

Sally Beauty Holdings, Inc.
Form 10-Q
May 02, 2013
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

FOR THE QUARTERLY PERIOD ENDED: MARCH 31, 2013

-OR-

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

Commission File No. 1-33145

SALLY BEAUTY HOLDINGS, INC.

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(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of
incorporation or organization)

**3001 Colorado Boulevard
Denton, Texas**
(Address of principal executive
offices)

36-2257936

(I.R.S. Employer Identification No.)

76210
(Zip Code)

Registrant's telephone number, including area code: **(940) 898-7500**

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 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 check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

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

As of April 26, 2013, there were 169,778,170 shares of the issuer's common stock outstanding.

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In this Quarterly Report, references to the Company, Sally Beauty, our company, we, our, ours and us refer to Sally Beauty Holdings, its consolidated subsidiaries unless otherwise indicated or the context otherwise requires.

Cautionary Notice Regarding Forward-Looking Statements

Statements in this Quarterly Report on Form 10-Q and in the documents incorporated by reference herein which are not purely historical facts or which depend upon future events may constitute forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, which we refer to as the Exchange Act. Words such as anticipate, believe, estimate, expect, intend, plan, project, target, can, could, may, should, will, would or similar words are used to identify such forward-looking statements.

Readers are cautioned not to place undue reliance on forward-looking statements as such statements speak only as of the date they were made. Any forward-looking statements involve risks and uncertainties that could cause actual events or results to differ materially from the events or results described in the forward-looking statements, including, but not limited to, risks and uncertainties related to:

- the highly competitive nature of, and the increasing consolidation of, the beauty products distribution industry;
- anticipating changes in consumer preferences and buying trends and managing our product lines and inventory;
- potential fluctuation in our same store sales and quarterly financial performance;
- our dependence upon manufacturers who may be unwilling or unable to continue to supply products to us;
- the possibility of material interruptions in the supply of products by our manufacturers;
- products sold by us being found to be defective in labeling or content;
- compliance with laws and regulations or becoming subject to additional or more stringent laws and regulations;
- product diversion to mass retailers or other unauthorized resellers;
- the operational and financial performance of our Armstrong McCall, L.P. (Armstrong McCall) franchise-based business;
- the success of our internet and catalogue-based businesses;
- successfully identifying acquisition candidates and successfully completing desirable acquisitions;
- integrating businesses acquired in the future;
- opening and operating new stores profitably;

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- the impact of the health of the economy upon our business;
- the success of our cost control plans;
- protecting our intellectual property rights, particularly our trademarks;
- conducting business outside the United States;
- disruption in our information technology systems;
- severe weather, natural disasters or acts of violence or terrorism;
- the preparedness of our accounting and other management systems to meet financial reporting and other requirements and the upgrade of our existing financial reporting system;
- being a holding company, with no operations of our own, and depending on our subsidiaries for cash;
- our substantial indebtedness;
- the possibility that we may incur substantial additional debt in the future;
- restrictions and limitations in the agreements and instruments governing our debt;
- generating the significant amount of cash needed to service our debt and refinancing all or a portion of our indebtedness or obtaining additional financing on favorable terms, if at all;
- changes in interest rates increasing the cost of servicing our debt;
- the potential impact on us if the financial institutions we deal with become impaired;
- the costs and effects of litigation; and
- the representativeness of our historical consolidated financial information with respect to our future financial position, results of operations or cash flows.

Additional factors that could cause actual events or results to differ materially from the events or results described in the forward-looking statements can be found in our Annual Report on Form 10-K for the fiscal year ended September 30, 2012, as filed with the Securities and Exchange Commission. The events described in the forward-looking statements might not occur or might occur to a different extent or at a different time than we have described. As a result, our actual results may differ materially from the results contemplated by these forward-looking statements. We assume no obligation to publicly update or revise any forward-looking statements.

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WHERE YOU CAN FIND MORE INFORMATION

Sally Beauty's quarterly financial results and other important information are available by calling the Investor Relations Department at (940) 297-3877.

Sally Beauty maintains a website at www.sallybeautyholdings.com where investors and other interested parties may obtain, free of charge, press releases and other information as well as gain access to our periodic filings with the SEC. The information contained on this website does not constitute part of this Quarterly Report on Form 10-Q.

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PART I FINANCIAL INFORMATION

Item 1. Financial Statements.

The following consolidated balance sheets as of March 31, 2013 and September 30, 2012, the consolidated statements of earnings and consolidated statements of comprehensive income for the three and six months ended March 31, 2013 and 2012, and the consolidated statements of cash flows for the six months ended March 31, 2013 and 2012 are those of Sally Beauty Holdings, Inc. and its consolidated subsidiaries.

Table of Contents**SALLY BEAUTY HOLDINGS, INC. AND SUBSIDIARIES**

Consolidated Statements of Earnings

(In thousands, except per share data)

(Unaudited)

	Three Months Ended March 31,		Six Months Ended March 31,	
	2013	2012	2013	2012
Net sales	\$ 898,239	\$ 889,281	\$ 1,803,680	\$ 1,754,096
Cost of products sold and distribution expenses	453,785	452,495	914,858	895,453
Gross profit	444,454	436,786	888,822	858,643
Selling, general and administrative expenses	299,370	289,189	605,059	582,203
Depreciation and amortization	17,247	15,940	34,055	31,493
Operating earnings	127,837	131,657	249,708	244,947
Interest expense	26,779	22,355	53,503	86,316
Earnings before provision for income taxes	101,058	109,302	196,205	158,631
Provision for income taxes	36,169	41,489	72,332	60,684
Net earnings	\$ 64,889	\$ 67,813	\$ 123,873	\$ 97,947
Earnings per share:				
Basic	\$ 0.37	\$ 0.36	\$ 0.70	\$ 0.53
Diluted	\$ 0.36	\$ 0.35	\$ 0.69	\$ 0.51
Weighted average shares:				
Basic	173,461	186,335	175,930	185,514
Diluted	178,389	191,684	180,743	190,662

The accompanying condensed notes, together with the Notes to Consolidated Financial Statements contained in the Company's Annual Report on Form 10-K for the fiscal year ended September 30, 2012, are an integral part of these financial statements.

Table of Contents**SALLY BEAUTY HOLDINGS, INC. AND SUBSIDIARIES**

Consolidated Statements of Comprehensive Income

(In thousands)

(Unaudited)

	Three Months Ended March 31,		Six Months Ended March 31,	
	2013	2012	2013	2012
Net earnings	\$ 64,889	\$ 67,813	\$ 123,873	\$ 97,947
Other comprehensive income (loss):				
Foreign currency translation adjustments	(11,794)	10,975	(9,136)	9,095
Deferred gain on interest rate swaps		2,328		4,771
Total other comprehensive income, before tax	(11,794)	13,303	(9,136)	13,866
Income taxes related to other comprehensive income		(903)		(1,851)
Other comprehensive income (loss), net of tax	(11,794)	12,400	(9,136)	12,015
Total comprehensive income	\$ 53,095	\$ 80,213	\$ 114,737	\$ 109,962

The accompanying condensed notes, together with the Notes to Consolidated Financial Statements contained in the Company's Annual Report on Form 10-K for the fiscal year ended September 30, 2012, are an integral part of these financial statements.

Table of Contents**SALLY BEAUTY HOLDINGS, INC. AND SUBSIDIARIES**

Consolidated Balance Sheets
(In thousands, except par value data)

	March 31, 2013 (Unaudited)	September 30, 2012
Assets		
Current assets:		
Cash and cash equivalents	\$ 62,256	\$ 240,220
Trade accounts receivable, less allowance for doubtful accounts of \$2,532 at March 31, 2013 and \$2,583 at September 30, 2012	56,859	59,496
Accounts receivable, other	40,560	42,260
Income taxes receivable	15,782	23,734
Inventory	752,741	735,356
Prepaid expenses	26,900	29,376
Deferred income tax assets, net	33,515	33,465
Total current assets	988,613	1,163,907
Property and equipment, net of accumulated depreciation of \$360,712 at March 31, 2013 and \$352,164 at September 30, 2012	216,903	202,661
Goodwill	529,137	532,331
Intangible assets, excluding goodwill, net of accumulated amortization of \$65,291 at March 31, 2013 and \$59,192 at September 30, 2012	121,076	128,437
Other assets	36,340	38,464
Total assets	\$ 1,892,069	\$ 2,065,800
Liabilities and Stockholders' Deficit		
Current liabilities:		
Current maturities of long-term debt	\$ 24,475	\$ 1,908
Accounts payable	254,286	262,209
Accrued liabilities	175,864	200,267
Income taxes payable	10,587	13,004
Total current liabilities	465,212	477,388
Long-term debt	1,613,893	1,615,322
Other liabilities	23,680	24,232
Deferred income tax liabilities, net	69,793	63,943
Total liabilities	2,172,578	2,180,885
Stockholders' deficit:		
Common stock, \$0.01 par value. Authorized 500,000 shares; 170,253 and 180,548 shares issued and 169,921 and 180,241 shares outstanding at March 31, 2013 and September 30, 2012, respectively	1,699	1,802
Preferred stock, \$0.01 par value. Authorized 50,000 shares; none issued		
Additional paid-in capital	259,949	540,007
Accumulated deficit	(522,368)	(646,241)
Accumulated other comprehensive loss, net of tax	(19,789)	(10,653)
Total stockholders' deficit	(280,509)	(115,085)
Total liabilities and stockholders' deficit	\$ 1,892,069	\$ 2,065,800

The accompanying condensed notes, together with the Notes to Consolidated Financial Statements contained in the Company's Annual Report on Form 10-K for the fiscal year ended September 30, 2012, are an integral part of these financial statements.

Table of Contents**SALLY BEAUTY HOLDINGS, INC. AND SUBSIDIARIES**

Consolidated Statements of Cash Flows

(In thousands)

(Unaudited)

	Six Months Ended	
	March 31,	
	2013	2012
Cash Flows from Operating Activities:		
Net earnings	\$ 123,873	\$ 97,947
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation and amortization	34,055	31,493
Share-based compensation expense	12,313	10,976
Amortization of deferred financing costs	1,810	2,992
Excess tax benefit from share-based compensation	(8,294)	(9,124)
Net loss on extinguishment of debt		35,145
Deferred income tax expense	6,082	(285)
Changes in (exclusive of effects of acquisitions):		
Trade accounts receivable	2,489	8,076
Accounts receivable, other	1,510	(2,805)
Income taxes receivable	7,952	
Inventory	(22,343)	(10,631)
Prepaid expenses	2,130	1,463
Other assets	(33)	1,126
Accounts payable and accrued liabilities	(30,970)	(30,440)
Income taxes payable	6,057	1,838
Other liabilities	(464)	319
Net cash provided by operating activities	136,167	138,090
Cash Flows from Investing Activities:		
Capital expenditures	(43,112)	(26,956)
Acquisitions, net of cash acquired	(670)	(43,154)
Net cash used by investing activities	(43,782)	(70,110)
Cash Flows from Financing Activities:		
Proceeds from issuance of long-term debt	58,500	929,200
Repayments of long-term debt	(36,947)	(1,010,474)
Repurchases of common stock	(313,349)	
Debt issuance costs		(15,191)
Proceeds from exercises of stock options	13,256	20,111
Excess tax benefit from share-based compensation	8,294	9,124
Net cash used by financing activities	(270,246)	(67,230)
Effect of foreign exchange rate changes on cash and cash equivalents	(103)	579
Net (decrease) increase in cash and cash equivalents	(177,964)	1,329
Cash and cash equivalents, beginning of period	240,220	63,481
Cash and cash equivalents, end of period	\$ 62,256	\$ 64,810
Supplemental Cash Flow Information:		
Interest paid (a)	\$ 53,373	\$ 77,819
Income taxes paid	\$ 52,998	\$ 60,746

(a) For the six months ended March 31, 2012, interest paid includes \$24.4 million in call premiums paid upon the redemption of certain notes.

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The accompanying condensed notes, together with the Notes to Consolidated Financial Statements contained in the Company's Annual Report on Form 10-K for the fiscal year ended September 30, 2012, are an integral part of these financial statements.

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Sally Beauty Holdings, Inc. and Subsidiaries

Condensed Notes to Consolidated Financial Statements

(Unaudited)

1. Description of Business and Basis of Presentation

Description of Business

Sally Beauty Holdings, Inc. and its consolidated subsidiaries (Sally Beauty or the Company) sell professional beauty supplies, through its Sally Beauty Supply retail stores primarily in the U.S., Puerto Rico, Canada, Mexico, Chile, the United Kingdom, Ireland, Belgium, France, Germany, the Netherlands and Spain. Additionally, the Company distributes professional beauty products to salons and salon professionals through its Beauty Systems Group (BSG) store operations and a commissioned direct sales force that calls on salons primarily in the U.S., Puerto Rico, Canada, the United Kingdom and certain other countries in Europe, and to franchises in the southern and southwestern regions of the U.S., and in Mexico through the operations of its subsidiary Armstrong McCall, L.P. (Armstrong McCall). Certain beauty products sold by BSG and Armstrong McCall are sold under exclusive territory agreements with the manufacturers of the products.

Basis of Presentation

The accompanying consolidated interim financial statements include the accounts of the Company and its subsidiaries. All significant inter-company accounts and transactions have been eliminated in consolidation. In the opinion of management, these consolidated financial statements reflect all adjustments which are of a normal recurring nature and which are necessary to present fairly the Company s consolidated financial position as of March 31, 2013 and September 30, 2012, its consolidated results of operations for the three and six months ended March 31, 2013 and 2012, and its consolidated cash flows for the six months ended March 31, 2013 and 2012.

Certain amounts for prior fiscal periods have been reclassified to conform to the current fiscal period s presentation.

All references in these notes to management are to the management of Sally Beauty.

2. Significant Accounting Policies

The consolidated interim financial statements included herein are unaudited and have been prepared by the Company pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). Certain information and note disclosures normally included in annual financial

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statements prepared in accordance with accounting principles generally accepted in the United States (GAAP) have been condensed or omitted pursuant to those rules and regulations, although the Company believes that the disclosures made are adequate to make the information not misleading. These consolidated interim financial statements should be read in conjunction with the financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the fiscal year ended September 30, 2012. The Company adheres to the same accounting policies in the preparation of its interim financial statements. As permitted under GAAP, interim accounting for certain expenses, including income taxes, is based on full year assumptions. Such amounts are expensed in full in the year incurred. For interim financial reporting purposes, income taxes are recorded based upon estimated annual effective income tax rates.

The results of operations for these interim periods are not necessarily indicative of the results that may be expected for any future interim period or the entire fiscal year.

3. Comprehensive Income and Accumulated Other Comprehensive (Loss) Income

In June 2011, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2011-05 which amended Accounting Standards Codification (ASC) Topic 220, *Comprehensive Income*. The Company adopted the provisions of ASU No. 2011-05, as amended, effective October 1, 2012. Accordingly, the components of the Company's other comprehensive income are reported in the accompanying consolidated statements of comprehensive income. The Company's other comprehensive (loss) income has historically consisted of foreign currency translation adjustments, as well as deferred gains (losses) on certain interest rate swaps until the expiration of such swaps in May 2012 (Please see Note 11 for more information about the Company's interest rate swaps).

For the three and six months ended March 31, 2013, other comprehensive loss consists exclusively of foreign currency translation adjustments of \$11.8 million and \$9.1 million, respectively. For the three months ended March 31, 2012, other comprehensive income consists of foreign currency translation adjustments of \$11.0 million and deferred gains on certain interest rate swaps of \$2.3 million (before income taxes of \$0.9 million). For the six months ended March 31, 2012, other comprehensive income consists of foreign currency translation adjustments of \$9.1 million and deferred gains on certain interest rate swaps of \$4.8 million (before income taxes of \$1.9 million).

At March 31, 2013 and September 30, 2012, accumulated other comprehensive loss (AOCI) consists of cumulative foreign currency translation adjustments of \$19.8 million and \$10.7 million and is net of income taxes of \$2.9 million and \$2.9 million, respectively. Any amounts previously reported in AOCI which were related to the interest rate swaps discussed above were

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Sally Beauty Holdings, Inc. and Subsidiaries

Condensed Notes to Consolidated Financial Statements

(Unaudited)

reclassified into interest expense, as a yield adjustment, in the same period in which interest on the hedged variable-rate debt obligations affected earnings.

4. Recent Accounting Pronouncements and Accounting Changes

Recent Accounting Pronouncements

In February 2013, the FASB issued ASU No. 2013-02, *Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income*, to improve the reporting of reclassifications out of AOCI. This amendment requires an entity to present the changes in each component of AOCI for the periods presented, to separately report significant amounts reclassified from each component of AOCI and to disclose among other things the components, if any, of net income affected by such reclassifications. The disclosures about such reclassifications must be presented either parenthetically on the face of the financial statements or disclosed in the notes to the financial statements. As permitted, the Company adopted the provisions of ASU No. 2013-02 effective January 1, 2013 and its adoption did not have a material effect on the Company's consolidated financial position, results of operations or cash flows.

In July 2012, the FASB issued ASU No. 2012-02, *Testing Indefinite-Lived Intangible Assets for Impairment*, which amended ASC Topic 350, *Intangibles-Goodwill and Other* (ASC 350). This amendment allows an entity to first assess relevant qualitative factors in order to determine whether it is necessary to perform the quantitative impairment test for indefinite-lived intangible assets otherwise required under ASC 350. In effect, the amendment eliminates the need to calculate the fair value of an indefinite-lived intangible asset in connection with the impairment test unless the entity determines, based on the qualitative assessment, that it is more likely than not that the asset is impaired. As permitted, the Company adopted the provisions of ASU No. 2012-02 effective January 1, 2013 and its adoption did not have a material effect on the Company's consolidated financial position, results of operations or cash flows.

Accounting Changes

The Company made no accounting changes during the six months ended March 31, 2013.

5. Fair Value Measurements

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The Company's financial instruments consist of cash and cash equivalents, trade and other accounts receivable, accounts payable, foreign currency derivative instruments and debt. The carrying amounts of cash and cash equivalents, trade and other accounts receivable and accounts payable approximate fair value due to the short-term nature of these financial instruments.

The Company measures on a recurring basis and discloses the fair value of its financial instruments under the provisions of ASC Topic 820, *Fair Value Measurement*, as amended (ASC 820). The Company defines fair value as the price that would be received to sell an asset or paid to transfer a liability (i.e., the exit price) in an orderly transaction between market participants at the measurement date. ASC 820 establishes a three-level hierarchy for measuring fair value and requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. This valuation hierarchy is based upon the transparency of inputs to the valuation of an asset or liability on the measurement date. The three levels of that hierarchy are defined as follows:

Level 1 - Unadjusted quoted prices in active markets for identical assets or liabilities;

Level 2 - Unadjusted quoted prices in active markets for similar assets or liabilities; or unadjusted quoted prices for identical or similar assets or liabilities in markets that are not active; or inputs other than quoted prices that are observable for the asset or liability; or inputs that are derived principally from or corroborated by observable market data; and

Level 3 - Unobservable inputs for the asset or liability.

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Sally Beauty Holdings, Inc. and Subsidiaries

Condensed Notes to Consolidated Financial Statements

(Unaudited)

Consistent with this hierarchy, the Company categorized certain of its financial assets and liabilities as follows at March 31, 2013 (in thousands):

	Total	Level 1	Level 2	Level 3
Assets				
Cash equivalents (a)	\$	\$	\$	
Foreign currency forwards (b)		113		113
Total assets	\$	113	\$	113
Liabilities				
Long-term debt (c)	\$	1,748,148	\$	1,718,625
Foreign currency forwards (b)		176		176
Total liabilities	\$	1,748,324	\$	1,718,625

Consistent with this hierarchy, the Company categorized certain of its financial assets and liabilities as follows at September 30, 2012 (in thousands):

	Total	Level 1	Level 2	Level 3
Assets				
Cash equivalents (a)	\$	155,000	\$	155,000
Foreign currency forwards (b)		4		4
Total assets	\$	155,004	\$	155,000
Liabilities				
Long-term debt (c)	\$	1,739,547	\$	1,731,625
Foreign currency forwards (b)		132		132
Total liabilities	\$	1,739,679	\$	1,731,625

(a) Cash equivalents, at September 30, 2012, consist of highly liquid investments which have no maturity and are valued using unadjusted quoted market prices for such securities. The Company may from time to time invest in securities with maturities of three months or less (consisting primarily of investment-grade corporate or government bonds), with the primary investment objective of minimizing the potential risk of loss of principal.

(b) Foreign currency forwards are valued for purposes of this disclosure using widely accepted valuation techniques, such as discounted cash flow analyses, and reasonable estimates, such as projected foreign currency exchange rates. Please see Note 11 for more information about the Company's foreign exchange contracts (including foreign currency forwards).

(c) Long-term debt (including borrowings under the ABL facility) is carried in the Company's consolidated financial statements at amortized cost of \$1,638.4 million at March 31, 2013 and \$1,617.2 million at September 30, 2012. The senior notes due 2019 and senior notes due 2022 are valued for purposes of this disclosure using unadjusted quoted market prices for such debt securities. Other long-term debt

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(consisting primarily of borrowings under the ABL facility and capital lease obligations), is generally valued for purposes of this disclosure using widely accepted valuation techniques, such as discounted cash flow analyses, and observable inputs, such as market interest rates. Please see Note 10 for more information about the Company's debt.

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Sally Beauty Holdings, Inc. and Subsidiaries

Condensed Notes to Consolidated Financial Statements

(Unaudited)

6. Accumulated Stockholders Equity (Deficit)

In August 2012, the Company announced that its Board of Directors approved a share repurchase program authorizing the Company to repurchase up to \$300.0 million of its common stock (the 2012 Share Repurchase Program). In addition, on March 5, 2013, the Company announced that its Board of Directors approved a new share repurchase program authorizing the Company to repurchase up to \$700.0 million of its common stock over the next eight quarters (the 2013 Share Repurchase Program). In connection with the authorization of the 2013 Share Repurchase Program, the Company's Board of Directors terminated the 2012 Share Repurchase Program.

Prior to such termination, the Company had repurchased approximately 10.4 million shares at a cost of \$266.4 million under the 2012 Share Repurchase Program. In addition, during the period from March 5, 2013 through March 31, 2013, the Company repurchased approximately 1.6 million shares at a cost of \$46.9 million under the 2013 Share Repurchase Program.

During the six months ended March 31, 2013, the Company repurchased and subsequently retired, in the aggregate, approximately 12.0 million shares of its common stock under the 2012 Share Repurchase Program or the 2013 Share Repurchase Program at an aggregate cost of \$313.3 million and reduced common stock and additional paid-in capital, in the aggregate, by an equal amount.

7. Earnings Per Share

Basic earnings per share, is calculated by dividing net earnings by the weighted average number of shares of common stock outstanding during the period. Diluted earnings per share is calculated similarly but includes the potential dilution from the exercise of all outstanding stock options and stock awards, except when the effect would be anti-dilutive.

The following table sets forth the computations of basic and diluted earnings per share (in thousands, except per share data):

	Three Months Ended		Six Months Ended	
	March 31,		March 31,	
	2013	2012	2013	2012
Net earnings	\$ 64,889	\$ 67,813	\$ 123,873	\$ 97,947
Total weighted average basic shares	173,461	186,335	175,930	185,514

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Dilutive securities:								
Stock options and stock award programs	4,928		5,349		4,813		5,148	
Total weighted average diluted shares	178,389		191,684		180,743		190,662	
Earnings per share:								
Basic	\$	0.37	\$	0.36	\$	0.70	\$	0.53
Diluted	\$	0.36	\$	0.35	\$	0.69	\$	0.51

At March 31, 2013, options to purchase 1,577,766 shares of the Company's common stock were outstanding but not included in the computation of diluted earnings per share for both the three and six months ended March 31, 2013 since these options were anti-dilutive. In addition, options to purchase 44,340 and 1,964,831 shares of the Company's common stock were outstanding but not included in the computation of diluted earnings per share for the three and six months ended March 31, 2012, respectively, since these options were anti-dilutive. Anti-dilutive options are: (a) out-of-the-money options (options the exercise price of which is greater than the average price per share of the Company's common stock during the period), and (b) in-the-money options (options the exercise price of which is less than the average price per share of the Company's common stock during the period) for which the sum of assumed proceeds, including any unrecognized compensation expense related to such options, exceeds the average price per share for the period.

8. Share-Based Payments

The Company measures the cost of services received from employees, directors and consultants in exchange for an award of equity instruments based on the fair value of the award on the date of grant, and recognizes compensation expense on a straight-line basis over the vesting period or over the period ending on the date a participant becomes eligible for retirement, if earlier.

The Company granted approximately 1.6 million and 2.0 million stock options and approximately 128,000 and 32,000 restricted share awards to its employees and consultants during the six months ended March 31, 2013 and 2012, respectively. Upon

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Sally Beauty Holdings, Inc. and Subsidiaries

Condensed Notes to Consolidated Financial Statements

(Unaudited)

issuance of such grants, the Company recognized accelerated share-based compensation expense of \$5.9 million and \$5.3 million in the six months ended March 31, 2013 and 2012, respectively, in connection with certain retirement eligible employees who are eligible to continue vesting awards upon retirement under the provisions of the Sally Beauty Holdings, Inc. 2010 Omnibus Incentive Plan (the 2010 Plan) and certain predecessor share-based compensation plans. In addition, the Company granted approximately 34,000 and 26,000 restricted stock units to its non-employee directors during the six months ended March 31, 2013 and 2012, respectively.

The following table presents the total compensation cost charged against income and included in selling, general and administrative expenses for the periods presented for all share-based compensation arrangements and the related tax benefits recognized in our consolidated statements of earnings (in thousands):

	Three Months Ended		Six Months Ended	
	March 31,		March 31,	
	2013	2012	2013	2012
Share-based compensation expense	\$ 3,262	\$ 2,945	\$ 12,313	\$ 10,976
Income tax benefit related to share-based compensation expense	\$ 1,168	\$ 1,143	\$ 4,570	\$ 4,259

Stock Options

Each option has an exercise price that equals 100% of the closing market price of the Company's common stock on the date of grant and generally has a maximum term of 10 years. Options generally vest ratably over a four year period and are generally subject to forfeiture until the vesting period is complete, subject to certain retirement provisions contained in the 2010 Plan and certain predecessor share-based compensation plans.

The following table presents a summary of the activity for the Company's stock option awards for the six months ended March 31, 2013:

	Number of Outstanding Options (in Thousands)	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (in Years)	Aggregate Intrinsic Value (in Thousands)
Outstanding at September 30, 2012	11,861	\$ 10.45	6.5	\$ 173,601
Granted	1,578	23.49		
Exercised	(1,623)	8.18		

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Forfeited or expired	(40)		18.54			
Outstanding at March 31, 2013	11,776	\$	12.49	6.6	\$	198,941
Exercisable at March 31, 2013	6,738	\$	9.23	5.4	\$	135,784

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The following table summarizes additional information about stock options outstanding under the Company's share-based compensation plans:

Range of Exercise Prices	Options Outstanding			Options Exercisable	
	Number Outstanding at March 31, 2013 (in Thousands)	Weighted Average Remaining Contractual Term (in Years)	Weighted Average Exercise Price	Number Exercisable at March 31, 2013 (in Thousands)	Weighted Average Exercise Price
\$2.00 - 9.66	5,846	5.0	\$ 7.87	5,185	\$ 7.92
\$11.39 - 23.49	5,930	8.2	17.04	1,553	13.59
Total	11,776	6.6	\$ 12.49	6,738	\$ 9.23

The Company uses the Black-Scholes option pricing model to value the Company's stock options for each stock option award. Using this option pricing model, the fair value of each stock option award is estimated on the date of grant. The fair value of the Company's stock option awards is expensed on a straight-line basis over the vesting period (generally four years) of the stock options or to the date a participant becomes eligible for retirement, if earlier.

The weighted average assumptions relating to the valuation of the Company's stock options are as follows:

	Six Months Ended	
	2013	2012
Expected life (in years)	5.0	5.0
Expected volatility for the Company's stock	56.3%	58.4%
Risk-free interest rate	0.8%	1.1%
Dividend yield	0.0%	0.0%

The expected life of options represents the period of time that the options granted are expected to be outstanding and is based on historical experience of employees of the Company who have been granted stock options. The risk-free interest rate is based on the five-year zero-coupon U.S. Treasury notes as of the date of the grant. Since the Company does not currently expect to pay dividends, the dividend yield used is 0%.

The weighted average fair value of the stock options issued to the Company's grantees at the date of grant in the six months ended March 31, 2013 and 2012 was \$11.29 and \$9.60 per option, respectively. The total intrinsic value of options exercised during the six months ended March 31, 2013 was \$29.4 million. The cash proceeds from these option exercises were \$13.3 million and the tax benefit realized from these option exercises was \$9.9 million.

At March 31, 2013, approximately \$20.7 million of total unrecognized compensation costs related to unvested stock option awards are expected to be recognized over the weighted average period of 2.6 years.

Stock Awards

Restricted Stock Awards

The Company from time to time grants restricted stock awards to employees and consultants under the 2010 Plan. A restricted stock award is an award of shares of the Company's common stock (which have full voting and dividend rights but are restricted with regard to sale or transfer) the restrictions over which lapse ratably over a specified period of time (generally five years). Restricted stock awards are independent of stock option grants and are generally subject to forfeiture if employment terminates prior to the restrictions lapsing, subject to certain retirement provisions of the 2010 Plan and certain predecessor share-based compensation plans.

The fair value of the Company's restricted stock awards is expensed on a straight-line basis over the period (generally five years) in which the restrictions on these stock awards lapse (vesting) or over the period ending on the date a participant becomes eligible for retirement, if earlier. For these purposes, the fair value of the restricted stock award is determined based on the closing market price of the Company's common stock on the date of grant.

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The following table presents a summary of the activity for the Company's restricted stock awards for the six months ended March 31, 2013:

Restricted Stock Awards	Number of Shares (in Thousands)	Weighted Average Fair Value Per Share	Weighted Average Remaining Vesting Term (in Years)
Unvested at September 30, 2012	307	\$ 10.42	2.5
Granted	128	23.49	
Vested	(103)	9.48	
Forfeited			
Unvested at March 31, 2013	332	\$ 15.77	3.0

At March 31, 2013, approximately \$2.8 million of total unrecognized compensation costs related to unvested restricted stock awards are expected to be recognized over the weighted average period of 3.0 years.

Restricted Stock Units

The Company currently grants Restricted Stock Unit (RSU or RSUs) awards, which generally vest less than one year from the date of grant, pursuant to the 2010 Plan. To date, the Company has only granted RSU awards to its non-employee directors. RSUs represent an unsecured promise of the Company to issue shares of common stock of the Company. Upon vesting, RSUs are generally retained by the Company as deferred stock units that are not distributed until six months after the independent director's service as a director terminates. With respect to awards made by the Company after September 30, 2012, an independent director who receives an RSU award may elect, upon receipt of such award, to defer until a later date delivery of the shares of common stock of the Company that would otherwise be issued to such director on the vesting date. RSUs are independent of stock option grants and are generally subject to forfeiture if service terminates prior to the vesting of the units. Participants have no voting rights with respect to unvested RSUs. Under the 2010 Plan, the Company may settle the vested deferred stock units with shares of the Company's common stock or in cash.

The Company expenses the cost of the RSUs, which is determined to be the fair value of the RSUs at the date of grant, on a straight-line basis over the vesting period (generally one year). For these purposes, the fair value of the RSU is determined based on the closing market price of the Company's common stock on the date of grant.

The following table presents a summary of the activity for the Company's RSUs for the six months ended March 31, 2013:

Restricted Stock Units	Number of Shares (in Thousands)	Weighted Average Fair Value Per Share	Weighted Average Remaining Vesting Term (in Years)
Unvested at September 30, 2012		\$	
Granted	34	23.49	
Vested			
Forfeited	(4)	23.49	
Unvested at March 31, 2013	30	\$ 23.49	0.5

At March 31, 2013, approximately \$0.4 million of total unrecognized compensation costs related to unvested RSUs are expected to be recognized over the weighted average period of 0.5 years.

9. Goodwill and Intangible Assets

The Company completed its annual assessment of goodwill for impairment during the quarter ended March 31, 2013. No impairment losses were recognized in the current or prior periods presented in connection with the Company's goodwill.

In July 2012, the FASB issued ASU No. 2012-02, *Testing Indefinite-Lived Intangible Assets for Impairment*, which amended ASC 350. This amendment allows an entity to first assess relevant qualitative factors in order to determine whether it is necessary to perform the quantitative impairment test for indefinite-lived intangible assets otherwise required under ASC 350. In effect, the amendment eliminates the need to calculate the fair value of an indefinite-lived intangible asset in connection with the impairment test unless the entity determines, based on the qualitative

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assessment, that it is more likely than not that the asset is impaired. As permitted, the Company adopted the provisions of ASU No. 2012-02 effective January 1, 2013.

The Company completed its annual assessment of intangible assets, other than goodwill, including indefinite-lived intangible assets, for impairment during the quarter ended March 31, 2013. No impairment losses were recognized in the current or prior periods presented in connection with the Company's intangible assets.

10. Short-term Borrowings and Long-term Debt

Details of long-term debt as of March 31, 2013 are as follows (in thousands):

	Amount	Maturity Dates	Interest Rates
ABL facility	\$ 22,500	Nov. 2015	(i) Prime plus (1.25% to 1.75%) or; (ii) LIBOR (a) plus (2.25% to 2.75%)
Senior notes due 2019	750,000	Nov. 2019	6.875%
Senior notes due 2022 (b)	858,845	Jun. 2022	5.750% (b)
Other (c)	1,886	2014-2015	4.93% to 5.79%
Total	\$ 1,633,231		
Capital leases and other	\$ 5,137		
Less: current portion	(24,475)		
Total long-term debt	\$ 1,613,893		

(a) London Interbank Offered Rate (LIBOR).

(b) Includes unamortized premium of \$8.8 million related to notes issued in September 2012 with an aggregate principal amount of \$150.0 million. The 5.75% interest rate relates to notes in the aggregate principal amount of \$850.0 million.

(c) Represents pre-acquisition debt of Pro-Duo NV and Sinelco Group BVBA (Sinelco).

In connection with the Separation Transactions, in November 2006, the Company, through its subsidiaries (Sally Investment Holdings LLC and Sally Holdings LLC) incurred \$1,850.0 million of indebtedness by: (i) borrowing \$70.0 million under a \$400.0 million revolving (asset-based

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lending (ABL) credit facility; (ii) entering into two senior term loan facilities (term loans A and B) in an aggregate amount of \$1,070.0 million; and (iii) issuing 9.25% senior notes due 2014 in an aggregate amount of \$430.0 million and 10.50% senior subordinated notes due 2016 in an aggregate amount of \$280.0 million.

Borrowings under the term loan A facility were paid in full in the fiscal year ended September 30, 2010.

In the fiscal year ended September 30, 2011, Sally Holdings LLC (Sally Holdings) entered into a new \$400 million, five-year asset-based senior secured loan facility (the ABL facility) and terminated its prior ABL credit facility. The availability of funds under the ABL facility is subject to a customary borrowing base comprised of a percentage of our credit card and trade receivables, and of our inventory (minus certain customary reserves) and reduced by certain outstanding letters of credit. The ABL facility includes a \$25.0 million Canadian sub-facility for our Canadian operations. At March 31, 2013, the Company had \$355.9 million available for borrowing under the ABL facility, including the Canadian sub-facility.

In the fiscal year ended September 30, 2012, the Company redeemed in full the 9.25% senior notes due 2014 and 10.50% senior subordinated notes due 2016 and repaid in full its borrowings under the term loan B facility with the net proceeds from the Company's issuance of \$750.0 million aggregate principal amount of its 6.875% Senior Notes due 2019 (the senior notes due 2019) and \$700.0 million aggregate principal amount of its 5.75% Senior Notes due 2022 (the senior notes due 2022). Please see Note 14 of the Notes to Consolidated Financial Statements in Item 8 - Financial Statements and Supplementary Data contained in our Annual Report on Form 10-K for the fiscal year ended September 30, 2012 for additional information about the Company's long-term debt.

In addition, in September 2012, the Company issued an additional \$150.0 million aggregate principal amount of the senior notes due 2022. The proceeds from this issuance were used for general corporate purposes. The senior notes due 2022 in this subsequent offering were issued at par plus a premium, which is being amortized over the term of the notes using the effective interest method.

The senior notes due 2019 and the senior notes due 2022 (together, the senior notes due 2019 and 2022) are unsecured obligations of Sally Holdings and Sally Capital Inc. (together, the Issuers) and are jointly and severally guaranteed by the Company and Sally Investment, and by each material domestic subsidiary of the Company. Interest on the senior notes due 2019 and 2022 is payable semi-annually, during the Company's first and third fiscal quarters. Please see Note 14 for certain condensed financial statement data pertaining to Sally Beauty, the Issuers, the guarantor subsidiaries and the non-guarantor subsidiaries.

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The senior notes due 2019 carry optional redemption features whereby the Company has the option to redeem the notes, in whole or in part, on or after November 15, 2017 at par, plus accrued and unpaid interest, if any, and on or after November 15, 2015 at par plus a premium declining ratably to par, plus accrued and unpaid interest, if any. Prior to November 15, 2015, the notes may be redeemed, in whole or in part, at a redemption price equal to par plus a make-whole premium as provided in the indenture, plus accrued and unpaid interest, if any. In addition, on or prior to November 15, 2014, the Company has the right to redeem at par plus a specified premium, plus accrued and unpaid interest, if any, up to 35% of the aggregate principal amount of notes originally issued, subject to certain limitations, with the proceeds from certain kinds of equity offerings, as defined in the indenture.

The senior notes due 2022 carry optional redemption features whereby the Company has the option to redeem the notes, in whole or in part, on or after June 1, 2020 at par, plus accrued and unpaid interest, if any, and on or after June 1, 2017 at par plus a premium declining ratably to par, plus accrued and unpaid interest, if any. Prior to June 1, 2017, the notes may be redeemed, in whole or in part, at a redemption price equal to par plus a make-whole premium as provided in the indenture, plus accrued and unpaid interest, if any. In addition, on or prior to June 1, 2015, the Company has the right to redeem at par plus a specified premium, plus accrued and unpaid interest, if any, up to 35% of the aggregate principal amount of notes originally issued, subject to certain limitations, with the proceeds from certain kinds of equity offerings, as defined in the indenture.

Maturities of the Company's long-term debt are as follows as of March 31, 2013 (in thousands):

Twelve months ending March 31:	
2014	\$ 23,713
2015	643
2016	30
2017	
2018	
Thereafter	1,608,845
	\$ 1,633,231
Capital lease obligations	5,137
Less: current portion	(24,475)
Total	\$ 1,613,893

We are a holding company and do not have any material assets or operations other than ownership of equity interests of our subsidiaries. The agreements and instruments governing the debt of Sally Holdings and its subsidiaries contain material limitations on their ability to pay dividends and other restricted payments to us which, in turn, constitute material limitations on our ability to pay dividends and other payments to our stockholders.

The ABL facility does not contain any restriction against the incurrence of unsecured indebtedness. However, the ABL facility restricts the incurrence of secured indebtedness if, after giving effect to the incurrence of such secured indebtedness, the Company's Secured Leverage Ratio

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exceeds 4.0 to 1.0. At March 31, 2013, the Company's Secured Leverage Ratio was approximately 0.1 to 1.0. Secured Leverage Ratio is defined as the ratio of (i) Secured Funded Indebtedness (as defined in the ABL facility) to (ii) Consolidated EBITDA, as defined in the ABL facility.

The ABL facility is pre-payable and the commitments thereunder may be terminated, in whole or in part, at any time without penalty or premium.

The indentures governing the senior notes due 2019 and 2022 contain terms which restrict the ability of Sally Beauty's subsidiaries to incur additional indebtedness. However, in addition to certain other material exceptions, the Company may incur additional indebtedness under the indentures if its Consolidated Coverage Ratio, after giving pro forma effect to the incurrence of such indebtedness, exceeds 2.0 to 1.0 (Incurrence Test). At March 31, 2013, the Company's Consolidated Coverage Ratio was approximately 6.2 to 1.0. Consolidated Coverage Ratio is defined as the ratio of (i) Consolidated EBITDA, as defined in the indentures, for the period containing the most recent four consecutive fiscal quarters, to (ii) Consolidated Interest Expense, as defined in the indentures, for such period.

The indentures governing the senior notes due 2019 and 2022 restrict Sally Holdings and its subsidiaries from making certain dividends and distributions to equity holders and certain other restricted payments (hereafter, a Restricted Payment or Restricted Payments) to us. However, the indentures permit the making of such Restricted Payments if, at the time of the making of such Restricted Payment, the Company satisfies the Incurrence Test as described above and the cumulative amount of all Restricted Payments made since the issue date of the applicable senior notes does not exceed the sum of: (i) 50% of Sally Holdings and its subsidiaries' cumulative consolidated net earnings since July 1, 2006, plus (ii) the proceeds from the issuance of certain equity securities or conversions of indebtedness to equity, in each case, since the issue date of the applicable senior notes plus (iii) the net reduction in investments in unrestricted subsidiaries since the issue date of the applicable senior notes plus

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(iv) the return of capital with respect to any sales or dispositions of certain minority investments since the issue date of the applicable senior notes. Further, in addition to certain other baskets, the indentures permit the Company to make additional Restricted Payments in an unlimited amount if, after giving pro forma effect to the incurrence of any indebtedness to make such Restricted Payment, the Company's Consolidated Total Leverage Ratio (as defined in the indentures) is less than 3.25 to 1.00. At March 31, 2013, the Company's Consolidated Total Leverage Ratio was approximately 2.6 to 1.0. Consolidated Total Leverage Ratio is defined as the ratio of (i) Consolidated Total Indebtedness, as defined in the indentures, *minus* cash and cash equivalents on-hand up to \$100.0 million, in each case, as of the end of the most recently-ended fiscal quarter to (ii) Consolidated EBITDA, as defined in the indentures, for the period containing the most recent four consecutive fiscal quarters.

The ABL facility also restricts the making of Restricted Payments. More specifically, under the ABL facility, as amended, Sally Holdings may make Restricted Payments if availability under the ABL facility exceeds certain thresholds, and no default then exists under the facility. For Restricted Payments up to \$30.0 million during each fiscal year, borrowing availability must exceed the lesser of \$80.0 million or 20% of the borrowing base for 45 days prior to such Restricted Payment. For Restricted Payments in excess of that amount, the same borrowing availability must be maintained and the Consolidated Fixed Charge Coverage Ratio (as defined in the ABL facility) must equal or exceed 1.2 to 1.0. Consolidated Fixed Charge Coverage Ratio is defined as the ratio of (i) Consolidated EBITDA, as defined in the ABL facility, *minus* certain unfinanced capital expenditures and tax payments to (ii) fixed charges, as specified in the ABL facility. In addition, during any period that availability under the ABL facility is less than the greater of \$40.0 million or 15% of the borrowing base, the level of the Consolidated Fixed Charge Coverage Ratio that the Company must satisfy is 1.1 to 1.0. As of March 31, 2013, the Consolidated Fixed Charge Coverage Ratio was approximately 4.5 to 1.0.

When used in this Quarterly Report, the phrase "Consolidated EBITDA" is intended to have the meaning ascribed to such phrase in the ABL facility or the indentures governing the senior notes due 2019 and 2022, as appropriate. EBITDA is not a recognized measurement under GAAP and should not be considered a substitute for financial performance and liquidity measures determined in accordance with GAAP, such as net earnings, total comprehensive income, operating earnings and operating cash flows.

The ABL facility and the indentures governing the senior notes due 2019 and 2022 contain other covenants regarding restrictions on assets dispositions, granting of liens and security interests, prepayment of certain indebtedness and other matters and customary events of default, including customary cross-default and/or cross-acceleration provisions. As of March 31, 2013, all the net assets of our consolidated subsidiaries were unrestricted from transfer under our credit arrangements.

11. Derivative Instruments and Hedging Activities

Risk Management Objectives of Using Derivative Instruments

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The Company is exposed to a wide variety of risks, including risks arising from changing economic conditions. The Company manages its exposure to certain economic risks (including liquidity, credit risk, and changes in foreign currency exchange rates and in interest rates) primarily: (a) by closely managing its cash flows from operating and investing activities and the amounts and sources of its debt obligations; (b) by assessing periodically the creditworthiness of its business partners; and (c) through the use of derivative instruments from time to time (including foreign exchange contracts and interest rate swaps) by Sally Holdings.

The Company from time to time uses foreign exchange contracts, as part of its overall economic risk management strategy, to fix the amount of certain foreign assets and obligations relative to its functional and reporting currency (the U.S. dollar) or relative to the functional currency of certain of its consolidated subsidiaries, or to add stability to cash flows resulting from its net investments (including intercompany notes not permanently invested) and earnings denominated in foreign currencies. The Company's foreign currency exposures at times offset each other, sometimes providing a natural hedge against its foreign currency risk. In connection with the remaining foreign currency risk, the Company uses foreign exchange contracts to effectively fix the foreign currency exchange rate applicable to specific anticipated foreign currency-denominated cash flows thus limiting the potential fluctuations in such cash flows as a result of foreign currency market movements.

The Company from time to time has used interest rate swaps, as part of its overall economic risk management strategy, to add stability to the interest payments due in connection with its debt obligations. At March 31, 2013, our exposure to interest rate fluctuations relates to interest payments under the ABL facility, if any, and the Company held no derivatives instruments in connection therewith.

As of March 31, 2013, the Company did not purchase or hold any derivative instruments for trading or speculative purposes.

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Designated Cash Flow Hedges

In 2008, Sally Holdings entered into certain interest rate swap agreements with an aggregate notional amount of \$300 million which enabled it to convert a portion of its then variable-interest rate obligations under the term loan B facility, to fixed-interest rate obligations. These agreements were designated and qualified as effective cash flow hedges, in accordance with ASC Topic 815, *Derivatives and Hedging* (ASC 815). Accordingly, changes in the fair value of these derivative instruments (which were adjusted quarterly) were recorded, net of income tax, in accumulated other comprehensive (loss) income (AOCI) until the swap agreements expired in May 2012. Amounts previously reported in AOCI which were related to such interest rate swaps were reclassified into interest expense, as a yield adjustment, in the same period in which interest on the hedged variable-rate debt obligations affected earnings. As such, for the three and six months ended March 31, 2012, the Company's other comprehensive income included deferred gains on these interest swaps of \$1.4 million and \$2.9 million, respectively, net of income tax of \$0.9 million and \$1.9 million, respectively.

Non-designated Cash Flow Hedges

The Company may use from time to time derivative instruments (such as foreign exchange contracts and interest rate swaps) not designated as hedges or that do not meet the requirements for hedge accounting to manage its exposure to interest rate or foreign currency exchange rate movements, as appropriate.

The Company uses foreign exchange contracts including, at March 31, 2013, foreign currency forwards with an aggregate notional amount of \$6.0 million to manage the exposure to the U.S. dollar resulting from certain of our Sinelco Group subsidiaries' purchases of merchandise from third-party suppliers. Sinelco's functional currency is the Euro. These foreign currency forwards enable Sinelco to buy U.S. dollars at a contractual exchange rate of 1.2772, are with a single counterparty and expire ratably through September 2013.

The Company also uses foreign exchange contracts to mitigate its exposure to changes in foreign currency exchange rates in connection with certain intercompany balances not permanently invested. As such, at March 31, 2013, we held: (a) a foreign currency forward which enables us to sell approximately 26.7 million (\$34.3 million, at the March 31, 2013 exchange rate) at the contractual exchange rate of 1.2867, (b) a foreign currency forward which enables us to sell approximately \$3.8 million Canadian dollars (\$3.7 million, at the March 31, 2013 exchange rate) at the contractual exchange rate of 1.0187, (c) a foreign currency forward which enables us to buy approximately \$15.9 million Canadian dollars (\$15.6 million, at the March 31, 2013 exchange rate) at the contractual exchange rate of 1.0179, (d) a foreign currency forward which enables us to sell approximately 9.3 million Mexican pesos (\$0.8 million, at the March 31, 2013 exchange rate) at the contractual exchange rate of 12.3495 and (e) a foreign currency forward which enables us to sell approximately £12.9 million (\$19.7 million, at the March 31, 2013 exchange rate) at the contractual exchange rate of 1.5146. The foreign currency forwards discussed in this paragraph are with a single counterparty, not the same party as the counterparties on the other forwards held at March 31, 2013, and expire on or before June 30, 2013.

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In addition, the Company uses foreign exchange contracts including, at March 31, 2013, foreign currency forwards with an aggregate notional amount of 1.8 million (\$2.3 million, at the March 31, 2013 exchange rate) to mitigate the exposure to the British pound sterling resulting from the sale of products and services among certain European subsidiaries of the Company. The foreign currency forwards discussed in this paragraph enable the Company to buy British pound sterling in exchange for Euro currency at the weighted average contractual exchange rate of 0.8149, are with a single counterparty, not the same party as the counterparties on the other forwards held at March 31, 2013, and expire ratably through September 2013.

The Company's foreign currency derivatives are not designated as hedges and do not currently meet the hedge accounting requirements of ASC 815. Accordingly, the changes in fair value of these derivative instruments, which are adjusted quarterly, are recorded in our consolidated statements of earnings. Selling, general and administrative expenses reflect net gains of \$1.3 million and net losses of \$1.3 million for the three months ended March 31, 2013 and 2012, respectively; and net gains of \$0.3 million and \$0.4 million for the six months ended March 31, 2013 and 2012, respectively, including marked-to-market adjustments, in connection with all of the Company's foreign currency derivatives.

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The table below presents the fair value of the Company's derivative financial instruments as well as their classification on the balance sheet as of March 31, 2013 and September 30, 2012 (in thousands):

	Classification	Asset Derivatives March 31, 2013	September 30, 2012	Classification	Liability Derivatives March 31, 2013	September 30, 2012
Derivatives designated as hedging instruments:						
None						
Derivatives not designated as hedging instruments:						
	Prepaid			Accrued		
Foreign Exchange Contracts	expenses	\$ 113	\$ 4	liabilities	\$ 176	\$ 132
		\$ 113	\$ 4		\$ 176	\$ 132

The table below presents the effect of the Company's derivative financial instruments on the statements of earnings for the three months ended March 31, 2013 and 2012 (in thousands):

Derivatives Designated as Hedging Instruments	Amount of Gain or (Loss) Recognized in OCI on Derivative (Effective Portion), net of tax Three Months Ended March 31,		Classification	Amount of Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion) Three Months Ended March 31,	
	2013	2012		2013	2012
Interest Rate Swaps	\$	\$ 1,425	Interest expense	\$	\$ (2,508)
Derivatives Not Designated as Hedging Instruments	Classification of Gain or (Loss) Recognized into Income		Amount of Gain or (Loss) Recognized in Income on Derivatives Three Months Ended March 31,		
			2013	2012	
Foreign Exchange Contracts	Selling, general and administrative expenses		\$ 1,305	\$ (1,337)	

The table below presents the effect of the Company's derivative financial instruments on the statements of earnings for the six months ended March 31, 2013 and 2012 (in thousands):

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Derivatives Designated as Hedging Instruments	Amount of Gain or (Loss) Recognized in OCI on Derivative (Effective Portion), net of tax Six Months Ended March 31,		Classification	Amount of Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion) Six Months Ended March 31,	
	2013	2012		2013	2012
Interest Rate Swaps	\$	\$ 2,920	Interest expense	\$	\$ (5,061)

Derivatives Not Designated as Hedging Instruments	Classification of Gain or (Loss) Recognized into Income	Amount of Gain or (Loss) Recognized in Income on Derivatives Six Months Ended March 31,	
		2013	2012
Foreign Exchange Contracts	Selling, general and administrative expenses	\$ 285	\$ 372

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Credit-risk-related Contingent Features

At March 31, 2013, the aggregate fair value of all foreign exchange contracts held which consisted of derivative instruments in a liability position was \$0.2 million. The Company was under no obligation to post and had not posted any collateral related to the agreements in a liability position.

The counterparties to all our derivative instruments are deemed by the Company to be of substantial resources and strong creditworthiness. However, these transactions result in exposure to credit risk in the event of default by a counterparty. The financial crisis that has affected the banking systems and financial markets in recent years resulted in many well-known financial institutions becoming less creditworthy or having diminished liquidity which could expose us to an increased level of counterparty credit risk. In the event that a counterparty defaults in its obligation under our derivative instruments, we could incur substantial financial losses. However, at the present time, no such losses are deemed probable.

12. Income Taxes

In January 2012, the IRS concluded the field work associated with their examination of the Company's consolidated federal income tax returns for the fiscal years ended September 30, 2007 and 2008 and issued their examination report. The Company is appealing certain disputed items and it does not anticipate the ultimate resolution of these items to have a material impact on the Company's financial statements.

The IRS is currently conducting an examination of the Company's consolidated federal income tax returns for the fiscal years ended September 30, 2009, 2010 and 2011. The IRS had previously audited the Company's consolidated federal income tax returns through the tax year ended September 30, 2006, thus our statute remains open from the year ended September 30, 2007 forward. Our foreign subsidiaries are impacted by various statutes of limitations, which are generally open from 2007 forward. Generally, states' statutes in the United States are open for tax reviews from 2006 forward.

13. Business Segments

The Company's business is organized into two separate segments: (i) Sally Beauty Supply, a domestic and international chain of cash and carry retail stores which offers professional beauty supplies to both salon professionals and retail customers primarily in North America, Puerto Rico, and parts of South America and Europe and (ii) BSG, including its franchise-based business Armstrong McCall, a full service beauty supply

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distributor which offers professional brands of beauty products directly to salons and salon professionals through its own sales force and professional-only stores (including franchise stores) in partially exclusive geographical territories in North America, Puerto Rico and parts of Europe.

The accounting policies of both of our business segments are the same as described in the summary of significant accounting policies contained in Note 2 of the Notes to Consolidated Financial Statements in Item 8 - Financial Statements and Supplementary Data contained in our Annual Report on Form 10-K for the fiscal year ended September 30, 2012.

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Sally Beauty Holdings, Inc. and Subsidiaries

Condensed Notes to Consolidated Financial Statements

(Unaudited)

Sales between segments, which were eliminated in consolidation, were not material during the three and six months ended March 31, 2013 and 2012. Segment data for the three and six months ended March 31, 2013 and 2012 is as follows (in thousands):

	Three Months Ended		Six Months Ended	
	March 31,		March 31,	
	2013	2012	2013	2012
Net sales:				
Sally Beauty Supply	\$ 555,977	\$ 553,973	\$ 1,114,793	\$ 1,090,331
BSG	342,262	335,308	688,887	663,765
Total	\$ 898,239	\$ 889,281	\$ 1,803,680	\$ 1,754,096
Earnings before provision for income taxes:				
Segment operating profit:				
Sally Beauty Supply	\$ 105,956	\$ 111,334	\$ 212,043	\$ 212,400
BSG	49,821	45,597	98,573	88,924
Segment operating profit	155,777	156,931	310,616	301,324
Unallocated expenses (a)	(24,678)	(22,329)	(48,595)	(45,401)
Share-based compensation expense	(3,262)	(2,945)	(12,313)	(10,976)
Interest expense (b)	(26,779)	(22,355)	(53,503)	(86,316)
Earnings before provision for income taxes	\$ 101,058	\$ 109,302	\$ 196,205	\$ 158,631

(a) Unallocated expenses consist of corporate and shared costs.

(b) For the six months ended March 31, 2012, interest expense includes a loss on extinguishment of debt of \$34.6 million in connection with the Company's redemption of its senior notes due 2014 and senior subordinated notes due 2016 with the net proceeds of the Company's senior notes due 2019.

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Sally Beauty Holdings, Inc. and Subsidiaries

Condensed Notes to Consolidated Financial Statements

(Unaudited)

14. Guarantor and Non-Guarantor Condensed Consolidated Financial Statements

The following condensed consolidating financial information presents the condensed consolidated balance sheets as of March 31, 2013 and September 30, 2012, the condensed consolidated statements of earnings and comprehensive income for the three and six months ended March 31, 2013 and 2012, and condensed consolidated statements of cash flows for the six months ended March 31, 2013 and 2012 of: (i) Sally Beauty Holdings, Inc., or the Parent; (ii) Sally Holdings LLC and Sally Capital Inc., or the Issuers; (iii) the guarantor subsidiaries; (iv) the non-guarantor subsidiaries; (v) elimination entries necessary for consolidation purposes; and (vi) Sally Beauty on a consolidated basis.

Investments in subsidiaries are accounted for using the equity method for purposes of the consolidating presentation. The principal elimination entries relate to investments in subsidiaries and intercompany balances and transactions. Separate financial statements and other disclosures with respect to the subsidiary guarantors have not been provided as management believes the following information is sufficient, as guarantor subsidiaries are 100 percent indirectly owned by the Parent and all guarantees are full and unconditional. Additionally, substantially all of the assets of the guarantor subsidiaries are pledged under the ABL facility and consequently may not be available to satisfy the claims of general creditors.

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Sally Beauty Holdings, Inc. and Subsidiaries

Condensed Notes to Consolidated Financial Statements

(Unaudited)

Condensed Consolidating Balance Sheet

March 31, 2013

(In thousands)

	Parent	Sally Holdings LLC and Sally Capital Inc.	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Consolidating Eliminations	Sally Beauty Holdings, Inc. and Subsidiaries
Assets						
Cash and cash equivalents	\$	\$	\$ 28,874	\$ 33,382	\$	\$ 62,256
Trade, income taxes and other accounts receivable, less allowance for doubtful accounts		12,494	62,644	38,063		113,201
Due from affiliates		2	1,090,849	1,516	(1,092,367)	
Inventory			557,876	194,865		752,741
Prepaid expenses	411	152	12,432	13,905		26,900
Deferred income tax assets, net	(408)	(423)	38,804	(4,458)		33,515
Property and equipment, net			144,512	72,391		216,903
Investment in subsidiaries	87,511	2,345,364	360,712		(2,793,587)	
Goodwill and other intangible assets, net			470,695	179,518		650,213
Other assets		30,212	1,095	5,033		36,340
Total assets	\$ 100,008	\$ 2,375,307	\$ 2,768,493	\$ 534,215	\$ (3,885,954)	\$ 1,892,069
Liabilities and Stockholders (Deficit) Equity						
Accounts payable	\$	\$	\$ 204,714	\$ 49,572	\$	\$ 254,286
Due to affiliates	381,820	617,088	1,516	91,943	(1,092,367)	
Accrued liabilities	224	36,487	112,395	26,758		175,864
Income taxes payable		3,500	4,596	2,491		10,587
Long-term debt		1,631,345	223	6,800		1,638,368
Other liabilities			21,834	1,846		23,680
Deferred income tax liabilities, net	(1,527)	(624)	77,851	(5,907)		69,793
Total liabilities	380,517	2,287,796	423,129	173,503	(1,092,367)	2,172,578
Total stockholders (deficit) equity	(280,509)	87,511	2,345,364	360,712	(2,793,587)	(280,509)
Total liabilities and stockholders (deficit) equity	\$ 100,008	\$ 2,375,307	\$ 2,768,493	\$ 534,215	\$ (3,885,954)	\$ 1,892,069

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Sally Beauty Holdings, Inc. and Subsidiaries

Condensed Notes to Consolidated Financial Statements

(Unaudited)

Condensed Consolidating Balance Sheet

September 30, 2012

(In thousands)

	Parent	Sally Holdings LLC and Sally Capital Inc.	Guarantor Subsidiaries	Non- Guarantor Subsidiaries	Consolidating Eliminations	Sally Beauty Holdings, Inc. and Subsidiaries
Assets						
Cash and cash equivalents	\$	\$ 155,000	\$ 48,582	\$ 36,638	\$	\$ 240,220
Trade, income taxes and other accounts receivable, less allowance for doubtful accounts		23,734	63,964	37,792		125,490
Due from affiliates		2	934,268	3,637	(937,907)	
Inventory			551,017	184,339		735,356
Prepaid expenses	1,181	24	12,189	15,982		29,376
Deferred income tax assets, net	(408)	(423)	38,805	(4,509)		33,465
Property and equipment, net			140,238	62,423		202,661
Investment in subsidiaries	(30,403)	2,194,771	367,435		(2,531,803)	
Goodwill and other intangible assets, net			475,623	185,145		660,768
Other assets		32,445	1,069	4,950		38,464
Total assets	\$ (5,896)	\$ 2,381,819	\$ 2,633,190	\$ 526,397	\$ (3,469,710)	\$ 2,065,800
Liabilities and Stockholders (Deficit) Equity						
Accounts payable	\$	\$	\$ 202,560	\$ 59,649	\$	\$ 262,209
Due to affiliates	110,512	761,262	3,637	62,496	(937,907)	
Accrued liabilities	141	38,171	134,387	27,568		200,267
Income taxes payable		4,136	4,596	4,272		13,004
Long-term debt		1,609,308	265	7,657		1,617,230
Other liabilities			21,060	3,172		24,232
Deferred income tax liabilities, net	(1,464)	(655)	71,914	(5,852)		63,943
Total liabilities	109,189	2,412,222	438,419	158,962	(937,907)	2,180,885
Total stockholders (deficit) equity	(115,085)	(30,403)	2,194,771	367,435	(2,531,803)	(115,085)
Total liabilities and stockholders (deficit) equity	\$ (5,896)	\$ 2,381,819	\$ 2,633,190	\$ 526,397	\$ (3,469,710)	\$ 2,065,800

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Sally Beauty Holdings, Inc. and Subsidiaries

Condensed Notes to Consolidated Financial Statements

(Unaudited)

Condensed Consolidating Statement of Earnings and Comprehensive Income
Three Months Ended March 31, 2013

(In thousands)

	Parent	Sally Holdings LLC and Sally Capital Inc.	Guarantor Subsidiaries	Non- Guarantor Subsidiaries	Consolidating Eliminations	Sally Beauty Holdings, Inc. and Subsidiaries
Net sales	\$	\$	\$ 729,330	\$ 168,909	\$	\$ 898,239
Related party sales			652		(652)	
Cost of products sold and distribution expenses			361,846	92,591	(652)	453,785
Gross profit			368,136	76,318		444,454
Selling, general and administrative expenses	2,657	85	226,988	69,640		299,370
Depreciation and amortization			12,432	4,815		17,247
Operating earnings (loss)	(2,657)	(85)	128,716	1,863		127,837
Interest expense		26,659	12	108		26,779
Earnings (loss) before provision for income taxes	(2,657)	(26,744)	128,704	1,755		101,058
Provision (benefit) for income taxes	(1,096)	(10,387)	46,675	977		36,169
Equity in earnings of subsidiaries, net of tax	66,450	82,807	778		(150,035)	
Net earnings	64,889	66,450	82,807	778	(150,035)	64,889
Other comprehensive income (loss), net of tax				(11,794)		(11,794)
Total comprehensive income (loss)	\$ 64,889	\$ 66,450	\$ 82,807	\$ (11,016)	\$ (150,035)	\$ 53,095

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Sally Holdings LLC and Subsidiaries

Condensed Notes to Consolidated Financial Statements

(Unaudited)

Condensed Consolidating Statement of Earnings and Comprehensive Income
Three Months Ended March 31, 2012

(In thousands)

	Parent	Sally Holdings LLC and Sally Capital Inc.	Guarantor Subsidiaries	Non- Guarantor Subsidiaries	Consolidating Eliminations	Sally Beauty Holdings, Inc. and Subsidiaries
Net sales	\$	\$	\$ 725,321	\$ 163,960	\$	\$ 889,281
Related party sales			685		(685)	
Cost of products sold and distribution expenses			362,559	90,621	(685)	452,495
Gross profit			363,447	73,339		436,786
Selling, general and administrative expenses	2,605	147	221,710	64,727		289,189
Depreciation and amortization	1		11,213	4,726		15,940
Operating earnings (loss)	(2,606)	(147)	130,524	3,886		131,657
Interest expense		22,177	33	145		22,355
Earnings (loss) before provision for income taxes	(2,606)	(22,324)	130,491	3,741		109,302
Provision (benefit) for income taxes	(869)	(8,658)	49,084	1,932		41,489
Equity in earnings of subsidiaries, net of tax	69,550	83,216	1,809		(154,575)	
Net earnings	67,813	69,550	83,216	1,809	(154,575)	67,813
Other comprehensive income, net of tax		1,425		10,975		12,400
Total comprehensive income	\$ 67,813	\$ 70,975	\$ 83,216	\$ 12,784	\$ (154,575)	\$ 80,213

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Sally Holdings LLC and Subsidiaries

Condensed Notes to Consolidated Financial Statements

(Unaudited)

Condensed Consolidating Statement of Earnings and Comprehensive Income
Six Months Ended March 31, 2013

(In thousands)

	Parent	Sally Holdings LLC and Sally Capital Inc.	Guarantor Subsidiaries	Non- Guarantor Subsidiaries	Consolidating Eliminations	Sally Beauty Holdings, Inc. and Subsidiaries
Net sales	\$	\$	\$ 1,448,289	\$ 355,391	\$	\$ 1,803,680
Related party sales			1,470		(1,470)	
Cost of products sold and distribution expenses			722,583	193,745	(1,470)	914,858
Gross profit			727,176	161,646		888,822
Selling, general and administrative expenses	5,133	175	459,547	140,204		605,059
Depreciation and amortization			24,557	9,498		34,055
Operating earnings (loss)	(5,133)	(175)	243,072	11,944		249,708
Interest expense		53,257	16	230		53,503
Earnings (loss) before provision for income taxes	(5,133)	(53,432)	243,056	11,714		196,205
Provision (benefit) for income taxes	(1,958)	(20,753)	91,333	3,710		72,332
Equity in earnings of subsidiaries, net of tax	127,048	159,727	8,004		(294,779)	
Net earnings	123,873	127,048	159,727	8,004	(294,779)	123,873
Other comprehensive income (loss), net of tax				(9,136)		(9,136)
Total comprehensive income (loss)	\$ 123,873	\$ 127,048	\$ 159,727	\$ (1,132)	\$ (294,779)	\$ 114,737

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Sally Beauty Holdings, Inc. and Subsidiaries

Condensed Notes to Consolidated Financial Statements

(Unaudited)

Condensed Consolidating Statement of Earnings and Comprehensive Income
Six Months Ended March 31, 2012

(In thousands)

	Parent	Sally Holdings LLC and Sally Capital Inc.	Guarantor Subsidiaries	Non- Guarantor Subsidiaries	Consolidating Eliminations	Sally Beauty Holdings, Inc. and Subsidiaries
Net sales	\$	\$	\$ 1,417,235	\$ 336,861	\$	\$ 1,754,096
Related party sales			1,485		(1,485)	
Cost of products sold and distribution expenses			712,506	184,432	(1,485)	895,453
Gross profit			706,214	152,429		858,643
Selling, general and administrative expenses	5,309	289	447,712	128,893		582,203
Depreciation and amortization	1		22,317	9,175		31,493
Operating earnings (loss)	(5,310)	(289)	236,185	14,361		244,947
Interest expense		85,963	57	296		86,316
Earnings (loss) before provision for income taxes	(5,310)	(86,252)	236,128	14,065		158,631
Provision (benefit) for income taxes	(1,870)	(33,452)	90,544	5,462		60,684
Equity in earnings of subsidiaries, net of tax	101,387	154,187	8,603		(264,177)	
Net earnings	97,947	101,387	154,187	8,603	(264,177)	97,947
Other comprehensive income, net of tax		2,920		9,095		12,015
Total comprehensive income	\$ 97,947	\$ 104,307	\$ 154,187	\$ 17,698	\$ (264,177)	\$ 109,962

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Sally Beauty Holdings, Inc. and Subsidiaries

Condensed Notes to Consolidated Financial Statements

(Unaudited)

Condensed Consolidating Statement of Cash Flows
Six Months Ended March 31, 2013

(In thousands)

	Parent	Sally Holdings LLC and Sally Capital Inc.	Guarantor Subsidiaries	Non- Guarantor Subsidiaries	Consolidating Eliminations	Sally Beauty Holdings, Inc. and Subsidiaries
Net cash provided (used) by operating activities	\$ 299,933	\$ (177,500)	\$ (3,000)	\$ 16,734	\$	\$ 136,167
Cash Flows from Investing Activities:						
Capital expenditures, net of proceeds from sale of property and equipment			(23,901)	(19,211)		(43,112)
Acquisitions, net of cash acquired				(670)		(670)
Net cash used by investing activities			(23,901)	(19,881)		(43,782)
Cash Flows from Financing Activities:						
Proceeds from issuance of long-term debt		58,500				58,500
Repayments of long-term debt		(36,000)	(41)	(906)		(36,947)
Repurchases of common stock	(313,349)					(313,349)
Proceeds from exercises of stock options	13,256					13,256
Excess tax benefit from share-based compensation	160		7,234	900		8,294
Net cash (used) provided by financing activities	(299,933)	22,500	7,193	(6)		(270,246)
Effect of foreign exchange rate changes on cash and cash equivalents				(103)		(103)
Net (decrease) increase in cash and cash equivalents		(155,000)	(19,708)	(3,256)		(177,964)
Cash and cash equivalents, beginning of period		155,000	48,582	36,638		240,220
Cash and cash equivalents, end of period	\$	\$	\$ 28,874	\$ 33,382	\$	\$ 62,256

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Sally Beauty Holdings, Inc. and Subsidiaries

Condensed Notes to Consolidated Financial Statements

(Unaudited)

Condensed Consolidating Statement of Cash Flows
Six Months Ended March 31, 2012

(In thousands)

	Parent	Sally Holdings LLC and Sally Capital Inc.	Guarantor Subsidiaries	Non- Guarantor Subsidiaries	Consolidating Eliminations	Sally Beauty Holdings, Inc. and Subsidiaries
Net cash (used) provided by operating activities	\$ (20,111)	\$ 94,574	\$ 31,884	\$ 31,743	\$	\$ 138,090
Cash Flows from Investing Activities:						
Capital expenditures, net of proceeds from sale of property and equipment			(17,217)	(9,739)		(26,956)
Acquisitions, net of cash acquired			(10,607)	(32,547)		(43,154)
Net cash used by investing activities			(27,824)	(42,286)		(70,110)
Cash Flows from Financing Activities:						
Proceeds from issuance of long-term debt		929,200				929,200
Repayments of long-term debt		(1,008,583)	(48)	(1,843)		(1,010,474)
Debt issuance costs		(15,191)				(15,191)
Proceeds from exercises of stock options	20,111					20,111
Excess tax benefit from share-based compensation			9,124			9,124
Net cash provided (used) by financing activities	20,111	(94,574)	9,076	(1,843)		(67,230)
Effect of foreign exchange rate changes on cash and cash equivalents				579		579
Net increase (decrease) in cash and cash equivalents			13,136	(11,807)		1,329
Cash and cash equivalents, beginning of period			22,583	40,898		63,481
Cash and cash equivalents, end of period	\$	\$	\$ 35,719	\$ 29,091	\$	\$ 64,810

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

This section discusses management's view of the financial condition, results of operations and cash flows of Sally Beauty and its consolidated subsidiaries. This section should be read in conjunction with the audited consolidated financial statements and the related notes included in our Annual Report on Form 10-K for the fiscal year ended September 30, 2012, as well as the Risk Factors section contained in that Annual Report and information contained elsewhere in this Quarterly Report, including the consolidated interim financial statements and condensed notes to those financial statements. This Management's Discussion and Analysis of Financial Condition and Results of Operations section may contain forward-looking statements. Please see Cautionary Notice Regarding Forward-Looking Statements, included at the beginning of this Quarterly Report for a discussion of the uncertainties, risks and assumptions associated with these forward-looking statements that could cause results to differ materially from those reflected in such forward-looking statements.

Highlights For the Six Months Ended March 31, 2013:

- Our consolidated net sales from company-operated stores that have been open for 14 months or longer increased by 1.0% for the six months ended March 31, 2013, compared to the six months ended March 31, 2012;
- Our consolidated net sales for the six months ended March 31, 2013, increased by \$49.6 million, or 2.8%, to \$1,803.7 million compared to \$1,754.1 million for the six months ended March 31, 2012;
- Our consolidated gross profit for the six months ended March 31, 2013, increased by \$30.2 million, or 3.5%, to \$888.8 million compared to \$858.6 million for the six months ended March 31, 2012. As a percentage of net sales, gross profit increased by 30 basis points to 49.3% for the six months ended March 31, 2013, compared to 49.0% for the six months ended March 31, 2012;
- Our consolidated operating earnings for the six months ended March 31, 2013, increased by \$4.8 million, or 1.9%, to \$249.7 million compared to \$244.9 million for the six months ended March 31, 2012. As a percentage of net sales, operating earnings decreased by 20 basis points to 13.8% for the six months ended March 31, 2013, compared to 14.0% for the six months ended March 31, 2012;
- Net earnings increased by \$25.9 million, or 26.5%, to \$123.9 million for the six months ended March 31, 2013, compared to \$97.9 million for the six months ended March 31, 2012. For the six months ended March 31, 2012, net earnings reflect charges of \$34.6 million, before tax, related to our redemption of certain senior notes and our senior subordinated notes. As a percentage of net sales, net earnings increased by 130 basis points to 6.9% for the six months ended March 31, 2013, compared to 5.6% for the six months ended March 31, 2012;
- Cash provided by operations was \$136.2 million for the six months ended March 31, 2013, compared to \$138.1 million for the six months ended March 31, 2012; and
- In March 2013, our Board of Directors approved a new share repurchase program authorizing us to repurchase up to \$700.0 million of our common stock. During the six months ended March 31, 2013, we repurchased and subsequently retired approximately 12.0 million shares of our common stock under share repurchase programs approved by our Board of Directors, including the repurchase program approved in March 2013, at an aggregate cost of \$313.3 million.

Overview

Description of Business

We operate primarily through two business units, Sally Beauty Supply and Beauty Systems Group, or BSG. We are the largest distributor of professional beauty supplies in the U.S. based on store count. As of March 31, 2013, through Sally Beauty Supply and BSG, we operated a multi-channel platform of 4,373 company-operated stores and supplied 185 franchised stores, primarily in North America and selected South American and European countries. Within BSG, we also have one of the largest networks of professional distributor sales consultants in North America. We provide our customers with a wide variety of leading third-party branded and exclusive-label professional beauty supplies, including hair color products, 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. For the six months ended March 31, 2013, our consolidated net sales and operating earnings were \$1,803.7 million and \$249.7 million, respectively.

We believe Sally Beauty Supply is the largest open-line distributor of professional beauty supplies in the U.S. based on store count. As of March 31, 2013, Sally Beauty Supply operated 3,331 company-operated retail stores, 2,618 of which are located in the U.S., with the remaining 713 company-operated stores located in Puerto Rico, Canada, Mexico, Chile, the United Kingdom, Ireland, Belgium, France, Germany, the Netherlands and Spain. Sally Beauty Supply also supplied 26 franchised stores located in the United Kingdom and certain other European countries. In the U.S. and Canada, our Sally Beauty Supply stores average approximately 1,700 square feet in size and are located primarily in strip shopping centers. Our Sally Beauty Supply stores carry an extensive selection of professional beauty supplies for both retail customers and salon professionals with between 6,000 and 9,000 SKUs of beauty products across product categories including hair color, hair care, skin and nail care, beauty sundries and electrical appliances. Sally Beauty Supply stores carry leading third-party brands such as Clairol®, Revlon® and Conair®, as well as an extensive selection of exclusive-label merchandise. Store formats, including average size and product selection, for Sally

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Beauty Supply outside the U.S. and Canada vary by marketplace. For the six months ended March 31, 2013, Sally Beauty Supply's net sales and segment operating profit were \$1,114.8 million and \$212.0 million, respectively.

We believe BSG is the largest full-service distributor of professional beauty supplies in North America, exclusively targeting salons and salon professionals. As of March 31, 2013, BSG had 1,042 company-operated stores, supplied 159 franchised stores and had a sales force of approximately 994 professional distributor sales consultants selling exclusively to salons and salon professionals in all states in the U.S., in portions of Canada, and in Puerto Rico, Mexico and certain European countries. Company-operated BSG stores, which primarily operate under the CosmoProf banner, average approximately 2,700 square feet in size and are primarily located in secondary strip shopping centers. BSG stores provide a comprehensive selection of between 5,000 and 10,000 beauty product SKUs that include hair color and care, skin and nail care, beauty sundries and electrical appliances. Through BSG's large store base and sales force, BSG is able to access a significant portion of the highly fragmented U.S. salon channel. BSG stores carry leading third-party brands, such as Paul Mitchell®, Wella®, Sebastian®, Goldwell®, Joico® and Aquage®, intended for use in salons and for resale by the salons to consumers. Certain BSG products are sold under exclusive distribution agreements with suppliers whereby BSG is designated as the sole distributor for a product line within certain geographic territories. For the six months ended March 31, 2013, BSG's net sales and segment operating profit were \$688.9 million and \$98.6 million, respectively.

Industry and Business Trends

We operate primarily within the large and growing U.S. professional beauty supply industry. Potential growth in the industry is expected to be driven particularly by increases in consumer demand for hair color, hair loss prevention and hair styling products. We believe the following key industry and business trends and characteristics will influence our business and our financial results going forward:

- *High level of marketplace fragmentation.* The U.S. salon channel is highly fragmented with nearly 280,000 salons and barbershops. 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 and frequent 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. In addition, booth renters, who comprise a significant percentage of total U.S. salon professionals, are often responsible for purchasing their own supplies. Historically, booth renters have significantly increased as a percentage of total salon professionals, and we expect this trend to continue. Given their smaller individual purchases and relative lack of financial resources, booth renters are likely to be dependent on frequent trips to professional beauty supply stores, like BSG and Sally Beauty Supply. We expect that these factors will continue to drive demand for conveniently located professional beauty supply stores.
- *Increasing use of exclusive-label products.* We offer a broad range of exclusive-label professional beauty products. As our lines of exclusive-label products have matured and become better known in our retail stores, we have seen an increase in sales of these products. Generally, our exclusive-label products have higher gross margins for us than the leading third-party branded products and, accordingly, we believe that the growth in sales of these products will likely enhance our overall gross margins. Please 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 in Item 1A of our Annual Report on Form 10-K for the fiscal year ended September 30, 2012.

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- *Favorable demographic and consumer trends.* We expect the aging baby-boomer population to drive future growth in professional beauty supply sales through an increase in the 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. Changes in consumer tastes and fashion trends can have an impact on our financial performance. Our continued success depends largely on our ability to anticipate, gauge and react in a timely and effective manner to changes in consumer spending patterns and preferences for beauty products. We continuously adapt our marketing and merchandising initiatives in an effort to expand our market reach or to respond to changing consumer preferences. If we are unable to anticipate and respond to trends in the marketplace for beauty products and changing consumer demands, our business could suffer. Please see *Risk Factors* We may be unable to anticipate changes in consumer preferences and buying trends or manage our product lines and inventory commensurate with consumer demand in Item 1A of our Annual Report on Form 10-K for the fiscal year ended September 30, 2012.

- *International growth strategies.* A key element of our growth strategy depends on our ability to capitalize on international growth opportunities and to grow our current level of non-U.S. operations. For example, from September 30, 2011 to September 30, 2012 our international company-operated stores increased from 679 stores to 720 stores, excluding the effect of acquisitions. In addition, we have completed a number of international acquisitions over the past three years that increased our European and South American footprint, including our November 2011 acquisition of

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Kappersservice Floral B.V. and two related companies (together, the Floral Group), a distributor of professional beauty products located in the Netherlands; our December 2009 acquisition of Sinelco Group BVBA (Sinelco), a wholesale distributor of professional beauty products located in Belgium with sales throughout Europe; and our September 2009 acquisition of Distribuidora Intersalon Limitada (Intersalon), a distributor of premier beauty supply products located in Chile. We intend to continue to identify and evaluate non-U.S. acquisition and/or organic international growth opportunities. Our ability to grow our non-U.S. operations, integrate our new non-U.S. acquisitions and successfully pursue additional non-U.S. acquisition and/or organic international growth opportunities may be affected by business, legal, regulatory and economic risks. Please see Risk Factors. We may not be able to successfully identify acquisition candidates or successfully complete desirable acquisitions. If we acquire any businesses in the future, they could prove difficult to integrate, disrupt our business or have an adverse effect on our results of operations and Our ability to conduct business in international marketplaces may be affected by legal, regulatory and economic risks in Item 1A of our Annual Report on Form 10-K for the fiscal year ended September 30, 2012.

- *Continuing consolidation.* There is continuing consolidation among professional beauty product distributors and professional beauty product manufacturers. We plan to continue to examine ways in which we can benefit from this trend, including the evaluation of opportunities to shift business from competitive distributors to the BSG network as well as seeking opportunistic, value-added acquisitions which complement our long-term growth strategy. We believe that suppliers are increasingly likely to focus on larger distributors and retailers with a broader scale and retail footprint. We also believe that we are well positioned to capitalize on this trend as well as participate in the ongoing consolidation at the distributor/retail level. However, changes often occur in our relationships with suppliers that may materially affect the net sales and operating earnings of our business segments. Consolidation among suppliers could exacerbate the effects of these relationship changes and could increase pricing pressures. For example, L'Oréal has acquired distributors that compete with BSG in the Midwest, Southeast and West Coast regions of the U.S. and, as a result, L'Oréal directly competes with BSG in certain geographic areas. If L'Oréal or any of our other suppliers acquired other distributors or suppliers that conduct significant business with BSG, we could lose related revenue. There can be no assurance that BSG will not lose further revenue over time (including within its franchise-based business) due to potential losses of additional products as well as from the increased competition from distribution networks affiliated with any of our suppliers. Please see Risk Factors. The beauty products distribution industry is highly competitive and is consolidating and 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 in Item 1A of our Annual Report on Form 10-K for the fiscal year ended September 30, 2012.

- *Relationships with suppliers.* Sally Beauty Supply and BSG, and their respective suppliers are dependent on each other for the distribution of beauty products. We do not manufacture the brand name or exclusive-label products we sell. We purchase our products from a limited number of manufacturers. As is typical in distribution businesses (particularly in our industry), these relationships are subject to change from time to time (including the expansion or loss of distribution rights, including exclusive rights, in various geographies and the addition or loss of product lines). Since we purchase products from many manufacturers on an at-will basis, under contracts which can generally be terminated without cause upon 90 days' notice or less or which expire without express rights of renewal, such manufacturers could discontinue sales to us at any time or upon the expiration of the distribution period. Some of our contracts with manufacturers may be terminated by such manufacturers if we fail to meet specified minimum purchase requirements. In such cases, we do not have contractual assurances of continued supply, pricing or access to new products and vendors may change the terms upon which they sell. Infrequently, a supplier will seek to terminate a distribution relationship through legal action. Changes in our relationships with suppliers occur often and could positively or negatively impact our net sales and operating profits. We expect to continue to expand our product line offerings and to gain additional distribution rights over time through either further negotiation with suppliers or by acquisitions of existing distributors. Although we focus on developing new revenue and cost management initiatives to mitigate the negative effects resulting from unfavorable changes in our supplier relationships, there can be no assurance that our efforts will continue to completely offset the loss of these or other distribution rights. Please 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 in Item 1A of our Annual Report on Form 10-K for the fiscal year ended September 30, 2012.

- *High level of competition.* Sally Beauty Supply competes with other domestic and international beauty product wholesale and retail outlets, including local and regional open-line beauty supply stores, professional-only beauty supply stores, salons, mass merchandisers, drug stores and supermarkets, as well as sellers on the internet and salons retailing hair care items. BSG competes with other domestic and international beauty product wholesale and retail suppliers and manufacturers selling professional beauty products directly to salons and

individual salon professionals. We also face competition from authorized and unauthorized retailers and internet sites offering professional salon-only products. The increasing availability of unauthorized professional salon products in large format retail stores such as drug stores,

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grocery stores and others could also have a negative impact on our business. Please see **Risk Factors** The beauty products distribution industry is highly competitive and is consolidating in Item 1A of our Annual Report on Form 10-K for the fiscal year ended September 30, 2012.

- *Economic conditions.* We appeal to a wide demographic consumer profile and offer a broad selection of professional beauty products sold directly to retail consumers, and salons and salon professionals. Historically, these factors have provided us with reduced exposure to downturns in economic conditions in the countries in which we operate. However, a downturn in the economy, especially for an extended period of time, could adversely impact consumer demand of discretionary items such as beauty products and salon services, particularly affecting our electrical products category and our full-service sales business. In addition, higher freight costs resulting from increases in the cost of fuel, especially for an extended period of time, may impact our expenses at levels that we cannot pass through to our customers. These factors could have a material adverse effect on our business, financial condition and results of operations. Please see **Risk Factors** The health of the economy in the channels we serve may affect consumer purchases of discretionary items such as beauty products and salon services, which could have a material adverse effect on our business, financial condition and results of operations in Item 1A of our Annual Report on Form 10-K for the fiscal year ended September 30, 2012.

- *Controlling expenses.* Another important aspect of our business is our ability to control costs, especially in our BSG business segment, by right-sizing the business and maximizing the efficiency of our business structure. Please see **Risk Factors** We are not certain that our ongoing cost control plans will continue to be successful in Item 1A of our Annual Report on Form 10-K for the fiscal year ended September 30, 2012.

- *Opening new stores.* Our future growth strategy depends in part on our ability to open and profitably operate new stores in existing and additional geographic areas. The capital requirements to open a U.S.-based Sally Beauty Supply or BSG store, excluding inventory, average approximately \$70,000 and \$80,000, respectively, with the capital requirements for international stores costing less or substantially more depending upon the marketplace. We may not be able to open all of the new stores we plan to open and any new stores we open may not be profitable, any of which could have a material adverse impact on our business, financial condition or results of operations. Please see **Risk Factors** If we are unable to profitably open and operate new stores, our business, financial condition and results of operations may be adversely affected in Item 1A of our Annual Report on Form 10-K for the fiscal year ended September 30, 2012.

- *Changes to our information technology systems.* As our operations grow in both size and scope, we will continuously need to improve and upgrade our information systems and infrastructure while maintaining the reliability and integrity of our systems and infrastructure. The expansion of our systems and infrastructure will require us to commit substantial financial, operational and technical resources in advance of any increase in the volume of our business, with no assurance that the volume of business will increase. For example, we are in the process of designing and implementing a standardized enterprise resource planning (ERP) system internationally, which we anticipate will be completed over the next few years. In addition, we are currently implementing a point-of-sale system upgrade program in a number of our divisions (primarily in our Sally Beauty Supply operations in the U.S.), which we anticipate will provide significant benefits, including enhanced tracking of customer sales and store inventory activity. These and any other required upgrades to our information systems and information technology (or new technology), now or in the future, will require that our management and resources be diverted from our core business to assist in completion of these projects. Many of our systems are proprietary, and as a result our options are limited in seeking third-party assistance with the operation and upgrade of those systems. There can be no assurance that the time and resources our management will need to devote to these upgrades, service outages or delays due to the installation of any new or upgraded technology (and customer issues therewith), or the impact on the reliability of our data from any new or upgraded technology will not have a material adverse effect on our financial reporting, business, financial condition or results of operations. Please see **Risk Factors** We may be adversely affected by any disruption in our information technology systems in Item 1A of our Annual Report on Form 10-K for the fiscal year ended September 30, 2012.

Significant Recent Acquisitions

In November 2011, we acquired the Floral Group, a 19-store distributor of professional beauty products based in Eindhoven, the Netherlands, for approximately 22.8 million (approximately \$31.2 million), subject to certain adjustments. The results of operations of the Floral Group are included in the Company's consolidated financial statements subsequent to the acquisition date. The assets acquired and liabilities assumed were recorded at their respective fair values at the acquisition date. Goodwill of \$15.0 million (which is not expected to be deductible for tax purposes) and intangible assets subject to amortization of \$11.8 million were recorded as a result of this acquisition based on their fair values. The final valuation of the assets acquired and liabilities assumed was completed during the second quarter of our fiscal year 2012. The acquisition was funded with cash from operations and with borrowings on our five-year asset-based senior secured loan facility (the ABL facility) in the amount of

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approximately \$17.0 million. In addition, during the six months ended March 31, 2012, we completed several other individually immaterial acquisitions at an aggregate cost of approximately \$12.4 million and we recorded additional goodwill in the amount of \$9.2 million (the majority of which is expected to be deductible for tax purposes) in connection with such acquisitions. Generally, we funded these acquisitions with cash from operations. The valuation of the assets acquired and liabilities assumed in connection with these acquisitions was based on their fair values at the acquisition date.

Share Repurchase Programs

In August 2012, we announced that our Board of Directors approved a share repurchase program authorizing us to repurchase up to \$300.0 million of our common stock (the 2012 Share Repurchase Program). In addition, on March 5, 2013, we announced that our Board of Directors approved a new share repurchase program authorizing us to repurchase up to \$700.0 million of our common stock over the next eight quarters (the 2013 Share Repurchase Program). In connection with the authorization of the 2013 Share Repurchase Program, the 2012 Share Repurchase Program was terminated.

Prior to such termination, the Company had repurchased approximately 10.4 million shares at a cost of \$266.4 million under the 2012 Share Repurchase Program. In addition, during the period from March 5, 2013 through March 31, 2013, the Company repurchased approximately 1.6 million shares at a cost of \$46.9 million under the 2013 Share Repurchase Program.

During the six months ended March 31, 2013, we repurchased and subsequently retired, in the aggregate, approximately 12.0 million shares of our common stock under the 2012 Share Repurchase Program or the 2013 Share Repurchase Program at an aggregate cost of \$313.3 million and reduced common stock and additional paid-in capital, in the aggregate, by an equal amount. Please see Item 2. Unregistered Sales of Equity Securities and Use of Proceeds Purchases of Equity Securities by the Issuer and Affiliated Purchasers in Part II, Other Information, of this Quarterly Report for additional information about the Company's share repurchase programs.

Other Significant Items

Derivative Instruments

As a multinational corporation, we are subject to certain market risks including changes in market interest rates and foreign currency fluctuations. We may consider a variety of practices in the ordinary course of business to manage these market risks, including, when deemed appropriate, the use of derivative instruments such as interest rate swaps and foreign currency options, collars and forwards (hereafter, foreign exchange contracts). Currently, we do not purchase or hold any derivative instruments for speculative or trading purposes.

Foreign Currency Derivative Instruments

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We are exposed to potential gains or losses from foreign currency fluctuations affecting net investments in subsidiaries (including intercompany notes not permanently invested) and earnings denominated in foreign currencies. Our primary exposures are to changes in exchange rates for the U.S. dollar versus the Euro, the British pound sterling, the Canadian dollar, the Chilean peso, and the Mexican peso. In addition, from time to time we may have exposure to changes in the exchange rates for the British pound sterling versus the Euro in connection with the sale of products and services among certain European subsidiaries of the Company. Our various foreign currency exposures at times offset each other, sometimes providing a natural hedge against foreign currency risk. In connection with the remaining foreign currency risk, the Company from time to time uses foreign exchange contracts to effectively fix the foreign currency exchange rate applicable to specific anticipated foreign currency-denominated cash flows, thus limiting the potential fluctuations in such cash flows resulting from foreign currency market movements.

The Company uses foreign exchange contracts including, at March 31, 2013, foreign currency forwards with an aggregate notional amount of \$6.0 million to manage the exposure to the U.S. dollar resulting from certain of our Sinelco Group subsidiaries' purchases of merchandise from third-party suppliers. Sinelco's functional currency is the Euro. These foreign currency forwards enable Sinelco to buy U.S. dollars at a contractual exchange rate of 1.2772, are with a single counterparty and expire ratably through September 2013.

The Company also uses foreign exchange contracts to mitigate its exposure to changes in foreign currency exchange rates in connection with certain intercompany balances not permanently invested. As such, at March 31, 2013, we held: (a) a foreign currency forward which enables us to sell approximately 26.7 million (\$34.3 million, at the March 31, 2013 exchange rate) at the contractual exchange rate of 1.2867, (b) a foreign currency forward which enables us to sell approximately \$3.8 million Canadian dollars (\$3.7 million, at the March 31, 2013 exchange rate) at the contractual exchange rate of 1.0187, (c) a foreign currency forward which enables us to buy approximately \$15.9 million Canadian dollars (\$15.6 million, at the March 31, 2013 exchange rate) at the contractual exchange rate of 1.0179, (d) a foreign currency forward which enables us to sell approximately 9.3 million Mexican pesos (\$0.8 million, at the March 31, 2013 exchange rate) at the contractual exchange rate of 12.3495 and (e) a foreign currency forward which enables us to sell approximately £12.9 million (\$19.7 million, at the March 31, 2013

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exchange rate) at the contractual exchange rate of 1.5146. The foreign currency forwards discussed in this paragraph are with a single counterparty, not the same party as the counterparties on the other forwards held at March 31, 2013, and expire on or before June 30, 2013.

In addition, the Company uses foreign exchange contracts including, at March 31, 2013, foreign currency forwards with an aggregate notional amount of 1.8 million (\$2.3 million, at the March 31, 2013 exchange rate) to mitigate its exposure to the British pound sterling resulting from the sale of products and services among certain European subsidiaries of the Company. The foreign currency forwards discussed in this paragraph enable the Company to buy British pound sterling in exchange for Euro currency at the weighted average contractual exchange rate of 0.8149, are with a single counterparty, not the same party as the counterparties on the other forwards held at March 31, 2013, and expire ratably through September 2013.

The Company's foreign currency forward agreements are not designated as hedges and do not currently meet the requirements for hedge accounting. Accordingly, the changes in the fair value (i.e., marked-to-market adjustments) of these derivative instruments (which are adjusted quarterly) are recorded in selling, general and administrative expenses in our consolidated statements of earnings. Please see Item 3 Quantitative and Qualitative Disclosures about Market Risk Foreign currency exchange rate risk contained in this Quarterly Report on Form 10-Q and Note 15 of the Notes to Consolidated Financial Statements in Item 8 - Financial Statements and Supplementary Data contained in our Annual Report on Form 10-K for the fiscal year ended September 30, 2012 for additional information about the Company's foreign currency derivatives.

Interest Rate Swap Agreements

We and certain of our subsidiaries are sensitive to interest rate fluctuations. In order to enhance our ability to manage risk relating to cash flow and interest rate exposure, we and/or our other subsidiaries who are borrowers under the ABL facility may, from time to time, enter into and maintain derivative instruments, such as interest rate swap agreements, for periods consistent with the related underlying exposures. At March 31, 2013, the Company held no interest rate derivative instruments.

Share-Based Compensation Awards

The Company granted approximately 1.6 million and 2.0 million stock options and approximately 128,000 and 32,000 restricted share awards to its employees and consultants during the six months ended March 31, 2013 and 2012, respectively. Upon issuance of such grants, the Company recognized accelerated share-based compensation expense of \$5.9 million and \$5.3 million in the six months ended March 31, 2013 and 2012, respectively, in connection with certain retirement eligible employees who are eligible to continue vesting awards upon retirement under the provisions of the Sally Beauty Holdings, Inc. 2010 Omnibus Incentive Plan and certain predecessor share-based compensation plans. In addition, the Company granted approximately 34,000 and 26,000 restricted stock units to its non-employee directors during the six months ended March 31, 2013 and 2012, respectively. For the six months ended March 31, 2013 and 2012, total share-based compensation costs charged against earnings was \$12.3 million and \$11.0 million, respectively.

Non-recurring Charges

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In December 2011, the Company redeemed \$430.0 million aggregate principal amount outstanding of its 9.25% senior notes due 2014 and \$275.0 million aggregate principal amount outstanding of its 10.50% senior subordinated notes due 2016, pursuant to the terms of the indentures governing the senior notes and the senior subordinated notes. During the six months ended March 31, 2012, the Company recorded a charge to earnings of approximately \$34.6 million (including approximately \$24.4 million in call premiums paid and approximately \$10.2 million in unamortized deferred financing costs expensed) in connection with the redemption of the senior notes and the senior subordinated notes. This amount is included in interest expense in the Company's consolidated statements of earnings.

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The following table shows the condensed results of operations of our business for the three and six months ended March 31, 2013 and 2012 (in thousands):

	Three Months Ended				Six Months Ended			
	March 31,		March 31,		March 31,		March 31,	
	2013	2012	2013	2012	2013	2012	2013	2012
Net sales	\$	898,239	\$	889,281	\$	1,803,680	\$	1,754,096
Cost of products sold and distribution expenses		453,785		452,495		914,858		895,453
Gross profit		444,454		436,786		888,822		858,643
Total other operating costs and expenses		316,617		305,129		639,114		613,696
Operating earnings		127,837		131,657		249,708		244,947
Interest expense		26,779		22,355		53,503		86,316
Earnings before provision for income taxes		101,058		109,302		196,205		158,631
Provision for income taxes		36,169		41,489		72,332		60,684
Net earnings	\$	64,889	\$	67,813	\$	123,873	\$	97,947

The following table shows the condensed results of operations of our business for the three and six months ended March 31, 2013 and 2012, expressed as a percentage of net sales for each respective period shown:

	Three Months Ended				Six Months Ended			
	March 31,		March 31,		March 31,		March 31,	
	2013	2012	2013	2012	2013	2012	2013	2012
Net sales	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Cost of products sold and distribution expenses	50.5%	50.9%	50.7%	51.0%	50.7%	51.0%	50.7%	51.0%
Gross profit	49.5%	49.1%	49.3%	49.0%	49.3%	49.0%	49.3%	49.0%
Total other operating costs and expenses	35.3%	34.3%	35.5%	35.0%	35.5%	35.0%	35.5%	35.0%
Operating earnings	14.2%	14.8%	13.8%	14.0%	13.8%	14.0%	13.8%	14.0%
Interest expense	2.9%	2.5%	2.9%	5.0%	2.9%	5.0%	2.9%	5.0%
Earnings before provision for income taxes	11.3%	12.3%	10.9%	9.0%	10.9%	9.0%	10.9%	9.0%
Provision for income taxes	4.1%	4.7%	4.0%	3.4%	4.0%	3.4%	4.0%	3.4%
Net earnings	7.2%	7.6%	6.9%	5.6%	6.9%	5.6%	6.9%	5.6%

Table of Contents**Key Operating Metrics**

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

	Three Months Ended		Six Months Ended	
	March 31,		March 31,	
	2013	2012	2013	2012
Net sales:				
Sally Beauty Supply	\$ 555,977	\$ 553,973	\$ 1,114,793	\$ 1,090,331
BSG	342,262	335,308	688,887	663,765
Consolidated	\$ 898,239	\$ 889,281	\$ 1,803,680	\$ 1,754,096
Gross profit	\$ 444,454	\$ 436,786	\$ 888,822	\$ 858,643
Gross profit margin	49.5%	49.1%	49.3%	49.0%
Selling, general and administrative expenses	\$ 299,370	\$ 289,189	\$ 605,059	\$ 582,203
Depreciation and amortization	\$ 17,247	\$ 15,940	\$ 34,055	\$ 31,493
Earnings before provision for income taxes:				
Segment operating profit:				
Sally Beauty Supply	\$ 105,956	\$ 111,334	\$ 212,043	\$ 212,400
BSG	49,821	45,597	98,573	88,924
Segment operating profit	155,777	156,931	310,616	301,324
Unallocated expenses (a)	(24,678)	(22,329)	(48,595)	(45,401)
Share-based compensation expense	(3,262)	(2,945)	(12,313)	(10,976)
Operating earnings	127,837	131,657	249,708	244,947
Interest expense (b)	(26,779)	(22,355)	(53,503)	(86,316)
Earnings before provision for income taxes	\$ 101,058	\$ 109,302	\$ 196,205	\$ 158,631
Segment operating profit margin:				
Sally Beauty Supply	19.1%	20.1%	19.0%	19.5%
BSG	14.6%	13.6%	14.3%	13.4%
Consolidated operating profit margin	14.2%	14.8%	13.8%	14.0%
Number of stores at end-of-period (including franchises):				
Sally Beauty Supply			3,357	3,228
BSG			1,201	1,164
Consolidated			4,558	4,392
Same store sales growth (decline) (c)				
Sally Beauty Supply	(1.6)%	9.3%	0.0%	8.7%
BSG	1.3%	8.7%	3.4%	6.9%
Consolidated	(0.8)%	9.1%	1.0%	8.1%

(a) Unallocated expenses consist of corporate and shared costs.

(b) For the six months ended March 31, 2012, interest expense includes a loss on extinguishment of debt of \$34.6 million in connection with the Company's redemption of its senior notes due 2014 and senior subordinated notes due 2016 with the net proceeds from the issuance of the Company's senior notes due 2019.

(c) For the purpose of calculating our same store sales metrics, we compare the current period sales for stores open for 14 months or longer as of the last day of a month with the sales, if any, for these stores for the comparable period in the prior fiscal year. Our same store sales are calculated in constant dollars and include internet-based sales and the effect of store expansions, if applicable, but do not generally include the

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sales from stores relocated until 14 months after the relocation. The sales from stores acquired are excluded from our same store sales calculation until 14 months after the acquisition.

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The table below presents net sales, gross profit and gross profit margin data for each reportable segment (dollars in thousands).

	Three Months Ended March 31,			
	2013	2012	Increase	
Net sales:				
Sally Beauty Supply	\$ 555,977	\$ 553,973	\$ 2,004	0.4%
BSG	342,262	335,308	6,954	2.1%
Consolidated net sales	\$ 898,239	\$ 889,281	\$ 8,958	1.0%
Gross profit:				
Sally Beauty Supply	\$ 303,095	\$ 300,069	\$ 3,026	1.0%
BSG	141,359	136,717	4,642	3.4%
Consolidated gross profit	\$ 444,454	\$ 436,786	\$ 7,668	1.8%
Gross profit margin:				
Sally Beauty Supply	54.5%	54.2%	0.3%	
BSG	41.3%	40.8%	0.5%	
Consolidated gross profit margin	49.5%	49.1%	0.4%	

*Net Sales**Consolidated Net Sales*

Consolidated net sales increased by \$9.0 million, or 1.0%, for the three months ended March 31, 2013, compared to the three months ended March 31, 2012, primarily as a result of increases in unit volume resulting from the 163 company-operated stores opened or acquired during the last twelve months. Company-operated Sally Beauty Supply and BSG stores that have been open for 14 months or longer contributed an increase in consolidated net sales of approximately \$14.4 million, or 1.6%. Other sales channels (including sales from stores that have been open for less than 14 months, sales through our BSG franchise-based businesses and distributor sales consultants, and sales from our Sally Beauty Supply non-store sales channels), in the aggregate, contributed an increase in sales of approximately \$2.4 million, or 0.3%, compared to the three months ended March 31, 2012. Incremental sales from businesses acquired in the preceding 12 months were \$7.8 million, or 0.9%, lower for the three months ended March 31, 2013, compared to the three months ended March 31, 2012. For the three months ended March 31, 2013, consolidated net sales were adversely impacted by having two fewer days of sales compared to the three months ended March 31, 2012, which approximates \$15 million. In the three months ended March 31, 2012, consolidated net sales benefited from both an extra sales day in February (as a result of 2012 being a leap year) and from the Easter holiday (when our U.S. stores are closed) being in April, rather than in March as it was in 2013. Consolidated net sales for the three months ended March 31, 2013 were not materially impacted by changes in foreign currency exchange rates.

For the three months ended March 31, 2013, consolidated net sales reflect weaker or negative same store sales growth rates, particularly in the U.S., compared to very strong performance for the same stores in the three months ended March 31, 2012. The consolidated same store sales growth rates for the three months ended March 31, 2013 were adversely impacted by lower traffic driven in part by two fewer days of sales, as discussed above, compared to the three months ended March 31, 2012, as well as a difficult comparison against very strong growth in certain

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Sally Beauty Supply product categories in the second quarter of 2012.

Sally Beauty Supply Net Sales

Net sales for Sally Beauty Supply increased by \$2.0 million, or 0.4%, for the three months ended March 31, 2013, compared to the three months ended March 31, 2012, primarily as a result of increases in unit volume resulting from the 127 company-

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operated stores opened or acquired during the last twelve months. In the Sally Beauty Supply segment, company-operated stores that have been open for 14 months or longer contributed an increase in segment net sales of approximately \$7.8 million, or 1.4%. Other sales channels (including sales from stores that have been open for less than 14 months and sales from our non-store sales channels, which include the catalog and internet sales of our Sinelco Group subsidiaries), in the aggregate, experienced an increase in sales of approximately \$1.7 million, or 0.4%, compared to the three months ended March 31, 2012. Incremental sales from businesses acquired in the preceding 12 months were \$7.5 million, or 1.4%, lower for the three months ended March 31, 2013, compared to the three months ended March 31, 2012. For the three months ended March 31, 2013, Sally Beauty Supply's net sales were adversely impacted by having two fewer days of sales compared to the three months ended March 31, 2012, which approximates \$11 million, as discussed above.

For the three months ended March 31, 2013, the Sally Beauty Supply segment's net sales reflect a negative same store sales growth rate, particularly in the U.S., compared to very strong performance for the same stores in the three months ended March 31, 2012. The Sally Beauty Supply same store sales growth rate for the three months ended March 31, 2013 was adversely impacted by lower consumer traffic driven in part by two fewer days of sales compared to the three months ended March 31, 2012, as discussed above, as well as a difficult comparison against very strong growth in certain product categories (such as electrical appliances, nail care and certain hair product lines) in the U.S. in the second quarter of the fiscal year 2012.

Beauty Systems Group Net Sales

Net sales for BSG increased by \$7.0 million, or 2.1%, for the three months ended March 31, 2013, compared to the three months ended March 31, 2012, primarily as a result of increases in unit volume, including increases in sales at existing stores and the incremental sales from 36 company-operated stores opened during the last twelve months. In the BSG segment, company-operated stores that have been open for 14 months or longer contributed an increase in segment net sales of approximately \$6.7 million, or 2.0%, and sales through our distributor sales consultants contributed an increase in sales of approximately \$2.2 million, or 0.7%, compared to the three months ended March 31, 2012. Other sales channels (including sales from businesses acquired in the preceding 12 months, if any, sales from stores that have been open for less than 14 months and sales through our franchise-based businesses), in the aggregate, experienced a decrease in sales of approximately \$1.9 million, or 0.6%, compared to the three months ended March 31, 2012. For the three months ended March 31, 2013, BSG's net sales were adversely impacted by having two fewer days of sales compared to the three months ended March 31, 2012, which approximates \$4 million, as discussed above.

For the three months ended March 31, 2013, the BSG segment's net sales reflect a weaker same store sales growth rate, adversely impacted by lower customer traffic driven in part by two fewer days of sales, as discussed above, compared to very strong performance for the same stores in the three months ended March 31, 2012.

Gross Profit

Consolidated gross profit increased by \$7.7 million, or 1.8%, for the three months ended March 31, 2013, compared to the three months ended March 31, 2012, principally due to higher sales volume and improved gross margins in both business segments as more fully described below. Consolidated gross profit as a percentage of net sales, or consolidated gross margin, increased to 49.5% for the three months ended March 31, 2013, compared to 49.1% for the three months ended March 31, 2012.

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Sally Beauty Supply. Sally Beauty Supply's gross profit increased by \$3.0 million, or 1.0%, for the three months ended March 31, 2013, compared to the three months ended March 31, 2012, principally as a result of higher sales volume and improved gross margins. Sally Beauty Supply's gross profit as a percentage of net sales increased to 54.5% for the three months ended March 31, 2013, compared to 54.2% for the three months ended March 31, 2012. This increase was the result of a shift in product and customer mix (including a year-over-year increase in sales of exclusive-label and other higher-margin products) and continued benefits from product cost reduction initiatives.

Beauty Systems Group. BSG's gross profit increased by \$4.6 million, or 3.4%, for the three months ended March 31, 2013, compared to the three months ended March 31, 2012, principally as a result of higher sales volume and improved gross margins. BSG's gross profit as a percentage of net sales increased to 41.3% for the three months ended March 31, 2013, compared to 40.8% for the three months ended March 31, 2012. This increase was principally the result of a favorable change in the sales mix across the business (including an increase in sales at company-owned stores as a percentage of total segment sales) and continued benefits from product cost reduction initiatives.

Selling, General and Administrative Expenses

Consolidated selling, general and administrative expenses increased by \$10.2 million, or 3.5%, for the three months ended March 31, 2013, compared to the three months ended March 31, 2012. This increase was attributable to incremental expenses (including employee compensation, rent and other occupancy-related expenses) resulting from stores opened and, to a lesser

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extent, from businesses acquired in the preceding 12 months (approximately 163 additional company-operated stores added since March 31, 2012, a 3.9% increase), as well as higher expenses related primarily to on-going upgrades to our information technology systems of \$2.0 million, including expenses associated with the Sally Beauty Supply point-of-sale system conversion and the international ERP system implementation, and higher advertising expenses in the Sally Beauty Supply segment of \$4.1 million. Selling, general and administrative expenses, as a percentage of net sales, increased to 33.3% for the three months ended March 31, 2013, compared to 32.5% for the three months ended March 31, 2012. This increase was due to a higher growth rate in selling, general and administrative expenses, compared to