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Ulta Salon, Cosmetics & Fragrance, Inc.

Form 10-Q

June 03, 2010

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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549
FORM 10-Q**

**Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the Quarterly Period Ended May 1, 2010**

or

**Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the transition period from _____ to _____**

**Commission File Number: 001-33764
ULTA SALON, COSMETICS & FRAGRANCE, INC.
(Exact name of Registrant as specified in its charter)**

Delaware
(State or other jurisdiction of
incorporation or organization)

36-3685240
(I.R.S. Employer
Identification No.)

**1000 Remington Blvd., Suite 120
Bolingbrook, Illinois**
(Address of principal executive offices)

60440
(Zip code)

Registrant's telephone number, including area code: (630) 410-4800

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

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

Indicate by checkmark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definition of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

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

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

The number of shares of the registrant's common stock, par value \$0.01 per share, outstanding as of May 27, 2010 was 58,623,805 shares.

**ULTA SALON, COSMETICS & FRAGRANCE, INC.
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Balance Sheets**

(In thousands)	May 1, 2010 (unaudited)	January 30, 2010	May 2, 2009 (unaudited)
Assets			
Current assets:			
Cash and cash equivalents	\$ 8,670	\$ 4,017	\$ 3,840
Receivables, net	8,051	13,477	12,392
Merchandise inventories, net	228,082	206,948	230,286
Prepaid expenses and other current assets	29,134	30,272	24,200
Prepaid income taxes			5,890
Deferred income taxes	8,060	8,060	8,195
Total current assets	281,997	262,774	284,803
Property and equipment, net	285,766	290,861	286,140
Total assets	\$567,763	\$553,635	\$570,943
Liabilities and stockholders equity			
Current liabilities:			
Current portion notes payable	\$	\$	\$ 12,534
Accounts payable	60,693	56,387	53,500
Accrued liabilities	54,789	59,189	43,757
Accrued income taxes	6,740	10,781	
Total current liabilities	122,222	126,357	109,791
Notes payable less current portion			88,047
Deferred rent	114,051	113,718	104,168
Deferred income taxes	20,952	20,952	17,616
Total liabilities	257,225	261,027	319,622
Commitments and contingencies (note 3)			
<i>See accompanying notes to financial statements.</i>			

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Ulta Salon, Cosmetics & Fragrance, Inc.
Balance Sheets (continued)

(In thousands, except per share data)	May 1, 2010 (unaudited)	January 30, 2010	May 2, 2009 (unaudited)
Stockholders' equity:			
Common stock, \$.01 par value, 400,000 shares authorized; 59,095, 58,674 and 58,254 shares issued; 58,590, 58,169 and 57,749 shares outstanding; at May 1, 2010 (unaudited), January 31, 2009 and May 2, 2009 (unaudited), respectively	\$ 591	\$ 586	\$ 583
Treasury stock-common, at cost	(4,179)	(4,179)	(4,179)
Additional paid-in capital	304,965	300,701	294,377
Retained earnings (accumulated deficit)	9,161	(4,500)	(38,936)
Accumulated other comprehensive loss			(524)
Total stockholders' equity	310,538	292,608	251,321
Total liabilities and stockholders' equity	\$567,763	\$553,635	\$570,943

See accompanying notes to financial statements.

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Ulta Salon, Cosmetics & Fragrance, Inc.
Statements of Income
(unaudited)

(In thousands, except per share data)	Three months ended	
	May 1, 2010	May 2, 2009
Net sales	\$ 320,196	\$ 268,825
Cost of sales	215,661	189,283
Gross profit	104,535	79,542
Selling, general and administrative expenses	80,729	69,393
Pre-opening expenses	474	1,195
Operating income	23,332	8,954
Interest expense	118	671
Income before income taxes	23,214	8,283
Income tax expense	9,553	3,363
Net income	\$ 13,661	\$ 4,920
Net income per common share:		
Basic	\$ 0.23	\$ 0.09
Diluted	\$ 0.23	\$ 0.08
Weighted average common shares outstanding:		
Basic	58,306	57,743
Diluted	60,276	58,750

See accompanying notes to financial statements.

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Ulta Salon, Cosmetics & Fragrance, Inc.
Statements of Cash Flows
(unaudited)

(In thousands)	Three months ended	
	May 1, 2010	May 2, 2009
Operating activities		
Net income	\$ 13,661	\$ 4,920
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	15,918	15,365
Non-cash stock compensation charges	1,735	1,295
Excess tax benefits from stock-based compensation	(724)	
Loss on disposal of property and equipment	197	39
Change in operating assets and liabilities:		
Receivables	5,426	5,876
Merchandise inventories	(21,134)	(16,684)
Prepaid expenses and other assets	1,138	94
Income taxes	(3,317)	2,738
Accounts payable	4,306	5,689
Accrued liabilities	(7,722)	(4,255)
Deferred rent	333	2,880
Net cash provided by operating activities	9,817	17,957
Investing activities		
Purchases of property and equipment	(7,698)	(12,320)
Net cash used in investing activities	(7,698)	(12,320)
Financing activities		
Proceeds on long-term borrowings		284,284
Payments on long-term borrowings		(289,750)
Proceeds from issuance of common stock under stock plans	1,810	31
Excess tax benefits from stock-based compensation	724	
Net cash provided by (used in) financing activities	2,534	(5,435)
Net increase in cash and cash equivalents	4,653	202
Cash and cash equivalents at beginning of period	4,017	3,638
Cash and cash equivalents at end of period	\$ 8,670	\$ 3,840

Supplemental cash flow information

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Cash paid for interest	\$ 94	\$ 723
Cash paid for income taxes	\$ 12,870	\$ 625
Noncash investing and financing activities:		
Change in property and equipment included in accrued liabilities	\$ 3,322	\$ (3,000)
Unrealized gain on interest rate swap hedge, net of tax	\$	\$ 107

See accompanying notes to financial statements.

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Ulta Salon, Cosmetics & Fragrance, Inc.
Statement of Stockholders Equity
(unaudited)

(In thousands, except per share data)	Common Stock Issued Shares	Common Stock Amount	Treasury Common Stock Shares	Treasury Amount	Additional Paid-In Capital	Retained Earnings (Accumulated Deficit)	Total Stockholders Equity
Balance January 30, 2010	58,674	\$586	(505)	\$(4,179)	\$300,701	\$ (4,500)	\$292,608
Common stock options exercised	421	5			1,805		1,810
Net income for the three months ended May 1, 2010						13,661	13,661
Excess tax benefits from stock-based compensation					724		724
Stock compensation charge					1,735		1,735
Balance May 1, 2010	59,095	\$591	(505)	\$(4,179)	\$304,965	\$ 9,161	\$310,538

See accompanying notes to financial statements.

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Ulta Salon, Cosmetics & Fragrance, Inc.
Notes to Financial Statements
(unaudited)

1. Business and basis of presentation

Ulta Salon, Cosmetics & Fragrance, Inc. (Company or Ulta) was incorporated in the state of Delaware on January 9, 1990, to operate specialty retail stores selling cosmetics, fragrance, haircare and skincare products, and related accessories and services. The stores also feature full-service salons. As of May 1, 2010, the Company operated 347 stores in 38 states, as shown in the table below:

State	Number of stores
Alabama	7
Arizona	23
Arkansas	1
California	30
Colorado	11
Connecticut	1
Delaware	1
Florida	25
Georgia	16
Illinois	33
Indiana	6
Iowa	3
Kansas	1
Kentucky	2
Louisiana	2
Maryland	6
Massachusetts	4
Michigan	9
Minnesota	7
Mississippi	3
Missouri	3
Nebraska	2
Nevada	6
New Jersey	11
New York	12
North Carolina	13
Ohio	7
Oklahoma	7
Oregon	3
Pennsylvania	16
Rhode Island	1
South Carolina	6
Tennessee	3
Texas	46
Utah	2
Virginia	10
Washington	5
Wisconsin	3

Total

347

The accompanying unaudited financial statements and related notes have been prepared in accordance with U.S. generally accepted accounting principles (GAAP) for interim financial information and with the instructions to Form 10-Q and the U.S. Securities and Exchange Commission's Article 10, Regulation S-X. In the opinion of management, the accompanying financial statements reflect all adjustments, which are of a normal recurring nature, necessary to fairly state the financial position and results of operations and cash flows for the interim periods presented.

The Company's business is subject to seasonal fluctuation. Significant portions of the Company's net sales and net income are realized during the fourth quarter of the fiscal year due to the holiday selling season. The results for the three months ended May 1, 2010 are not necessarily indicative of the results to be expected for the fiscal year ending January 29, 2011, or for any other future interim period or for any future year.

These interim financial statements and the related notes should be read in conjunction with the financial statements and notes included in the Company's Annual Report on Form 10-K for the year ended January 30, 2010. All amounts are stated in thousands, with the exception of per share amounts and number of stores.

2. Summary of significant accounting policies

Information regarding the Company's significant accounting policies is contained in Note 2, Summary of significant accounting policies, to the financial statements in the Company's Annual Report on Form 10-K for the year ended January 30, 2010. Presented

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below in this and the following notes is supplemental information that should be read in conjunction with Notes to Financial Statements in the Annual Report.

Fiscal quarter

The Company's quarterly periods are the 13 weeks ending on the Saturday closest to April 30, July 31, October 31, and January 31. The Company's first quarters in fiscal 2010 and 2009 ended on May 1, 2010 and May 2, 2009, respectively.

Reclassifications

The Company made a reclassification of \$199 to the first quarter 2009 statement of income to decrease cost of sales and increase selling, general and administrative expenses to conform to the first quarter 2010 presentation.

Share-based compensation

The Company measures share-based compensation cost on the grant date, based on the fair value of the award, and recognizes the expense over the requisite service period for awards expected to vest. The Company estimated the grant date fair value of stock options using a Black-Scholes valuation model using the following assumptions for the periods indicated:

	Three months ended	
	May 1, 2010	May 2, 2009
Volatility rate	55.0%	58.0%
Average risk-free interest rate	3.1%	2.5%
Average expected life (in years)	6.3	6.3
Dividend yield	None	None

The Company granted 109 and 76 stock options during the three months ended May 1, 2010 and May 2, 2009, respectively. The weighted-average grant date fair value of these options was \$12.68 and \$3.57, respectively.

The Company recorded stock compensation expense of \$1,735 and \$1,295 for the three months ended May 1, 2010 and May 2, 2009, respectively. At May 1, 2010, there was approximately \$12,172 of unrecognized compensation expense related to unvested options.

On April 26, 2010, the Company announced that Mr. Carl (Chuck) Rubin would be appointed President and Chief Operating Officer and as a member of our Board of Directors effective May 10, 2010. In connection with Mr. Rubin's employment agreement dated April 12, 2010, he received a restricted share grant of 119 shares valued at \$2,775 which will vest in full on December 29, 2011. Mr. Rubin also received a grant of 319 stock options valued at \$3,694 which will vest and become exercisable in four equal installments commencing on February 1, 2011 and each subsequent anniversary, such that all such options will be fully vested on February 1, 2014. Both of these share-based grants occurred on May 10, 2010 and will be recognized in subsequent periods according to their vesting schedules. Mr. Rubin will also receive a one-time cash payment of \$2,800 in August 2010 as part of his employment agreement.

Comprehensive income

Comprehensive income is comprised of net income and gains and losses from derivative instruments designated as cash flow hedges, net of income tax. Total comprehensive income is as follows:

	Three months ended	
	May 1, 2010	May 2, 2009
Net income	\$13,661	\$4,920
Unrealized gain on interest rate swap hedge, net of income tax		107
Comprehensive income	\$13,661	\$5,027

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3. Commitments and contingencies

Leases The Company leases stores, distribution and office facilities, and certain equipment. Original non-cancelable lease terms range from three to ten years, and store leases generally contain renewal options for additional years. A number of the Company's store leases provide for contingent rentals based upon sales. Contingent rent amounts were insignificant in the three months ended May 1, 2010 and May 2, 2009. Total rent expense under operating leases was \$19,459 and \$17,936 for the three months ended May 1, 2010 and May 2, 2009, respectively.

General litigation As previously disclosed, in July 2009, a putative employment class action lawsuit was filed against the Company and certain unnamed defendants in State Court in California. The suit alleges that Ulta misclassified its store General Managers and Salon Managers as exempt from the Fair Labor Standards Act and California Labor Code. The suit seeks to recover damages and penalties as a result of this alleged misclassification. On August 27, 2009, the Company filed its answer to the lawsuit, and on August 31, 2009 the Company moved the action to the United States District Court for the Northern District of California. On November 2, 2009, the plaintiffs filed an amended complaint adding another named plaintiff. On May 26, 2010, the Company and plaintiffs engaged in a voluntary mediation. Although the company continues to deny plaintiffs' allegations, in the interest of putting the Salon Manager claims behind it, the company agreed in principle to settle all claims of the putative Salon Manager class. The settlement, which is not an admission of liability, is subject to final documentation and Court approval. Counsel for the plaintiffs has agreed to dismiss without prejudice the claims of the General Managers. The Company does not believe that the amount of settlement is material.

In May, 2010, a putative employment class action lawsuit was filed against the Company and certain unnamed defendants in State Court in California. The plaintiff and members of the proposed class are alleged to be (or have been) nonexempt hourly employees. The suit alleges that Ulta violated various provisions of the California labor laws and failed to provide plaintiff and members of the proposed class with full meal periods, paid rest breaks, certain wages, overtime compensation and premium pay. The suit seeks to recover damages and penalties as a result of these alleged practices. Although the Company believes that it has meritorious defenses to the claims made in the putative class action and the Company intends to contest the lawsuit vigorously, an adverse resolution could have a material adverse effect on its financial position and results of operations in the period in which the lawsuit is resolved. The Company is not presently able to reasonably estimate potential losses, if any, related to the lawsuit.

The Company is also involved in various legal proceedings that are incidental to the conduct of its business. In the opinion of management, the amount of any liability with respect to these proceedings, either individually or in the aggregate, will not be material.

4. Notes payable

The Company's credit facility is with Bank of America National Association as the administrative agent, Wachovia Capital Finance Corporation as collateral agent, and JP Morgan Chase Bank as documentation agent. This facility provides maximum credit of \$200,000 through May 31, 2011. The facility provides maximum borrowings equal to the lesser of \$200,000 or a percentage of eligible owned inventory. The advance rates on owned inventory are 80% (85% from September 1 to January 31). The credit facility agreement contains a restrictive financial covenant requiring the Company to maintain tangible net worth of not less than \$80,000. On May 1, 2010, the Company's tangible net worth was approximately \$311,000. Substantially all of the Company's assets are pledged as collateral for outstanding borrowings under the facility. Outstanding borrowings bear interest at the prime rate or the Eurodollar rate plus 1.00% up to \$100,000 and 1.25% thereafter.

The Company had no outstanding borrowings under the facility as of May 1, 2010 and January 30, 2010. The Company had approximately \$190,855 and \$196,933 of availability as of May 1, 2010 and January 30, 2010, respectively.

5. Financial instruments

The Company had an interest rates swap agreement which expired in January 2010 and held no derivative instruments as of May 1, 2010 and January 30, 2010. The Company's derivative financial instrument was designated and qualified as a cash flow hedge. Accordingly, the effective portion of the gain or loss on the derivative instrument was reported as a component of accumulated other comprehensive loss and reclassified into interest expense in the same period or periods during which the hedged transaction affects earnings. The remaining gain or loss, the ineffective portion, on

the derivative instrument, if other than inconsequential, was recognized in interest expense during the period of change. Hedge ineffectiveness was not material in the three months ended May 1, 2010 and May 2, 2009.

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The following table presents the impact of derivatives in cash flow hedging relationships and their location within the unaudited statements of income and accumulated other comprehensive loss (AOCL):

	Amount of Gain (Loss) Recognized in AOCL on Derivative (Effective Portion) Three months ended		Amount of Gain Reclassified from AOCL into Income (Effective Portion) Three months ended		Amount of Gain Recognized in Income on Derivative (Ineffective Portion) Three months ended	
	May 1, 2010	May 2, 2009	May 1, 2010	May 2, 2009	May 1, 2010	May 2, 2009
Interest rate swap, net of tax	\$	\$ 107	\$	\$	\$	\$

6. Fair Value Measurements

The carrying value of cash and cash equivalents, accounts receivable, and accounts payable approximates their estimated fair values due to the short maturities of these instruments. The estimated fair value of any variable rate debt outstanding approximates its carrying value since the rate of interest on the variable rate debt is revised frequently based upon the current prime rate or the Eurodollar rate.

On February 3, 2008, the Company adopted the ASC rules for fair value measurements and disclosures. The adoption had no impact on the Company's financial statements. The new rules established a three-tier hierarchy for fair value measurements, which prioritizes the inputs used in measuring fair value as follows:

Level 1 observable inputs such as quoted prices for identical instruments in active markets.

Level 2 inputs other than quoted prices in active markets that are observable either directly or indirectly through corroboration with observable market data.

Level 3 unobservable inputs in which there is little or no market data, which would require the Company to develop its own assumptions.

As of May 1, 2010, the Company held certain liabilities that are required to be measured at fair value on a recurring basis. The fair value of the Company's liabilities associated with its non-qualified deferred compensation plan are based primarily on third-party reported net asset values, which are primarily based on quoted market prices of the underlying assets of the funds and have been categorized as Level 2. The following table presents the Company's financial liabilities as of May 1, 2010 measured at fair value on a recurring basis:

	Fair value measurement using		
	Level 1	Level 2	Level 3
Deferred compensation liabilities	\$	\$984	\$

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The following is a reconciliation of net income and the number of shares of common stock used in the computation of net income per basic and diluted share:

	Three months ended	
	May 1, 2010	May 2, 2009
Net income	\$ 13,661	\$ 4,920
Denominator for basic net income per share weighted-average common shares	58,306	57,743
Dilutive effect of stock options	1,970	1,007
Denominator for diluted net income per share	60,276	58,750
Net income per common share:		
Basic	\$ 0.23	\$ 0.09
Diluted	\$ 0.23	\$ 0.08

The denominators for diluted net income per common share for the three months ended May 1, 2010 and May 2, 2009 exclude 803 and 3,481 employee stock options, respectively, due to their anti-dilutive effects.

Table of Contents**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our financial statements and related notes included elsewhere in this quarterly report. This discussion contains forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934 and the safe harbor provisions of the Private Securities Litigation Reform Act of 1995, which reflect our current views with respect to, among other things, future events and financial performance. You can identify these forward-looking statements by the use of forward-looking words such as outlook, believes, expects, plans, estimates, or other comparable words. Any forward-looking statements contained in this Form 10-Q are based upon our historical performance and on current plans, estimates and expectations. The inclusion of this forward-looking information should not be regarded as a representation by us or any other person that the future plans, estimates or expectations contemplated by us will be achieved. Such forward-looking statements are subject to various risks and uncertainties, which include, without limitation: the impact of weakness in the economy; changes in the overall level of consumer spending; changes in the wholesale cost of our products; the possibility that we may be unable to compete effectively in our highly competitive markets; the possibility that our continued opening of new stores could strain our resources and have a material adverse effect on our business and financial performance; the possibility that new store openings may be impacted by developer or co-tenant issues; the possibility that the capacity of our distribution and order fulfillment infrastructure may not be adequate to support our recent growth and expected future growth plans; the possibility of material disruptions to our information systems; weather conditions that could negatively impact sales; and other risk factors detailed in our public filings with the Securities and Exchange Commission (the SEC), including risk factors contained in Item 1A, Risk Factors of our Annual Report on Form 10-K for the year ended January 30, 2010. We assume no obligation to update any forward-looking statements as a result of new information, future events or developments. References in the following discussion to we, us, our, the Company, Ulta and similar references mean Ulta Salon, Cosmetics & Fragrance, Inc. unless otherwise expressly stated or the context otherwise requires.

Overview

We were founded in 1990 as a discount beauty retailer at a time when prestige, mass and salon products were sold through separate distribution channels. In 1999 we embarked on a multi-year strategy to understand and embrace what women want in a beauty retailer and transform Ulta into the shopping experience that it is today. We pioneered what we believe to be our unique combination of beauty superstore and specialty store attributes. We believe our strategy provides us with the competitive advantages that have contributed to our strong financial performance.

We are currently the largest beauty retailer that provides one-stop shopping for prestige, mass and salon products and salon services in the United States. We combine the unique elements of a beauty superstore with the distinctive environment and experience of a specialty retailer. Key aspects of our beauty superstore strategy include our ability to offer our customers a broad selection of over 21,000 beauty products across the categories of cosmetics, fragrance, haircare, skincare, bath and body products and salon styling tools, as well as salon haircare products. We focus on delivering a compelling value proposition to our customers across all of our product categories. Our stores are conveniently located in high-traffic, primarily off-mall locations such as power centers and lifestyle centers with other destination retailers. As of May 1, 2010, we operated 347 stores across 38 states. In addition to these fundamental elements of a beauty superstore, we strive to offer an uplifting shopping experience through what we refer to as The Five E's: Escape, Education, Entertainment, Esthetics and Empowerment.

The continued growth of our business and any future increases in net sales, net income and cash flows are dependent on our ability to execute our growth strategy, including growing our store base, expanding our prestige brand offerings, driving incremental salon traffic, expanding our online business and continuing to enhance our brand awareness. We believe that the steadily expanding U.S. beauty products and services industry, the shift in distribution of prestige beauty products from department stores to specialty retail stores, coupled with Ulta's competitive strengths, positions us to capture additional market share in the industry through successful execution of our growth strategy. Comparable store sales is a key metric that is monitored closely within the retail industry. We do not expect our comparable store sales increases over the next five years to reflect the sustained high single digit to low double digit increases we experienced in 2005 through early 2007. We believe the sequential decline in our quarterly comparable

store sales during 2008 and the comparable store sales declines in first and second quarter 2009 were due primarily to the difficult economic environment. Our comparables store sales trend improved during the second half of fiscal 2009 and into the first quarter of fiscal 2010. We believe the continuing economic uncertainty and related impact on consumer sentiment may affect the level of comparable store sales we can achieve.

Over the long-term, our growth strategy is to increase total net sales through increases in our comparable store sales and by opening new stores. Gross profit as a percentage of net sales is expected to increase as a result of our ability to leverage our supply chain

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infrastructure and fixed store costs with comparable store sales increases. We plan to continue to improve our operating results by leveraging our fixed costs and decreasing our selling, general and administrative expenses, as a percentage of our net sales.

Global economic conditions

The global economic crisis and the continued volatility and disruption to the capital and credit markets have had a significant, adverse impact on global economic conditions, resulting in additional significant recessionary pressures and declines in consumer confidence and economic growth. As a result of these market conditions, the cost and availability of credit has been and may continue to be adversely affected by illiquid credit markets and wider credit spreads. Concern about the stability of the markets generally and the strength of counterparties specifically has led many lenders and institutional investors to reduce, and in some cases, cease to provide credit to businesses and consumers. These factors have led to a decrease in spending by businesses and consumers alike, and a corresponding decrease in global infrastructure spending. Continued turbulence in the United States and international markets and economies and prolonged declines in business and consumer spending may adversely affect our liquidity and financial condition, and the liquidity and financial condition of our customers, including our ability to refinance maturing liabilities and access the capital markets to meet liquidity needs.

Current business trends

We recorded a 10.8% increase in our comparable store sales during the first quarter of fiscal 2010 which extended the sequential comparable store sales improvement which began in the second half of fiscal 2009. We believe the improvement in our comparable store sales trends is due to a combination of factors including our ability to better plan our marketing and merchandise programs for the current economic environment and the relatively lower comparable in the prior year first quarter period. We also believe that overall consumer sentiment and shopping patterns began to improve in the second half of 2009 which may have contributed to our improving trends. In light of the current economic uncertainty in both the U.S. and world financial markets, consumer sentiment could turn negative which could result in a deceleration of the favorable comparable store sales trends we have experienced in recent quarters.

Change in Management

On April 26, 2010, we announced that Mr. Carl (Chuck) Rubin would be appointed President and Chief Operating Officer and as a member of our Board of Directors effective May 10, 2010. Following a transition period of up to four months, Mr. Rubin will become Chief Executive Officer. Lyn Kirby will continue as Chief Executive Officer through the transition period and thereafter is expected to provide guidance and counsel as a member of the Company's Board of Directors through March 17, 2011.

Basis of presentation

Net sales include store and e-commerce merchandise sales as well as salon service revenue. Salon service revenue represented less than 10% of our combined product sales and services revenues for the three months ended May 1, 2010 and May 2, 2009 and therefore, these revenues are combined with product sales. We recognize merchandise revenue at the point of sale (POS) in our retail stores and the time of shipment in the case of Internet sales.

Merchandise sales are recorded net of estimated returns. Salon service revenue is recognized at the time the service is provided. Gift card sales revenue is deferred until the customer redeems the gift card. Company coupons and other incentives are recorded as a reduction of net sales.

Comparable store sales reflect sales for stores beginning on the first day of the 14th month of operation. Therefore, a store is included in our comparable store base on the first day of the period after one year of operations plus the initial one month grand opening period. Non-comparable store sales include sales from new stores that have not yet completed their 13th month of operation and stores that were closed for part or all of the period in either year as a result of remodel activity. Remodeled stores are included in comparable store sales unless the store was closed for a portion of the current or prior period. E-commerce merchandise sales are excluded from comparable store sales. There may be variations in the way in which some of our competitors and other retailers calculate comparable or same store sales. As a result, data herein regarding our comparable store sales may not be comparable to similar data made available by our competitors or other retailers.

Comparable store sales is a critical measure that allows us to evaluate the performance of our store base as well as several other aspects of our overall strategy. Several factors could positively or negatively impact our comparable

store sales results:

the general national, regional and local economic conditions and corresponding impact on customer spending levels;

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the introduction of new products or brands;

the location of new stores in existing store markets;

competition;

our ability to respond on a timely basis to changes in consumer preferences;

the effectiveness of our various marketing activities; and

the number of new stores opened and the impact on the average age of all of our comparable stores.

Cost of sales includes:

the cost of merchandise sold, including all vendor allowances, which are treated as a reduction of merchandise costs;

warehousing and distribution costs including labor and related benefits, freight, rent, depreciation and amortization, real estate taxes, utilities, and insurance;

store occupancy costs including rent, depreciation and amortization, real estate taxes, utilities, repairs and maintenance, insurance, licenses, and cleaning expenses;

salon payroll and benefits;

customer loyalty program expense; and

shrink and inventory valuation reserves.

Our cost of sales may be negatively impacted as we open an increasing number of stores. Changes in our merchandise mix may also have an impact on cost of sales. This presentation of items included in cost of sales may not be comparable to the way in which our competitors or other retailers compute their cost of sales.

Selling, general and administrative expenses include:

payroll, bonus and benefit costs for retail and corporate employees;

advertising and marketing costs;

occupancy costs related to our corporate office facilities;

stock-based compensation expense;

depreciation and amortization for all assets except those related to our retail and warehouse operations, which is included in cost of sales; and

legal, finance, information systems and other corporate overhead costs.

This presentation of items in selling, general and administrative expenses may not be comparable to the way in which our competitors or other retailers compute their selling, general and administrative expenses.

Pre-opening expense includes non-capital expenditures during the period prior to store opening for new and remodeled stores including rent during the construction period for new stores, store set-up labor, management and employee training, and grand opening advertising.

Interest expense includes interest costs associated with our credit facility, which is structured as an asset based lending instrument. Our interest expense will fluctuate based on the seasonal borrowing requirements associated with

acquiring inventory in advance of

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key holiday selling periods and fluctuation in the variable interest rates we are charged on outstanding balances. Our credit facility is used to fund seasonal inventory needs and new and remodel store capital requirements in excess of our cash flow from operations. Our credit facility interest is based on a variable interest rate structure which can result in increased cost in periods of rising interest rates.

Income tax expense reflects the federal statutory tax rate and the weighted average state statutory tax rate for the states in which we operate stores.

Results of operations

Our quarterly periods are the 13 weeks ending on the Saturday closest to April 30, July 31, October 31, and January 31. The Company's first quarters in fiscal 2010 and 2009 ended on May 1, 2010 and May 2, 2009, respectively. Our quarterly results of operations have varied in the past and are likely to do so again in the future. As such, we believe that period-to-period comparisons of our results of operations should not be relied upon as an indication of our future performance.

The following tables present the components of our results of operations for the periods indicated:

	Three months ended		Three months ended	
	May 1, 2010	May 2, 2009	May 2, 2009	May 3, 2008
	(Dollars in thousands)		(Percentage of net sales)	
Net sales	\$320,196	\$268,825	100.0%	100.0%
Cost of sales	215,661	189,283	67.4%	70.4%
Gross profit	104,535	79,542	32.6%	29.6%
Selling, general and administrative expenses	80,729	69,393	25.2%	25.8%
Pre-opening expenses	474	1,195	0.1%	0.4%
Operating income	23,332	8,954	7.3%	3.3%
Interest expense	118	671	0.0%	0.2%
Income before income taxes	23,214	8,283	7.2%	3.1%
Income tax expense	9,553	3,363	3.0%	1.3%
Net income	\$ 13,661	\$ 4,920	4.3%	1.8%

Other operating data:

Number stores end of period	347	320
Comparable store sales increase (decrease)	10.8%	(2.3)%

Comparison of three months ended May 1, 2010 to three months ended May 2, 2009**Net sales**

Net sales increased \$51.4 million, or 19.1%, to \$320.2 million for the three months ended May 1, 2010, compared to \$268.8 million for the three months ended May 2, 2009. The increase is primarily due to an additional 27 new stores operating since May 2, 2009 which contributed \$23.0 million to net sales while comparable stores contributed \$28.4 million to net sales when compared to last year.

Our comparable store sales increased 10.8%, which included an 8.8% increase in traffic and a 2.0% increase in average ticket. We attribute the increase in comparable store sales to our successful marketing and merchandising strategies and lower relative comparable in the prior year quarter.

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Gross profit

Gross profit increased \$25.0 million, or 31.4%, to \$104.5 million for the three months ended May 1, 2010, compared to \$79.5 million for the three months ended May 2, 2009. Gross profit as a percentage of net sales increased 300 basis points to 32.6% for the three months ended May 1, 2010, compared to 29.6% for the three months ended May 2, 2009. The increases in gross profit margin were primarily driven by:

160 basis points of leverage in fixed store costs due to a combination of less drag on the relatively smaller new store program in fiscal 2009 and increased comparable store sales levels;

70 basis points improvement in merchandise margins driven by our marketing and merchandising strategies; and

20 basis points of leverage in supply chain due to efficiencies and increased comparable store sales levels.

Selling, general and administrative expenses

Selling, general and administrative (SG&A) expenses increased \$11.3 million, or 16.3%, to \$80.7 million for the three months ended May 1, 2010, compared to \$69.4 million for the three months ended May 2, 2009. As a percentage of net sales, SG&A expenses decreased 60 basis points to 25.2% for the three months ended May 1, 2010, compared to 25.8% for the three months ended May 2, 2009. The improvement in SG&A expenses is primarily due to:

40 basis points of leverage in marketing expense attributed to the carry-forward benefit of our fiscal 2009 cost efficiencies and stronger comparable store sales levels; and

20 basis points of leverage in store payroll and variable store expenses on increased comparable store sales levels.

Pre-opening expenses

Pre-opening expenses decreased \$0.7 million, or 60.3%, to \$0.5 million for the three months ended May 1, 2010, compared to \$1.2 million for the three months ended May 2, 2009. During the three months ended May 1, 2010, we opened 2 new stores and relocated 1 store, compared to 9 new store openings during the three months ended May 2, 2009.

Interest expense

Interest expense was \$0.1 million for the three months ended May 1, 2010, compared to \$0.7 million for the three months ended May 2, 2009. We did not access our credit facility during the first quarter fiscal 2010. Interest expense for the period represents various fees related to the credit facility.

Income tax expense

Income tax expense of \$9.6 million for the three months ended May 1, 2010 represents an effective tax rate of 41.2%, compared to \$3.4 million of tax expense representing an effective tax rate of 40.6% for the three months ended May 2, 2009. The increase in the effective tax rate is primarily due to an increase in non-deductible compensation expense in fiscal 2010.

Net income

Net income increased \$8.8 million, or 177.7%, to \$13.7 million for the three months ended May 1, 2010, compared to \$4.9 million for the three months ended May 2, 2009. The increase is primarily related to the \$25.0 million increase in gross profit, partially offset by an \$11.3 million increase in SG&A expenses.

Liquidity and capital resources

Our primary cash needs are for capital expenditures for new, relocated and remodeled stores, increased merchandise inventories related to store expansion, and for continued improvement in our information technology systems.

Our primary sources of liquidity are cash flows from operations, including changes in working capital, and borrowings under our credit facility. The most significant component of our working capital is merchandise inventories reduced by related accounts payable and accrued expenses. Our working capital position benefits from the fact that we generally collect cash from sales to customers the same day, or within several days of the related sale, while we typically have up to 30 days to pay our vendors.

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Our working capital needs are greatest from August through November each year as a result of our inventory build-up during this period for the approaching holiday season. This is also the time of year when we are at maximum investment levels in our new store class and may not have collected all of the landlord allowances due to us as part of our lease agreements. Based on past performance and current expectations, we believe that cash generated from operations and borrowings under the credit facility will satisfy the Company's working capital needs, capital expenditure needs, commitments, and other liquidity requirements through at least the next 12 months.

The following table presents a summary of our cash flows for the three months ended May 1, 2010 and May 2, 2009:

(In thousands)	Three months ended	
	May 1, 2010	May 2, 2009
Net cash provided by operating activities	\$ 9,817	\$ 17,957
Net cash used in investing activities	(7,698)	(12,320)
Net cash provided by (used in) financing activities	2,534	(5,435)
Net increase in cash and cash equivalents	\$ 4,653	\$ 202

Operating activities

Operating activities consist of net income adjusted for certain non-cash items, including depreciation and amortization, non-cash stock-based compensation, excess tax benefits from stock-based compensation, realized gains or losses on disposal of property and equipment, and the effect of working capital changes.

Merchandise inventories were \$228.1 million at May 1, 2010, compared to \$230.3 million at May 2, 2009, representing an decrease of \$2.2 million. The decrease is due to an 8.7% decrease in average inventory per store driven by our management initiatives offset by the addition of 27 net new stores opened since May 2, 2009. The reduction in inventories did not affect our store in-stock levels or the customer experience.

Deferred rent liabilities were \$114.1 million at May 1, 2010, an increase of \$9.9 million compared to May 2, 2009. Deferred rent includes deferred construction allowances, future rental increases and rent holidays which are all recognized on a straight-line basis over their respective lease term. The increase is due to activity since May 2, 2009 which includes 27 net new stores.

Investing activities

We have historically used cash primarily for new and remodeled stores as well as investments in information technology systems. Investment activities related to capital expenditures were \$7.7 million during the three months ended May 1, 2010, compared to \$12.3 million during the three months ended May 2, 2009. The decrease in capital expenditures year over year is primarily due to the reduced number of new stores during the three months ended May 1, 2010. The reduction in new stores is primarily due to a shift in the pacing of our new store opening schedule in fiscal 2010 as compared to fiscal 2009. Capital expenditures for the three months ended May 1, 2010 included 2 new stores and 1 relocated store while capital expenditures for the three months ended May 2, 2009 included 9 new stores.

Financing activities

Financing activities consist principally of capital stock transactions. The decrease in net cash provided by financing activities of \$7.9 million for the three months ended May 1, 2010 compared to the three months ended May 2, 2009 is primarily the result of increased payments on long-term borrowings during first quarter fiscal 2009 and proceeds from the issuance of common stock under stock plans during first quarter fiscal 2010.

We had no borrowings outstanding under our credit facility as of May 1, 2010 and January 30, 2010. The zero outstanding borrowings position is due to a combination of factors including stronger than expected sales growth, overall performance of management initiatives including expense control as well as inventory and other working capital reductions. While we expect the level of borrowings under the facility will be lower than historical amounts, we expect that we will require borrowings under the facility from time to time in future periods to support our new store program and seasonal inventory needs.

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Credit facility

Our credit facility is with Bank of America National Association as the administrative agent, Wachovia Capital Finance Corporation as collateral agent, and JP Morgan Chase Bank as documentation agent. This facility provides maximum credit of \$200 million through May 31, 2011. The facility provides maximum borrowings equal to the lesser of \$200 million or a percentage of eligible owned inventory. The advance rates on owned inventory are 80% (85% from September 1 to January 31). The credit facility agreement contains a restrictive financial covenant requiring us to maintain tangible net worth of not less than \$80 million. On May 1, 2010, our tangible net worth was approximately \$311 million. Substantially all of our assets are pledged as collateral for outstanding borrowings under the facility. Outstanding borrowings bear interest at the prime rate or the Eurodollar rate plus 1.00% up to \$100 million and 1.25% thereafter.

We had no outstanding borrowings under the facility as of May 1, 2010 and January 30, 2010. We had approximately \$190.9 million and \$196.9 million of availability as of May 1, 2010 and January 30, 2010, respectively.

Off-balance sheet arrangements

Our off-balance sheet arrangements consist of operating lease obligations. We do not have any non-cancelable purchase commitments as of May 1, 2010.

Contractual obligations

Our contractual obligations consist of operating lease obligations and our revolving line of credit. No material changes outside the ordinary course of business have occurred in our contractual obligations during the three months ended May 1, 2010.

Critical accounting policies and estimates

Management's discussion and analysis of financial condition and results of operations is based upon our financial statements, which have been prepared in accordance with U.S. generally accepted accounting principles (GAAP). The preparation of these financial statements required the use of estimates and judgments that affect the reported amounts of our assets, liabilities, revenues and expenses. Management bases estimates on historical experience and other assumptions it believes to be reasonable under the circumstances and evaluates these estimates on an on-going basis. Actual results may differ from these estimates. There have been no significant changes to the critical accounting policies and estimates included in our Annual Report on Form 10-K for the year ended January 30, 2010.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

Market risk represents the risk of loss that may impact our financial position due to adverse changes in financial market prices and rates. Our market risk exposure is primarily the result of fluctuations in interest rates. We do not hold or issue financial instruments for trading purposes.

Interest rate sensitivity

We did not access our credit facility during the first quarter of fiscal 2010. The interest expense recognized in our statement of income for the first quarter fiscal 2010 represents fees associated with the credit facility.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures over Financial Reporting

We have established disclosure controls and procedures to ensure that material information relating to the Company is made known to the officers who certify our financial reports and to the members of our senior management and board of directors.

Based on management's evaluation as of May 1, 2010, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934) are effective to ensure that the information required to be disclosed by us in our reports that we file or submit under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms.

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Changes in Internal Control over Financial Reporting

There were no changes to our internal controls over financial reporting during the three months ended May 1, 2010 that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

Part II Other Information

Item 1. Legal Proceedings

General litigation As previously disclosed, in July 2009, a putative employment class action lawsuit was filed against us and certain unnamed defendants in State Court in California. The suit alleges that Ulta misclassified its store General Managers and Salon Managers as exempt from the Fair Labor Standards Act and California Labor Code. The suit seeks to recover damages and penalties as a result of this alleged misclassification. On August 27, 2009, we filed our answer to the lawsuit, and on August 31, 2009 we moved the action to the United States District Court for the Northern District of California. On November 2, 2009, the plaintiffs filed an amended complaint adding another named plaintiff. On May 26, 2010, the Company and plaintiffs engaged in a voluntary mediation. Although we continue to deny plaintiffs' allegations, in the interest of putting the Salon Manager claims behind us, we agreed in principle to settle all claims of the putative Salon Manager class. The settlement, which is not an admission of liability, is subject to final documentation and Court approval. Counsel for the plaintiffs has agreed to dismiss without prejudice the claims of the General Managers. We do not believe that the amount of settlement is material.

In May, 2010, a putative employment class action lawsuit was filed against us and certain unnamed defendants in State Court in California. The plaintiff and members of the proposed class are alleged to be (or have been) nonexempt hourly employees. The suit alleges that Ulta violated various provisions of the California labor laws and failed to provide plaintiff and members of the proposed class with full meal periods, paid rest breaks, certain wages, overtime compensation and premium pay. The suit seeks to recover damages and penalties as a result of these alleged practices. Although we believe that we have meritorious defenses to the claims made in the putative class action and we intend to contest the lawsuit vigorously, an adverse resolution could have a material adverse effect on our financial position and results of operations in the period in which the lawsuit is resolved. We are not presently able to reasonably estimate potential losses, if any, related to the lawsuit.

We are also involved in various legal proceedings that are incidental to the conduct of our business. In the opinion of management, the amount of any liability with respect to these proceedings, either individually or in the aggregate, will not be material.

Item 1A. Risk Factors

In addition to the other information set forth in this report and the risk factor set forth below, you should carefully consider the factors discussed in Part I, Item 1A. Risk Factors in our Annual Report on Form 10-K for the year ended January 30, 2010, which could materially affect our business, financial condition, financial results or future performance. There have been no material changes from the risk factors previously disclosed in our Annual Report on Form 10-K for the year ended January 30, 2010.

We are currently undergoing a leadership transition. The execution of our business plan and development strategy could be harmed if we are not able to successfully manage this transition.

Our senior management team has historically been led by Lyn Kirby, our Chief Executive Officer, as well as Gregg Bodnar, our Chief Financial Officer. As part of a leadership transition plan, we announced on April 26, 2010 that Carl Chuck Rubin would join the Company as President and Chief Operating Officer and as a member of our Board of Directors effective May 10, 2010. Following a transition period of up to approximately four months, Mr. Rubin will take over as Chief Executive Officer from Lyn Kirby and work with our management team and our Board of Directors. This transition could create uncertainty if Chuck's integration into our company is not successful or if the transition creates uncertainty among our employees, customers, or vendors. New leadership could also result in changes to the strategic direction of our business, which could negatively affect our business, operating results and financial position.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

None

Item 3. Defaults Upon Senior Securities

None

Item 4. [Reserved]

None

Item 5. Other Information

None

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Exhibit Number	Description of document	Filed Herewith	Form	Incorporated by Reference		
				Exhibit Number	File Number	Filing Date
3.1	Amended and Restated Certificate of Incorporation		S-1	3.1	333-144405	8/17/2007
3.2	Amended and Restated Bylaws		S-1	3.2	333-144405	8/17/2007
4.1	Specimen Common Stock Certificate		S-1	4.1	333-144405	10/11/2007
4.2	Third Amended and Restated Registration Rights Agreement between Ulta Salon, Cosmetics & Fragrance, Inc. and the stockholders party thereto		S-1	4.2	333-144405	8/17/2007
4.3	Stockholder Rights Agreement		S-1	4.4	333-144405	8/17/2007
10.1	Succession agreement, dated as of April 23, 2010, by and between Ulta Salon, Cosmetics & Fragrance, Inc. and Lyn Kirby.		8-K	10.1	001-33764	4/27/2010
10.2	Employment Agreement, dated as of April 12, 2010, by and between Ulta Salon, Cosmetics & Fragrance, Inc. and Carl Rubin.		8-K	10.2	001-33764	4/27/2010
10.2(a)	First Amendment to Carl Rubin Employment Agreement, dated April 28, 2010.	X				
10.3	Restricted Stock Award Agreement, dated May 10, 2010, by and between Ulta Salon, Cosmetics & Fragrance, Inc. and Carl Rubin.		8-K	10.3	001-33764	4/27/2010
10.4	Option Agreement, dated May 10, 2010, by and between Ulta Salon, Cosmetics & Fragrance, Inc. and Carl Rubin.		8-K	10.4	001-33764	4/27/2010
31.1	Certification of the Chief Executive Officer pursuant to Rules 13a-14(a) and 15d-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to section 302 of the Sarbanes-Oxley Act of 2002	X				
31.2		X				

Certification of the Chief Financial Officer
pursuant to Rules 13a-14(a) and 15d-14(a)
of the Securities Exchange Act of 1934, as
adopted pursuant to section 302 of the
Sarbanes-Oxley Act of 2002

32.1 Certification of the Chief Executive
Officer and Chief Financial Officer
pursuant to 18 U.S.C. Section 1350, as
adopted pursuant to Section 906 of the
Sarbanes-Oxley Act of 2002

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on June 3, 2010 on its behalf by the undersigned, thereunto duly authorized.

ULTA SALON, COSMETICS &
FRAGRANCE, INC.

By: /s/ Lynelle P. Kirby
Lynelle P. Kirby
Chief Executive Officer and Director

By: /s/ Gregg R. Bodnar
Gregg R. Bodnar
Chief Financial Officer