclass
   - Number of doors/stores
   - Leading retailers
   - Role of cosmetics and toiletries
   - Manufacturers' sales by product category for 2001 and 2006
   - Retail sales by product category for 2001 and 2006
   - Promotional and advertising activity
   - Role of private-label products
   - Outlook to 2011

4. PRODUCT CATEGORIES

   Profiles will be given for each of the categories listed in Table 2. Information provided in each category profile includes the following:

   - Historical overview
   - Key developments and shifts
   - Analysis by purchase channel
   - Manufacturers' sales by purchase channel for 2001 and 2006
   - Retail sales by purchase channel for 2001 and 2006
   - Outlook to 2011

5. RETAILER PROFILES

   Profiles of 10 retailers (as shown in Table 3) will be provided with specific discussion pertaining to the cosmetic and toiletry business of these companies. Profiles will include:

   - Overview
   - Corporate sales
   - Number of stores
   - Competitive focus and strengths
   - Role of cosmetics and toiletries
   - Role of private-label products
   - Recent developments
   - Marketing activities
   - Outlook to 2011

Beauty Retailing USA 2006

Table 1 PURCHASE CHANNELS	
Department stores ■ Low-end (e.g., Sears, J.C. Penney, Kohl's) ■ Traditional (e.g., Macy's, Dillard's) ■ Specialty (e.g., Nordstrom, Neiman Marcus)	**Food outlets** ■ Traditional supermarkets ■ Superstores ■ Food/drug combination stores ■ Supercenters/combo stores ■ Convenience stores
Direct marketing ■ Person-to-person ■ Home shopping networks ■ Informercials ■ E-commerce ■ Catalogs and other direct response	**Mass merchandisers**
Dollar stores ■ Chain dollar stores ■ Independents	**Specialty stores** ■ Vertically integrated (e.g., Bath & Body Works, Origins) ■ Cosmetic specialty (e.g., Sephora, Sally Beauty, Ulta) ■ Apparel (H&M, Banana Republic)
Drug outlets ■ Chain drug stores ■ Independents	**Warehouse clubs**

Table 2 PRODUCT CATEGORIES	
Fragrances ■ Fragrances for men ■ Fragrances for women	**Hair Care** ■ Ethnic hair care products ■ Hair coloring products ■ Hair styling products ■ Shampoos and conditioners
Skin Care ■ Bath additives ■ Facial treatments ■ Hand and body creams, lotions,and treatments ■ Sun care products	**Color Cosmetics** ■ Includes blushers, eye makeup, make-up bases, face powders, lipsticks, and nail polishes (Color cosmetics are analyzed as single category, given that the distribution patterns for individual products are similar)
Oral Care ■ Mouthwashes ■ Toothpastes	**Other Toiletries** ■ Deodorants and antiperspirants ■ Personal cleansing products

Table 3 RETAILER PROFILES	
The Body Shop	Federated Department Stores
BJ's Wholesale Club	J.C. Penney
C.O. Bigelow	Nordstrom
CVS	Target
Drugstore.com	Trader Joe's

Beauty Retailing USA 2006

Objectives

The objectives of **Beauty Retailing USA 2006** are to provide subscribers with an accurate and independent assessment of cosmetic and toiletry purchase channels and, most importantly, to deliver the information and insights required to capitalize on changes in these channels.

To complete these objectives, Kline will analyze the market for cosmetics and toiletries by conducting extensive primary research with retail executives, buyers, distributors, sales representatives, manufacturers, and marketers in the beauty products industry.

Based on this research, together with information from Kline's databases and previously published market research reports, the study will present an objective and pragmatic assessment of issues confronting marketers today.

Sources and Methodology

Members of Kline & Company's Consumer Products practice will conduct the research and analysis for **Beauty Retailing USA 2006.** Using previous editions of our retailing series, as well as our **Cosmetics & Toiletries USA** annual service and other marketing data as a foundation, the sources of data for the study will consist of the following:

- In-person and telephone interviews with retail executives, category managers/buyers, store/counter managers, distributors, sales representatives, manufacturers, marketers, trade organizations, and consumers
- A review of pertinent secondary materials, including annual reports, 10-Ks, company literature and other reports, product literature, trade publications, and nonconfidential information from Kline's extensive database
- Store and Web site checks to obtain information on product selection and availability, display and sales techniques, and other merchandising trends

Forecasts in this report will be generated with Kline's FutureView Scenario Forecasting Model. With the enhanced forecasts, subscribers can see how adjustments in the assumptions behind the forecasts can bring about different outcomes.

Tentative Schedule

The report is scheduled for publication in the second quarter of 2007. Draft sections can be made available to subscribers prior to final publication.

Subscription Terms and Privileges

Beauty Retailing USA 2006 is available only by subscription. In order to maximize the value and usefulness of this report to each subscriber, the following privileges and services will be made available:

- An **executive summary presentation** to be given by the project team, either in-person or via Web conference.
- **One day of consultation** with members of the project team to be used at the client's discretion within six months of receipt of the report. This meeting can be used as a company-specific work session to help each subscriber obtain maximum value from the program. Expenses related to any travel made at the request of the subscriber are to be reimbursed by the subscriber.
- **Hard copy, online, and pdf versions** of the report. The standard subscription includes one hard copy, the report contents in pdf format, and unlimited online access to the report contents through KlineOnline.com for members of the subscribing company. Additional hard copies will be available for a nominal fee.
- A **discount** from the standard price for companies subscribing to the report before it is completed.

Details regarding subscription options and rates are described in the attached subscription agreement. To subscribe now, please complete the subscription agreement and forward it to our offices. For more details on the study program, please contact us at any of our locations listed on the back cover.

Credentials

Kline & Company is an international management consulting and market research firm offering a broad range of services to the consumer products, cosmetics and toiletries, and chemicals industries.

Established in 1959 as a specialist in the chemicals field, Kline has evolved over the past four decades to provide consulting services and syndicated market research reports across the entire value chain. We help management solve practical problems in marketing strategies, acquisition and divestiture programs, and the appraisal of new technology. Kline provides clients with facts, forecasts, and recommended solutions to business problems, based solidly on the realities of the market as well as modern strategic principles.

Through our Consumer Products practice, Kline has attained a leadership position in providing consulting services to the consumer products industry. Our firm has developed in-depth expertise in this area by tracking and analyzing U.S. markets for cosmetics, toiletries, fragrances, and household products for more than 40 years.

In addition to our resources in the finished goods sector, Kline has a thorough understanding of the markets for specialty raw materials for consumer products through our Specialty Chemicals practice.

The Consumer Products Practice has published its Cosmetics & Toiletries USA syndicated report annually since 1980. Beauty Retailing USA, now in its seventh edition, was first published in 1992. These reports are considered the authoritative source of information on the U.S. personal care market. A partial list of other recently published syndicated analyses by the Consumer Products Practice and those currently under consideration is shown below:

- Global Cosmetics and Toiletries
- Competitor Cost Structures
- Home Fragrances USA
- Household Cleaning Products USA (annual service)
- Professional Skin Care
- Salon Hair Care USA
- The U.S. Male Grooming Market

Subscription Agreement

Please enter our subscription to your comprehensive study ***BEAUTY RETAILING USA 2006***. The standard subscription includes one hard copy of the report, online access to the report contents via KlineOnline.com, pdf files of the report sections, and one day of consultation time to be used within six months of publication of the report. Expenses related to any travel made at the request of the subscriber are to be reimbursed by the subscriber. Additional hard copies are available for a nominal fee.

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Kline & Company, Inc. similarly agrees that it will use all reasonable precautions to prevent the disclosure of the contents of this report to any persons or organizations other than subscribers for three years after its date of issue.

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SUBSCRIPTION OPTIONS AND RATES

Beauty Retailing USA 2006

Standard price	20% off Through Nov. 30, 2006	15% off Dec. 1, 2006 through Jan. 15, 2007	10% off Jan. 16 through Feb. 28, 2007	5% off Mar. 1 through Apr. 30, 2007	Amount (please fill in price)
$22,000	$17,600	$18,700	$19,800	$20,900	
			Additional hard copies: _______ @ $500 each =		
				Subtotal	
				NJ only: 7% sales tax	
				TOTAL	

NOTE: All prices in U.S. funds.

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AMERICAN EXPRESS PLATINUM LUXURY SURVEY SHOWS WEALTHY GEN X CONSUMERS ARE MIGHTY IN LUXURY BUYING POWER, SPENDING MORE THAN BABY BOOMER POPULATION

Study Reveals Compelling Data About Luxury Spending Trends, Attitudes and Motivations between the Rich and the Affluent as well as Gen X and Baby Boomer Generations

NEW YORK, June 07, 2005 -- American Express Platinum Card® today announced the results of The Second Annual American Express Platinum Luxury Survey, which found that the wealthy are spending lavishly on luxury goods and services. Households that were surveyed had an average annual income of $235,900, were among the top 8% in the U.S., and spend over 20% of their income on luxury goods and services.

The survey results show that wealthy members of the younger Gen X, despite being the smallest total generational group in the U.S. (numbering 49 million) budget their luxury dollars quite differently than the wealthy older Baby Boomers, whose generation has 78 million people. Gen Xers are far more invested in buying up the material trappings of wealth.

The survey investigated the differing attitudes, expectations and motivations among the wealthy with a close look at the rich (incomes $200,000 and above) and the affluent (incomes $125,000 to $199,999), as well as the wealthy Gen Xers, born between 1965 and 1976, and their Baby Boomer counterparts, born between 1946 and 1964.

Members of Gen X Mighty in Luxury Buying Power

Overall, the wealthy members of Gen X have an average income of $213,000 and spend 18% more than the Boomers on luxury goods annually, $26,751 compared with $22,631. This difference is made more significant by the fact that the average income of wealthy Baby Boomers, $222,900, is similar to Gen X.

Gen X spending far exceeds the Baby Boomers in a number of luxury goods categories including:

- 60% more than Baby Boomers on fragrance, cosmetics and beauty products ($3,235 vs. $2,017),
- 47% more on fashion accessories ($6,066 vs. $4,116),
- 37% more on men's and women's clothing ($23,027 vs. $16,924),
- 32% more on wines and liquors ($3,922 vs. $2,966).

For luxury experiences, including dining, travel, and home services, both generations spend roughly the same: $17,554 for Gen X compared with $17,651 for Boomers.

However, in a number of luxury experience categories Gen X spending exceeds the Baby Boomers:

- 33% more than Boomers for entertainment ($3,629 vs. $2,722),
- 17% more for personal/health services ($3,324 vs. $2,838),
- 11% more for sporting events ($4,176 vs. $3,769).

"Marketers tend to think of the Gen Xers as a cohort too small to even worry about, but this research shows that Gen X may be small in size but they are mighty in luxury buying power," Pam Danziger, founder of Unity Marketing, a marketing consulting firm that specializes in marketing to the luxury market, and who conducted this year's Platinum Luxury Survey. "They are in a more youthful life stage and are accumulating a lot of big, material goods. Their influence is destined to grow even more in the luxury market in the future now that the leading edge of this generation reaches 40 years of age this year."

Contrary to the Gen X population, many Baby Boomers are approaching a near plateau in terms of their career trajectory, as the leading edge of the generation turns 59 years old in 2005. Furthermore, their overall wealth may even decline after retirement. The Boomers are at a different life stage and thus have accumulated many of the "big purchases" the Gen X are currently making, or planning to make. The Boomers are more likely to own original art (31% as compared with 24% among Gen X), a fine jewelry collection (29% to 25%), a vacation/second home (26% to 18%) and an antique or other collection (24% to 16%). Members of Gen X, by comparison, are more likely to place a greater emphasis on active or experiential 'toys' such as sports cars, (owned by 28% of Gen X compared with 24% of Boomers) and boats and yachts (21% to 17%).

Dramatic Spending Differences Among Rich vs. Affluent
The survey also looked at the difference in spending patterns and attitudes between the rich and the affluent. In this survey, the rich sample earn an average of $390,400 per year with approximately $10 million in investible assets and represent the top 2% of American households. The affluent sample earn an average of $152,500 per year with approximately $1 million in investible assets.

In comparing the rich with the affluent, the rich spend three times more than the affluent in both the luxury goods and luxury experiences categories – an astounding $81,172 total per year. And in several categories the rich spend nearly four times as much as the affluent. For instance, the rich spend $17,185 on luxury jewelry and watches vs. $5,163 by the affluent; $12,831 on luxury pet products vs. $1,316; $11,679 on luxury children's goods vs. $3,577; $9,931 on luxury fashion accessories vs. $2,898; and $7,703 on luxury wines and liquors vs. $1,880.

Interestingly, the rich spend about as much on luxury products for their pets as they do on luxuries for the children.

The rich also indulge more in luxury experiences than the affluent, spending three times more in almost every category: $6,281 on personal and health services vs. $1,851 by the affluent; $6,363 on entertainment vs. $1,791; $9,313 on sporting events vs. $2,891; $7,611 on dining vs. $2,632; and $17,051 on luxury travel vs. $7,815.

Value Conscious But Willing to Pay More For Personal Service and High Quality
While the luxury consumers surveyed buy luxury in a variety of categories, they also enjoy shopping wisely and searching for the best value and price.

- 80% of luxury consumers surveyed agree with the statement, "Getting a discount or finding a really good sale price on a luxury item makes me feel like a smart shopper."
- 63% agreed that "The price of most luxury goods is too high, and I rarely pay full price for a luxury brand."
- 58% said their last luxury purchase was bought on sale and 83% said a sale or discount was very or somewhat important to their purchase decision.

"The luxury shopper is value conscious and passionate about getting the best price. However, despite their propensity to watch their wallets, they are willing to pay more for superior service and greater convenience," said Peggy Maher, senior vice president and general manger, Consumer Charge Card, American Express Company. "Most of the wealthy consumers surveyed come from middle-class backgrounds and are thus more value-conscious. As we know from our Platinum Cardmembers, they are willing to pay for goods and services as long as they see the value."

About two-thirds (64%) of wealthy consumers surveyed are willing to pay more for special services when they travel or shop at a more exclusive boutique. The overwhelming majority of survey respondents said luxury had to do with quality and service, not a price tag or label.

- Nearly 80% of the luxury consumers surveyed agreed with the statement, "An important part of my enjoyment of a luxury experience is how well the service personnel treat me and the extra service they provide."
- Sometimes buying luxury is based on pure convenience with 43% of wealthy consumers agreeing, "I often trade off spending more money for convenience, because I know I could find it cheaper but it is just too much of a hassle."

About The American Express Platinum Luxury Survey
The American Express Platinum Luxury Survey was a quantitative survey conducted in March 2005 among a random cross-section of 770 wealthy consumers in the U.S. including:

- 270 consumers with a household income over $200,000 of any age group
- 250 Baby Boomers with a household income of $125,000 to $199,999 (average age of 50 years)
- 250 Gen Xers with a household income of $125,000 to $199,999 (average age of 34 years)

Those surveyed had to possess an income of at least $125,000 to be considered and were not required to be American Express Cardmembers to participate.

All of the participants purchased a luxury good or experience in the past 12 months to qualify. The average income of the respondents was $235,900. Unity Marketing conducted the survey on behalf of American Express.

http://home3.americanexpress.com/corp/pc/2005/genx_lux.asp

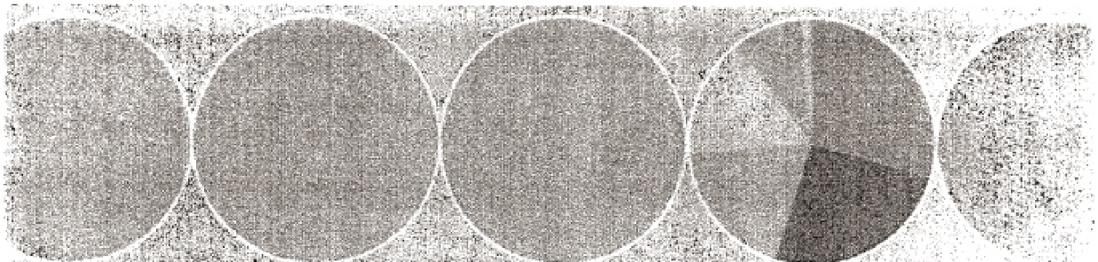
IBISWorld

WHERE KNOWLEDGE IS POWER

IBISWorld Industry Report

March 26 2007

Hair, Nail and Skin Care Services in the US: 81211



Contents

Industry Definition

This industry comprises establishments primarily engaged in one or more of the following: (1) providing hair care services; (2) providing nail care services; and (3) providing facials or applying makeup (except permanent makeup).

ACTIVITIES (PRODUCTS AND SERVICES)

The primary activities of this industry are:

- Barber shops
- Beauty salons
- Cosmetology salons or shops
- Nail salons
- Beautician services
- Beauty and barber shops, combined
- Beauty parlors
- Beauty shops
- Esthetician (i.e., skin care) services
- Facial salons
- Hair stylist salons or shops, unisex or women's
- Hair stylist services, unisex or women's
- Hairdresser services
- Hairdressing salons or shops, unisex or women's
- Make-up (except permanent) salons

The major products and services in this industry are:

- Hair Care Services
- Nail Salons and associated services
- Barber Shops

SIMILAR INDUSTRIES

Industry: • 61151 - Technical and Trade Schools in the US
Description: Establishments primarily engaged in offering training in barbering, hair styling, or the cosmetic arts

Industry: • 62 - Health Care and Social Assistance in the US
Description: Establishments primarily engaged in providing medical skin care services (e.g., cosmetic surgery, dermatology)

Industry: • 81219 - Other Personal Care Services in the US
Description: Establishments primarily engaged in providing massage, electrolysis (i.e., hair removal), permanent makeup, or tanning services

DEMAND & SUPPLY INDUSTRIES

- 42221 - Drugs and Druggists' Sundries Wholesalers in the US
- 44612 - Cosmetics, Beauty Supplies and Perfume Stores in the US
- 53112 - Lessors of Nonresidential Buildings (except Miniwarehouses) in the US

- 81232 - Drycleaning and Laundry Services (except Coin-Operated) in the US
- 81411 - Private Households in the US

Key Statistics

CONSTANT PRICES

	2001	2002	2003	2004	2006	
Industry Revenue	*34,101.0	*34,786.0	*36,001.0	*38,756.0	*40,000.0	$Mill
Industry Gross Product	*18,641.0	*19,035.0	*19,755.0	*21,230.0	*22,289.0	$Mill
Number of Establishments	*650,315	*671,103	*696,605	*726,559	*741,090	Units
Number of Enterprises	*599,985	*610,747	*622,235	*628,457	*639,769	Units
Employment	*950,742	*941,235	*961,942	*991,027	*1,011,839	Units
Exports	N/A	N/A	N/A	N/A	N/A	
Imports	N/A	N/A	N/A	N/A	N/A	
Total Wages	*8,900.0	*9,079.0	*9,396.0	*10,116.0	*10,440.0	$Mill
Domestic Demand	NC	NC	NC	NC	NC	$Mill

CURRENT PRICES

	2001	2002	2003	2004	2005	
Industry Revenue	*31,137.4	*32,317.5	*34,126.2	*37,705.3	*40,000.0	$Mill
Industry Gross Product	*17,021.0	*17,684.2	*18,726.2	*20,653.4	*22,289.0	$Mill
Number of Establishments	*650,315	*671,103	*696,605	*726,559	*741,090	Units
Number of Enterprises	*599,985	*610,747	*622,235	*628,457	*639,769	Units
Employment	*950,742	*941,235	*961,942	*991,027	*1,011,839	Units
Exports	N/A	N/A	N/A	N/A	N/A	
Imports	N/A	N/A	N/A	N/A	N/A	
Total Wages	*8,126.5	*8,434.7	*8,906.7	*9,841.2	*10,440.0	$Mill
Domestic Demand	NC	NC	NC	NC	NC	$Mill

REAL GROWTH

	2001	2002	2003	2004	2005	
Industry Revenue	*4.2	*2.0	*3.5	*7.7	*3.2	%
Industry Gross Product	*4.4	*2.1	*3.8	*7.5	*5.0	%
Number of Establishments	*4.7	*3.2	*3.8	*4.3	*2.0	%
Number of Enterprises	*1.4	*1.8	*1.9	*1.0	*1.8	%
Employment	*-0.3	*-1.0	*2.2	*3.0	*2.1	%
Exports	N/A	N/A	N/A	N/A	N/A	%
Imports	N/A	N/A	N/A	N/A	N/A	%
Total Wages	*4.2	*2.0	*3.5	*7.7	*3.2	%
Domestic Demand	NC	NC	NC	NC	NC	%

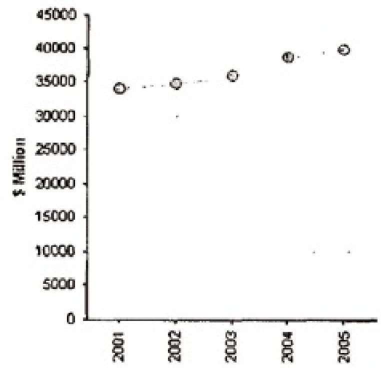
Note
Unless otherwise specified, an asterisk (*) associated with a number in a table indicates and IBISWorld estimate.
Unless otherwise specified, references to dollars are to US dollars

RATIO TABLE

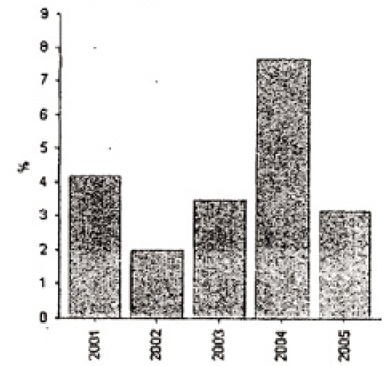
	2001	2002	2003	2004	2005	
Imports share of domestic demand	N/A	N/A	N/A	N/A	N/A	%
Exports Share of Revenue	N/A	N/A	N/A	N/A	N/A	%
Average Revenue per Employee	*0.04	*0.04	*0.04	*0.04	*0.04	$Mil
Wages and Salaries Share of Revenue	*26.10	*26.10	*26.10	*26.10	*26.10	%

GRAPHS

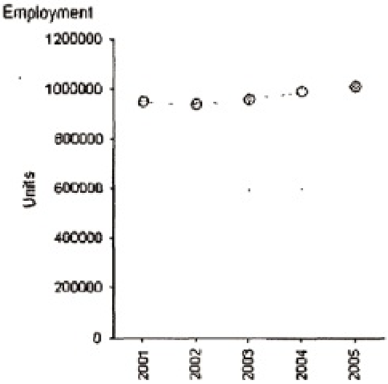
Revenue



Revenue Growth Rate

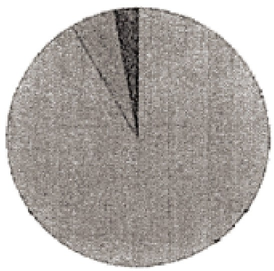


Employment



Segmentation

PRODUCTS AND SERVICE SEGMENTATION



Product/Services	Share
Hair Care Services	91.5%
Nail Salons and associated services	5.4%
Barber Shops	3.1%

- Results from the US Census Bureau's 2002 Economic Census indicated that there were 4,060 barbers' shops which had total revenue of $506.3 million; there were 73,933 beauty salons with aggregate revenues of $15,098 million and 8,481 nail salons with combined revenues of $889.7 million. These results excluded figures for non-employer establishments (i.e. self-employed persons).

For Hair Care/Beauty Salons:

- This segment includes both female and unisex salons.
- Revenue from hair services accounts for 79.0% of the total segment sales, revenue from nail services accounts for 4.5%, rental income from leased stations and booths within beauty salons accounts for 3.9% and sales of hair care. revenue from diet and weight reducing programs accounts for 0.9% and merchandise sales for 5.3% of total revenue. Other sales revenues accounts for the remainder.
- Sub-leasing of space to nail and other personal care service providers is a significant component of the total personal care services offered by some beauty salons, such as nail or diet service operators. In all, about 20.0% of beauty salons derive additional income from the sub-leasing of areas to other beauty operators.
- The most common beauty services provided include eyelash and eyebrow tinting hair removal and manicures.
- The major benefit provided to clients by the beauty salon industry is the feeling of being pampered and, associated with this, total satisfaction with the end result. These factors are more important than price to the client. However, segments of the industry still continue to compete heavily on price.
- Day spas, offering massages and other services for the mind and body to assist in relieving stress and the built up of life pressures, is currently a growth segment in the beauty area. Surveys indicate that since 1997, about 8.0% of salons that offer hair and nail treatments have also commenced to convert and offer day spa treatments and this is expected to grow further.

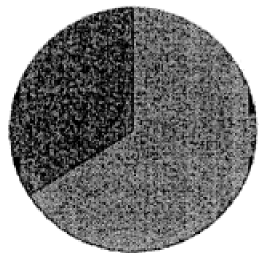
Nail Care Salons

- Revenue from stand alone, independent contractors, those located within hair care salons, and including booth renters, is estimated to account for 5.4 % of total industry revenue.

- Revenue from nail services accounts for 95.5 % of total revenue, hair services accounts for 0.6 %, rental income from leased stations and booths within beauty salons accounts for 1.1 % and sales of merchandise accounts for 0.7 % of total revenue.
- For 2005, research by NAILS magazine indicated that there were 57,838 salons in operation, and that there were 380,635 licensed technicians - or an average of 6.6 per salon. The estimated revenue of this segment by this magazine was $6,430 million, which decreased by 6 % over 2004. This translated to an average annual revenue of $111,173 per salon or $16,893 per licensed technician. Again, the major benefit provided by the nail care segment to their clients is the feeling of being pampered and, associated with this, satisfaction with the end result.
- The magazine reported that at least 75 % of nail salons offered manicures, acrylics (any type), paraffin dips, nail art and waxing services. 61 % offered hair care, just under half offered gels/UV light-cured systems and 42 % used fibreglass. Around a third of salons offered facials, massage, make up application, skin care, silk wraps, colored/design acrylics and UV top coat service. Between 20 and 25 % offered nail jewelry, reflexology, powder/gel extensions, tanning, aromatherapy treatments, earpiercing and airbrushing.
- In 2005, 95.6 % of salon employees were female, and 96.4 % of salons were licensed. Most people have been doing nails for an average of 8.6 years and the average age for technicians is just over 38 years. 33.5 % were salon owners doing nails, 32.2 % were nail technicians/booth renters, 25.7 % were nail technicians/employees, 5.7 % were salon managers or nail department managers who did nails. The average salon had 2.3 nail technicians. 93.6 % of clients were female, mostly aged 26 years and over and 72.5 % of clients use the service every other week. The average weekly income was $619.52. In terms of payment, 7.6 % of employees were on a salary only, 13.8 % were on a salary plus commission, 56.3 % were on commission only and 8.9 % on tiered commissions. The average commission rate was 55.7 %. The average number of clients per week was 30.6 and the average prices for services ranged from $17.16 for a manicure, $32.45 for a pedicure, $40.23 for a acrylic full nail set (tips with overlay) and $24.36 for an acrylic fill, $45.39 for a full set/sculptured acrylic. Most operators sell retail products for their clients' use at home. NAILS Magazine estimated that 46 % of nail technicians are Caucasian, 6 % African American, 8 % Hispanic and 37 % Vietnamese.

Barber Shops

- The smallest segment of this industry is the barber shops which account for around 3 per cent of total industry revenue. In 2002 there were 4060 employer establishments (down from 4242 operators in 1997) which had an average revenue of $124,700 per annum. 94.4 per cent of revenue was derived from hair services and 3.6 per cent from rental of leased stations or booths.



Market Segment	Share
Women	66.0%
Men	34.0%

- The industry derives most of its revenue from households.
- It is estimated by IBISWorld that women account for around two thirds of the total expenditure on hair care and beauty treatments, given their greater use of higher value added services and their overall greater frequency of use
- Nails Magazine's survey for 2005 indicated that 93.6% of clients were female, mostly aged 26 years and over and 72.5% of clients used the service every other week.
- The gradual aging of the population has led to an increase in demand for hair coloring (with 6 weekly visits common in this area) and wrinkle/facial and other beauty services.
- Surveys indicated that the number of men using salons is increasing and are requesting a greater array of services, such as, hair, skin, nail treatments, and also purchasing retail products from salons.

INDUSTRY CONCENTRATION

Concentration in this industry is low

- The industry has a low level of ownership concentration, despite there being a number of chain and franchised operators. It mainly comprises small business, single salon owner/operators.
- NAILS Magazine's 2005 industry survey results indicated that 52.0% of nail salons employed only one nail technician, 20.1% employed 2 people, 11.1% employed 3 people, 6.6% employed 4 people and 10.2% employed 5 people or more. The average number of clients seen per week was 30.6 and the average weekly income was $619.52.

The following information from the US Census Bureau for employer establishments in this industry for 2003 supports the above.

Employment Size for Employer Establishments, 2003

Employment Size	Units Establishments	Percent Total
1-4 employees	55348	63.3%
5-9 employees	18825	21.5%
10-19 employees	9879	11.3%
20-49 employees	2906	3.3%
50-99 employees	371	0.4%
100-249 employees	65	0.1%
250-499 employees	4	0.0%
500-999 employees	0	0.0%

1000 or more employees	0	0.0%
	87398	

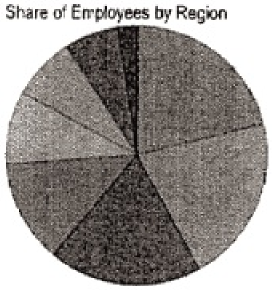
Source: US Census - County Business Patterns
Note: Released September 2005. Information relates to employer establishments only (i.e. excludes nonemployer establishments).

The table indicates that almost two-thirds of employer establishments have 4 or less employees and with 85.0% having 9 or fewer employees. The industry is small business oriented and will remain so. Therefore, the level of industry concentration is not expected to change in the near future.

GEOGRAPHIC SPREAD

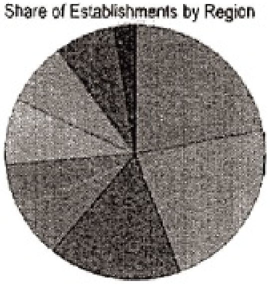
Year: 2007

Share of Employees by Region



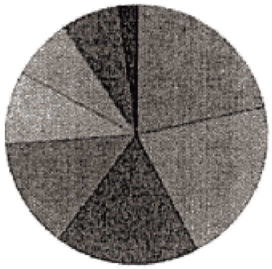
Region	Percentage
South East	21.0
Mid East	20.8
Great Lakes	19.1
Far West	12.7
South West	9.1
Plains	7.8
New England	6.8
Rocky Mountains	2.4

Share of Establishments by Region



Region	Percentage
South East	21.9
Mid East	22.4
Great Lakes	16.7
Far West	12.6
South West	8.4
Plains	7.8
New England	7.5
Rocky Mountains	2.7

Share of Revenue by Region



Region	Percentage
South East	21.3
Mid East	20.8
Great Lakes	17.7
Far West	13.7
South West	9.2
Plains	7.5
New England	7.2
Rocky Mountains	2.3

- The general regional share of overall s provided in the table below from US Census.

Regional Shares of National Population, 2007

Region	Percentage
New England	4.8
Mid East	15.9
Great Lakes	15.3
Plains	6.7
South East	25.1
South West	11.7
Rocky Mts	3.4
Far West	17.1
Total	100

Source: IBISWorld

- In general, the location of hair care and beauty salons is found in direct proportion to an area's population (and in areas such as the CBD in terms of workforce) size and numbers and this pattern has not changed significantly over time.
- Nail salons, however, tend to be more concentrated in the relatively higher household income suburbs.
- For this industry it tends to have a higher concentration, in terms number of salons, above average size and revenue, in the Rocky Mountains, South West, Plains, Mid East and New England regions - many of which have large population and cities. This is reinforced by other information provided below.
- In terms of nail salons, NAILS Magazine in 2005 estimated that 17.5% were in the Mid West (particularly in Illinois, Michigan and Ohio), 30.7% resided in the West (particularly California and Texas), 22.7% in the South (particularly Florida). 25.9% resided in the Eastern (particularly New York, New Jersey and Pennsylvania) and 3.2 % in the Mountain region (particularly Colorado). The is, again, largely related to population distribution across all regions.
- This level of geographic concentration is expected by IBISWorld to not change in the near future.

Market Characteristics

MARKET SIZE

- IBISWorld estimates that, in constant 2005 prices, the Hair, Nail and Skin Care Services Industry will generate $42,107 million in revenue in 2007, which represents real revenue growth of 2.3%.
- This industry will also contribute an estimated $23,293 million to the US economy in 2007, which represents 0.17% of total GDP.

In 2007, IBISWorld also estimates that this industry:

- Consists of approximately 769,578 establishments, which is 1.8% higher than in 2006
- Employs approximately 1.05 million, which is 1.8% higher than in 2006.
- Pays total wages of $10,911 million, which was 2.4% higher than in 2006.
- In 2005, according to NAILS magazine there were 57,838 salons (up from 51,571 licensed nail salons in 2002 and from 54,120 in 2004). These have a total of 380,635 licensed technicians (up from 358,818 in 2002, but down 1.9% over 388,635 in 2004), or an average of 6.6 technicians per licensed salon. Industry revenue was estimated to have decreased 6.0%, in nominal terms, to $6,430 million in 2005 (compared with $6,450 million in 2002 and $6,840 million in 2004).

LINKAGES

Demand Linkages

81411 - Private Households in the US
Private households account for nearly all of the demand for services provided by this industry.

Supply Linkages

42221 - Drugs and Druggists' Sundries Wholesalers in the US
Supply of cosmetic and related products

44612 - Cosmetics, Beauty Supplies and Perfume Stores in the US
Supply of products for direct use and sale

53112 - Lessors of Nonresidential Buildings (except Miniwarehouses) in the US
Leasing of shop space

81232 - Drycleaning and Laundry Services (except Coin-Operated) in the US
Laundry services for linen

DEMAND DETERMINANTS

- Most households access hair care salons.
- IBISWorld analysis indicates that the industry displays a high degree of sensitivity to changes in household disposable income, which results from changes in employment and from tax and interest rates. More recently, the high and increasing gas prices is also having an adverse effect on disposable income, and consumer expenditure. It is evident that as the growth in household disposable income changes a shift in the frequency of use of services occurs. Also, there is a shift in the use of higher priced/value added services (above the basic cut service), and in the purchase of haircare and beauty products from salons. Other important aspects include population growth and the progressive aging of the population, particularly, among a portion the post-war baby boom era that are now retiring or

approaching retirement, with a far higher level of disposable incomes and wealth, and fewer financial commitments than previous generations.

- Day spas, offering massages and other services for the mind and body, to assist in relieving stress and the built up life pressures is currently still a growth segment in the nails segment. NAILS Magazine industry survey indicated that in 2001, 36% of salons offered spa services.
- The American Salon Green Book indicates that day spas are a growing segment and almost half of all people who use a day spa are between the ages of 34 and 52, many have college degrees and over a third earn more than $75,000 per annum. Most spas are used for relaxation purposes.
- Surveys have also indicated that the number of men using salons is increasing and for a greater array of services such as hair, skin, nail treatments, and they are also purchasing the salons' retail products.

DOMESTIC AND INTERNATIONAL MARKETS

Domestic and International Markets Exports
Exports in this industry are low
Exports in this industry are steady

Domestic and International Markets Imports
Imports in this industry are low
Imports in this industry are steady

Domestic and International Markets Analysis

- In general, the industry services the needs of the domestic market.
- One major operator, Regis Corporation has, however, expanded both its company owned and franchised salons internationally. In late-2005, the company's North American operations included 6,551 corporate salons and 2,310 franchised ones, while internationally it had 426 corporate salons and 1,592 franchised ones, mainly located in the UK, France, Italy and Spain. It had 55,000 corporate employees globally (an average of around 8 per salon). However, the company generates 85% of its revenue domestically.

BASIS OF COMPETITION

Competition in this industry is high
Competition in this industry is increasing

- IBISWorld contends that the basis of competition in the hair care component appears, overwhelmingly, to be price-based, due to both the number of operators and the ease of entry into the industry
- Many more successful operators, however, compete on the basis of quality service, consistent cuts and services and according to the client's wants and desires. They also seek to ensure high client satisfaction and return rates and, therefore, obtain the benefit of good word of mouth recommendations.
- Many of the same factors are important in the nails salon segment - with sanitation and service being important.

LIFE CYCLE

Life Cycle Stage
The life cycle stage is growth

Life Cycle Reasons

- Changing age structure of the population.
- Changing attitudes to beauty and other treatments, by both males and females

- Increased demand for day spas.

Life Cycle Analysis

- While over the longer term, total real industry revenue tends to grow slowly and in line with the domestic population growth, there are a number of segments that are growing at slightly faster rates.
- A part of this industry which is in a growth phase is the beauty segment and is related to the changing age structure of the population and the increasing demand for more facials, beauty treatments, hair colorings, nails and general pampering etc.
- Some industry segments, such as the basic hair cut services, operate in a very price competitive environment, and this may be an indication that there may be too many operators in some segments.
- Some industry services, particularly beauty and health ones, are increasingly being provided in health retreats and holiday resorts.
- New services are increasingly being offered by operators - including unique or custom ones - which reinforce pampering - and can be linked to massage, facials, tanning, waxing and reflexology
- Growth in this industry is occurring in the franchising area - both domestically and internationally, and with further potential for further growth over the outlook period.

-

Industry Conditions

BARRIERS TO ENTRY

Barriers to entry in this industry are low
These barriers are steady

- The level of capital investment required is low.
- Operators can lease suitable premises.
- Operators can lease equipment.
- Some training is required

Analysis

- The barriers to entry are low. The industry relies on personal skills and training and new operators have the ability to lease all their equipment and to rent retail space to enter the industry. Some licensing of operators occurs in some States

TAXATION

Goods	Tax Rate	Tax Type
Licensing of Establishment	50 - 100%	Industry Specific
Licensing of Individuals	25 - 50%	Industry Specific

- In some States, there are annually renewable license fees for the location/shop where hair and beauty care services are provided, as well as for individually qualified persons.

INDUSTRY ASSISTANCE

The level of Industry Assistance is none
The trend of Industry Assistance is increasing

There are no specific tariffs for this industry

- This industry, like most personal services ones, is totally unprotected and receives no assistance in any form from government, apart from operators having to meet some licensing requirements. In some states, the need for further hair care or beauty apprentices has to be established first, prior to obtaining the approval of the relevant State Board and commencing an apprenticeship.

REGULATION AND DEREGULATION

The level of Regulation is medium
The trend of Regulation is increasing

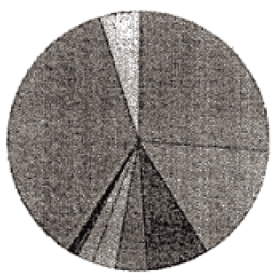
- Most States have individual requirements for the training and testing of persons in this industry and a consumer complaints process.
- In both the hair and beauty treatment areas (including for demonstrators and instructors), most people need to be licensed by the appropriate State Board of Cosmetology and the establishment where services are provided may also need to be separately licensed.
- Licensing requires between 300 and 3,000 hours of study as an apprentice under a fully qualified operator or in an approved/licensed school, sitting for a written exam and paying the appropriate license fee. In some States,

apprentices have to indicate or prove that there is an actual need or demand for the apprenticeship, prior to approval to commence. In most States applicants have to be at least 16 years old. All licenses and work permits must be posted in public view with a current photo attached. State Boards also establish and enforce safety and sanitation practice standards for operators and perform regular inspections.

- Some of the more specific regulation may require that all tools and implements used are sterilized/disinfected, that testing be undertaken prior to hair coloring and that certain chemicals be not used on hair, nails or with facials. Any special need of people with diabetes, who have a manicure or pedicure, need to taken into account. No medical services, such as removal of nails etc., can be undertaken.
- Currently, many States are considering legislation to regulate salons which rent space for a booth to an independent contractor rather than an employee and for the licensing of these activities. These regulations currently vary according to State.

COST STRUCTURE

Year: 2006



Item	Cost %
Wages	26.1%*
Purchases	15.0%*
Rent	7.6%*
Utilities	4.0%*
Employer costs of fringe benefits	2.9%*
Depreciation	2.0%*
Communication costs	0.7%*
Repairs and maintenance	0.6%*
Other	36.1%*
Profit	5.0%*

Analysis

- Since this industry is a labor-intensive, the major cost relates to wages, which accounts for an estimated 26 % of total revenue.
- Given the general intense state of competition in this industry, the return on investment, is generally low, with an estimated 5 % margin accruing to owners. The small margin makes this industry financially vulnerable to any changes in demand for services and/or price-based competition. It is also affected by any factor which affects wages and benefit costs, including recently increasing workers' compensation insurance and for medical benefits.

CAPITAL AND LABOR INTENSITY

The level of Capital Intensity is low

- The industry involves a large degree of personal client service.

- Most areas of operation from taking appointments, to providing hair and nail and other services and cleaning requires direct labor input.
- There has been no significant change in industry operation, which involves a significant change in capital requirements recently.

Analysis

- Ratio: The labor intensity of this industry is determined by the ratio of labor to capital. To calculate this ratio, wage and depreciation costs (taken from the cost structure) are utilized as proxies.
- Labor costs, in total, account for around 50 % of the total and depreciation for under 2 %. The ratio of labor to capital is 1:0.04, meaning that for every dollar spent on wages, only 4 cents is spent on utilizing and replacing equipment and buildings.
- This industry, like all others in the personal services industry, requires a very high direct labor input. Personal quality and professional service are all important, as is client satisfaction with the end result.

TECHNOLOGY AND SYSTEMS

The level of Technology Change is low

- Technology has impacted only slowly on the hair care component. However, technology and products used in the beauty industry have changed dramatically over the last few years with the emergence of new computerized equipment. This includes equipment using the Blend method, which combines electrolysis with a short wave current.
- Franchising has emerged as a major segment in the hair care area and is the major area of change currently affecting it. The major hair care franchisor is Regis Corporation, utilizing its Regis Salons, MasterCuts, Trade Secrets, SmartStyle, Supercuts, Cost Cutters, Hair Masters, Style America, First Choice Haircutters, Magicuts brands both in the domestic and international market (mainly France and the UK, but expanding rapidly elsewhere).

INDUSTRY VOLATILITY

The level of volatility is medium

- The industry is sensitive to economic conditions, including consumer confidence.
- The demand for value added services follows the trend rate of growth of household disposable income.
- Some hair and nail and other services are seen as discretionary by consumers.
- Most households require regular haircuts.
- Continued growth in the nails segment, with spas being popular.

GLOBALIZATION

The level of Globalization is low

The trend of Globalization is increasing

- The industry, in general, services the needs of the domestic market. One major operator, Regis Corporation, has expanded both its company owned and franchised personal hair care salons internationally, but still generates 85% of its revenue domestically

Key Factors

KEY SENSITIVITIES

The key sensitivities affecting the performance of the Hair, Nail and Skin Care Services industry include:

Consumer Sentiment Index
Description: The level of consumer confidence.

Changes in consumer confidence levels has a direct effect on their spending on basic and value added services.

Per Capita Disposable Income
Description: The level of and/or movements in real per capita disposable income

The industry is sensitive to changes in household disposable income, which is affected by changes in general employment growth as well as in tax and interest rates. It has a direct effect on the demand for value added services, purchases of merchandise and, to some extent, the frequency of use of services

Population Growth Rate
Description: The level of population growth in the US

The industry is sensitive to population size, age structure and growth rate within an individual operator's catchment area.

KEY SUCCESS FACTORS

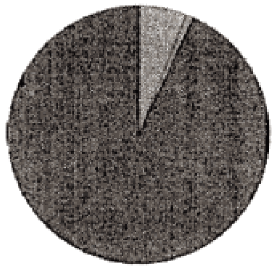
The key success factors in the Hair, Nail and Skin Care Services industry are:

- Access to multiskilled and flexible workforce
  To have the right mix of people and services needed by customers in the catchment area.
- Access to niche markets
  To develop niche areas of service/expertise so as not to be as affected by local price competition
- Having a loyal customer base
  Have a highly satisfied and repeat client base.
- Must have license
  To have the appropriate licenses
- Maintenance of excellent customer relations
  To ensure on-going customer satisfaction and good word of mouth recommendations.

Key Competitors

MAJOR PLAYERS

Market Share



	Major Player	Market Share Range
	Regis Corporation	5.91% (2006)
	Ulta Salon, Cosmetics & Fragrance, Inc.	0.94% (2006)
	Other	93.15% (2006)

PLAYER PERFORMANCE

Regis Corporation
Brand/Trading Name(s): Regis Salons, MasterCuts, Trade Secrets, Smart Style, Supercuts, Cost Cutters, Hair Master, Style America, First Choice Haircutters, Magicuts
Market Share: 5.91%

History

Regis Corporation is the leading hair care and retail salon owner, operator and franchisor, and has its head office in Minnesota. It provides a full range of services from custom hairstyling, cutting, coloring, perms and manicures and sells hair care products. It operates under the brands of Regis Salons, MasterCuts, Trade Secret, SmartStyle Supercuts, Cost Cutters, Hair Masters, Style America, First Choice Haircutters and Magicuts. Its up market salons operate under the Regis Salons brand, its value-priced salons trade under the Cost Cutters and MasterCuts brands. Regis' salons are also located in shopping malls (under the brand, Regis, MasterCuts and Trade secret) and strip centers (under the brand, Supercuts, Cost Cutters). They are also found within Wal-Marts where they trade under the brand, SmartStyle. It continues to expand through a combination of mergers, acquisitions and openings. As at the end of December 2005, it had a total of 11,211 company-owned and franchised stores worldwide.

In January 2006, it was announced that a subsidiary of Regis Corporation was to merge with Sally Beauty Company, a business unit of Alberto-Culver Company, that would own 54.5 % of the new company, subject to shareholder and regulatory approvals. The company would retain the Regis name and continue to be headquartered in Minneapolis. Sally Beauty Company is a leading global marketer of professional beauty supplies, with annual revenue of $2.25 billion and with 822 Beauty Systems Stores and 1,244 sales people. Regis was to be transformed into a professional beauty products distribution and services company. However, the merger did not proceed and Regis received $50 million as a merger termination fee, of which cost offsets was $34.1 million.

A summary of the recent financial performance of this company is provided in the following table, with further discussion below.

Summary of Recent Financial Performance

Fiscal Year	Million Dollars Revenue	Percent Growth	Million Dollars Net Income	Percent Growth
1998	800	N/C	31	N/C
1999	975	21.9%	30	-3.2%
2000	1140	16.9%	50	66.7%
2001	1312	15.1%	53.1	6.2%
2002	1454	10.8%	70.3	32.4%
2003	1685	15.9%	86.7	23.3%
2004	1920	13.9%	105.0	21.1%
2005	2194	14.3%	64.6	-38.5%
2006	2431	10.8%	109.6	69.7%

Source: Annual Report
Note: Fiscal year ending June

In 1999, Regis acquired Barbers Hairstyling for Men and Women Inc and Heidi's Inc. In that year, sales revenue increased to about $975 million, but net income growth was static at around $30 million (or 3.0% of revenue). In 2000, it acquired Supercuts, UK. For that year, revenue increased to $1,140 million and net income increased to almost $50 million, which represented 4.3% of revenue. In September 2001, it acquired the French franchisor, GCG.

Fiscal 2001

In fiscal 2001, revenue totaled $1312 million (up 14.8%) and it had 41,130 employees. Service revenue increased 14.6% to $893.5 million, product sales increased 15.6% to $361.9 million, franchise revenue increased 12.0% to $56.3 million and total system-wide sales was $1,903 million, up 13.7%. Just under 93.0% of revenue (or around $1,200 million) was generated in the domestic market. The EBITDA to sales ratio was around 13.3%, operating income increased 9.1% to $109.3 million and the net profit margin was about 4.0% of sales (or $53.1 million). Same store sales growth was 2.8% and total assets was valued at $736.5 million. During the year, it serviced around 118 million customers worldwide through its 5,655 company owned and franchised salons in the US, 632 stores in Canada, 30 stores in Puerto Rico and 364 stores in the UK. The total stores numbered 6,681 worldwide.

The firm generated around two thirds of its revenue from hair services, 28.0% from high margin hair care merchandise sales and 3.0% from franchisor income. It also stocks a range of hair care products. During 2002, the firm planned to open a further 550 stores.

Fiscal 2002

In early 2002, the firm expanded its operations to Italy, Spain, Brazil, Belgium, Switzerland and Poland.
It also acquired the Jean Louis David trademark and salons, which was the number one salon operator in Europe.

In July, it acquired 328 salons operating as BoRics, which generated revenue of $62 million. These were added to an additional 53 salons which had been acquired over the previous three months and had a total of $9 million in revenue. The BoRics were added to the existing 3,400 strip shopping center salons. The firm estimated that there were 40,000 salons in US strip shopping centers.

Since the early-1990s, the company made 233 acquisitions, which added 6,622 salons, with annual revenue that totaled $735 million and system-wide sales of over $1,800 million.

For fiscal 2002, system-wide sales increased 18.4% to $2,253 million and total revenue were up 10.9% to $1,454 million. Operating income increased 22.5% to $109.3 million, net income increased 32.4% to $70.3 million and the EDITDA increased 10.6% to $153.6 million. At the end of June 2002, the company had a total of 8,684 salons, of which 4,776 were company-owned and 3,908 were franchised. The domestic salons comprised 1,016 Regis Salons, 551 Mastercuts, 490 company-owned and 26 franchised Trade Secret, 861 company-owned and 210 franchised Smartstyle/Cost Cutters and 1,476 company-owned and 1,988 franchised Strip Centers. Internationally, it had 382 company-owned and 1,684 franchised stores. Regis Salons generated $416.2 million in revenue, Mastercuts generated $164.8 million, Trade Secret generated $190 million, SmartStyle generated $178.7 million, Strip Center generated $321.3 million, internationally located salons generated $105.6 million and franchised revenue generated $77.6 million

Fiscal 2003

At the end of December 2002, the company had 9,313 salons, of which 5,373 were company-owned and the remainder were franchised, while internationally it had 382 company-owned salons and 1,684 franchised ones. It was also announced that the company had acquired Vidal Sassoon salons and academies and introduced a new salon concept, Vidal Sassoon Studios. It also acquired Haircare Limited's licensing agreement with Procter & Gamble to expand the salon group using the Vidal Sassoon brand name in North America, UK and Germany.

In March, the company announced that it would expand its European high-fashion hair salon brand, Jean Louis David, outside of New York City and planned to add between 100 and 200 stores in the greater New York, New Jersey and Connecticut areas. In that same month, the company transferred its stock listing to the NYSE.

In May, the company acquired 286 salons from Opal Concepts, of which 90 were company-owned, and the remainder were franchised. The franchised salons operated under the Pro-Cuts brand and were primarily located in Texas. Over the past 10 years Regis had completed 255 acquisitions, which involved 7,043 salons and annual total revenues of $817 million, and system-wide sales of over $1,000 million.

For fiscal 2003, system-wide sales increased 23.0% to $2,800 million, while consolidated sales increased 15.8% to $1,684.5 million (of which international revenue was $171.5 million), and operating expenses was $1,526.0 million. Operating income was $158.9 million and net income was $86.7 million, or 5.1% of revenue. The firm constructed 397 new salons, added a further 275 franchised stores and acquired a further 758 salons, which included 198 franchised ones. As at June 2003, the company owned, operated or franchised 9,617 salons, compared with 8,684 in June 2002. It had 1,096 Regis Salons, 590 Mastercuts, 517 company-owned Trade Secret, 25 franchised Trade Secret, 1,033 company-owned Smartstyle/Cost Cutters in Wal-Mart, 230 franchised Smartstyle/Cost Cutters in Wal-Mart, 1928 company-owned Strip Centers, 2172 franchised strip centers and 399 company-owned and 1,627 franchised international salons.

Fiscal 2004

In April, the company announced that it acquired 153 Holiday Hair salons located primarily in Pennsylvania which was expected to add around $45 million to annualized revenues. During the third quarter 2004 the company also acquired 115 salons in 14 separate transactions, of which 86 were franchise buy-backs, which added $25 million to annualized revenues.

For fiscal 2004, revenue increased 14.0% to $1,920 million and same store revenue growth was 2.6%. Net income increased 22.0% to $105 million (a margin of 5.5%). At year-end, the company had a total of 10,162 salons (6,238 company owned and 3,924 franchised), compared with 9,617 salons previously, which represented a net increase of 545 salons. The company constructed 452 salons and franchisees built an additional 268 and, in addition, 411 salons were acquired. This included 206 franchise buybacks and 380 salons were closed or relocated. It had 1,096 Regis Salons, 590 Mastercuts and 517 Trade Secret salons. Most of its salons (around 4,435 salons) were located in strip retail centers, although it had 1,465 company owned and franchised salons located in Wal-Mart stores. Total value of its assets was $1,271 million. Internationally, it had 420 company-owned and 1,594 franchised stores. Regis Salons had revenue of $482 million, Mastercuts had revenue of $170.3 million, Trade Secret had revenue of $210 million, SmartStyle had revenue of $227.5 million, Strip Centers had revenue of $468 million and its international stores had revenue of $171.5 million.

In June, the company acquired the Blaine Beauty Career Schools, a beauty school operator with six schools, located in Massachusetts and which added $13 million to annual revenue. Regis employed 156 artistic directors and invested around $16 million each year in training its 53,000 stylists worldwide.

Fiscal 2005

For fiscal 2005, total consolidated revenue increased 14.1% to $2,194.3 million, although same store sales increased only 0.9%, compared to 2.1% in fiscal 2004 and 1.2% in fiscal 2003. North American salons revenue was $1,874.0 million, up from $1,706.0 million over the previous year. International revenue totaled $227.0 million, up from $203.0 million, beauty schools revenue was $33.9 million and the hair restoration centers revenue was $59.4 million. Services revenue comprised 66.9% of the total, with product revenue at 29.6% and franchise royalties and fees at 3.6%. Cost of services represented 57.0% of service revenue, and cost of product comprised 51.8% of this revenue. Site operating revenue comprised 8.3% of total, while general and administrative costs were 11.9%, rent at 14.2% and depreciation and amortization at 4.2%. Operating income represented 6.3% of total revenue, but decreased from 9.3% over the previous two years. This was largely due to lower product revenue, due to lower retail margins and increased competition. The net income represented 2.9% of total revenue, down from 5.4% in 2004 and 5.1% in 2003. The company estimated the total value of the hair care industry at $53.0 billion domestically and $150.0 billion globally. The company's North American operations included 6,551 corporate salons and 2,310 franchised ones, while internationally it had 426 corporate salons and 1,592 franchised ones, mainly located in the UK, France, Italy and Spain. It had 55,000 corporate employees globally (an average of around 8 per salon).

In May, the company purchased 130 salons of TGF Precision Haircutters for an undisclosed sum.

Over the past 12 years the company made 339 acquisitions, that added 7,165 locations, a net 700 new salons added in 2005 by construction and acquisition. For company-owned salons, its services comprised 72.0% of total revenue from haircutting and styling, 18.0% from hair coloring, 5.0% from hair waxing, 2.0% from waxing and 3.0% from other services. In general, the proportion of total revenue from hair coloring service revenues had increased over the past three years, but decreased from haircutting and styling services.

Fiscal 2006

For fiscal 2006, revenue increased 10.8% to $2,430.9 million, with $1,634.0 million from services (up 11.4%), $718.9 million in product sales (up 10.9%) and $77.9 million in royalties and fees (-2.0%). Operating expenses increased 8.3% to $2,226.4 million (or to 91.6% of revenue). Costs of services was $928.5 million, cost of product at $371.0 million, site operating expenses at $199.6 million, general and administrative costs at $294.1 million, rent at $350.9 million and depreciation at $115.9 million. Operating income was $204.5 million (or 8.4% of revenue) and net income increased to $109.6 million (4.5% of revenue). Total value of assets was $1,982.1 million.

At the end of June 2006, it had a total of 11,477 salons, (up 4.4%), of which 7,559 were company-owned, 3,774 were franchised, 54 beauty career schools, 48 company owned hair restoration centers and 42 franchised hair restoration centers. In North America it had 1,079 Regis Salons, 642 Mastercuts, 634 Trade Secret, 1,903 Smartstyle/Cost Cutters in Wal Marts and 5,035 Strip Center Salons. It had 2,040 international salons (of which 1,587 were franchised).

Total revenue from North America salons increased 8.7% to $2,036.6 million (with $481.8 from Regis, $174.7 million from MasterCuts, $262.9 million from Trade Secret, $413.9 million from SmartStyle and $703.3 million from Strip Centers).

The same store increase in revenue was 0.4%, down from 0.9% in 2005.

The company's results were affected by the impact of the hurricanes Katrina, Rita and Wilma and lower product sales, which cost the company 2,700 lost salon days and $2.5 million in revenue. 15 company-owned stores were still closed at the end of December 2005.

Also in December, Regis was affected by lower retail product margins due to higher promotional activities. Overall, it indicated that it had operated in a challenging market over the previous 18 months in terms of growth in earnings. At the end of December 2005, it had 11,211 worldwide locations.

In 2005 the company acquired less than a 20.0% interest in Cool Cuts 4 Kids salons, but wrote off its contribution in 2006 due to results being less than anticipated. It still held its option to purchase the remaining stock in 2008. Also during 2006, it closed 64 underperforming Regis and MasterCuts salons, largely based in malls.

Fiscal 2007

For the first half fiscal 2007, total revenue increased 8.9% to $1,296.2 million, as service revenue increased 10.7% to $874.9 million, product revenue increased 5.5% to $381.7 million and royalties and fees increased 2.4% to $38.7 million. Operating expenses increased 9.6% to $1,205.0 million, or 93.0% of revenue. Net income was static at $50.0 million, a margin of 3.9% of revenue). Total store locations increased 2.1% to 11,713, as international stores increased 1.8% to 2,077. Same store revenue growth was 0.2%, compared to 1.0% previously. North America revenue increased 7.4% to $1,078.8 million, operating expenses were $942.1 million (87.3% of revenue) and the operating income before tax was $137.7 million (a margin of 12.8%). The company indicated that there were signs of recovery of its business in the second quarter.

Ulta Salon, Cosmetics & Fragrance, Inc.
Market Share: 0.94%

This company is privately owned by Doublemousse Investments and Global Retail Partners among others, and operates in both the hair care and beauty services components. It has around 130 stores across 16 States, with most being in Texas and Illinois. It also retails hair, fragrances and beauty products. In 2002, it had revenues of around $308 million, which was up almost 20% over 2001, and employed 3,200 people, (up by 73%). For 2003, estimated revenue was $362 million, $375 million for 2005 and $385 million in 2006.

OTHER PLAYERS

Cheveax LLC

In August 2003, Cheveax LLC purchased the 1300 Fantastic Sams salons for $17 million. Fantastic Sams operates in the US, Canada and Asia. The majority of these salons are individually owned and operated.

Industry Performance

CURRENT PERFORMANCE

Industry Contribution to GDP

- IBISWorld estimates that, in constant 2005 prices, the Hair, Nail and Skin Care Services Industry will generate $42,107 million in revenue in 2007, which represents real revenue growth of 2.3%.
- This industry will also contribute an estimated $23,293 million to the US economy in 2007, which represents 0.17% of total GDP
- The industry revenue is estimated to comprise: 73 per cent from hair care services operators, 24 per cent from nail and beauty services and 3 per cent from barber shops.

Sensitivities

- The hair care industry is sensitive to changes in real household disposable incomes, which is affected by changes in employment and from tax and interest rate changes, and more recently gas prices. It is evident that as the growth in household disposable incomes fluctuates, there is a shift in the frequency of use of hair care and beauty services, particularly of higher priced/value added services (above the basic cut service). More recently high and increasing gas prices has also affected household disposable income and consumer expenditure on hair and beauty care.

Revenue

Over the five years to 2007, real industry revenue is expected by IBISWorld to increase at an average annual rate of 3.9%, due to:

- continuing population growth;
- increasing aging of the population and demand for skin care and other pampering services, and
- the general provision of higher value/higher priced services and products to meet customer demand.

However forecast low economic growth in 2007 is expected to slow industry growth in that year.

Employment

Over the same five year period, industry employment is expected by IBISWorld to have grown at an average annual rate of 2.3% to 1.05 million and relating to the tendency to use casual and part-time staff to provide services at peak customer times. Also, some affecting this was some fluctuation in demand for services, particularly higher priced ones, as consumer sentiment falls, or when household disposable income growth comes under pressure from interest rate and gas price rises, such as in 2005 and 2006.

Value Added - Profitability

Real value added, over the five years to 2007, was expected by IBISWorld to have grown at an average annual rate of 4.1%, due largely to:

- some increase in industry employment, even with the greater use of casual staff; and

- some increase in profit margins, although it will continue to remain relatively low, due to continuing high level of industry competition, as economic growth slows in 2007.

Industry Trends

In general, the hair care industry suffers from significant financial problems caused by a lack of working capital, general lack of management and marketing skills, competition being based mainly on price, cost pressures due to over-staffing of salons (i.e. hiring of full-time staff to levels which ensure full service at peak times), low productivity and lack of profitability. Some of the above problems are being overcome by the establishment of franchised operators, although these still only account for a small part of total industry operators and revenue.

Day spas (offering massages and other services for the mind and body) to assist in relieving stress and built up life pressures were a growth segment in the beauty area. Industry surveys indicated that in 2002 around 36 % of nail and beauty salons offered day spa treatments, along with other beauty treatments, and this was estimated to have continued to grow further.

Surveys have indicated that the number of men using salons is increasing and for a greater array of services such as hair, skin, nail treatments and also purchasing retail products for home use. Referrals from near-by medical practitioners provides some additional business and salons should, particularly, develop links with local plastic surgeons.

Recent Performance By Year

2001

For 2001, the significantly slower economic growth (and, therefore, in employment and household incomes) was estimated by IBISWorld to have led to relatively slow real industry revenue of about 4.2% and value added growth, from reduced profits and employment. Both the frequency of people attending hair care and beauty salons and sales of retail products through salons fell. Coupled with the intensified price-based competition was operator consolidation. In this year, the industry experienced its first year of slow revenue growth since 1996. The events of September 11, 2001 also led to reduced consumer confidence and to an associated tightening in general consumer expenditures, especially on the higher priced services and products, towards year-end. NAILS Magazine estimated that for 2001, the revenue of the nails salon services segment, in nominal terms, was the same as in 1999.

2002

In 2002, while economic growth increased slightly, it was accompanied by reduced business and consumer confidence and increased general unemployment. The fluctuations in stock market values had a negative impact on household wealth and the failure of a number of high profile companies also depressed general confidence levels. As such, it was estimated by IBISWorld that the industry experienced lower growth in real revenue of 2.0% and in profits and employment (and therefore value added) and as competition increased. Both the frequency of people attending hair care and beauty salons, requesting higher priced value added services and the revenue obtained from the sales of retail products also slowed. Some further operator consolidation occurred. NAILS Magazine estimated that in 2002, the nail technicians' real revenue growth fell and that working hours fell, as the number of salons increased 4.1% and technicians 1.2%.

2003

For 2003, for the first half, continued low economic growth led to the industry experiencing similar trading conditions as 2002. However, the increased household disposable income from past income tax reductions and improved consumer sentiment in the second half was estimated by IBISWorld to have resulted in significantly increased real industry revenue growth, particularly in the second half year, to 3.5%. This led to improved industry employment and profits, and therefore value added growth, as the demand for hair care and beauty services increased. While competition levels remained fierce, operators were once again able to sell their higher margin, value-added services and products. In real terms, the nails segment total revenue, once again decreased marginally.

2004

In 2004, both stronger economic growth and in household disposable income was estimated by IBISWorld to have led to the industry experiencing much stronger trading conditions. Real revenue growth was, therefore, estimated by IBISWorld to have re-bounded to 7.7%, to the level last experienced in the late-1990s and in 2000. More favorable economic growth also significantly increased value added growth, as industry employment and profitability increased. Competition remained strong, but there was some increased demand for higher margin, value added hair, beauty and nails products and services. Based on Nails Magazine survey information, this industry segment's revenues grew strongly, in real terms, and possibly for the first time since the late-1990s. However, towards the end of the year, some industry components may have commenced to have felt some adverse effects on demand from the increased interest rates and of high gas prices. Both of these had a direct effect on household disposable incomes, which, in turn, adversely affected demand for industry services and product sales.

2005

In 2005, both slower economic growth and in household disposable income, was estimated by IBISWorld to have led to the industry experiencing slower trading conditions and real revenue to 3.2%, and value added growth. The industry commenced to feel the lagged effects from the general interest rate increases throughout 2005. This reduced growth in household disposable income, and, therefore, consumer expenditures, which included on hair and nail services. According to Nails Magazine survey results, the beauty segment experienced a real reduction in overall industry revenue, as well as employment. Overall, lower real revenue growth flowed through into lower growth in industry employment and profits, and, therefore, value added. Competition remained high.

2006

IBISWorld estimated that in 2006 both the continued low economic and household disposable income growth, resulted in the industry experiencing slower trading conditions, with real revenue growth at 2.9%, together with low value added growth. The industry is expected to feel the lagged effects from the general interest rate increases which occurred to mid-2006, as well as from high gas prices. These factors both had a direct impact on household disposable income, and, therefore, consumer sentiment and expenditure, including on personal services, such as hair and beauty care. Low revenue growth also flowed through into lower industry employment and profit growth, and, therefore, in value added. Competition increased significantly as revenue growth declined.

2007

In 2007, IBISWorld expects that the forecast slow economic growth and in household disposable income, will result in the industry experiencing slower trading conditions and real revenue of about 2.3%. The industry is also expected to continue to feel the lagged effects from the general interest rate increases which occurred to mid-2006, as well as from the high gas prices in the latter part of 2006. These factors have a direct impact on household disposable income growth. Overall industry competition will increase and some industry consolidation is expected, with possibly faster growth in the franchised component and from mergers and acquisitions.

Barriers to Future Industry Growth

The major barrier to future industry growth is the continuing price-based competition, in the basic services area. It is also highly sensitive to changes in economic conditions, especially any factor which affects the growth in household disposable incomes. However, the industry does potentially offer opportunities for further expansion and development of chain or franchised operators.

HISTORICAL PERFORMANCE

The hair care and beauty industry has experienced significant change in its operations over a number of years. A major change was the development of hair care salons for both males and females, away from the former barber shops which serviced only men. More recently, there has been an increased demand for beauty services, in line with the general aging of the population, and an increasing emphasis and awareness on appearance, health and lifestyle

The industry has shown a degree of sensitivity to changes in real household disposable income. In low economic growth periods, there is a tendency for customers to defer hair or beauty services, particularly higher value added ones, and to not purchase retail merchandise from salons.

During the early 1990s, it was estimated that the industry was affected by the economic recession, which led to a significantly slower real growth in household disposable incomes, as unemployment rose. This led to both decreased demand for higher priced services and reduced frequency of visits by clients. It also intensified the level of price-based competition among operators and led to salon closures and reduced industry employment.

From 1994 to 1998, the return of stronger economic growth was estimated to have led to significantly increased industry revenue and value added growth, as industry profitability and employment increased. This resulted from increased real household disposable incomes, as employment grew rapidly and from tax and, particularly, interest rates reductions. The industry also witnessed increased consumer confidence. While industry operators and employment levels increased, profit margins remained small, due to continued aggressive competition.

In 1997, the US Census Bureau found that there were 83,991 employer establishments (i.e. excluded non-employer establishments) in this industry, which had a combined revenue of $12100 million dollars (an average of revenue of $144,000 per establishment), that employed a total of 410,995 persons (an average of 5 employees per establishment) and paid total wages of $5400 million. Average salaries paid in this industry was still low. To this figure, had to be added a further 462,414 non-employer establishments (self-employed operators) which had total revenues of $8100 million.

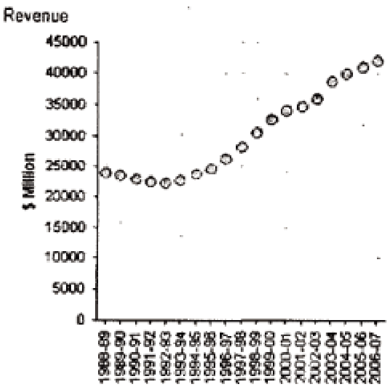
Over this period, there was a significant expansion in franchised operators, but the majority remained single shop owner-operators.

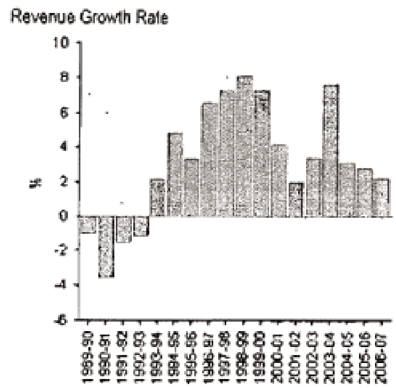
In 1999 and 2000, the strong economic growth was estimated to have led to stronger industry revenue and value added growth, as real household disposable incomes increased. This led to increased frequency of attendance at salons and increased demand for high priced/value added services (such as hair coloring and beauty treatments). In terms of the nail/beauty services, this segment was also estimated to have experienced high growth related to changed perceptions by consumers that beauty treatments were no longer a luxury, but increasingly were akin to hair care and other personal services. The emphasis in the general community on increased health and fitness and diets also assisted. Between 1997 and 1999, NAILS Magazine estimated that total industry segment revenue increased from $6,280 million to $6,440 million

The market for beauty services also expanded and included both males and females of any age group and income. Salons were established to cater for males only, as well as for various age groups.

Revenue

	Revenue $ Million	Growth %
1988-89	23,895.0	N/A
1989-90	23,656.0	-1.0
1990-91	22,828.0	-3.5
1991-92	22,465.0	-1.5
1992-93	22,234.0	-1.1
1993-94	22,726.0	2.2
1994-95	23,839.0	4.9
1995-96	24,659.0	3.4
1996-97	26,286.0	6.6
1997-98	28,210.0	7.3
1998-99	30,493.0	8.1
1999-00	32,727.0	7.3
2000-01	34,101.0	4.2
2001-02	34,786.0	2.0
2002-03	36,001.0	3.5
2003-04	38,758.0	7.7
2004-05	40,000.0	3.2
2005-06	41,160.0	2.9
2006-07	42,107.0	2.3

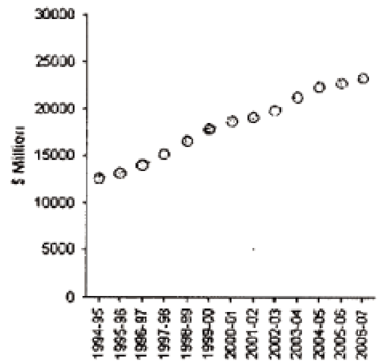




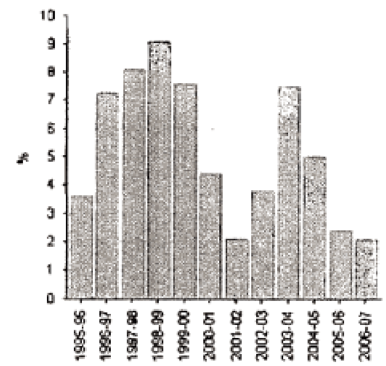
Gross Product

	Gross Product $ Million	Growth %
1994-95	12,647.0	N/A
1995-96	13,107.0	3.6
1996-97	14,065.0	7.3
1997-98	15,207.0	8.1
1998-99	16,590.0	9.1
1999-00	17,855.0	7.6
2000-01	18,641.0	4.4
2001-02	19,035.0	2.1
2002-03	19,755.0	3.8
2003-04	21,230.0	7.5
2004-05	22,289.0	5.0
2005-06	22,814.0	2.4
2006-07	23,293.0	2.1

Gross Product



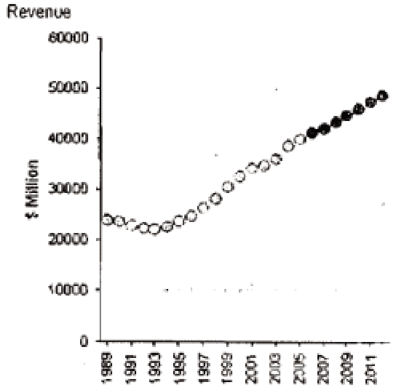
Gross Product Growth Rate

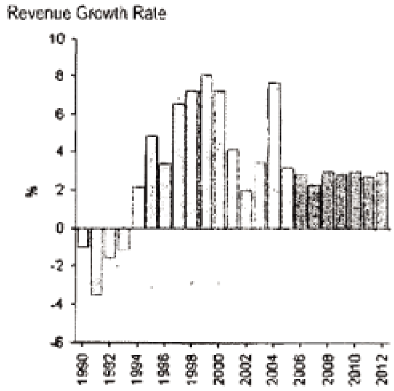


Outlook

Revenue

	Revenue $ Million	Growth %
2006	41,160.0	2.9
2007	42,107.0	2.3
2008	43,370.0	3.0
2009	44,628.0	2.9
2010	45,967.0	3.0
2011	47,208.0	2.7
2012	48,624.0	3.0





Hair, Nail and Skin Care Services Industry - Future Growth to 2012.

Revenue

Over the five years to 2012, real industry revenue is expected by IBISWorld to increase at an average annual rate of 2.9%, with this relating to:

- continuing population growth and in its aging;
- but also, in particular, from the forecast slower economic growth and, therefore, in household disposable income, which will affect the demand for higher value/priced products and services.
- Industry competition is expected to also increase due to slower growth.

Employment

Over the five years to 2012, industry employment is expected by IBISWorld to increase at an average annual rate of 2.2% to 1.17 million with this mainly relating to the increasing use of casual and part-time staff to cover peak customer service periods, especially in the expected slow industry growth environment.

Value Added - Profitability

Over the five years to 2012, real industry value added is expected by IBISWorld to increase at an average annual rate of 3.0%, which is only slightly higher than expected for GDP growth over the same period of 2.8%, with this being related mainly to industry employment growth, with only an expected marginal improvement in industry profitability, and the continuing low profit margin, due to on-going high levels of competition.

Trends

Over this period, it is expected that there will continue to be further restructuring of the hair care industry towards the establishment of unisex hair care and beauty salons, with the traditional barber shops continuing to decline.

Operators in the hair care component are expected to continue to face significant price competition. This is not so much consumer led, since having the feeling of being pampered, helping a person to feel good about themselves and overall satisfaction with the end result are repeatedly highlighted in consumer research as being the key benefits sought by their client. Price-based competition is usually salon-owner-led and is an indicator of the general lack of managerial and marketing skills of operators. The basic need, therefore, is for an improvement in overall managerial skills, especially in the marketing and financial areas and including pricing, cash flow management and cost control.

2008

In 2008 IBISWorld expects that the forecast slow economic growth and in household disposable income, will result in the industry experiencing continuing slow trading conditions, with real revenue growth of about 3.0%. The industry will continue to feel the lagged effects from the general interest rate increases which occurred to mid-2006, as well as from the high gas prices in the latter part of 2006. These factors have a direct impact on household disposable income, and, therefore, consumer sentiment and expenditure, including on hair, nail and skin care services. Demand particularly for high value services and products is expected to slow. Overall, the level of industry competition will also increase and some industry consolidation will occur, with possibly faster growth in the franchised component and from mergers and acquisitions.

2009-2012

The forecast continuing low economic growth through to 2012 is expected to lead to similar conditions as in 2008 right through this period. The industry will continue to segment into large franchised operators and niche ones that offer special services and have a very good understanding of their clients' needs, with high and consistent levels of customer service and outcomes. It will also become increasing important to offer a range of products that are suited to clients, although overstocking needs to be avoided. Franchised operators will continue to expand domestically and internationally as competition increases.

Opportunities for the industry are seen as possibly occurring in selling an increasing range of value-added hair and beauty services to men and to the baby boomer generation. Day spas have increased in some areas and among certain components of the population, especially those with above average incomes, and is expected to continue. However, these services have to be professionally targeted, delivered and packaged to the right households to succeed. Franchising of the industry is also expected to continue. Finally, in 2000 about 33% of total sales of hair care products was through salons and since this is a high margin area, this area should continue to be expanded, where possible.

Overall, the outlook for this industry is for continuing slow growth, and with continuing low profit margins, but with increasing professionalism, franchising and expansion of services into new mass (i.e. males and baby boomer generation) and niche markets (e.g. day spas) areas, as well as, from the wider market awareness and acceptance of beauty treatments and services.

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NPD REPORTS THE INTERNET IS ONE OF THE FASTEST GROWING CHANNELS FOR BUYING BEAUTY PRODUCTS

Older Women Just as Connected as Younger Ones

PORT WASHINGTON, NY, June 28, 2007 –Sales over the Internet now make up four percent of all sales or about $1.7 billion in the more than $42 billion dollar beauty industry. Even though it's only about four percent of sales- it's one of the fastest growing channels for shopping, according to a new report from leading consumer and retail information provider The NPD Group.

In its recent report, ***Emerging Channels: Beauty Care Products Over the Internet***, one in ten women across all age groups tell NPD they shop for beauty products, such as makeup, skincare, and fragrances, on the Web. Forty-three percent of women who shop for beauty on the Internet say they spent more online in 2006 than they did in 2005. The number one reason they use the Internet is convenience. More than seven out of ten (74%) of those women say it "saves time" and about 70 percent say "it's easier/quicker to shop online than a store."

"Consumers have become more wired and so they are more likely to research, choose and replenish beauty brands online. We find that women are less accepting of buying new brands over the Internet, but they are spending their money on brands they know and trust," said Karen Grant, senior beauty industry analyst for The NPD Group.

Baby Boomer women are just as likely to shop on the Internet for beauty products as their younger counterparts. Women ages 45-64 make up a large segment of the Internet shopper base, and this age group will become increasingly more important as it's the fastest growing segment of the population. In fact, among the women who shop the Web for beauty products over four in 10 (41%) are 45 to 64 years old compared to 36 percent of women who are 18-34 years old.

"Buying beauty products has traditionally been a touch and feel experience, but we are seeing women utilizing the Internet more and more to buy beauty products, particularly the brands they are familiar with. Age is not an issue; we find shopping online crosses all age groups," said Grant.

The higher the income, the greater the likelihood women will shop for beauty products via the Internet. Fifteen percent of women in the $75,000 and above category shop the Web for beauty products, versus 10 percent of women with household incomes of $35,000-44,000 and seven percent of women with household incomes of <$35,000.

Top 5 Websites Women Report Buying From
Drugstore.com
Sephora.com
Avon.com
Clinique.com
Bathandbodyworks.com

"As a channel, the growing importance of the Internet for beauty is undeniable. However, like every other channel, it also has inherent challenges that must be better understood to fully leverage its power as it relates to beauty shopping," said Grant. "For example, women love the Internet for its convenience, but they also love the in store experience. In fact, nine out of 10 females ages 18-64 tell us that the number one reason they will shop in-store is the experience of touching and feeling the products – something the Internet does not provide. So, it's important to get a deeper understanding of what drives consumer choice on the Internet. Where and how beauty is purchased is not an either-or scenario. It is the marriage of the in-store experience *with* the Internet that will secure the success for brands, manufacturers and retailers in the future," said Grant.

Emerging Channels: Beauty Care Products Over the Internet
Survey over 15,000 women ages 18-64 with an ending sample of 4,135 women who reported shopping for beauty products during the past 12 months.

About The NPD Group, Inc.
The NPD Group is the leading provider of reliable and comprehensive consumer and retail information for a wide range of industries. Today, more than 1,600 manufacturers, retailers, and service companies rely on NPD to help them drive critical business decisions at the global, national, and local market levels. NPD helps our clients to identify new business opportunities and guide product development, marketing, sales, merchandising, and other functions. Information is available for the following industry sectors: automotive, beauty, commercial technology, consumer technology, entertainment, fashion, food and beverage, foodservice, home, office supplies, software, sports, toys, and wireless. For more information, visit www.npd.com.

Age	Census 2000	Projection 2004	Projection 2005	Projection 2006	Projection 2007	Projection 2008	Projection 2009	Projection 2010	Projection 2011	Projection 2012	Projection 2013	Projection 2014	Projection 2015
Total	281421906	292800571	295507134	298217215	300512947	303597646	306272395	308935581	311600880	314201008	316971485	319687598	322385787
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21	3641087	4136130	4116810	4163905	4216042	4218301	4281192	4371538	4499594	4462255	4409469	4347208	4267795
22	3756848	4140791	4152524	4184734	4167328	4250882	4232334	4334560	4364888	4512206	4496647	4423323	4361431
23	3673582	4195608	4160579	4171716	4152257	4215145	4247730	4248635	4370669	4400977	4529376	4512404	4440483
24	3641241	4156238	4221611	4188815	4193852	4173640	4234998	4256785	4367530	4339726	4420253	4548832	4522163
25	3744539	3989156	4185246	4246071	4214273	4217782	4197784	4257848	4289635	4290476	4362902	4449654	4573419
26	3619960	3988552	4018008	4213248	4275211	4240822	4243309	4222499	4282360	4314094	4315407	4388044	4469001
27	3789605	3913420	3910302	4044764	4239062	4300205	4284866	4266775	4245713	4305789	4337754	4339077	4412180
28	3964812	3770962	3838626	3948290	4088453	4261653	4322222	4256116	4287844	4267050	4377340	4359639	4381309
29	4242525	3936827	3784417	3861478	3902808	4099671	4282193	4341609	4305544	4367460	4286946	4347422	4379842
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31	4051576	3950772	3766015	3882844	3839470	3905170	4005195	4130466	4321799	4381114	4345613	4347970	4327956
32	3904121	4033582	3871998	3803627	3900122	3868270	3921373	4020764	4145725	4377870	4396757	4361363	4363875
33	4025673	4265860	4049724	3887509	3819018	3914681	3870423	3932995	4034126	4159153	4350488	4410917	4375094
34	4185149	4256151	4270241	4062747	3900812	3832645	3927138	3862524	3946590	4046095	4371163	4362470	4422422
35	4515118	4146776	4387622	4290551	4073060	3911864	3842781	3937571	3897703	3937567	4056415	4181505	4372758
20-35	63371845	64459303	64790845	64829634	65138788	65639754	66350685	67266264	68062516	68621235	69460073	69632975	70235472
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37	4517980	4079613	4067275	4156311	4385938	4339450	4031787	3929438	3860160	3954463	3910257	3974871	4024179
38	4553914	4192076	4078506	4374968	4173572	4392479	4314756	4058125	3935964	3866816	3961275	3917299	3951970
39	4608504	4489090	4198529	4384047	4581105	4179191	4397452	4318625	4103041	3941500	3872704	3967097	3923354
40	4711434	4543101	4473904	4203672	4390052	4035670	4183643	4401314	4323850	4107650	3946381	3877858	3977258
41	4456676	4510761	4546388	4477175	4207244	4095674	4093332	4186614	4403873	4326421	4111090	3950713	3881055
42	4547220	4564074	4542784	4548081	4478984	4200378	4095751	4051235	4188368	4405320	4328591	4113410	3952092
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44	4326685	4691998	4606572	4563137	4541632	4546700	4477279	4208406	4095086	4090658	4187862	4404133	4337664
45	4341460	4626595	4687657	4632990	4550513	4537015	4542816	4475296	4205178	4002246	4088072	4185028	4401877
46	4397183	4570277	4522310	4682870	4598041	4554645	4633171	4537523	4466712	4201384	4098935	4064964	4181874
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51	3616997	4001765	4109546	4235761	4292675	4369040	4473750	4475481	4603010	4545548	4507321	4456101	4491942
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55	2450680	3601970	3721789	3709768	3827410	3937094	4542214	4215799	4213621	4318141	4401156	4402847	4599038
56	2457482	3613781	3582578	3701964	3689090	3806267	3916016	4090916	4193160	4191564	4215406	4278170	4390900
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84	801328	909781	925505	951460	951852	976066	992971	982700	987054	991990	987657	1001815	987536
85+	4239587	4912564	5120394	5339411	5565547	5743859	5935376	6123458	6284470	6434090	6575099	6694665	6821568
Total	4447100	4513287	4527486	4541263	4556107	4568080	4592038	4596300	4606620	4622248	4636437	4649632	4663111

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editor's note

Due to stagnant domestic sales, western beauty brands must move abroad to bolster their business as well as look cross-border for product-development ideas.

One article in this issue of the WWD International Beauty Report focuses on the evolution of China's beauty salon market. Alongside ramped-up pressure from local authorities, domestic companies feel the heat from multinational beauty brands—among them, Nippon Menard and Pola—which are rapidly setting up their own shops countrywide. The salon market there is already huge. In 2004, its sales leapt 37.5% to 220 billion yuan (€22.8 billion/£15.7 billion/$27.3 billion) over 2003, according to China's Beauty and Cosmetics Chamber.

In the run-up to the Cosmoprof trade show in Bologna, Italy, in early April, WWD International Beauty Report queried the country's executives about their business. While they look to make changes at home, Italian beauty marketers say they plan to expand abroad—particularly in Asia and Eastern European markets, including Russia, Japan and Korea. "You can't depend on the Italian market anymore," said Gianluca Bonetti, vice president of strategies and business development of the Deborah Group.

Meanwhile, beauty companies such as Coty Inc., Procter & Gamble and Unilever have gleaned product inspiration from the upcoming World Cup soccer championship in Germany. Executives are playing up the competition and hoping to cash in on the new themed squad of toiletries products. "With 300 million spectators, it is a unique occasion," said Muriel Pauk, marketing director at Coty Beauty, referring to the event's media coverage bringing matches to possible consumers around the planet.

Indeed, globalization is taking place at an ever-quicker clip these days.

Jennifer Weil

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contents

ON THE COVER

Photo by Delphine Achard taken backstage at the Emanuel Ungaro ready-to-wear show in Paris in March. Makeup artist Lisa Butler drew inspiration for the natural look from the designer's clothes. Hairstylist [illegible] gave the models a Seventies aura with a center part. For more on hair, see the story on page 8.


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06

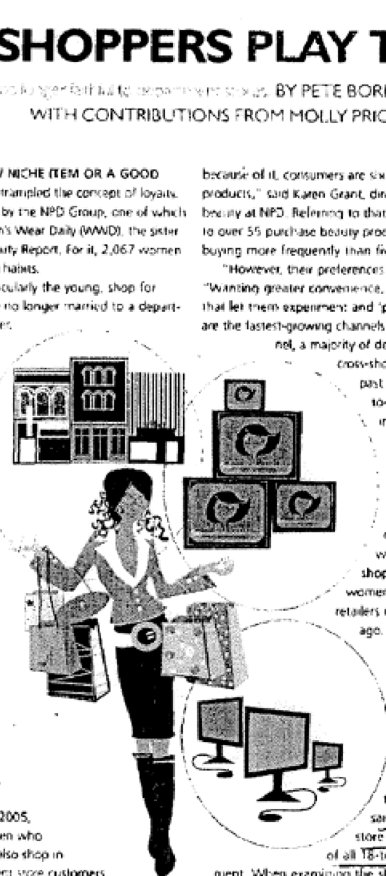
SHOPPERS PLAY THE FIELD

BY PETE BORN, WITH CONTRIBUTIONS FROM MOLLY PRIOR

WHILE SEARCHING FOR THAT NEW NICHE ITEM OR A GOOD deal, American beauty shoppers have trampled the concept of loyalty.

At least that's according to studies by the NPD Group, one of which was recently commissioned by Women's Wear Daily (WWD), the sister publication of WWD International Beauty Report. For it, 2,067 women were asked about their beauty buying habits.

Its results show that women, particularly the young, shop for beauty more these days, but they are no longer married to a department store or any other type of retailer. Increasingly, consumers are playing the field by dabbling in cosmetics specialty chains, such as Sephora or Victoria's Secret, and electronic media, like the Internet or QVC on TV.



"People are looking for something that's different," said Wendy Liebmann, industry analyst and president of WSL Strategic Retail. She added if they find that item, they will pay for it. "I don't even know how to define prestige anymore."

"Consumers are looking for choice and education," said industry veteran Jane Terker, adding once consumers find that level of trust and comfort, they'll keep returning. Today's shoppers look for a no-pressure environment offering a legitimate chance of finding solutions, added Terker, who is chief marketing officer of Klinger Advanced Aesthetics.

An earlier NPD study, which drew responses from 6,863 women in May 2005, showed two out three American women who shop for beauty in department stores also shop in specialty stores. Of the same department store customers, 41% also shop in spas and salons. Another 30% shop online.

But it doesn't work the other way. Of the specialty store clientele, less than 30% shop in department stores. Also, another 30% shop in spas and salons and 20% on the Internet, which is a magnet for the most prolific buyers.

That earlier study singled out the Internet as the channel drawing the highest proportion of women—or 38%—who have spent more on beauty products in the past year. The Internet also drew the highest number, 21%, who intend to spend more in the future.

This theme was reinforced by the recent NPD study for WWD. "Despite increased pressure on discretionary income, or perhaps because of it, consumers are shopping and they are buying beauty products," said Karen Grant, director and senior industry analyst for beauty at NPD. Referring to that study, Grant noted women aged 18 to over 55 purchase beauty products at least once a year and they are buying more frequently than five years ago—across all categories.

"However, their preferences have changed," continued Grant. "Wanting greater convenience, unique products and environments that let them experiment and 'play,' the Internet and specialty stores are the fastest-growing channels for beauty. Not tied to any one channel, a majority of department store shoppers are also cross-shopping in specialty stores, and in the past 12 months, more than half of all 18-to-24-year-olds across the U.S. shopped in specialty stores for beauty."

In terms of momentum, the specialty chains and Internet have a small portion of shoppers in the WWD survey but the most dramatic growth in attracting customers. In makeup, for instance, only one in 10 women list specialty stores as "usually shopped," but more than 60% of these women say they are buying from these retailers more often that they were five years ago. The Internet shows a similar story.

Age dynamics are revealing. Analysts note younger consumers look for ideas and directions. According to the survey, these consumers are constantly on the lookout for advice, in-store or through an ad.

The earlier NPD study indicated that 40% of women aged 18-to-64 said they had shopped in a specialty store in the previous year. A total of 55% of all 18-to-24-year-olds made the same statement. When examining the shopping constituencies of specific retail chains, it was revealed that 68% of Sephora's female shoppers were 18 to 34, with 27% between 18 and 24. At Victoria's Secret, 59% of the chain's female beauty shoppers are between 18 and 34, with 32% being 18-to-24. For department stores, less than half—or 42%—are 18-to-34.

Liebmann sees a seismic shift in progress with consumers gravitating toward either "supersized" outfits like Wal-Mart or highly specialized boutiques like the Apple stores. "Department stores fall through the cracks," she declared. "They do less and less specializing, lack service and can be intimidating. Value, ease-of-shopping experience, emotion and an edited mix are the factors driving the shift." ■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HAIR TODAY, YOUNG TOMORROW

BY ELLEN GROVES

BEAUTY BRANDS' LATEST ELIXIRS ARE MEANT TO KEEP HAIR from showing signs of age by reinvigorating scalps and protecting from pollution.

Hair, like skin, changes as people get on in years.

"With time, the production of sebum diminishes and the scalp becomes dry," said Rolario de la Mettrie, scientific director at L'Oréal Professional Products division, in a release. "Hair can thus loose its softness, suppleness and shine. Micro-circulation and cellular exchanges slow down, the root loses vitality and produces hair that is thinner and less toned."

From a marketing standpoint, targeting the aging baby-boomer population is alluring, since it represents a growing demographic. Worldwide, there are 629 million people more than 60 years old, three-times more than 50 years ago, according to United Nations research. In France alone, 30% of the population is older than 50.

These baby boomers have deep pockets, with money to spend on keeping that youthful glow.

Beauty executives see anti-age hair care as a natural progression.

"It's related to the growing trend of anti-aging skin care," said Edina Dobos, product manager of Stockholm-based Oriflame Cosmetics, which debuted a three-unit anti-aging line for older hair in more than 50 countries in October 2005. "The target group of mature and elderly women is growing, and they are looking for products adapted to their specific needs."

And those needs have shifted.

"Now, at 60 years old, you can still be a beautiful woman—not necessarily [just] a grandmother," said Muriel Guillo, marketing director of Phyto, owned by the Paris-based Alès Groupe.

L'Oréal's Kérastase brand came up with a product for the scalp and another for the hair that are combined with a massage in salons. Called Age-Resist, the three-step program said to strengthen often brittle, aging hair, was introduced in France at the end of February.

A two-step version for at-home use bowed in tandem. It comes in a set comprising 10, 6-ml. bottles of Lipo-Recharge massage treatment, said to reinforce the scalp's hydro-lipidic film, which becomes weaker and more sensitive with age, and to protect it from external factors. There is also a 200-ml. jar of Age Recharge strengthening hair mask, containing a complex designed to reinforce a hair shaft's core. The duo retails for €65 (£45/$78).

Oriflame's three-unit Anti Ageing collection contains a strengthening complex that also provides a film to protect hair's surface and anti-oxidants to protect hair from damage from pollution, weather and over-styling.

The line includes a 250-ml. shampoo and a 250-ml. conditioner both for €4.50, and a 125-ml. mask, for €7.

While Dobos declined to discuss specific figures, she said the anti-aging line has outperformed the brand's existing hair care collections.

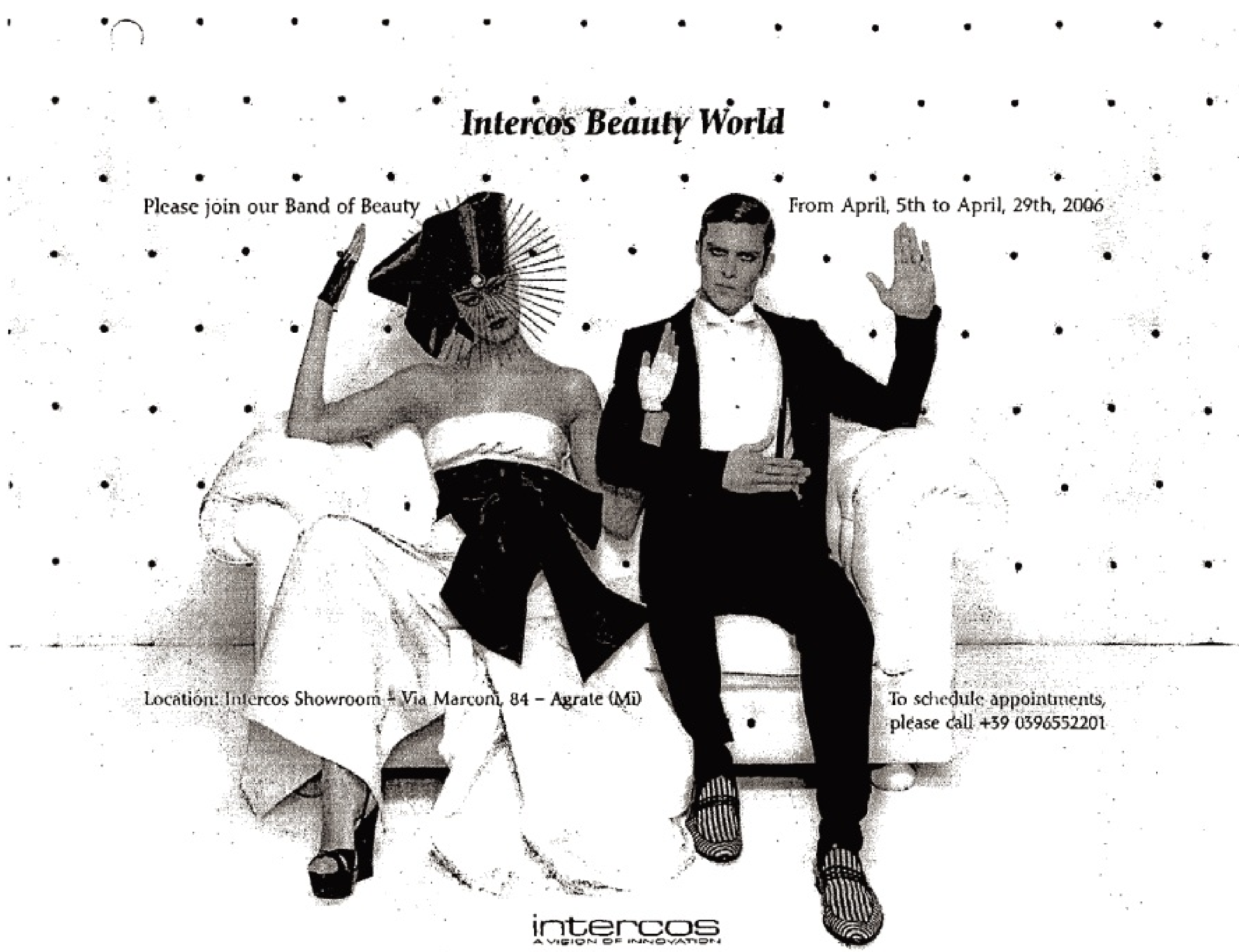
It's not just older consumers being targeted by anti-aging hair care lines. As with skin care, some brands claim their products have a preventative function, that people starting from the age of 30 should begin taking steps to fortify their hair.

"We know that with age, like the skin, hair becomes finer and loses its thickness," said Phyto's Guillo. "Earlier and earlier, women try and slow down aging, and now you can use hair products for prevention, like a cosmetics cream, when you're in your thirties and forties."

Phyto's two-unit Phytodensium is an anti-aging line including a shampoo said to restore minerals to hair's fiber and provide a protective film on the hair's surface. There is also a serum—to be applied directly to the scalp—containing Gatuline Age Defense, a vegetable active ingredient that fights free radicals, blackcurrant seed oil and omega acids, which are billed to regenerate the scalp.

The duo comprises a 200-ml. shampoo and a 50-ml. serum, which retail for €11 and €30, respectively.

Alès sold 90,000 units of Phytodensium in the three months following its October 2005 launch. A treatment mask may be added to the lineup, said Guillo. ■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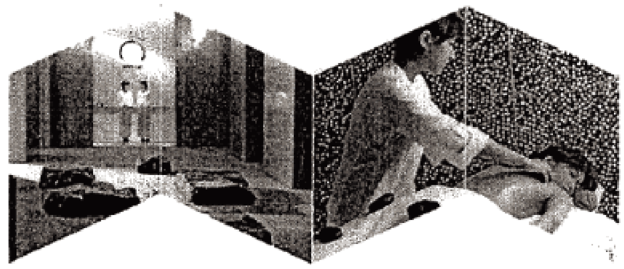

CHINA'S SALONS FEEL THE RUB

BY JANE MOIR

CHINA'S BEAUTY SALON INDUSTRY IS READYING FOR A FACELIFT.

As women across the country spend more than ever on beauty treatments, local parlors are coming under intense pressure to raise the bar. There are tough times ahead for the majority of small operators offering little more than a couple of beds and one masseuse in a 555-sq.-ft. converted apartment.

But foreign companies that have started nibbling at the edges of this fast-growing market are poised to make serious progress in launching their own beauty salons.

In most of China's major cities, they are already making their presence known. Japanese brands such as Nippon Menard have sought to tap the high end of the market, with eight salons in China.

Menard's peer Pola just opened its second salon in Shanghai in September, where a two-hour treatment at 500 yuan (€62/£43/$75) outstrips the national average by six times.

Leading the charge, however, are salon chains from Taiwan and Hong Kong. Taipei-based Natural Beauty has rolled out 850 salons across China, while Hong Kong's BAL Holdings plans to open 100 parlors over the next five years with joint-venture partners in cities such as Guangzhou, Shenzhen and Xi'an.

As they compete for mid-range clientele, an increase in disposable income is giving the larger chains an edge. Chinese women can now afford to avoid the smaller parlors that have for years been dogged by tales of botched treatments and dangerous mishaps.

Over the past decade, more than 300,000 people have been injured as a result of shoddy beauty treatments, according to the China Beauty and Hairdressing Association.

More than 200,000 disputes involving beauty salons have, moreover, been reported to the China Consumer Association since 1995.

"There are so many small enterprises that have got two beds and call themselves beauty parlors," said Bernadette Lai, director of spa development at the Shangri-La's Chi spa in Shanghai, which was opened in September. "They are using laser machines that should be handled by a doctor or professional."

The government recently stepped in to force some kind of quality control. A draft notice was issued by the Ministry of Commerce last April demanding the industry set up a "blacklist" system, under which salons that failed to meet basic standards would be reported to the authorities.

The Chinese ministry is also drafting detailed standards for the industry, which is expected to result soon in a star-rating system. China's 1.72 million beauty parlors will be under pressure to call it quits unless they improve their game.

The stakes are high. Rapid growth in China's beauty business has turned the salon industry into a huge moneymaker. Sales in 2004 leapt 37.5% to 220 billion yuan in 2004 over 2003, according to China's Beauty and Cosmetic Chamber.

A group of economists at Beijing Normal University in August, moreover, predicted the sector's earnings will double over the next five years.

Such figures reflect a general boom in cosmetics demand. Average yearly spending on beauty items has increase from about 1 yuan in the early Eighties to 25 yuan in more recent years.

Traditionally, 40% of customers will visit their local beauty salon once a month, while one-third will go two to three times monthly. Body and neck massages are the most popular treatments.

"Massages are more important than facials [for customers]," said Amanda Teng, assistant director at the Evian Spa in Shanghai. "Even when it comes to a facial, they want a massage throughout."

Customers are also very particular about the facial products used in treatments. However, brand recognition is still low compared to what it is overseas.

Yet that's set to change. Foreign companies with a quality track record look set to gain a definite edge as skills and service take on greater importance. Big multinational brands, such as Groupe Clarins, are rumored to be eyeing the possibility of opening a beauty salon in Shanghai.

And Teng expects foreign competition to intensify.

"I have been hearing news of a lot of spa companies coming in over the next half year," she explained.

This is echoed by Lai, who added, "I think it's all happening. It's all go-go out there." ■

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ITALY CHANGES TACK

It hasn't been smooth sailing for the country's beauty companies, so they're shifting course. BY STEPHANIE EPIRO

IN THE WAKE OF A THREE-YEAR SLUMP, ITALY'S BEAUTY INDUSTRY IS GEARING UP FOR some major changes—both at home and abroad.

For 2005 (the latest year's statistics available at press time) the business' sales were expected to rise just 2.7% to €7.4 billion (£5.1 billion/$8.9 billion) over 2004, according to Unipro, the Italian association of cosmetics industries.

"The Italian economy is really suffering, and that is reflecting back on the industry," said Fabio Franchina, Unipro's new president. "We are facing two major problems. We need to grow outside the country, and internally, we need to have an evolution in the industry. For Italian beauty companies to move ahead now, they need to specialize in something that's of great quality and great service."

Gianluca Bonetti, vice president of strategies and business development of the Deborah Group, agreed, saying, "You can't depend on the Italian market anymore."

Numerous factors have contributed to this phenomenon. Among them was the introduction of the euro, which drove consumer goods prices up and helped drive down consumer confidence, which now is at its lowest since 1996, said Oma Schezen Nolarber, managing director of the Estée Lauder Cos. Italy. Further, beauty manufacturers have only recently begun diversifying

their product offer to meet the needs of an increasingly segmented trade channel, in which pharmacies and herbal stores have gained muscle, she added.

There's been ramped up competition from Asia, as well.

"We can't compete with China on packaging, promotion and makeup kits. In fact, what Italian cosmetics producers need to do now is effectively reduce costs of production while not losing the quality that we are famous for," said Roberto Martone, chairman of ITF-ICR.

Changes are expected to take place on Italy's beauty retail front, too.

"Italian consumers like the ease of buying their products in perfumeries within stores, and the market is starting to shift [in that direction]," said Alfredo Grasselli, a partner at management consultancy Bain & Co., referring particularly to new beauty corner formats being conceived for supermarkets.

He added that half of Italian consumers still prefer buying makeup from traditional perfumeries, however. Yet such perfumeries, in turn, are feeling the heat from mass-market beauty sellers. And the resulting price war has picked up speed over the past three years.

Mazzolari, among Italy's most prestigious perfumery chains, with five stores in Milan and 23 Olimpia stores elsewhere in Italy, is leading a group of perfumeries, including Gruppo Garbo, Rosa Bianca and Desireé, intent on stabilizing prices.

"We want to work together to make a stand on brands that should have similar prices in perfumeries across the board," said Antonella Mandelli, general manager of Mazzolari. "How can you sell a customer something if she knows she can get it down the street with a big discount?"

For other retailers, their focus more than ever is on customer service.

"Prices are really important, but we will invest more money this year on bettering the quality of our service," said Stefano Biagi, commercial director of Limoni.

Other manufacturers are changing their production to lower-priced beauty goods. Massimo Bedin, commercial director of Medicea, a two-year-old company that produces perfumery lines destined for the youth market, such as Sweet Years and Billionaire, said the company's sales growth of 54% to €6 million last year was largely driven by fragrances costing less than €30.

"Our consumers watch their money, but they want to come into a perfumery and buy a good-quality product—our lines are really accessible," he said. "I think the Italian perfumery of the future will be one that sells a lot of products with a price range from €0.50 to €200."

Ultra-expensive beauty items are selling well in Italy. Executives at perfumeries Mazzolari and Limoni recorded strong sales of über-prestige products, such as Estée Lauder's Re-Nutriv Re-Creation cream, which goes for €500.

"Nice growth is coming from the very selective, high-positioned brands," said Estée Lauder's Nolarber. "This segment has not been impacted by the decline in consumption. Estée Lauder brands like Re-Nutriv Re-Creation and La Mer, very selectively distributed, are part of this trend."

However, the biggest growth for Italy's beauty business is predicted to stem from exports.

"You can't depend on the Italian market anymore."

— Gianluca Bonetti, vice president of strategic development of the Deborah Group

At press time, sales abroad were expected to have risen 6.5% to reach €2.13 billion in 2005 versus 2004.

Russia and China are considered key markets for the industry. Export sales there from Italy were believed to increase 41% and 133%, respectively, in 2005. A relatively new entry on the export scene for Italy is Vietnam. Sales to that country spiked 160% for the first three quarters of 2005 versus 2004, said Unipro.

Most Italian beauty executives regard exporting as key to survival. Even historically Italy-centric companies, such as Deborah Group, have begun exploring new horizons. For example, the company plans to export its Health & Color line to two new markets—the U.K. and U.S.—by 2008.

Ferragamo Parfums is among the many Italian companies gearing its strategy toward selling in Asian countries, where it is enjoying retail success.

Luciano Bertinelli, perfumes division director of Ferragamo Parfums, said the company had achieved extraordinary sales in Japan—where they increased 39% in 2005, and in Korea, where Ferragamo Parfums is the seventh bestselling brand. Set to launch a new women's Salvatore Ferragamo scent this spring, the company's fragrance arm will invest in television advertising for the first time in Japan and Korea. Ferragamo Parfums will also rework the juice of Emanuel Ungaro's Apparition fragrance, since it was considered too sweet by some Asian retailers. The re-launch is expected next year.

"Korea and Japan are markets that are running at top speed for us," said Bertinelli. "It's an extraordinary world that presents thousands of opportunities that we will be part of." ■

PACKING A PUNCH

BY BRID COSTELLO

Blinking lights, zany holograms and flashy games. Sound like a scene from Las Vegas? Maybe. But if packaging designers have their way, perfumery and supermarket cosmetics shelves will look just as glitzy in the very near future. Creators are busy concocting newfangled, high-tech methods to attract shoppers' attention. And it's a good thing, considering the thousands of new products hitting beauty counters yearly, making statement-making paramount. Here, WWD International Beauty Report reports on some new designs likely to cause an in-store stir.

SCREEN SCENE

Siemens has created technology that will allow brands to bring their products' packaging to life.

The Munich-based firm is perfecting miniature screens to display animated graphics—such as advertising, how-to instructions or computer games—on labels.

"[The technology] could be used on any kind of packaging," said a company spokesman.

Such displays show images in color and can be printed on paper-foil labels. They work thanks to electrochromic materials, which change color when an electrical volt alters their molecules' charge. As this shifts, the colors alter to create the effect of moving pictures. The labels are charged using printable batteries that last for several months.

Such animated labels are expected to be commercially available next year.

Siemens touts the technology as being accessible for any industry and distribution channel—including the mass market. That's because the cost per label will likely be in cents, not euros, the company spokesman said.

METAL WORKS

A pair of eyes appears and disappears as a customer strolls around a store. But it's not an over-zealous sales assistant following her around. Rather, it's the latest packaging for an eye cream featuring holographic print.

MetalFx, a Leeds, England-based company, has developed HoloFx, a printing system that enables images to appear and disappear according to changes of light. It can even create holograms.

"We're adding value with an attractive finish," said Philip Sheppard, marketing manager at the firm. "It puts [a brand using the technology] ahead of the crowd."

For the beauty industry, MetalFx's metallic printing technology could allow cosmetics brands to reproduce shimmering makeup shades on packaging and advertising.

The technology is already being used on some food and toy packaging, added Sheppard.

SAFE SCENT

ScentSational Technologies is serious about security. So much so, in fact, that the Jenkintown, Pennsylvania-based firm has developed a fragrance encapsulation technology that lets shoppers smell a product without actually meddling with the substance itself.

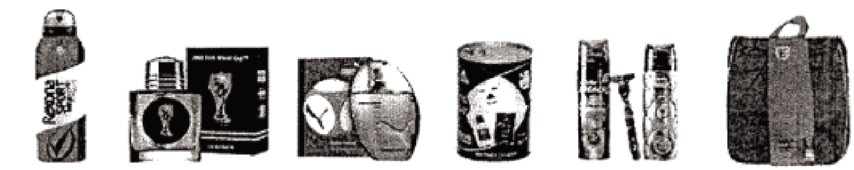
"Most people who buy a shampoo open it and smell it," said Steven Landau, chief technology officer at the firm, adding companies shy away from using tamper-proof seals as that could impede the shopper's purchase decision. But this could have a serious downside. "If you don't put a tamper-evident system in place, your product is potentially exposed, and someone could tamper with the product," said Landau.

To ensure the safety of a formula, ScentSational Technologies allows brands to inject the scent of their shampoo, for example, into the lid of the packaging, so that when shoppers open it they can smell the product's odor from the cap, while the liquid remains protected by a safety seal.

"They probably wouldn't realize [the smell was coming from the cap]," said Landau, adding the cost of such a system is minimal, estimated at less than one cent per product.

MARKETERS HAVE A BALL

BY MELISSA DRIER, WITH CONTRIBUTIONS FROM ELLEN GROVES AND BRID COSTELLO



TO HELP KICK OFF THE WORLD CUP SOCCER CHAMPIONSHIPS in Germany, from June 9 to July 9, the beauty industry is putting together a team of special-edition products.

Soccer fans might never have been particularly known for their sweet-smelling behavior. But Coty Beauty, for one, sees huge potential in its Adidas Victory League men's fragrance line, due out in April in mass-market doors in Europe, the Middle and Far East, plus Latin America.

"With 300 million spectators, it is a unique occasion for Adidas," said Muriel Pauli, marketing director at Coty Beauty, referring to the event's widespread media coverage bringing the matches into homes around the globe.

The brand's special-edition line for men, including an eau de toilette, aftershave, shower gel and deodorant, range in price from €3.50 (£2.40/$4.20) to €13.80.

Coty intends to beat the score set by its previous soccer scents (for the Euro 2004 competition, for instance, it sold 4.4 million units). Executives banking on Adidas's high visibility as one of the World Cup's official sponsors are targeting global sales of 7 million units for Adidas Victory League.

In France and Germany, the collection will be available in a gift set, called the Supporter's Kit, which includes face paints in each participating country's national colors.

Adidas has also created a soccer dream-team to advertise the brand. It plans to run 12 different posters, each starring a high-profile player, including France's Zinedine Zidane and England's David Beckham.

Puma, which sponsors various World Cup teams, such as Italy, Ghana and Senegal, is after soccer-loving guys and gals with its fragrance duo, Puma Limited Edition Woman and Man, which was launched in March. The fragrances are packaged in red for her and blue for him, with a soccer ball-shaped window cut into their outer boxes. Prices for the line, also including shower gel and body lotion, are €10 to €15.

While producer Procter & Gamble executives remained mum on a sales target, industry sources estimate the line will bring in €60 million at retail in its first year.

Douglas Perfumeries also caught soccer fever in March, when it offered an exclusive on the licensed men's World Cup fragrance, FIFA WM 2006. Available in Douglas doors in Germany, Holland, Switzerland, Italy, France, Spain, Portugal, Hungary, Poland, Slovakia, the Czech Republic and Denmark, plus Douglas online, the 100-ml. eau de toilette spray retails for €29.95.

"It's performing fantastically and is a top-seller at the moment," said a Douglas spokesman. "Women are buying it for men; collectors are snapping it up, and it's sure to be a prized souvenir during the World Cup."

There are numerous toiletries products out with World Cup themes, including Rexona's deodorant, introduced in February, to help fans keep their cool. The Unilever-owned brand launched the limited-edition Men Sport product packaged in colors of participating nations, including France, Brazil, Germany and Poland. The 200-ml. can, priced at €3.36, contains an antiperspirant agent billed to reduce humidity by 40%.

Official World Cup partner Gillette launched a shaving gel with packaging sporting the tournament's logo to go with the introduction of its Mach3 Power Nitro razor in January. The P&G-owned brand introduced the razor, for €5.90, and gels, from €4, in the U.K., Spain, Portugal, Italy and Germany. And visitors to Gillette's website can compete to win much sought-after World Cup tickets.

Among the earliest in the game was Link Brand Solutions, of Chesterfield, England, which created a grooming products line under license for England's Football Association. The collection, comprising two shower gels, two deodorant sprays and a range of gift sets, is available in two scents, "Home" and "Away." It bowed in Sainsburys supermarket chain during the holidays.

"Our target market is into football," said managing director Ivan Taggart, noting the products have been selling well as both gifts and personal items. Over the Christmas period alone, 100,000 gift sets with an average retail price of £5.99 were sold. However, Taggart expects sales to increase ten- to twentyfold in the run-up to the World Cup.

He underlined, however, that astute branding is key for a product's longevity following the soccer season.

"If it's purely a brand-slapping exercise on a weak product, there's not too much to be gained in the development of the male grooming market," he said. ■

MEMO PAD

CLICK CAFES

Lynx has often boasted that its odiferous body sprays help males attract female admirers. And recently, the Unilever-owned men's beauty brand was out to prove it. During the month of March, the brand (a.k.a. Axe, in France) ran "Click Cafes" around Europe that were inspired by its latest fragrance, Click.

The spaces, created to attract students, were full of attractive girls hired by Lynx. Boys entering the cafés were judged on their powers of seduction by girls scoring them with clicks of handheld gizmos. The highest-scoring guy at each event then had his picture taken—in a pose like that of actor Ben Affleck in an earlier Axe commercial—and then the image was displayed in the café where the event was held.

"Young people like to keep score on everything," explained a spokesman for the Lynx brand, adding that "click dating," a take on speed dating, was also among the Click Cafés' girl-meets-boy activities.

ONLINE TIME

Parfums Hermès tried to net male consumers via the Internet for its newest fragrance before it hit shelves.

The company ran terre-et-ciel.com, a site dedicated to its men's scent Terre d'Hermès, from Feb. 19 to March 4, two weeks before the product's in-store launch. Each day, information pertaining to the scent's concept was revealed on the site. Meanwhile, a clock counted down time to when the site's full purpose would be revealed.

The idea was to generate buzz in a noncommercial way, said an Hermès spokesman.

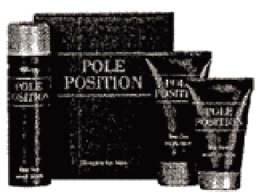
"What we wanted with the idea of introducing the website before introducing the product was to go step-by-step, creating desire," he said. "We didn't want it to be very branded on purpose because it's about the experience linked to the universe of Terre d'Hermès."

COMPETITIVE BRAND

Men are often found racing out of perfumeries. That's why Formula One star David Coulthard's men's grooming line, Pole Position, was designed to give men a break from visiting stores altogether.

Introduced in March, the three-unit treatment collection—including a 40-ml. face wash, a 40-ml. shaving foam and a 30-ml. moisturizing balm for $34 (€24.80/£19.50)—is delivered directly to customers' doors. Store-averse shoppers can buy the products online and even have their order automatically renewed monthly.

"People are really busy," said Justine Sparks, marketing director at Norfolk, England-based Direct Beauty Products, the brand's producer. "We're all looking for faster ways to get things done. Women enjoy picking out their cosmetics, but men don't so much. This is a very simple way of receiving your essentials each month."



FRAGRANCE FEATURE

Esquire magazine teamed with Elizabeth Arden to host a competition promoting the Provocative Woman scent. For the event, Esquire asked readers to nominate their partners to star in a photoshoot inspired by the fragrance.

"The feature brings interesting content and beautiful photography to the magazine," said Helen Brocklebank, group promotions director at NatMag, Esquire's parent company. "Through this competition, readers can see what men really view as sexy in a woman, including personality and not just looks."

Five finalists will appear in the four-page piece, which is to be in magazine's April issue.

PREEMPTIVE ACTION

Kingfisher Airlines is offering fragrances and cosmetics for free to travelers before they even get to the airport.

The Indian airline gives beauty product vouchers valued at 4,000 rupees (€75/£52/$90) to its customers spending 10,000 rupees or more on a pair of air tickets. The coupons are then redeemable in department stores and perfumery chains in India, including Shoppers' Stop and Life Style.

The program, which was kicked off on Jan. 23 and runs through June 30, is called Scent of Good Times.

"The idea behind the scheme is to associate with like-minded leading international brands to provide maximum value to our guests and also create an opportunity to communicate with the relevant target audience through a non-conventional platform," said Girish Shah, general manager of marketing for the airline, in a statement.


What is the most delicate part of your face? Your eyes... Take a look and see. Clarins created Sun Wrinkle Control Eye Contour Care SPF 30 which is lightweight, oil-free and invisible with 100% mineral filters. It helps prevent fine lines and protects against over dry skin. But it doesn't take away what the sun does best: make us look happy and sparkling for a long time.
A beautiful tan with less sun exposure, that's smart sun protection.
A technological breakthrough. Clarins new Phyto-Sunactyl 2 Complex includes Senna, Olive, Baobab, Pea and Plane tree extracts which help preserve skin's youthful qualities. 100% mineral filters and a non-oily texture respect the delicate nature of the eye contour area.
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