

Sally Beauty Holdings, Inc.  
Form 10-Q  
August 03, 2017  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

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**FORM 10-Q**

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

**FOR THE QUARTERLY PERIOD ENDED: JUNE 30, 2017**

**-OR-**

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

Commission File No. 1-33145

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**SALLY BEAUTY HOLDINGS, INC.**

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(Exact name of registrant as specified in its charter)

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**Delaware**  
(State or other jurisdiction of  
incorporation or organization)

**36-2257936**  
(I.R.S. Employer Identification No.)

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

**76210**  
(Zip Code)

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

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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, a smaller reporting company, or an emerging growth company. See the definitions of large accelerated filer, accelerated filer, smaller reporting company and emerging growth company in Rule 12b-2 of the Exchange Act.

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

Accelerated filer   
Smaller reporting company   
Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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 July 28, 2017, there were 131,373,713 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 in 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:

- our ability to anticipate and effectively responding to changes in consumer and professional stylist preferences and buying trends in a timely manner;
- the success of our strategic initiatives, including our store refresh program and increased marketing efforts, to enhance the customer experience, attract new customers, drive brand awareness and improve customer loyalty;
- our ability to efficiently manage and control our costs and the success of our cost control plans, including our recently implemented restructuring plan;
- our ability to implement our restructuring plan in various jurisdictions;
- our ability to manage the effects of our cost-reduction plans on our employees and other operations costs;
- charges related to the restructuring plan;

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- possible changes in the size and components of the expected costs and charges associated with the restructuring plan;
- our ability to realize the anticipated cost savings from the restructuring plan within the anticipated time frame, if at all;
- the highly competitive nature of, and the increasing consolidation of, the beauty products distribution industry;
- the timing and acceptance of new product introductions;
- shifts in the mix of product sold during any period;
- 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;
- our dependence upon manufacturers who have developed or could develop their own distribution businesses which compete directly with ours;
- the possibility of material interruptions in the supply of products by our third-party manufacturers or distributors or increases in the prices of the products we purchase from our third-party manufacturers or distributors;
- products sold by us being found to be defective in labeling or content;
- compliance with current laws and regulations or becoming subject to additional or more stringent laws and regulations;
- the success of our e-commerce businesses;

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- diversion of professional products sold by Beauty Systems Group to mass retailers or other unauthorized resellers;
- the operational and financial performance of our Armstrong McCall, L.P. franchise-based business, which we refer to as Armstrong McCall;
- successfully identifying acquisition candidates and successfully completing desirable acquisitions;
- integrating acquired businesses;
- the success of our initiatives to expand into new geographies;
- the success of our existing stores, and our ability to increase sales at existing stores;

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- opening and operating new stores profitably;
- the volume of traffic to our stores;
- the impact of general economic conditions upon our business;
- the challenges of conducting business outside the United States;
- the impact of Britain's recent decision to leave the European Union and related or other disruptive events in the United Kingdom, the European Union or other geographies in which we conduct business;
- rising labor and rental costs;
- protecting our intellectual property rights, particularly our trademarks;
- the risk that our products may infringe on the intellectual property rights of others;
- successfully updating and integrating our information technology systems;
- disruption in our information technology systems;
- a significant data security breach, including misappropriation of our customers', employees' or suppliers' confidential information, and the potential costs related thereto;
- the negative impact on our reputation and loss of confidence of our customers, suppliers and others arising from a significant data security breach;



- the costs and diversion of management's attention required to investigate and remediate a data security breach and to continuously upgrade our information technology security systems to address evolving cyber-security threats;
- the ultimate determination of the extent or scope of the potential liabilities relating to our past or any future data security incidents;
- our ability to attract and retain highly skilled management and other personnel;
- 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 our liquidity needs;
- our ability to execute and implement our share repurchase program;
- our substantial indebtedness;
- the possibility that we may incur substantial additional debt, including secured debt, in the future;
- restrictions and limitations in the agreements and instruments governing our debt;
- generating the significant amount of cash needed to service all of our debt and refinancing all or a portion of our indebtedness or obtaining additional financing;
- changes in interest rates increasing the cost of servicing or refinancing our debt; and

- the costs and effects of litigation.

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](http://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 Securities and Exchange Commission ( SEC ). The information contained on this website should not be considered to be a part of this or any other report filed with or furnished to the SEC.

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**PART I FINANCIAL INFORMATION**

**Item 1. Financial Statements.**

The following consolidated balance sheets as of June 30, 2017 and September 30, 2016, the consolidated statements of earnings and consolidated statements of comprehensive income for the three and nine months ended June 30, 2017 and 2016, and consolidated statements of cash flows for the nine months ended June 30, 2017 and 2016 are those of Sally Beauty Holdings, Inc. and its subsidiaries.

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

## Consolidated Statements of Earnings

(In thousands, except per share data)

(Unaudited)

|                                                 | Three Months Ended<br>June 30, |            | Nine Months Ended<br>June 30, |              |
|-------------------------------------------------|--------------------------------|------------|-------------------------------|--------------|
|                                                 | 2017                           | 2016       | 2017                          | 2016         |
| Net sales                                       | \$ 998,043                     | \$ 998,161 | \$ 2,964,122                  | \$ 2,976,260 |
| Cost of products sold and distribution expenses | 495,404                        | 499,185    | 1,481,669                     | 1,495,761    |
| Gross profit                                    | 502,639                        | 498,976    | 1,482,453                     | 1,480,499    |
| Selling, general and administrative expenses    | 337,992                        | 339,459    | 1,017,383                     | 1,020,497    |
| Depreciation and amortization                   | 29,255                         | 25,433     | 83,972                        | 72,524       |
| Restructuring charges                           | 5,054                          |            | 14,265                        |              |
| Operating earnings                              | 130,338                        | 134,084    | 366,833                       | 387,478      |
| Interest expense                                | 26,969                         | 26,703     | 80,616                        | 117,617      |
| Earnings before provision for income taxes      | 103,369                        | 107,381    | 286,217                       | 269,861      |
| Provision for income taxes                      | 36,830                         | 39,462     | 106,860                       | 99,540       |
| Net earnings                                    | \$ 66,539                      | \$ 67,919  | \$ 179,357                    | \$ 170,321   |
| <b>Earnings per share:</b>                      |                                |            |                               |              |
| Basic                                           | \$ 0.49                        | \$ 0.47    | \$ 1.28                       | \$ 1.15      |
| Diluted                                         | \$ 0.49                        | \$ 0.46    | \$ 1.28                       | \$ 1.14      |
| <b>Weighted average shares:</b>                 |                                |            |                               |              |
| Basic                                           | 135,450                        | 145,957    | 139,888                       | 147,741      |
| Diluted                                         | 136,159                        | 147,837    | 140,634                       | 149,476      |

The accompanying condensed notes are an integral part of these condensed consolidated financial statements.

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

## Consolidated Statements of Comprehensive Income

(In thousands)

(Unaudited)

|                                                              | Three Months Ended<br>June 30, |           | Nine Months Ended<br>June 30, |            |
|--------------------------------------------------------------|--------------------------------|-----------|-------------------------------|------------|
|                                                              | 2017                           | 2016      | 2017                          | 2016       |
| Net earnings                                                 | \$ 66,539                      | \$ 67,919 | \$ 179,357                    | \$ 170,321 |
| Other comprehensive income (loss):                           |                                |           |                               |            |
| Foreign currency translation adjustments                     | 17,686                         | (14,119)  | 7,044                         | (16,191)   |
| Total other comprehensive income (loss),<br>before tax       | 17,686                         | (14,119)  | 7,044                         | (16,191)   |
| Income taxes related to other comprehensive<br>income (loss) |                                |           |                               |            |
| Other comprehensive income (loss), net of tax                | 17,686                         | (14,119)  | 7,044                         | (16,191)   |
| Total comprehensive income                                   | \$ 84,225                      | \$ 53,800 | \$ 186,401                    | \$ 154,130 |

The accompanying condensed notes are an integral part of these condensed consolidated financial statements.

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## Consolidated Balance Sheets

(In thousands, except par value data)

|                                                                                                                                                                                               | June 30,<br>2017<br>(Unaudited) | September 30,<br>2016 |
|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------------------|-----------------------|
| <b>Assets</b>                                                                                                                                                                                 |                                 |                       |
| Current assets:                                                                                                                                                                               |                                 |                       |
| Cash and cash equivalents                                                                                                                                                                     | \$ 54,100                       | \$ 86,622             |
| Trade accounts receivable, less allowance for doubtful accounts of \$1,130 at June 30, 2017 and \$1,407 at September 30, 2016                                                                 | 46,994                          | 46,942                |
| Accounts receivable, other                                                                                                                                                                    | 41,413                          | 37,041                |
| Inventory                                                                                                                                                                                     | 947,623                         | 907,337               |
| Other current assets                                                                                                                                                                          | 49,984                          | 54,861                |
| Deferred income tax assets                                                                                                                                                                    | 40,126                          | 40,024                |
| Total current assets                                                                                                                                                                          | 1,180,240                       | 1,172,827             |
| Property and equipment, net of accumulated depreciation of \$531,890 at June 30, 2017 and \$467,865 at September 30, 2016                                                                     | 310,176                         | 319,558               |
| Goodwill                                                                                                                                                                                      | 533,950                         | 532,714               |
| Intangible assets, excluding goodwill, net of accumulated amortization of \$120,970 at June 30, 2017 and \$110,713 at September 30, 2016                                                      | 83,305                          | 92,963                |
| Other assets                                                                                                                                                                                  | 12,808                          | 14,001                |
| Total assets                                                                                                                                                                                  | \$ 2,120,479                    | \$ 2,132,063          |
| <b>Liabilities and Stockholders' Deficit</b>                                                                                                                                                  |                                 |                       |
| Current liabilities:                                                                                                                                                                          |                                 |                       |
| Current maturities of long-term debt                                                                                                                                                          | \$ 82,246                       | \$ 716                |
| Accounts payable                                                                                                                                                                              | 291,878                         | 271,376               |
| Accrued liabilities                                                                                                                                                                           | 166,484                         | 214,584               |
| Income taxes payable                                                                                                                                                                          | 1,413                           | 1,989                 |
| Total current liabilities                                                                                                                                                                     | 542,021                         | 488,665               |
| Long-term debt                                                                                                                                                                                | 1,784,480                       | 1,783,294             |
| Other liabilities                                                                                                                                                                             | 19,012                          | 21,614                |
| Deferred income tax liabilities, net                                                                                                                                                          | 127,242                         | 114,656               |
| Total liabilities                                                                                                                                                                             | 2,472,755                       | 2,408,229             |
| Stockholders' deficit:                                                                                                                                                                        |                                 |                       |
| Common stock, \$0.01 par value. Authorized 500,000 shares; 132,694 and 144,842 shares issued and 132,505 and 144,571 shares outstanding at June 30, 2017 and September 30, 2016, respectively | 1,325                           | 1,446                 |
| Preferred stock, \$0.01 par value. Authorized 50,000 shares; none issued                                                                                                                      |                                 |                       |
| Additional paid-in capital                                                                                                                                                                    |                                 |                       |
| Accumulated deficit                                                                                                                                                                           | (260,594)                       | (177,561)             |
| Accumulated other comprehensive loss, net of tax                                                                                                                                              | (93,007)                        | (100,051)             |
| Total stockholders' deficit                                                                                                                                                                   | (352,276)                       | (276,166)             |
| Total liabilities and stockholders' deficit                                                                                                                                                   | \$ 2,120,479                    | \$ 2,132,063          |

The accompanying condensed notes are an integral part of these condensed consolidated financial statements.





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## Consolidated Statements of Cash Flows

(In thousands)

(Unaudited)

|                                                                                     | Nine Months Ended<br>June 30, |            |
|-------------------------------------------------------------------------------------|-------------------------------|------------|
|                                                                                     | 2017                          | 2016       |
| <b>Cash Flows from Operating Activities:</b>                                        |                               |            |
| Net earnings                                                                        | \$ 179,357                    | \$ 170,321 |
| Adjustments to reconcile net earnings to net cash provided by operating activities: |                               |            |
| Depreciation and amortization                                                       | 83,972                        | 72,524     |
| Share-based compensation expense                                                    | 8,590                         | 10,011     |
| Amortization of deferred financing costs                                            | 2,364                         | 2,467      |
| Excess tax (benefit) shortfall from share-based compensation                        | 1,060                         | (1,296)    |
| Loss on extinguishment of debt                                                      |                               | 33,296     |
| Deferred income taxes                                                               | 11,325                        | 12,787     |
| Changes in (exclusive of effects of acquisitions):                                  |                               |            |
| Trade accounts receivable                                                           | 90                            | (956)      |
| Accounts receivable, other                                                          | (4,185)                       | 6,338      |
| Inventory                                                                           | (36,221)                      | (32,759)   |
| Other current assets                                                                | 5,355                         | (4,403)    |
| Other assets                                                                        | 622                           | (923)      |
| Accounts payable and accrued liabilities                                            | (27,177)                      | (11,182)   |
| Income taxes payable                                                                | 886                           | (1,851)    |
| Other liabilities                                                                   | (2,623)                       | (5,561)    |
| Net cash provided by operating activities                                           | 223,415                       | 248,813    |
| <b>Cash Flows from Investing Activities:</b>                                        |                               |            |
| Capital expenditures                                                                | (66,565)                      | (110,798)  |
| Proceeds from disposal of property and equipment                                    | 36                            | 2,528      |
| Acquisitions, net of cash acquired                                                  |                               | (2,250)    |
| Net cash used by investing activities                                               | (66,529)                      | (110,520)  |
| <b>Cash Flows from Financing Activities:</b>                                        |                               |            |
| Proceeds from issuance of long-term debt                                            | 296,500                       | 912,000    |
| Repayments of long-term debt                                                        | (215,519)                     | (938,346)  |
| Repurchases of common stock                                                         | (286,503)                     | (162,367)  |
| Debt issuance costs                                                                 |                               | (12,748)   |
| Proceeds from exercises of stock options                                            | 16,941                        | 13,072     |
| Excess tax benefit (shortfall) from share-based compensation                        | (1,060)                       | 1,296      |
| Net cash used by financing activities                                               | (189,641)                     | (187,093)  |
| Effect of foreign exchange rate changes on cash and cash equivalents                | 233                           | (241)      |
| Net decrease in cash and cash equivalents                                           | (32,522)                      | (49,041)   |
| Cash and cash equivalents, beginning of period                                      | 86,622                        | 140,038    |
| Cash and cash equivalents, end of period                                            | \$ 54,100                     | \$ 90,997  |
| <b>Supplemental Cash Flow Information:</b>                                          |                               |            |
| Interest paid (a)                                                                   | \$ 103,493                    | \$ 138,563 |
| Income taxes paid                                                                   | \$ 84,319                     | \$ 86,916  |
| Capital expenditures incurred but not paid                                          | \$ 1,200                      | \$ 6,848   |

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(a) For the nine months ended June 30, 2016, interest paid includes \$25.8 million in call premiums paid in connection with the Company's December 2015 redemption in full of its senior notes due 2019.

The accompanying condensed notes are an integral part of these condensed consolidated 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 products and supplies through its Sally Beauty Supply ( SBS ) retail store and online operations in the U.S., Puerto Rico, Canada, Mexico, Chile, Colombia, Peru, the United Kingdom, Ireland, Belgium, France, Germany, the Netherlands and Spain. In addition, the Company distributes professional beauty products and supplies to salons and salon professionals through its Beauty Systems Group ( BSG ) professional-only store and online operations and through a commissioned direct sales force that services salons in the U.S. and Canada, and to franchisees 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 ). A significant number of the Company's products are available through a number of Sally Beauty Supply and BSG-operated websites. Certain beauty products sold by BSG and Armstrong McCall are sold under exclusive territory agreements with the third-party manufacturers.

#### **Basis of Presentation**

The accompanying condensed consolidated interim financial statements have been prepared in accordance with accounting principles generally accepted in the United States ( GAAP ) and pursuant to the rules and regulations of the SEC. Certain information and note disclosures normally included in annual financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to the rules and regulations of the SEC, 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, 2016. All significant intercompany accounts and transactions have been eliminated in consolidation. In the opinion of management, these condensed consolidated financial statements reflect all adjustments that are of a normal recurring nature and which are necessary to present fairly the Company's consolidated financial position as of June 30, 2017 and September 30, 2016, its consolidated results of operations and consolidated comprehensive income for the three and nine months ended June 30, 2017 and 2016, and its consolidated cash flows for the nine months ended June 30, 2017 and 2016.

Certain amounts for the prior fiscal periods have been reclassified to conform to the current fiscal period presentation, in connection with realignment of a business component from our BSG segment to our Sally Beauty Supply segment.

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

## 2. Significant Accounting Policies

The Company adheres to the same accounting policies in the preparation of its interim financial statements as it adheres to in the preparation of its full-year 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.

## 3. Recent Accounting Pronouncements and Accounting Changes

### Recent Accounting Pronouncements

The Company has not yet adopted and is currently assessing the potential effect of the following pronouncements on its consolidated financial statements:

In November 2015, the Financial Accounting Standards Board ( FASB ) issued Accounting Standards Update ( ASU ) No. 2015-17, *Income Taxes (Topic 740): Balance Sheet Classification of Deferred Income Taxes* ( ASU 2015-17 ) which aims to simplify the classification of deferred taxes on the balance sheet. More specifically, ASU 2015-17 will require that all deferred tax assets and liabilities, and any related valuation allowance, be reported as noncurrent in a classified balance sheet. The new guidance will replace the existing practice of reporting deferred taxes for each tax jurisdiction (or taxing component of a jurisdiction) as (a) a net current asset or liability *and* (b) a net noncurrent asset or liability. The new guidance does not change the existing requirement that only permits offsetting assets and liabilities within the same jurisdiction. For public companies, this amendment is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2016. Early adoption is permitted.

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### Sally Beauty Holdings, Inc. and Subsidiaries

#### Condensed Notes to Consolidated Financial Statements

(Unaudited)

In February 2016, the FASB issued ASU No. 2016-02, *Leases*, which will require lessees to report on their balance sheets a right-of-use asset and a lease liability in connection with most lease agreements classified as operating leases under the current guidance. Under the new guidance, the lease liability will be measured initially based on the present value of future lease payments, subject to certain conditions. The right-of-use asset will be measured initially based on the amount of the liability, plus certain initial direct costs. The new guidance will further require that leases be classified at inception as either (a) operating leases or (b) finance leases. For operating leases, periodic expense will generally be flat (straight-line) throughout the life of the lease. For finance leases, periodic expense will decline (similar to capital leases under current rules) over the life of the lease. The new standard must be adopted using a modified retrospective transition method. For public companies, this amendment is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. Early adoption is permitted.

In March 2016, the FASB issued ASU No. 2016-09, *Improvements to Employee Share-Based Payment Accounting*, intended to simplify various aspects of how share-based payments are recorded and presented on the financial statements. For example, the new guidance will require that all the income tax effect related to share-based payments be recorded in income tax expense. The new guidance further removes the current requirement to delay recognition of a windfall tax benefit until it reduces current taxes payable. In addition, the new standard will require that excess tax benefits and shortfalls from share-based compensation awards be reported in operating activities in the statement of cash flows. For public companies, these amendments are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2016. Early adoption is permitted.

In addition, the Company has not yet adopted the following recent accounting pronouncement and does not believe, based on the Company's preliminary assessment, that its adoption will have a material effect on its consolidated financial statements:

In May 2014, the FASB issued ASU No. 2014-09, *Revenue from Contracts with Customers* which will supersede Accounting Standards Codification (ASC) Topic 605, *Revenue Recognition*. A core principle of the new guidance is that an entity should measure revenue in connection with its sale of goods and services to a customer based on the consideration to which the entity expects to be entitled in exchange for each of those goods and services. The new standard must be adopted using either the retrospective or cumulative effect transition method. For public companies, this amendment is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2017. Early adoption is permitted. The Company has not yet selected a transition method.

## **Accounting Changes**

In April 2015, the FASB issued ASU No. 2015-05, *Customer's Accounting for Fees Paid in Cloud Computing Arrangement*. This pronouncement provides guidance to determine whether a cloud-based computing arrangement includes a software license. If a cloud-based computing arrangement includes a software license, the customer must account for the software element of the arrangement consistent with the acquisition of other software licenses. Otherwise, the customer must account for the arrangement as a service contract. The new standard permits the use of either the prospective or retrospective transition method. As required, the Company adopted the provisions of ASU No. 2015-05, prospectively, in the first quarter of its fiscal year ending September 30, 2017 and its adoption did not have a material impact on the Company's

consolidated financial statements.

In September 2015, the FASB issued ASU No. 2015-16, *Business Combinations (Topic 805): Simplifying the Accounting for Measurement-Period Adjustments* ( ASU 2015-16 ) which eliminates the prior requirement to recognize measurement-period adjustments to provisional amounts retrospectively. Instead, ASU 2015-16 requires the acquirer to recognize measurement-period adjustments, as well as the impact on earnings of changes in depreciation, amortization and similar items (if any) resulting from the change to the provisional amounts, in the period when the amount of each measurement-period adjustment is determined. As required, the Company adopted the provisions of ASU 2015-16 in the first quarter of its fiscal year ending September 30, 2017 and its adoption did not have a material impact on the Company's consolidated financial statements.

In January 2017, the FASB issued ASU No. 2017-01, *Business Combinations (Topic 805): Clarifying the Definition of a Business* ( ASU 2017-01 ). ASU 2017-01 must be applied prospectively and provides a narrower framework to be used to determine if a set of assets and activities constitutes a business compared to the framework under the prior guidance and is generally expected to result in greater consistency in the application of ASC Topic 805, *Business Combinations*. As permitted, the Company adopted ASU 2017-01 in the second quarter of its fiscal year ending September 30, 2017 and its adoption did not have a material impact on the Company's consolidated financial statements.

In January 2017, the FASB issued ASU No. 2017-04, *Intangibles - Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment* ( ASU 2017-04 ), which eliminates step two of the two-step quantitative goodwill impairment test. ASU 2017-04 applies to an entity that elects to use the quantitative method to test goodwill for impairment, but ASU 2017-04 does not eliminate the option to use instead the qualitative method to test goodwill for impairment. Step two of the quantitative impairment test guidance measures the amount of impairment loss and is performed when an entity concludes, as a result of performing step one of the quantitative test, that potential impairment exists. As permitted, the Company adopted ASU 2017-04 in the second quarter of its fiscal year ending September 30, 2017 and its adoption did not have a material impact on the Company's consolidated financial statements.

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## Sally Beauty Holdings, Inc. and Subsidiaries

## Condensed Notes to Consolidated Financial Statements

(Unaudited)

**4. Fair Value Measurements**

The Company's financial instruments consist of cash equivalents, if any, trade and other accounts receivable, accounts payable, foreign currency derivative instruments and debt. The carrying amounts of cash equivalents, if any, trade and other accounts receivable and accounts payable approximate their respective fair values 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. This valuation hierarchy is based upon the transparency of inputs to the valuation of an asset or liability on the measurement date.

Consistent with the hierarchy contained in ASC 820, the Company categorized certain of its financial assets and liabilities as follows at June 30, 2017 and September 30, 2016 (in thousands):

|                                | As of June 30, 2017 |              |           |         |
|--------------------------------|---------------------|--------------|-----------|---------|
|                                | Total               | Level 1      | Level 2   | Level 3 |
| <b>Assets</b>                  |                     |              |           |         |
| Foreign exchange contracts (a) | \$ 25               | \$           | \$ 25     | \$      |
| Total assets                   | \$ 25               | \$           | \$ 25     | \$      |
| <b>Liabilities</b>             |                     |              |           |         |
| Long-term debt (b)             | \$ 1,922,179        | \$ 1,839,063 | \$ 83,116 | \$      |
| Foreign exchange contracts (a) | 1,521               |              | 1,521     |         |
| Total liabilities              | \$ 1,923,700        | \$ 1,839,063 | \$ 84,637 | \$      |

|                                | As of September 30, 2016 |              |          |         |
|--------------------------------|--------------------------|--------------|----------|---------|
|                                | Total                    | Level 1      | Level 2  | Level 3 |
| <b>Assets</b>                  |                          |              |          |         |
| Foreign exchange contracts (a) | \$                       | \$           | \$       | \$      |
| Total assets                   | \$                       | \$           | \$       | \$      |
| <b>Liabilities</b>             |                          |              |          |         |
| Long-term debt (b)             | \$ 1,899,748             | \$ 1,897,625 | \$ 2,123 | \$      |
| Foreign exchange contracts (a) | 272                      |              | 272      |         |
| Total liabilities              | \$ 1,900,020             | \$ 1,897,625 | \$ 2,395 | \$      |

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

(b) Long-term debt (including current maturities and borrowings under the asset-based senior secured loan facility (the ABL facility), if any, is carried in the Company's consolidated financial statements at amortized cost of \$1,888.0 million at June 30, 2017 and \$1,807.7 million at September 30, 2016, less unamortized debt issuance costs of \$21.2 million at June 30, 2017 and \$23.7 million at September 30, 2016. The Company's senior notes are valued for purposes of this disclosure using unadjusted quoted market prices for such debt securities. Other long-term debt (consisting primarily of borrowings under the ABL facility, if any, 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 and Note 15 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)

**5. Accumulated Stockholders Deficit**

In August 2014, the Company announced that its Board of Directors (the Board) approved a share repurchase program authorizing it to repurchase up to \$1.0 billion of its common stock over an approximate three-year period expiring on September 30, 2017 (the 2014 Share Repurchase Program). During the nine months ended June 30, 2017 and 2016, the Company repurchased and subsequently retired approximately 13.1 million and 6.2 million shares, respectively, of its common stock under the 2014 Share Repurchase Program at an aggregate cost of \$286.5 million and \$162.4 million, respectively. The Company funded these share repurchases with existing cash balances, cash from operations and borrowings under the ABL facility. The Company reduced common stock and additional paid-in capital, in the aggregate, by these amounts. However, as required by GAAP, to the extent that share repurchase amounts exceeded the balance of additional paid-in capital prior to the Company recording such repurchases, the Company recorded the excess in accumulated deficit.

At June 30, 2017 and September 30, 2016, accumulated other comprehensive loss consists of cumulative foreign currency translation adjustments of \$93.0 million and \$100.1 million, respectively, net of income taxes of \$2.3 million at both dates. At June 30, 2017, the Company's only component of comprehensive income, other than net earnings, is foreign currency translation adjustments, net of income tax.

**6. Earnings Per Share**

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

|                                       | Three Months Ended<br>June 30, |           | Nine Months Ended<br>June 30, |            |
|---------------------------------------|--------------------------------|-----------|-------------------------------|------------|
|                                       | 2017                           | 2016      | 2017                          | 2016       |
| Net earnings                          | \$ 66,539                      | \$ 67,919 | \$ 179,357                    | \$ 170,321 |
| Weighted average basic shares         | 135,450                        | 145,957   | 139,888                       | 147,741    |
| Dilutive securities:                  |                                |           |                               |            |
| Stock option and stock award programs | 709                            | 1,880     | 746                           | 1,735      |
| Weighted average diluted shares       | 136,159                        | 147,837   | 140,634                       | 149,476    |
| Earnings per share:                   |                                |           |                               |            |
| Basic                                 | \$ 0.49                        | \$ 0.47   | \$ 1.28                       | \$ 1.15    |
| Diluted                               | \$ 0.49                        | \$ 0.46   | \$ 1.28                       | \$ 1.14    |

At June 30, 2017 and 2016, options to purchase 4,792,717 shares and 66,573 shares, respectively, of the Company's common stock were outstanding but not included in the computations of diluted earnings per share for the *three* months ended June 30, 2017 and 2016, respectively.

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since these options were anti-dilutive. At June 30, 2017 and 2016, options to purchase 4,792,717 shares and 1,094,343 shares, respectively, of the Company's common stock were outstanding but not included in the computations of diluted earnings per share for the *nine* months ended June 30, 2017 and 2016, respectively, since these options were anti-dilutive. An anti-dilutive option is an option that is: (a) out-of-the-money (an option with an exercise price which is greater than the average price per share of the Company's common stock during the period), *or* (b) in-the-money (an option with an exercise price 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 option, exceeds the average price per share for the Company's common stock during the period.

### 7. Share-Based Payments

The Company from time to time may grant, subject to approval by the Board, performance-based awards and service-based awards to its employees under the Sally Beauty Holdings, Inc. Amended and Restated 2010 Omnibus Incentive Plan (the 2010 Plan), a stockholder-approved share-based compensation plan. The following table presents the total compensation cost included in selling, general and administrative expenses for all share-based compensation arrangements, and the related income tax benefits recognized in our consolidated statements of earnings (in thousands):

|                                                                | Three Months Ended<br>June 30, |          | Nine Months Ended<br>June 30, |           |
|----------------------------------------------------------------|--------------------------------|----------|-------------------------------|-----------|
|                                                                | 2017                           | 2016     | 2017                          | 2016      |
| Share-based compensation expense                               | \$ 2,378                       | \$ 2,838 | \$ 8,590                      | \$ 10,011 |
| Income tax benefit related to share-based compensation expense | \$ 884                         | \$ 1,062 | \$ 3,210                      | \$ 3,769  |

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## Sally Beauty Holdings, Inc. and Subsidiaries

## Condensed Notes to Consolidated Financial Statements

(Unaudited)

**Performance-Based Awards**

The Company from time to time grants performance-based restricted stock units ( performance units ) pursuant to the 2010 Plan. The Company's performance units represent unsecured obligations of the Company to issue shares of its common stock. The number of shares, if any, which will be issued in connection with these awards, is contingent upon both (a) employee service conditions and (b) the Company's level of achievement with respect to specified performance targets over a specified period of time. The Company measures the cost of services received from employees in exchange for an award of performance units based on the fair value of the award on the date of grant and it recognizes expense over the requisite service period (generally three years). The fair value of a performance unit is determined based on the closing market price of the Company's common stock on the date of grant.

During the nine months ended June 30, 2017 and 2016, the Company granted approximately 146,000 and 152,000 performance units ( target shares ), respectively, to its employees. Under the terms of these awards, a grantee may earn from 0% to 200% of his or her target shares, with the ultimate number of units earned upon settlement (and expense recognized) dependent on the Company's level of achievement with respect to certain specified cumulative performance targets during the three-year period specified in each award (the performance period ) and satisfaction of the employee service condition. Periodic expense for performance unit awards, which is estimated quarterly, is based on the Company's projected performance during the performance period compared to the performance targets contained in the award. As such, for the nine months ended June 30, 2017 and 2016, the Company has estimated and recognized compensation expense for each award based on the percentage of the performance targets that the Company deems probable of achievement. The Company's assessment of the compensation expense, if any, to be ultimately recognized in connection with its performance unit awards is based on currently available information. The compensation expense, if any, ultimately recognized may be significantly different from such estimates. To date, the Company has only granted performance units subject to the Company's achievement of two performance targets: consolidated sales growth (as defined in the award documents) and return on invested capital (as defined in the award documents), in addition to service conditions.

The following table presents a summary of the activity for the Company's performance unit awards for the nine months ended June 30, 2017:

| <b>Performance Unit Awards</b> | <b>Number of Shares<br/>(in Thousands)</b> | <b>Weighted Average<br/>Fair Value Per<br/>Share</b> | <b>Weighted Average<br/>Remaining<br/>Vesting Term (in<br/>Years)</b> |
|--------------------------------|--------------------------------------------|------------------------------------------------------|-----------------------------------------------------------------------|
| Unvested at September 30, 2016 | 132                                        | \$ 23.45                                             | 2.0                                                                   |
| Granted                        | 146                                        | 25.53                                                |                                                                       |
| Vested                         |                                            |                                                      |                                                                       |
| Forfeited                      | (66)                                       | 24.62                                                |                                                                       |
| Unvested at June 30, 2017      | 212                                        | \$ 24.52                                             | 1.8                                                                   |

The maximum compensation expense to be potentially recognized in connection with all outstanding performance unit awards is approximately \$10.4 million, including \$1.5 million of cumulative expense recognized on or prior to June 30, 2017.

### **Service-Based Awards**

The Company measures the cost of services received from employees and directors in exchange for a service-based 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 recipient becomes eligible for retirement, if earlier, in connection with employees eligible to continue vesting awards upon retirement ( retirement-eligible ) under the provisions of the 2010 Plan. During the nine months ended June 30, 2017 and 2016, the Company recognized accelerated share-based compensation expense of \$1.1 million and \$1.3 million, respectively, in connection with service-based awards to retirement-eligible employees.

### *Stock Option Awards*

The Company granted approximately 1.5 million service-based stock options to employees during both the nine months ended June 30, 2017 and 2016. Each option has an exercise price equal to the closing market price of the Company's common stock on the date of grant and has a maximum term of 10 years. Options generally vest ratably over a three or four year period and are generally subject to forfeiture if employment terminates prior to completion of the vesting period, subject to certain retirement provisions contained in the 2010 Plan.

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(Unaudited)

The following table presents a summary of the activity for the Company's service-based stock option awards for the nine months ended June 30, 2017:

|                                   | Number of<br>Outstanding<br>Options (in<br>Thousands) | Weighted<br>Average<br>Exercise<br>Price | Weighted<br>Average<br>Remaining<br>Contractual<br>Term (in<br>Years) | Aggregate<br>Intrinsic<br>Value (in<br>Thousands) |
|-----------------------------------|-------------------------------------------------------|------------------------------------------|-----------------------------------------------------------------------|---------------------------------------------------|
| Outstanding at September 30, 2016 | 5,584                                                 | \$ 22.95                                 | 6.1                                                                   | \$ 19,615                                         |
| Granted                           | 1,457                                                 | 25.60                                    |                                                                       |                                                   |
| Exercised                         | (919)                                                 | 18.44                                    |                                                                       |                                                   |
| Forfeited or expired              | (604)                                                 | 25.82                                    |                                                                       |                                                   |
| Outstanding at June 30, 2017      | 5,518                                                 | \$ 24.09                                 | 6.0                                                                   | \$ 4,649                                          |
| Exercisable at June 30, 2017      | 2,742                                                 | \$ 22.48                                 | 4.6                                                                   | \$ 4,649                                          |

The following table summarizes additional information about service-based stock options outstanding at June 30, 2017 under the Company's share-based compensation plans:

| Range of<br>Exercise Prices | Options Outstanding                                   |                                                                       |                                          | Options Exercisable                                      |                                          |  |
|-----------------------------|-------------------------------------------------------|-----------------------------------------------------------------------|------------------------------------------|----------------------------------------------------------|------------------------------------------|--|
|                             | Number of<br>Options<br>Outstanding<br>(in Thousands) | Weighted<br>Average<br>Remaining<br>Contractual<br>Term (in<br>Years) | Weighted<br>Average<br>Exercise<br>Price | Number of<br>Options<br>Exercisable<br>(in<br>Thousands) | Weighted<br>Average<br>Exercise<br>Price |  |
| \$5.24 - 19.99              | 726                                                   | 2.9                                                                   | \$ 13.84                                 | 726                                                      | \$ 13.84                                 |  |
| \$20.00 - 24.99             | 1,678                                                 | 6.4                                                                   | 23.46                                    | 933                                                      | 23.47                                    |  |
| \$25.00 - 31.58             | 3,114                                                 | 6.5                                                                   | 26.81                                    | 1,083                                                    | 27.41                                    |  |
| Total                       | 5,518                                                 | 6.0                                                                   | \$ 24.09                                 | 2,742                                                    | \$ 22.48                                 |  |

The Company uses the Black-Scholes option pricing model to value the Company's stock options for each stock option award. Using the Black-Scholes 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 three or four years) of the stock options or over a period ending on the date a recipient becomes retirement-eligible, if earlier.

The weighted average assumptions relating to the valuation of the Company's stock options using the Black-Scholes option pricing model are as follows:

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|                                                    | Nine months ended<br>June 30, |       |
|----------------------------------------------------|-------------------------------|-------|
|                                                    | 2017                          | 2016  |
| Expected life (in years)                           | 5.0                           | 5.0   |
| Expected volatility for the Company's common stock | 25.3%                         | 27.2% |
| Risk-free interest rate                            | 1.3%                          | 1.5%  |
| 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 zero-coupon U.S. Treasury notes with a comparable term as of the date of the grant. Since the Company does not currently expect to pay dividends, the assumed dividend yield is 0%.

The weighted average fair value at the date of grant of the stock options issued by the Company in the nine months ended June 30, 2017 and 2016 was \$6.37 and \$6.32 per option, respectively. The aggregate intrinsic value of options exercised during the nine months ended June 30, 2017 was \$7.4 million. The cash proceeds from these option exercises were \$16.9 million and the tax benefit realized from these option exercises was \$2.8 million.

At June 30, 2017, unrecognized compensation expense related to unvested stock option awards is approximately \$9.3 million and is expected to be recognized over the weighted average period of 1.8 years.

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*Restricted Stock Awards*

The Company granted approximately 35,000 and 40,000 service-based restricted share awards to its employees during the nine months ended June 30, 2017 and 2016, respectively. 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 three to five years). Restricted stock awards are generally subject to forfeiture if employment terminates prior to these restrictions lapsing, subject to certain retirement provisions of the 2010 Plan.

The fair value of the Company's restricted stock awards is expensed on a straight-line basis over the period (generally three to five years) in which the restrictions on these stock awards lapse (vesting) or over the period ending on the date a recipient becomes retirement-eligible, if earlier. The fair value of a service-based restricted stock award 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 service-based restricted stock awards for the nine months ended June 30, 2017:

| <b>Restricted Stock Awards</b> | <b>Number of Shares<br/>(in Thousands)</b> | <b>Weighted Average<br/>Fair Value Per<br/>Share</b> | <b>Weighted Average<br/>Remaining<br/>Vesting Term (in<br/>Years)</b> |
|--------------------------------|--------------------------------------------|------------------------------------------------------|-----------------------------------------------------------------------|
| Unvested at September 30, 2016 | 271                                        | \$ 26.80                                             | 1.9                                                                   |
| Granted                        | 35                                         | 23.79                                                |                                                                       |
| Vested                         | (94)                                       | 25.66                                                |                                                                       |
| Forfeited                      | (23)                                       | 27.48                                                |                                                                       |
| Unvested at June 30, 2017      | 189                                        | \$ 26.72                                             | 1.5                                                                   |

At June 30, 2017, unrecognized compensation expense related to unvested restricted stock awards is approximately \$2.0 million and is expected to be recognized over the weighted average period of 1.5 years.

*Restricted Stock Units*

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The Company from time to time grants service-based restricted stock unit ( RSU or RSUs ) awards, which generally vest within one year from the date of grant, pursuant to the 2010 Plan. To date, the Company has only granted service-based RSU awards to its non-employee directors. RSUs represent an unsecured promise of the Company to issue shares of the Company s common stock. Unless forfeited prior to the vesting date, RSUs are converted into shares of the Company s common stock generally on the vesting date. 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 granted prior to the fiscal year 2012 are generally retained by the Company as deferred stock units that are not settled until six months after the independent director s service as a director terminates. RSUs are generally subject to forfeiture if service terminates prior to the vesting of the units. Recipients have no voting rights with respect to unvested RSUs. Under the 2010 Plan, the Company may settle some or all of the vested deferred stock units with shares of the Company s common stock or in cash.

The Company granted approximately 42,000 and 27,000 service-based RSUs to its non-employee directors during the nine months ended June 30, 2017 and 2016, respectively. The Company expenses the cost of a service-based RSU, which is determined to be the fair value of the RSU 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 service-based RSUs for the nine months ended June 30, 2017:

| Restricted Stock Units         | Number of Shares<br>(in Thousands) | Weighted Average<br>Fair Value Per<br>Share | Weighted Average<br>Remaining<br>Vesting Term (in<br>Years) |
|--------------------------------|------------------------------------|---------------------------------------------|-------------------------------------------------------------|
| Unvested at September 30, 2016 |                                    | \$                                          |                                                             |
| Granted                        | 42                                 | 25.18                                       |                                                             |
| Vested                         |                                    |                                             |                                                             |
| Forfeited                      |                                    |                                             |                                                             |
| Unvested at June 30, 2017      | 42                                 | \$ 25.18                                    | 0.2                                                         |



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At June 30, 2017, unrecognized compensation expense related to unvested RSUs is approximately \$0.3 million and is expected to be recognized over the weighted average period of 0.2 years.

**8. Goodwill and Intangible Assets**

During the three months ended March 31, 2017, the Company completed its annual assessment for impairment of goodwill and other intangible assets. No material impairment losses were recognized in the current or prior periods presented in connection with the Company's goodwill and other intangible assets.

For the three months ended June 30, 2017 and 2016, amortization expense related to other intangible assets was \$3.2 million and \$3.4 million, respectively, and, for the nine months ended June 30, 2017 and 2016, amortization expense was \$9.9 million and \$10.3 million, respectively.

**9. Commitments and Contingencies**

During the fiscal year 2014, the Company disclosed that it had experienced a data security incident (the 2014 data security incident). During the fiscal year 2015, the Company disclosed that it had experienced a second data security incident (the 2015 data security incident) and, together with the 2014 data security incident, the data security incidents). The data security incidents involved the unauthorized installation of malicious software (malware) on our information technology systems, including our point-of-sale systems that the Company believes may have placed at risk certain payment card data for some transactions. The costs that the Company has incurred to date in connection with the data security incidents include assessments by payment card networks, professional advisory fees and legal fees relating to investigating and remediating the data security incidents. In April 2017, the Company entered into agreements pursuant to which all existing claims and assessments by certain payment card networks were settled. The Company cannot provide any assurances regarding whether additional assessments by payment card networks will be received. Selling, general and administrative expenses for the nine months ended June 30, 2016 reflect expenses of \$2.6 million related to the data security incidents.

The table that follows summarizes the activity for the Company's loss contingency obligation for the nine months ended June 30, 2017 (in thousands):

| Contingency | Liability at<br>September 30, | Expense | Payments, net<br>of recovery | Liability at<br>June 30, |
|-------------|-------------------------------|---------|------------------------------|--------------------------|
|-------------|-------------------------------|---------|------------------------------|--------------------------|

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|                         | 2016 (1) |        | 2017 |         |          |
|-------------------------|----------|--------|------|---------|----------|
| Data security incidents | \$       | 15,644 | \$   | (9,285) | \$ 6,359 |

(1) Unpaid costs are included in Accrued liabilities in the Company's consolidated balance sheet.

The Company expects to incur additional costs and expenses related to the data security incidents in the future. These costs and expenses may result from potential additional liabilities to other payment card networks, governmental or third party investigations, proceedings or litigation and legal and other fees necessary to defend against any potential liabilities or claims, and further investigatory and remediation costs. As of June 30, 2017, the scope of these additional costs and expenses, or a range thereof, beyond amounts management has determined to be probable, cannot be reasonably estimated. While the Company does not anticipate these additional costs and expenses or liabilities would have a material adverse impact on its business, financial condition and operating results, these additional costs and expenses could be significant.

### 10. Short-term Borrowings and Long-term Debt

At June 30, 2017, the Company, through its subsidiary (Sally Holdings LLC, hereafter "Sally Holdings") had a \$500 million, five-year asset-based senior secured loan facility (the "ABL facility"), including a \$25.0 million Canadian sub-facility for its Canadian operations. At June 30, 2017, the Company had borrowings of \$81.5 million outstanding under the ABL facility and the Company had \$398.3 million available for borrowing under the ABL facility, including the Canadian sub-facility. In addition, at June 30, 2017, the Company, through its subsidiaries Sally Holdings and Sally Capital Inc. (collectively, the "Issuers") had \$1,800.0 million of senior notes outstanding, as summarized in the table below. Please see Note 13 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, 2016 and Notes 4 and 15 in Item 1 of this Quarterly Report for more information about these debt obligations.

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Details of long-term debt as of June 30, 2017 and September 30, 2016 are as follows (dollars in thousands):

|                                                           | June 30,<br>2017 | September 30,<br>2016 | Interest Rates(a)                                                          |
|-----------------------------------------------------------|------------------|-----------------------|----------------------------------------------------------------------------|
| ABL facility(b)                                           | \$ 81,500        | \$                    | (i) Prime plus (0.50% to 0.75%) or;<br>(ii) LIBOR(b) plus (1.50% to 1.75%) |
| Senior notes due Jun. 2022                                | 850,000          | 850,000               | 5.750%                                                                     |
| Senior notes due Nov. 2023                                | 200,000          | 200,000               | 5.500%                                                                     |
| Senior notes due Dec. 2025                                | 750,000          | 750,000               | 5.625%                                                                     |
| Total                                                     | \$ 1,881,500     | \$ 1,800,000          |                                                                            |
| Plus: capital lease obligations                           | 1,616            | 2,123                 |                                                                            |
| Less: unamortized debt issuance costs and premium, net(c) | 16,390           | 18,113                |                                                                            |
| Total debt                                                | \$ 1,866,726     | \$ 1,784,010          |                                                                            |
| Less: current maturities                                  | 82,246           | 716                   |                                                                            |
| Total long-term debt                                      | \$ 1,784,480     | \$ 1,783,294          |                                                                            |

- (a) Interest rates shown represent the coupon or contractual rate or rates related to each debt instrument listed.
- (b) When used in this Quarterly Report, LIBOR means the London Interbank Offered Rate. At June 30, 2017 and September 30, 2016, unamortized debt issuance costs of \$0.9 million and \$1.6 million, respectively, related to the ABL facility are reported in other assets in the Company's consolidated balance sheets.
- (c) Amounts are net of unamortized premium of \$4.8 million and \$5.6 million as of June 30, 2017 and September 30, 2016, respectively, related to notes with an aggregate principal amount of \$150.0 million of the 5.750% senior notes due 2022 (the "senior notes due 2022").

Maturities of the Company's long-term debt are as follows as of June 30, 2017 (in thousands):

| Twelve months ending June 30:                          |              |
|--------------------------------------------------------|--------------|
| 2018-2021                                              | \$ 81,500    |
| 2022                                                   | 850,000      |
| Thereafter                                             | 950,000      |
|                                                        | \$ 1,881,500 |
| Plus: capital lease obligations                        | 1,616        |
| Less: unamortized debt issuance costs and premium, net | 16,390       |
| Less: current maturities                               | 82,246       |

|                      |    |           |
|----------------------|----|-----------|
| Total long-term debt | \$ | 1,784,480 |
|----------------------|----|-----------|

As further described in Note 15, on July 6, 2017, the Company announced that it had amended and restated its ABL facility (as defined below), entered into a new Term Loan B (as defined below), and completed its previously-announced redemption of all \$850.0 million in aggregate principal amount of its Senior Notes due 2022 primarily with the proceeds of the new Term Loan B as well as existing cash balances and borrowings under the its new ABL facility. Please see Note 15 in Item 1 of this Quarterly Report for more information on the Term Loan B and the new ABL facility.

## 11. Derivative Instruments and Hedging Activities

### Risk Management Objectives of Using Derivative Instruments

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 (including foreign exchange contracts and interest rate swaps or caps) by Sally Holdings and its subsidiaries.

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The Company uses foreign exchange contracts (including foreign currency forwards) as part of its overall economic risk management strategy to effectively 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 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 uses interest rate derivatives (including interest rate swaps or caps) as part of its overall economic risk management strategy to add stability to the interest payments due in connection with its debt obligations. At June 30, 2017, the Company's exposure to interest rate fluctuations relates to interest payments, if any, under the ABL facility and the Company held no derivative instruments in connection therewith. During the nine months ended June 30, 2017, the Company did not purchase or hold any derivative instruments for trading or speculative purposes.

**Designated Cash Flow Hedges**

The Company may use from time to time derivative instruments designated as hedges to manage its exposure to interest rate or foreign currency exchange rate movements, as appropriate. During the nine months ended June 30, 2017, the Company did not purchase or hold any such derivatives. Please see Note 15 for more information.

**Non-designated Cash Flow Hedges**

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

The Company uses foreign exchange contracts to manage the exposure to the U.S. dollar resulting from certain of its Sinelco Group subsidiaries purchases of merchandise from third-party suppliers. Sinelco's functional currency is the Euro. As such, at June 30, 2017, the Company holds foreign currency forward contracts that enable it to sell approximately 4.0 million (\$4.6 million, at the June 30, 2017 exchange rate) at a weighted average contractual EUR-USD exchange rate of 1.1291. The foreign currency forward contracts discussed in this paragraph are with a single counterparty and expire ratably through September 15, 2017.

The Company also uses foreign exchange contracts to manage the exposure to the U.S. dollar resulting from purchases of merchandise, primarily from third-party suppliers, by the Company's subsidiary in Mexico. Such subsidiary's functional currency is the Mexican Peso. As such, at June 30, 2017, the Company holds foreign currency forward contracts that enable it to sell approximately MXN155.9 million (\$8.7 million, at the June 30, 2017 exchange rate) at a weighted average contractual USD-MXN exchange rate of 21.9557. The foreign currency forward contracts discussed in this paragraph are with a single counterparty (not the same counterparty as that on the forward contracts discussed in the preceding paragraph) and expire ratably through September 29, 2017.

In addition, the Company 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 June 30, 2017, the Company holds: (a) a foreign currency forward contract that enables it to sell approximately 8.4 million (\$9.6 million, at the June 30, 2017 exchange rate) at a contractual EUR-USD exchange rate of 1.1432, (b) a foreign currency forward contract that enables it to sell approximately C\$8.9 million (\$6.8 million, at the June 30, 2017 exchange rate) at a contractual USD-CAD exchange rate of 1.2987, (c) a foreign currency forward contract that enables it to buy approximately C\$6.5 million (\$5.0 million, at the June 30, 2017 exchange rate) at a contractual USD-CAD exchange rate of 1.3007 and (d) a foreign currency forward contract that enables it to buy approximately £0.2 million (\$0.3 million, at the June 30, 2017 exchange rate) at a contractual GBP-USD exchange rate of 1.2966. All the foreign currency forward contracts discussed in this paragraph are with a single counterparty (not the same counterparty as that on the forward contracts discussed in the two preceding paragraphs) and expire on or before September 29, 2017.

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At June 30, 2017, the Company's foreign exchange contracts are not designated as hedges and do not 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. Selling, general and administrative expenses reflect a net loss of \$0.8 million and a net gain of \$0.2 million for the three months ended June 30, 2017 and 2016, respectively, and a net loss of \$1.4 million and \$0.4 million for the nine months ended June 30, 2017 and 2016, respectively, in connection with all of the Company's foreign currency derivative instruments, including marked-to-market adjustments.

The table below presents the fair value of the Company's derivative financial instruments and their classification on the Company's consolidated balance sheets as of June 30, 2017 and September 30, 2016 (in thousands):

|                                                           | Classification       | Asset Derivatives |                    | Classification      | Liability Derivatives |                    |
|-----------------------------------------------------------|----------------------|-------------------|--------------------|---------------------|-----------------------|--------------------|
|                                                           |                      | June 30, 2017     | September 30, 2016 |                     | June 30, 2017         | September 30, 2016 |
| <b>Derivatives designated as hedging instruments:</b>     |                      |                   |                    |                     |                       |                    |
| None                                                      |                      |                   |                    |                     |                       |                    |
| <b>Derivatives not designated as hedging instruments:</b> |                      |                   |                    |                     |                       |                    |
| Foreign exchange contracts                                | Other current assets | \$ 25             | \$                 | Accrued liabilities | \$ 1,521              | \$ 272             |
|                                                           |                      | \$ 25             | \$                 |                     | \$ 1,521              | \$ 272             |

The table below presents the effect of the Company's derivative financial instruments on the Company's consolidated statements of earnings for the three months ended June 30, 2017 and 2016 (in thousands):

| Derivatives Designated as Hedging Instruments | Amount of Gain or (Loss) Recognized in OCI on Derivative (Effective Portion), net of tax | Amount of Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion) |
|-----------------------------------------------|------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------|
| None                                          |                                                                                          |                                                                                            |
| Foreign exchange contracts                    | Selling, general and administrative expenses                                             | \$ (817) \$ 165                                                                            |

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The table below presents the effect of the Company's derivative financial instruments on the Company's consolidated statements of earnings for the nine months ended June 30, 2017 and 2016 (in thousands):

| Derivatives Designated as Hedging Instruments | Amount of Gain or (Loss) Recognized in OCI on Derivative (Effective Portion), net of tax | Amount of Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion) |
|-----------------------------------------------|------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------|
| None                                          |                                                                                          |                                                                                            |
|                                               |                                                                                          |                                                                                            |
| Foreign exchange contracts                    | Selling, general and administrative expenses                                             | \$ (1,449) \$ (434)                                                                        |



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Condensed Notes to Consolidated Financial Statements

(Unaudited)

**Credit-risk-related Contingent Features**

At June 30, 2017, the aggregate fair value of all foreign exchange contracts held which consisted of derivative instruments in a liability position was \$1.5 million. The Company was under no obligation to post and had not posted any collateral related to the derivative instruments in a liability position.

The counterparties to 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. In the event that a counterparty defaults in its obligation under our derivative instruments, the Company could incur material financial losses. However, at the present time, no such losses are deemed probable.

**12. Business Segments**

The Company's business is organized into two operating and reporting segments: (i) Sally Beauty Supply, a domestic and international chain of retail stores and a consumer-facing e-commerce website that offers professional beauty products and supplies to both retail customers and salon professionals primarily in North America, Puerto Rico, and parts of Europe and South America and (ii) Beauty Systems Group, including its franchise-based business Armstrong McCall, a full service distributor of beauty products and supplies that offers professional beauty products directly to salons and salon professionals through its professional-only stores, e-commerce websites and its own sales force in partially exclusive geographical territories primarily in North America.

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, 2016. Sales between segments, which were eliminated in consolidation, were not material during the three and nine months ended June 30, 2017 and 2016.

Segment data for the three and nine months ended June 30, 2017 and 2016 is as follows (in thousands):

**Three Months Ended  
June 30,**

**Nine Months Ended  
June 30,**

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|                                             | 2017 |          | 2016 (a) |          | 2017 |           | 2016 (a) |           |
|---------------------------------------------|------|----------|----------|----------|------|-----------|----------|-----------|
| Net sales:                                  |      |          |          |          |      |           |          |           |
| Sally Beauty Supply                         | \$   | 594,880  | \$       | 602,632  | \$   | 1,760,732 | \$       | 1,797,068 |
| BSG                                         |      | 403,163  |          | 395,529  |      | 1,203,390 |          | 1,179,192 |
| Total                                       | \$   | 998,043  | \$       | 998,161  | \$   | 2,964,122 | \$       | 2,976,260 |
| Earnings before provision for income taxes: |      |          |          |          |      |           |          |           |
| Segment operating earnings:                 |      |          |          |          |      |           |          |           |
| Sally Beauty Supply                         | \$   | 104,880  | \$       | 104,908  | \$   | 294,245   | \$       | 313,792   |
| BSG                                         |      | 67,327   |          | 65,196   |      | 193,630   |          | 191,649   |
| Segment operating earnings                  |      | 172,207  |          | 170,104  |      | 487,875   |          | 505,441   |
| Unallocated corporate expenses (b)          |      | (34,437) |          | (33,182) |      | (98,187)  |          | (107,952) |
| Restructuring charges                       |      | (5,054)  |          |          |      | (14,265)  |          |           |
| Share-based compensation expense            |      | (2,378)  |          | (2,838)  |      | (8,590)   |          | (10,011)  |
| Interest expense (c)                        |      | (26,969) |          | (26,703) |      | (80,616)  |          | (117,617) |
| Earnings before provision for income taxes  | \$   | 103,369  | \$       | 107,381  | \$   | 286,217   | \$       | 269,861   |

(a) Certain amounts for the prior fiscal periods have been reclassified to conform to the current fiscal period presentation, in connection with realignment of a business component from our BSG segment to our Sally Beauty Supply segment.

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

(c) For the nine months ended June 30, 2016, interest expense includes a loss on extinguishment of debt of \$33.3 million in connection with the Company's December 2015 redemption of its senior notes due 2019.

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Condensed Notes to Consolidated Financial Statements

(Unaudited)

**13. Parent, Issuers, Guarantor and Non-Guarantor Condensed Consolidating Financial Statements**

The following consolidating financial information presents the condensed consolidating balance sheets as of June 30, 2017 and September 30, 2016, the related condensed consolidating statements of earnings and comprehensive income for the three and nine months ended June 30, 2017 and 2016, and the condensed consolidating statements of cash flows for the nine months ended June 30, 2017 and 2016 of: (i) Sally Beauty Holdings, Inc., or the Parent; (ii) Sally Holdings and Sally Capital Inc. (iii) the guarantor subsidiaries; (iv) the non-guarantor subsidiaries; (v) elimination entries necessary for consolidation purposes; and (vi) Sally Beauty on a condensed consolidated basis.

Separate financial statements and other disclosures with respect to the subsidiary guarantors have not been provided because management believes the following information is sufficient since the guarantor subsidiaries are 100% indirectly owned by the Parent and all guarantees are full and unconditional. The accounts, inventory, credit card receivables, deposit accounts, certain intercompany notes and certain other personal property of the guarantor subsidiaries relating to the inventory and accounts are pledged under the ABL facility and consequently may not be available to satisfy the claims of general creditors. Please see Note 15 for more information.

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Sally Beauty Holdings, Inc. and Subsidiaries

Condensed Notes to Consolidated Financial Statements

(Unaudited)

Condensed Consolidating Balance Sheet

June 30, 2017

(In thousands)

|                                                                           | Parent       | Sally Holdings LLC and Sally Capital Inc. | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Consolidating Eliminations | Sally Beauty Holdings, Inc. and Subsidiaries |
|---------------------------------------------------------------------------|--------------|-------------------------------------------|------------------------|----------------------------|----------------------------|----------------------------------------------|
| <b>Assets</b>                                                             |              |                                           |                        |                            |                            |                                              |
| Cash and cash equivalents                                                 | \$           | \$ 10                                     | \$ 15,684              | \$ 38,406                  | \$                         | \$ 54,100                                    |
| Trade and other accounts receivable, less allowance for doubtful accounts | 14           |                                           | 59,917                 | 28,476                     |                            | 88,407                                       |
| Due from affiliates                                                       |              |                                           | 2,198,096              |                            | (2,198,096)                |                                              |
| Inventory                                                                 |              |                                           | 725,638                | 221,985                    |                            | 947,623                                      |
| Other current assets                                                      | 4,304        | 83                                        | 27,956                 | 17,641                     |                            | 49,984                                       |
| Deferred income tax assets                                                | 50           |                                           | 35,740                 | 4,336                      |                            | 40,126                                       |
| Property and equipment, net                                               | 11           |                                           | 229,895                | 80,270                     |                            | 310,176                                      |
| Investment in subsidiaries                                                | 1,062,261    | 3,636,311                                 | 372,778                |                            | (5,071,350)                |                                              |
| Goodwill and other intangible assets, net                                 |              |                                           | 471,429                | 145,826                    |                            | 617,255                                      |
| Other assets                                                              | 1,515        | 1,938                                     | (8,114)                | 17,469                     |                            | 12,808                                       |
| Total assets                                                              | \$ 1,068,155 | \$ 3,638,342                              | \$ 4,129,019           | \$ 554,409                 | \$ (7,269,446)             | \$ 2,120,479                                 |
| <b>Liabilities and Stockholders (Deficit)</b>                             |              |                                           |                        |                            |                            |                                              |
| <b>Equity</b>                                                             |              |                                           |                        |                            |                            |                                              |
| Accounts payable                                                          | \$ 209       | \$                                        | \$ 230,426             | \$ 61,243                  | \$                         | \$ 291,878                                   |
| Due to affiliates                                                         | 1,420,179    | 697,816                                   |                        | 80,101                     | (2,198,096)                |                                              |
| Accrued liabilities                                                       | 259          | 11,484                                    | 123,219                | 31,522                     |                            | 166,484                                      |
| Income taxes payable                                                      | 66           | 1,619                                     |                        | (272)                      |                            | 1,413                                        |
| Long-term debt                                                            |              | 1,865,110                                 | 2                      | 1,614                      |                            | 1,866,726                                    |
| Other liabilities                                                         |              |                                           | 15,174                 | 3,838                      |                            | 19,012                                       |
| Deferred income tax liabilities                                           | (282)        | 52                                        | 123,887                | 3,585                      |                            | 127,242                                      |
| Total liabilities                                                         | 1,420,431    | 2,576,081                                 | 492,708                | 181,631                    | (2,198,096)                | 2,472,755                                    |
| Total stockholders (deficit) equity                                       | (352,276)    | 1,062,261                                 | 3,636,311              | 372,778                    | (5,071,350)                | (352,276)                                    |
| Total liabilities and stockholders (deficit) equity                       | \$ 1,068,155 | \$ 3,638,342                              | \$ 4,129,019           | \$ 554,409                 | \$ (7,269,446)             | \$ 2,120,479                                 |



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Sally Beauty Holdings, Inc. and Subsidiaries

Condensed Notes to Consolidated Financial Statements

(Unaudited)

Condensed Consolidating Balance Sheet

September 30, 2016

(In thousands)

|                                                                           | Parent     | Sally Holdings LLC and Sally Capital Inc. | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Consolidating Eliminations | Sally Beauty Holdings, Inc. and Subsidiaries |
|---------------------------------------------------------------------------|------------|-------------------------------------------|------------------------|----------------------------|----------------------------|----------------------------------------------|
| <b>Assets</b>                                                             |            |                                           |                        |                            |                            |                                              |
| Cash and cash equivalents                                                 | \$         | \$ 28,372                                 | \$ 22,368              | \$ 35,882                  | \$                         | \$ 86,622                                    |
| Trade and other accounts receivable, less allowance for doubtful accounts |            | 16                                        | 55,989                 | 27,978                     |                            | 83,983                                       |
| Due from affiliates                                                       |            |                                           | 1,966,505              |                            | (1,966,505)                |                                              |
| Inventory                                                                 |            |                                           | 709,523                | 197,814                    |                            | 907,337                                      |
| Other current assets                                                      | 14,816     | 30                                        | 23,864                 | 16,151                     |                            | 54,861                                       |
| Deferred income tax assets                                                | 50         |                                           | 35,740                 | 4,234                      |                            | 40,024                                       |
| Property and equipment, net                                               | 15         |                                           | 239,791                | 79,752                     |                            | 319,558                                      |
| Investment in subsidiaries                                                | 870,907    | 3,395,436                                 | 359,193                |                            | (4,625,536)                |                                              |
| Goodwill and other intangible assets, net                                 |            |                                           | 479,682                | 145,995                    |                            | 625,677                                      |
| Other assets                                                              | 1,515      | 2,158                                     | (8,090)                | 18,418                     |                            | 14,001                                       |
| Total assets                                                              | \$ 887,319 | \$ 3,425,996                              | \$ 3,884,565           | \$ 526,224                 | \$ (6,592,041)             | \$ 2,132,063                                 |
| <b>Liabilities and Stockholders (Deficit)</b>                             |            |                                           |                        |                            |                            |                                              |
| <b>Equity</b>                                                             |            |                                           |                        |                            |                            |                                              |
| Accounts payable                                                          | \$ 116     | \$ 1                                      | \$ 215,552             | \$ 55,707                  | \$                         | \$ 271,376                                   |
| Due to affiliates                                                         | 1,162,045  | 736,373                                   |                        | 68,087                     | (1,966,505)                |                                              |
| Accrued liabilities                                                       | 1,324      | 35,320                                    | 145,661                | 32,279                     |                            | 214,584                                      |
| Income taxes payable                                                      |            | 1,508                                     |                        | 481                        |                            | 1,989                                        |
| Long-term debt                                                            |            | 1,781,887                                 | 17                     | 2,106                      |                            | 1,784,010                                    |
| Other liabilities                                                         |            |                                           | 17,852                 | 3,762                      |                            | 21,614                                       |
| Deferred income tax liabilities                                           |            |                                           | 110,047                | 4,609                      |                            | 114,656                                      |
| Total liabilities                                                         | 1,163,485  | 2,555,089                                 | 489,129                | 167,031                    | (1,966,505)                | 2,408,229                                    |
| Total stockholders (deficit) equity                                       | (276,166)  | 870,907                                   | 3,395,436              | 359,193                    | (4,625,536)                | (276,166)                                    |
| Total liabilities and stockholders (deficit) equity                       | \$ 887,319 | \$ 3,425,996                              | \$ 3,884,565           | \$ 526,224                 | \$ (6,592,041)             | \$ 2,132,063                                 |



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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 June 30, 2017

(In thousands)

|                                                      | Parent    | Sally Holdings<br>LLC and Sally<br>Capital Inc. | Guarantor<br>Subsidiaries | Non-<br>Guarantor<br>Subsidiaries | Consolidating<br>Eliminations | Sally Beauty<br>Holdings, Inc.<br>and Subsidiaries |
|------------------------------------------------------|-----------|-------------------------------------------------|---------------------------|-----------------------------------|-------------------------------|----------------------------------------------------|
| Net sales                                            | \$        | \$                                              | \$ 814,423                | \$ 183,620                        | \$                            | \$ 998,043                                         |
| Related party sales                                  |           |                                                 | 648                       |                                   | (648)                         |                                                    |
| Cost of products sold and<br>distribution expenses   |           |                                                 | 398,707                   | 97,345                            | (648)                         | 495,404                                            |
| Gross profit                                         |           |                                                 | 416,364                   | 86,275                            |                               | 502,639                                            |
| Selling, general and<br>administrative expenses      | 2,725     | 81                                              | 263,021                   | 72,165                            |                               | 337,992                                            |
| Depreciation and amortization                        | 1         |                                                 | 22,412                    | 6,842                             |                               | 29,255                                             |
| Restructuring charges                                |           |                                                 | 5,054                     |                                   |                               | 5,054                                              |
| Operating earnings (loss)                            | (2,726)   | (81)                                            | 125,877                   | 7,268                             |                               | 130,338                                            |
| Interest expense (income)                            |           | 26,952                                          | (1)                       | 18                                |                               | 26,969                                             |
| Earnings (loss) before provision<br>for income taxes | (2,726)   | (27,033)                                        | 125,878                   | 7,250                             |                               | 103,369                                            |
| Provision (benefit) for income<br>taxes              | (1,058)   | (10,500)                                        | 44,929                    | 3,459                             |                               | 36,830                                             |
| Equity in earnings of<br>subsidiaries, net of tax    | 68,207    | 84,740                                          | 3,791                     |                                   | (156,738)                     |                                                    |
| Net earnings                                         | 66,539    | 68,207                                          | 84,740                    | 3,791                             | (156,738)                     | 66,539                                             |
| Other comprehensive income,<br>net of tax            |           |                                                 |                           | 17,686                            |                               | 17,686                                             |
| Total comprehensive income                           | \$ 66,539 | \$ 68,207                                       | \$ 84,740                 | \$ 21,477                         | \$ (156,738)                  | \$ 84,225                                          |



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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 June 30, 2016

(In thousands)

|                                                      | Parent    | Sally Holdings<br>LLC and Sally<br>Capital Inc. | Guarantor<br>Subsidiaries | Non-<br>Guarantor<br>Subsidiaries | Consolidating<br>Eliminations | Sally Beauty<br>Holdings, Inc.<br>and Subsidiaries |
|------------------------------------------------------|-----------|-------------------------------------------------|---------------------------|-----------------------------------|-------------------------------|----------------------------------------------------|
| Net sales                                            | \$        | \$                                              | \$ 811,657                | \$ 186,504                        | \$                            | \$ 998,161                                         |
| Related party sales                                  |           |                                                 | 678                       |                                   | (678)                         |                                                    |
| Cost of products sold and<br>distribution expenses   |           |                                                 | 399,317                   | 100,546                           | (678)                         | 499,185                                            |
| Gross profit                                         |           |                                                 | 413,018                   | 85,958                            |                               | 498,976                                            |
| Selling, general and<br>administrative expenses      | 2,799     | 93                                              | 265,887                   | 70,680                            |                               | 339,459                                            |
| Depreciation and amortization                        | 1         |                                                 | 19,488                    | 5,944                             |                               | 25,433                                             |
| Operating earnings (loss)                            | (2,800)   | (93)                                            | 127,643                   | 9,334                             |                               | 134,084                                            |
| Interest expense                                     |           | 26,681                                          | (8)                       | 30                                |                               | 26,703                                             |
| Earnings (loss) before provision<br>for income taxes | (2,800)   | (26,774)                                        | 127,651                   | 9,304                             |                               | 107,381                                            |
| Provision (benefit) for income<br>taxes              | (1,088)   | (10,399)                                        | 48,037                    | 2,912                             |                               | 39,462                                             |
| Equity in earnings of<br>subsidiaries, net of tax    | 69,631    | 86,006                                          | 6,392                     |                                   | (162,029)                     |                                                    |
| Net earnings                                         | 67,919    | 69,631                                          | 86,006                    | 6,392                             | (162,029)                     | 67,919                                             |
| Other comprehensive income,<br>net of tax            |           |                                                 |                           | (14,119)                          |                               | (14,119)                                           |
| Total comprehensive income<br>(loss)                 | \$ 67,919 | \$ 69,631                                       | \$ 86,006                 | \$ (7,727)                        | \$ (162,029)                  | \$ 53,800                                          |

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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  
Nine Months Ended June 30, 2017

(In thousands)

|                                                      | Parent     | Sally Holdings<br>LLC and Sally<br>Capital Inc. | Guarantor<br>Subsidiaries | Non-<br>Guarantor<br>Subsidiaries | Consolidating<br>Eliminations | Sally Beauty<br>Holdings, Inc.<br>and Subsidiaries |
|------------------------------------------------------|------------|-------------------------------------------------|---------------------------|-----------------------------------|-------------------------------|----------------------------------------------------|
| Net sales                                            | \$         | \$                                              | \$ 2,429,104              | \$ 535,018                        | \$                            | \$ 2,964,122                                       |
| Related party sales                                  |            |                                                 | 1,991                     |                                   | (1,991)                       |                                                    |
| Cost of products sold and<br>distribution expenses   |            |                                                 | 1,201,427                 | 282,233                           | (1,991)                       | 1,481,669                                          |
| Gross profit                                         |            |                                                 | 1,229,668                 | 252,785                           |                               | 1,482,453                                          |
| Selling, general and<br>administrative expenses      | 8,095      | 412                                             | 794,360                   | 214,516                           |                               | 1,017,383                                          |
| Depreciation and amortization                        | 3          |                                                 | 65,431                    | 18,538                            |                               | 83,972                                             |
| Restructuring charges                                |            |                                                 | 14,265                    |                                   |                               | 14,265                                             |
| Operating earnings (loss)                            | (8,098)    | (412)                                           | 355,612                   | 19,731                            |                               | 366,833                                            |
| Interest expense (income)                            |            | 80,560                                          | (1)                       | 57                                |                               | 80,616                                             |
| Earnings (loss) before<br>provision for income taxes | (8,098)    | (80,972)                                        | 355,613                   | 19,674                            |                               | 286,217                                            |
| Provision (benefit) for income<br>taxes              | (3,145)    | (31,451)                                        | 132,727                   | 8,729                             |                               | 106,860                                            |
| Equity in earnings of<br>subsidiaries, net of tax    | 184,310    | 233,831                                         | 10,945                    |                                   | (429,086)                     |                                                    |
| Net earnings                                         | 179,357    | 184,310                                         | 233,831                   | 10,945                            | (429,086)                     | 179,357                                            |
| Other comprehensive income,<br>net of tax            |            |                                                 |                           | 7,044                             |                               | 7,044                                              |
| Total comprehensive income                           | \$ 179,357 | \$ 184,310                                      | \$ 233,831                | \$ 17,989                         | \$ (429,086)                  | \$ 186,401                                         |

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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  
Nine Months Ended June 30, 2016

(In thousands)

|                                                      | Parent     | Sally Holdings<br>LLC and Sally<br>Capital Inc. | Guarantor<br>Subsidiaries | Non-<br>Guarantor<br>Subsidiaries | Consolidating<br>Eliminations | Sally Beauty<br>Holdings, Inc.<br>and Subsidiaries |
|------------------------------------------------------|------------|-------------------------------------------------|---------------------------|-----------------------------------|-------------------------------|----------------------------------------------------|
| Net sales                                            | \$         | \$                                              | \$ 2,427,585              | \$ 548,675                        | \$                            | \$ 2,976,260                                       |
| Related party sales                                  |            |                                                 | 2,060                     |                                   | (2,060)                       |                                                    |
| Cost of products sold and<br>distribution expenses   |            |                                                 | 1,201,276                 | 296,545                           | (2,060)                       | 1,495,761                                          |
| Gross profit                                         |            |                                                 | 1,228,369                 | 252,130                           |                               | 1,480,499                                          |
| Selling, general and<br>administrative expenses      | 8,375      | 263                                             | 801,954                   | 209,905                           |                               | 1,020,497                                          |
| Depreciation and amortization                        | 2          |                                                 | 55,139                    | 17,383                            |                               | 72,524                                             |
| Operating earnings (loss)                            | (8,377)    | (263)                                           | 371,276                   | 24,842                            |                               | 387,478                                            |
| Interest expense                                     |            | 117,547                                         | (4)                       | 74                                |                               | 117,617                                            |
| Earnings (loss) before<br>provision for income taxes | (8,377)    | (117,810)                                       | 371,280                   | 24,768                            |                               | 269,861                                            |
| Provision (benefit) for income<br>taxes              | (3,254)    | (45,758)                                        | 139,860                   | 8,692                             |                               | 99,540                                             |
| Equity in earnings of<br>subsidiaries, net of tax    | 175,444    | 247,496                                         | 16,076                    |                                   | (439,016)                     |                                                    |
| Net earnings                                         | 170,321    | 175,444                                         | 247,496                   | 16,076                            | (439,016)                     | 170,321                                            |
| Other comprehensive income<br>(loss), net of tax     |            |                                                 |                           | (16,191)                          |                               | (16,191)                                           |
| Total comprehensive income<br>(loss)                 | \$ 170,321 | \$ 175,444                                      | \$ 247,496                | \$ (115)                          | \$ (439,016)                  | \$ 154,130                                         |

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## Sally Beauty Holdings, Inc. and Subsidiaries

## Condensed Notes to Consolidated Financial Statements

(Unaudited)

Condensed Consolidating Statement of Cash Flows  
Nine Months Ended June 30, 2017

(In thousands)

|                                                                           | Parent    | Sally Holdings<br>LLC and<br>Sally Capital<br>Inc. | Guarantor<br>Subsidiaries | Non-<br>Guarantor<br>Subsidiaries | Consolidating<br>Eliminations | Sally Beauty<br>Holdings,<br>Inc. and<br>Subsidiaries |
|---------------------------------------------------------------------------|-----------|----------------------------------------------------|---------------------------|-----------------------------------|-------------------------------|-------------------------------------------------------|
| <b>Net cash provided (used) by operating activities</b>                   | \$ 12,488 | \$ (71,305)                                        | \$ 275,021                | \$ 7,211                          | \$                            | \$ 223,415                                            |
| <b>Cash Flows from Investing Activities:</b>                              |           |                                                    |                           |                                   |                               |                                                       |
| Capital expenditures, net of proceeds from sale of property and equipment |           |                                                    | (50,099)                  | (16,430)                          |                               | (66,529)                                              |
| Due from affiliates                                                       |           |                                                    | (231,591)                 |                                   | 231,591                       |                                                       |
| Net cash used by investing activities                                     |           |                                                    | (281,690)                 | (16,430)                          | 231,591                       | (66,529)                                              |
| <b>Cash Flows from Financing Activities:</b>                              |           |                                                    |                           |                                   |                               |                                                       |
| Proceeds from issuance of long-term debt                                  |           | 296,500                                            |                           |                                   |                               | 296,500                                               |
| Repayments of long-term debt                                              |           | (215,000)                                          | (15)                      | (504)                             |                               | (215,519)                                             |
| Repurchases of common stock                                               | (286,503) |                                                    |                           |                                   |                               | (286,503)                                             |
| Proceeds from exercises of stock options                                  | 16,941    |                                                    |                           |                                   |                               | 16,941                                                |
| Due to affiliates                                                         | 258,134   | (38,557)                                           |                           | 12,014                            | (231,591)                     |                                                       |
| Excess tax benefit/shortfall from share-based compensation                | (1,060)   |                                                    |                           |                                   |                               | (1,060)                                               |
| Net cash (used) provided by financing activities                          | (12,488)  | 42,943                                             | (15)                      | 11,510                            | (231,591)                     | (189,641)                                             |
| Effect of foreign exchange rate changes on cash and cash equivalents      |           |                                                    |                           | 233                               |                               | 233                                                   |
| Net decrease in cash and cash equivalents                                 |           | (28,362)                                           | (6,684)                   | 2,524                             |                               | (32,522)                                              |
| Cash and cash equivalents, beginning of period                            |           | 28,372                                             | 22,368                    | 35,882                            |                               | 86,622                                                |
| Cash and cash equivalents, end of period                                  | \$        | \$ 10                                              | \$ 15,684                 | \$ 38,406                         | \$                            | \$ 54,100                                             |



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## Sally Beauty Holdings, Inc. and Subsidiaries

## Condensed Notes to Consolidated Financial Statements

(Unaudited)

Condensed Consolidating Statement of Cash Flows  
Nine Months Ended June 30, 2016

(In thousands)

|                                                                           | Parent     | Sally Holdings<br>LLC and<br>Sally Capital<br>Inc. | Guarantor<br>Subsidiaries | Non-<br>Guarantor<br>Subsidiaries | Consolidating<br>Eliminations | Sally Beauty<br>Holdings,<br>Inc. and<br>Subsidiaries |
|---------------------------------------------------------------------------|------------|----------------------------------------------------|---------------------------|-----------------------------------|-------------------------------|-------------------------------------------------------|
| <b>Net cash provided (used) by operating activities</b>                   | \$ 148,015 | \$ (7,470)                                         | \$ 89,972                 | \$ 18,296                         | \$                            | \$ 248,813                                            |
| <b>Cash Flows from Investing Activities:</b>                              |            |                                                    |                           |                                   |                               |                                                       |
| Capital expenditures, net of proceeds from sale of property and equipment | (16)       |                                                    | (90,109)                  | (18,145)                          |                               | (108,270)                                             |
| Acquisitions, net of cash acquired                                        |            |                                                    | (2,250)                   |                                   |                               | (2,250)                                               |
| Net cash used by investing activities                                     | (16)       |                                                    | (92,359)                  | (18,145)                          |                               | (110,520)                                             |
| <b>Cash Flows from Financing Activities:</b>                              |            |                                                    |                           |                                   |                               |                                                       |
| Proceeds from issuance of long-term debt                                  |            | 912,000                                            |                           |                                   |                               | 912,000                                               |
| Repayments of long-term debt                                              |            | (937,785)                                          | (69)                      | (492)                             |                               | (938,346)                                             |
| Repurchases of common stock                                               | (162,367)  |                                                    |                           |                                   |                               | (162,367)                                             |
| Debt issuance costs                                                       |            | (12,748)                                           |                           |                                   |                               | (12,748)                                              |
| Proceeds from exercises of stock options                                  | 13,072     |                                                    |                           |                                   |                               | 13,072                                                |
| Excess tax benefit from share-based compensation                          | 1,296      |                                                    |                           |                                   |                               | 1,296                                                 |
| Net cash used by financing activities                                     | (147,999)  | (38,533)                                           | (69)                      | (492)                             |                               | (187,093)                                             |
| Effect of foreign exchange rate changes on cash and cash equivalents      |            |                                                    |                           | (241)                             |                               | (241)                                                 |
| Net decrease in cash and cash equivalents                                 |            | (46,003)                                           | (2,456)                   | (582)                             |                               | (49,041)                                              |
| Cash and cash equivalents, beginning of period                            |            | 46,003                                             | 58,851                    | 35,184                            |                               | 140,038                                               |
| Cash and cash equivalents, end of period                                  | \$         | \$                                                 | \$ 56,395                 | \$ 34,602                         | \$                            | \$ 90,997                                             |



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## Sally Beauty Holdings, Inc. and Subsidiaries

## Condensed Notes to Consolidated Financial Statements

(Unaudited)

**14. Restructuring Plan**

In January 2017, the Board approved a comprehensive restructuring plan (the "Restructuring Plan") for the Company's businesses that included a number of organizational efficiency initiatives and other cost reduction opportunities. The Restructuring Plan comprises the closure of four administrative offices in the U.S. and Canada, reductions in both salaried and hourly workforce and certain other cost reduction activities. The Company had initially estimated that it would incur total aggregate charges of approximately \$12 million to \$14 million in connection with the Restructuring Plan. Subsequently, the Company expanded the restructuring initiatives contemplated by the Restructuring Plan and estimated that it would incur total charges of up to \$17 million. The remaining costs relate to the planned facility closures and to other cost reduction activities, and are expected to be recognized during the quarter ending September 30, 2017.

Certain information about the Restructuring Plan as of June 30, 2017 is as follows (in thousands):

| Restructuring Activity | Liability at<br>December 31,<br>2016 | Expenses (1) | Cost Paid<br>and Other | Liability at<br>June 30,<br>2017 (2) |
|------------------------|--------------------------------------|--------------|------------------------|--------------------------------------|
| Workforce reductions   | \$                                   | \$ 9,962     | \$ 8,559               | \$ 1,403                             |
| Facility closures      |                                      | 2,748        | 2,293                  | 455                                  |
| Other                  |                                      | 1,555        | 1,500                  | 55                                   |
| Total                  | \$                                   | \$ 14,265    | \$ 12,352              | \$ 1,913                             |

(1) Expenses include costs incurred in connection with Sally Beauty Supply (\$8.4 million), BSG (\$4.1 million) and corporate (\$1.8 million) activities.

(2) Unpaid costs are included in accrued liabilities in the Company's consolidated balance sheet at June 30, 2017.

**15. Subsequent Events**

On July 6, 2017, Sally Holdings and Sally Capital Inc. (collectively, the "Borrowers"), both indirect wholly-owned subsidiaries of the Company, entered into a seven-year term loan credit facility pursuant to which the Borrowers borrowed \$850 million (the "Term Loan B"). The Term Loan B consists of a variable-rate tranche in the amount of \$550 million which bears interest at LIBOR plus 2.50% or, at the option of the Borrowers, at an alternate base rate plus 1.50%, and a fixed-rate tranche in the amount of \$300 million which bears interest at 4.50%. The initial interest rate on the variable-rate tranche is 3.75%. The agreement governing the Term Loan B contains a customary covenant package substantially consistent with the indentures governing the Company's existing senior notes. Borrowings under the Term Loan B are secured by a first-priority



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lien in and upon substantially all of the assets of the Company and its domestic subsidiaries other than the accounts, inventory (and the proceeds thereof) and other assets that secure the ABL facility on a first-priority basis. In addition, the variable-rate tranche contains provisions requiring quarterly repayments of principal in an amount equal to 0.25% of the original amount for the variable-rate tranche. The Term Loan B matures on July 5, 2024.

Simultaneously with the entry into the Term Loan B, the Company and certain of the Company's indirect and direct subsidiaries that are borrowers or guarantors entered into an amended and restated \$500 million, asset-based senior secured loan facility (the "new ABL facility"). After the refinancing of certain of our debt in July 2017 and payment of certain expenses related to the refinancing, there were \$118.0 million in borrowings outstanding under the new ABL facility, including the amount drawn in connection with the Company's redemption of the senior notes due 2022 described below. The terms of the new ABL facility are substantially the same as those of the previous ABL facility (which are described in our Annual Report on Form 10-K for the fiscal year ended September 30, 2016), except for an extension of the maturity to July 6, 2022, improved pricing, a relaxation of the restrictions on Sally Holdings' ability to make Restricted Payments, as defined in the new ABL facility, and certain other improved terms. After the refinancing of certain of our debt in July 2017, the Company had approximately \$362 million available for borrowing under the new ABL facility, including the Canadian sub-facility. In connection with the Company's modification of the ABL facility, the Company will record a loss on extinguishment of debt in the amount of approximately \$0.4 million.

The Company used the net proceeds from the Term Loan B (approximately \$845.8 million), as well as existing cash balances and borrowings under the new ABL facility in the amount of \$33.5 million (i) to redeem \$850.0 million aggregate outstanding principal amount of its senior notes due 2022 at a premium equal to 102.875%, plus accrued and unpaid interest up to, but not including, July 6, 2017 and (ii) to pay fees and expenses incurred in connection with the origination of the Term Loan B and redemption of the senior notes due 2022. In connection with the Company's redemption of its senior notes due 2022, the Company will record a loss on extinguishment of debt in the amount of approximately \$27.6 million, including a redemption

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Sally Beauty Holdings, Inc. and Subsidiaries

Condensed Notes to Consolidated Financial Statements

(Unaudited)

premium in the amount of approximately \$24.4 million and unamortized deferred financing costs of approximately \$8.0 million, partially offset by the write-off of unamortized premium of \$4.8 million.

The Company has exposure to interest rate fluctuations in connection with the above-described variable-rate tranche of its Term Loan B. In order to in part mitigate this exposure, on July 6, 2017, the Company entered into two interest rate caps with an initial aggregate notional amount of \$550 million (the "interest rate caps"). The interest rate caps expire on June 30, 2023 and limit the Company's maximum interest rate in connection with the variable-rate tranche of its Term Loan B (the "hedged cash flows") to 5.5%. The Company intends to designate the interest rate caps as effective cash flow hedges in accordance with GAAP.

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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. This section should be read in conjunction with the audited consolidated financial statements and the related notes included in the Company's Annual Report on Form 10-K for the fiscal year ended September 30, 2016, as well as the Risk Factors section contained in that Annual Report and information contained elsewhere in this Quarterly Report, including the interim condensed consolidated 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.

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

**Highlights for the Three Months Ended June 30, 2017:**

- Our consolidated net sales for the three months ended June 30, 2017 were \$998.0 million, approximately the same as consolidated net sales of \$998.2 million for the three months ended June 30, 2016;
- Our consolidated net sales from company-operated stores that have been open for 14 months or longer, which we refer to as same store sales, increased 0.3% for the three months ended June 30, 2017, compared to an increase of 2.5% for the three months ended June 30, 2016;
- Our consolidated gross profit for the three months ended June 30, 2017, increased by \$3.7 million, or 0.7%, to \$502.6 million compared to \$499.0 million for the three months ended June 30, 2016. As a percentage of net sales, gross profit increased by 40 basis points to 50.4% for the three months ended June 30, 2017;
- During the three months ended June 30, 2017, we incurred approximately \$5.1 million in expenses, including severance and related expenses of \$1.5 million, facility closure expenses of \$2.7 million and other costs of \$0.8 million, in connection with the comprehensive restructuring plan announced earlier this year;
- Our consolidated operating earnings for the three months ended June 30, 2017, decreased by \$3.7 million, or 2.8%, to \$130.3 million compared to \$134.1 million for the three months ended June 30, 2016. As a percentage of net sales, operating earnings decreased by 30 basis points to 13.1% for the three months ended June 30, 2017;

- Our consolidated net earnings decreased by \$1.4 million, or 2.0%, to \$66.5 million for the three months ended June 30, 2017, compared to \$67.9 million for the three months ended June 30, 2016. As a percentage of net sales, net earnings decreased by 10 basis points to 6.7% for the three months ended June 30, 2017;
- Our diluted earnings per share for the three months ended June 30, 2017, were \$0.49 compared to \$0.46 for the three months ended June 30, 2016;
- Cash provided by operations was \$63.9 million for the three months ended June 30, 2017, compared to \$36.6 million for the three months ended June 30, 2016;
- During the three months ended June 30, 2017, we repurchased and subsequently retired approximately 6.2 million shares of our common stock at an aggregate cost of approximately \$117.6 million;
- In July 2017, the Company redeemed in full its 5.75% senior notes due 2022 (the "senior notes due 2022") primarily with the net proceeds from its July 2017 issuance of an \$850.0 million seven-year term loan credit facility (the "Term Loan B"). For the quarter ending September 30, 2017, the Company will record a loss on extinguishment of debt of \$27.6 million in connection therewith; and
- In July 2017, the Company and certain of the Company's subsidiaries entered into an amended and restated \$500 million, asset-based senior secured loan facility, extending the maturity to July 2022 and amending certain other terms.

## Overview

### *Description of Business*

As of June 30, 2017, we operated primarily through two business units, Sally Beauty Supply and Beauty Systems Group, ("BSG"). We believe that the Company is the largest open-line distributor of professional beauty products and supplies in the U.S. based on store count. As of June 30, 2017, through Sally Beauty Supply and BSG, we had a multi-channel platform of 5,003 company-operated stores and supplied 185 franchised stores in North America and select 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 products and supplies, including hair color products, hair care products, styling tools, skin and nail care products and other beauty items. Our Sally Beauty stores service retail consumers and salon professionals, while BSG services exclusively salons and salon



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professionals. For the nine months ended June 30, 2017, our consolidated net sales and operating earnings were \$2,964.1 million and \$366.8 million, respectively.

As of June 30, 2017, Sally Beauty Supply (SBS) operated 3,807 company-operated retail stores (generally under the Sally Beauty banner), 2,925 of which are located in the U.S., with the remaining 882 company-operated stores located in Canada, Mexico, Chile, Colombia, Peru, the United Kingdom, Ireland, Belgium, France, Germany, the Netherlands and Spain, and also operated a consumer-facing e-commerce website. SBS also supplied 19 franchised stores located in the United Kingdom, Ireland, Belgium and France. In the U.S. and Canada, our Sally Beauty stores average approximately 1,700 square feet in size and are located primarily in strip shopping centers. Our Sally Beauty stores carry an extensive selection of professional beauty products and supplies for both retail customers and salon professionals, featuring an average of 8,000 SKUs of beauty products across product categories including hair color, hair care, skin and nail care, beauty sundries and styling tools. Our Sally Beauty stores carry leading third-party brands, such as OPI®, China Glaze®, Wella®, Clairol®, Conair® and Hot Shot Tools®, as well as an extensive selection of exclusive-label merchandise. Store formats, including average size and product selection, for SBS outside the U.S. and Canada vary by marketplace. For the nine months ended June 30, 2017, SBS's net sales and segment operating earnings were \$1,760.7 million and \$294.2 million, representing 59% and 60%, respectively, of our consolidated net sales and consolidated operating earnings before unallocated corporate expenses, restructuring charges and share-based compensation expense.

We believe that BSG is the largest full-service distributor of professional beauty products and supplies in North America, servicing exclusively salons and salon professionals. As of June 30, 2017, BSG had 1,196 company-operated stores, supplied 166 franchised stores and operated several e-commerce websites selling exclusively to salons and salon professionals in the U.S., Canada and Mexico. In addition, BSG had a sales force of approximately 839 professional distributor sales consultants selling exclusively to salons and salon professionals in the U.S. and Canada. Company-operated BSG stores, which operate primarily under the CosmoProf banner, average approximately 2,600 square feet in size and are located primarily in secondary strip shopping centers. BSG stores, with an average of 9,500 SKUs per location, offer a comprehensive selection of beauty products that include hair color and care, skin and nail care, beauty sundries and styling tools. Through BSG's large store base and sales force, BSG is able to access a significant portion of the highly fragmented U.S. salon industry. BSG stores carry leading third-party brands such as Paul Mitchell®, Wella®, Matrix®, Schwarzkopf®, Kenra®, Goldwell®, Joico® and Aquage®, intended for use in salons and for resale by salons to retail consumers. BSG is also the exclusive source for certain well-known third-party branded products pursuant to exclusive distribution agreements with certain suppliers within specified geographic territories. For the nine months ended June 30, 2017, BSG's net sales and segment operating earnings were \$1,203.4 million and \$193.6 million, representing 41% and 40%, respectively, of our consolidated net sales and consolidated operating earnings before unallocated corporate expenses, restructuring charges and share-based compensation expense.

***Share Repurchase Program***

In August 2014, the Company announced that Company's Board of Directors (the Board) had approved a share repurchase program authorizing it to repurchase up to \$1.0 billion of its common stock over an approximate three-year period expiring on September 30, 2017 (the 2014 Share Repurchase Program).

During the three months ended June 30, 2017, the Company repurchased and subsequently retired approximately 6.2 million shares of its common stock under the 2014 Share Repurchase Program at an aggregate cost of \$117.6 million. The Company did not repurchase any of its

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common stock during the three months ended June 30, 2016. During the nine months ended June 30, 2017 and 2016, the Company repurchased and subsequently retired approximately 13.1 million shares and 6.2 million shares at a cost of \$286.5 million and \$162.4 million, respectively. We funded these share repurchases with existing cash balances, cash from operations and borrowings under the ABL facility. The Company reduced common stock and additional paid-in capital, in the aggregate, by these amounts. However, as required by accounting principles generally accepted in the United States ( GAAP ), to the extent that the share repurchase amounts exceeded the balance of additional paid-in capital prior to such repurchases, the Company recorded the excess in accumulated deficit.

As of June 30, 2017, the Company had approximately \$278.6 million of additional share repurchase authorization remaining under the 2014 Share Repurchase Program. Please see Item 2. Unregistered Sales of Equity Securities and Use of Proceeds (c) 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 repurchases.

### ***Restructuring Plan***

In January 2017, the Board approved a comprehensive restructuring plan (the Restructuring Plan ) for the Company's businesses that includes a wide range of organizational efficiency initiatives and other cost reduction opportunities. Subsequently, the Company expanded the restructuring initiatives contemplated by the Restructuring Plan and estimated that it would incur total charges of up to \$17 million from the Restructuring Plan. During the three and nine months ended June 30, 2017, the

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Company recognized restructuring charges of approximately \$5.1 million and \$14.3 million, respectively in connection with the Restructuring Plan, including severance and related expenses of approximately \$1.5 million and \$10.0 million, respectively. During the nine months ended June 30, 2017, the Company also recognized facility closure expenses of \$2.7 million and expenses related to other cost-reduction initiatives of \$1.6 million in connection with the Restructuring Plan. The remaining estimated costs related to the Restructuring Plan are expected to be recognized during the quarter ending September 30, 2017. The annualized pre-tax benefit of the restructuring initiatives is estimated to be between \$20 million and \$22 million in future fiscal years, with estimated benefits of approximately \$12.0 million realized in fiscal year 2017.

*Refinancing of Debt*

On July 6, 2017, Sally Holdings LLC ( Sally Holdings ) and Sally Capital Inc. (collectively, the Borrowers ), both indirect wholly-owned subsidiaries of the Company, entered into a seven-year term loan credit facility pursuant to which the Borrowers borrowed \$850 million. The Term Loan B consists of a variable-rate tranche in the amount of \$550 million which bears interest at LIBOR plus 2.50% (or at an alternate base rate plus 1.50%, at the option of the Borrowers), and a fixed-rate tranche in the amount of \$300 million which bears interest at 4.50%. The initial interest rate on the variable-rate tranche is 3.75%. The agreement governing the Term Loan B contains a customary covenant package substantially consistent with the indentures governing the Company's existing senior notes. Borrowings under the Term Loan B are secured by a first-priority lien in and upon substantially all of the assets of the Company and its domestic subsidiaries other than the accounts, inventory (and the proceeds thereof) and other assets that secure the ABL facility on a first-priority basis. In addition, the variable-rate tranche contains provisions requiring quarterly repayments of principal in an amount equal to 0.25% of the original amount for that tranche. The Term Loan B matures on July 5, 2024.

Simultaneously with the entry into the Term Loan B, the Company and certain of the Company's indirect and direct subsidiaries that are borrowers or guarantors entered into an amended and restated \$500 million, asset-based senior secured loan facility (the new ABL facility ). After the refinancing of certain of our debt in July 2017, there were \$118.0 million in borrowings outstanding under the new ABL facility, including the amount drawn in connection with the Company's redemption of the senior notes due 2022 as described below. The terms of the new ABL facility are substantially the same as those on the previous ABL credit facility (which are described in our Annual Report on Form 10-K for the fiscal year ended September 30, 2016), except for an extension of the maturity to July 6, 2022, improved pricing, a relaxation of the restrictions on Sally Holdings' ability to make Restricted Payments, as defined in the new ABL facility, and certain other improved terms. After the refinancing of certain of our debt in July 2017, the Company had approximately \$362 million available for borrowing under the new ABL facility, including the Canadian sub-facility.

In July 2017, the Issuers redeemed \$850 million aggregate principal amount of their senior notes due 2022 at a redemption price equal to 102.875% plus accrued but unpaid interest to, but not including, the redemption date. The redemption was funded primarily with the net proceeds of the Term Loan B, in the principal amount of \$850 million, as well as existing cash balances and borrowings under the new ABL facility, as appropriate. Please see Note 15 of the Condensed Notes to Consolidated Financial Statements included in Item 1 of this Quarterly Report for more information about the Company's refinancing of debt.

The Company has exposure to interest rate fluctuations in connection with the variable-rate tranche of its Term Loan B, as described above. In order to in part mitigate this exposure, on July 6, 2017, the Company entered into two interest rate caps with an initial aggregate notional amount of \$550 million (the interest rate caps ). The interest rate caps expire on June 30, 2023 and limit the Company's maximum interest rate in connection with the variable-rate tranche under the Term Loan B (the hedged cash flows ) to 5.5%. The Company intends to designate the interest rate caps as effective cash flow hedges in accordance with GAAP.



*Data Security Incidents*

During the fiscal year 2014, the Company disclosed that it had experienced a data security incident (the 2014 data security incident ). During the fiscal year 2015, the Company disclosed that it had experienced a second data security incident (the 2015 data security incident and, together with the 2014 data security incident, the data security incidents ). The data security incidents involved the unauthorized installation of malicious software ( malware ) on our information technology systems, including our point-of-sale systems, that we believe may have placed at risk certain payment card data for some transactions. The costs that the Company has incurred to date in connection with the data security incidents include assessments by payment card networks, professional advisory fees and legal costs and expenses relating to investigating and remediating the data security incidents.

As of September 30, 2016, the Company had an aggregate accrued liability relating to the data security incidents of \$15.6 million. During the nine months ended June 30, 2017 and 2016, selling, general and administrative expenses reflect expenses of less than \$0.1 million and \$2.6 million, respectively, consisting of expenses related to the data security incidents. During the nine months ended June 30, 2017, the Company made net payments against prior assessments by two payment card networks in connection with the data security incidents in the aggregate amount of \$9.3 million. As of June 30, 2017, the Company had an accrued liability relating to the data security incidents of \$6.4 million.

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The Company expects to incur additional costs and expenses related to the data security incidents in future periods. These costs and expenses may result from potential additional liabilities to other payment card networks, governmental or third party investigations, proceedings or litigation and legal and other fees necessary to defend against any potential liabilities or claims, and further investigatory and remediation costs. As of June 30, 2017, the scope of these additional costs and expenses, or a range thereof, beyond amounts management has determined to be probable, cannot be reasonably estimated and, while we do not anticipate these additional costs and expenses or liabilities would have a material adverse impact on our business, financial condition and operating results, these additional costs and expenses could be significant.

*Other Significant Items*

During the nine months ended June 30, 2016, the Company redeemed in full its 6.875% senior notes due 2019 (the "senior notes due 2019") primarily with the net proceeds from its December 2015 issuance of \$750.0 million principal amount of its 5.625% senior notes due 2025. In connection therewith, the Company recorded a loss on extinguishment of debt of \$33.3 million, including a call premium of \$25.8 million and unamortized debt issuance costs associated with the senior notes due 2019 (\$7.5 million) expensed, in connection therewith.

In March 2017, the United Kingdom gave formal notice to the European Union of its intent to withdraw from the European Union. Due to uncertainty regarding the terms of the negotiated withdrawal and separation, the Company is unable to predict the potential impact of this event and any related or other disruptive events on the economies of the United Kingdom or the European Union. The Company does not believe that this event will have a material adverse impact on its business, financial condition and operating results, although the Company believes its businesses in the U.K. could be affected by incremental costs in the future related to the United Kingdom's withdrawal from the European Union, including increased shipping costs, customs, duties and value added taxes.

Table of Contents**Results of Operations**

The following table shows the consolidated results of operations of our business for the three and nine months ended June 30, 2017 and 2016 (in thousands):

|                                                 | Three Months Ended<br>June 30, |            | Nine Months Ended<br>June 30, |              |
|-------------------------------------------------|--------------------------------|------------|-------------------------------|--------------|
|                                                 | 2017                           | 2016       | 2017                          | 2016         |
| Net sales                                       | \$ 998,043                     | \$ 998,161 | \$ 2,964,122                  | \$ 2,976,260 |
| Cost of products sold and distribution expenses | 495,404                        | 499,185    | 1,481,669                     | 1,495,761    |
| Gross profit                                    | 502,639                        | 498,976    | 1,482,453                     | 1,480,499    |
| Total operating costs and expenses              | 372,301                        | 364,892    | 1,115,620                     | 1,093,021    |
| Operating earnings                              | 130,338                        | 134,084    | 366,833                       | 387,478      |
| Interest expense                                | 26,969                         | 26,703     | 80,616                        | 117,617      |
| Earnings before provision for income taxes      | 103,369                        | 107,381    | 286,217                       | 269,861      |
| Provision for income taxes                      | 36,830                         | 39,462     | 106,860                       | 99,540       |
| Net earnings                                    | \$ 66,539                      | \$ 67,919  | \$ 179,357                    | \$ 170,321   |

The following table shows the consolidated results of operations of our business for the three and nine months ended June 30, 2017 and 2016, expressed as a percentage of net sales for each respective period shown:

|                                                 | Three Months Ended<br>June 30, |        | Nine Months Ended<br>June 30, |        |
|-------------------------------------------------|--------------------------------|--------|-------------------------------|--------|
|                                                 | 2017                           | 2016   | 2017                          | 2016   |
| Net sales                                       | 100.0%                         | 100.0% | 100.0%                        | 100.0% |
| Cost of products sold and distribution expenses | 49.6%                          | 50.0%  | 50.0%                         | 50.3%  |
| Gross profit                                    | 50.4%                          | 50.0%  | 50.0%                         | 49.7%  |
| Total operating costs and expenses              | 37.3%                          | 36.6%  | 37.6%                         | 36.7%  |
| Operating earnings                              | 13.1%                          | 13.4%  | 12.4%                         | 13.0%  |
| Interest expense                                | 2.7%                           | 2.6%   | 2.7%                          | 3.9%   |
| Earnings before provision for income taxes      | 10.4%                          | 10.8%  | 9.7%                          | 9.1%   |
| Provision for income taxes                      | 3.7%                           | 4.0%   | 3.6%                          | 3.4%   |
| Net earnings                                    | 6.7%                           | 6.8%   | 6.1%                          | 5.7%   |

Table of Contents**Key Operating Metrics**

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

|                                                           | Three Months Ended<br>June 30, |            | Nine Months Ended<br>June 30, |              |
|-----------------------------------------------------------|--------------------------------|------------|-------------------------------|--------------|
|                                                           | 2017                           | 2016 (a)   | 2017                          | 2016 (a)     |
| Net sales:                                                |                                |            |                               |              |
| SBS                                                       | \$ 594,880                     | \$ 602,632 | \$ 1,760,732                  | \$ 1,797,068 |
| BSG                                                       | 403,163                        | 395,529    | 1,203,390                     | 1,179,192    |
| Consolidated                                              | \$ 998,043                     | \$ 998,161 | \$ 2,964,122                  | \$ 2,976,260 |
| Gross profit                                              | \$ 502,639                     | \$ 498,976 | \$ 1,482,453                  | \$ 1,480,499 |
| Gross margin                                              | 50.4%                          | 50.0%      | 50.0%                         | 49.7%        |
| Selling, general and administrative expenses              | \$ 337,992                     | \$ 339,459 | \$ 1,017,383                  | \$ 1,020,497 |
| Depreciation and amortization                             | \$ 29,255                      | \$ 25,433  | \$ 83,972                     | \$ 72,524    |
| Earnings before provision for income taxes:               |                                |            |                               |              |
| Segment operating earnings:                               |                                |            |                               |              |
| SBS                                                       | \$ 104,880                     | \$ 104,908 | \$ 294,245                    | \$ 313,792   |
| BSG                                                       | 67,327                         | 65,196     | 193,630                       | 191,649      |
| Segment operating earnings                                | 172,207                        | 170,104    | 487,875                       | 505,441      |
| Unallocated corporate expenses (b)                        | (34,437)                       | (33,182)   | (98,187)                      | (107,952)    |
| Restructuring charges                                     | (5,054)                        |            | (14,265)                      |              |
| Share-based compensation expense                          | (2,378)                        | (2,838)    | (8,590)                       | (10,011)     |
| Operating earnings                                        | 130,338                        | 134,084    | 366,833                       | 387,478      |
| Interest expense (c)                                      | (26,969)                       | (26,703)   | (80,616)                      | (117,617)    |
| Earnings before provision for income taxes                | \$ 103,369                     | \$ 107,381 | \$ 286,217                    | \$ 269,861   |
| Segment operating margin:                                 |                                |            |                               |              |
| SBS                                                       | 17.6%                          | 17.4%      | 16.7%                         | 17.5%        |
| BSG                                                       | 16.7%                          | 16.5%      | 16.1%                         | 16.3%        |
| Consolidated operating margin                             | 13.1%                          | 13.4%      | 12.4%                         | 13.0%        |
| Number of stores at end-of-period (including franchises): |                                |            |                               |              |
| SBS                                                       |                                |            | 3,826                         | 3,750        |
| BSG                                                       |                                |            | 1,362                         | 1,322        |
| Consolidated                                              |                                |            | 5,188                         | 5,072        |
| Same store sales growth (decline) (d)                     |                                |            |                               |              |
| SBS                                                       | (0.8)%                         | 1.3%       | (1.3)%                        | 2.0%         |
| BSG                                                       | 2.8%                           | 5.4%       | 1.4%                          | 6.8%         |
| Consolidated                                              | 0.3%                           | 2.5%       | (0.4)%                        | 3.5%         |

(a) Certain amounts for the prior fiscal period have been reclassified to conform to the current fiscal period presentation, in connection with realignment of a business component from our BSG segment to our Sally Beauty Supply segment.

(b) Unallocated corporate expenses consist of corporate and shared costs and are included in selling, general and administrative expenses in our consolidated statements of earnings.

(c) For the nine months ended June 30, 2016, interest expense includes a loss on extinguishment of debt of \$33.3 million in connection with the Company's December 2015 redemption of its senior notes due 2019.

(d) 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 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 (which are not separately material for each of the periods presented herein) and the effect of store expansions, if applicable, but do not generally include the sales from stores that have been 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.

Table of Contents***The Three Months Ended June 30, 2017 compared to the Three Months Ended June 30, 2016***

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

|                           | 2017 |         | Three Months Ended June 30,<br>2016 |         | Increase (Decrease) |                |
|---------------------------|------|---------|-------------------------------------|---------|---------------------|----------------|
| <b>Net sales:</b>         |      |         |                                     |         |                     |                |
| SBS                       | \$   | 594,880 | \$                                  | 602,632 | \$                  | (7,752) (1.3)% |
| BSG                       |      | 403,163 |                                     | 395,529 |                     | 7,634 1.9%     |
| Consolidated net sales    | \$   | 998,043 | \$                                  | 998,161 | \$                  | (118)          |
| <b>Gross profit:</b>      |      |         |                                     |         |                     |                |
| SBS                       | \$   | 333,398 | \$                                  | 332,705 | \$                  | 693 0.2%       |
| BSG                       |      | 169,241 |                                     | 166,271 |                     | 2,970 1.8%     |
| Consolidated gross profit | \$   | 502,639 | \$                                  | 498,976 | \$                  | 3,663 0.7%     |
| <b>Gross margin:</b>      |      |         |                                     |         |                     |                |
| SBS                       |      | 56.0%   |                                     | 55.2%   |                     | 0.8%           |
| BSG                       |      | 42.0%   |                                     | 42.0%   |                     |                |
| Consolidated gross margin |      | 50.4%   |                                     | 50.0%   |                     | 0.4%           |

***Net Sales***

Consolidated net sales were essentially flat for the three months ended June 30, 2017, compared to the three months ended June 30, 2016. Consolidated net sales for the three months ended June 30, 2017, are inclusive of a net negative impact from changes in foreign currency exchange rates of \$10.2 million, or 1.0% of consolidated net sales. Sales from company-operated SBS and BSG stores that have been open for 14 months or longer increased approximately \$5.8 million, or 0.6% of consolidated net sales, compared to the three months ended June 30, 2016. For the three months ended June 30, 2017, consolidated same store sales increased at a rate of 0.3%, compared to 2.5% for the three months ended June 30, 2016, primarily as a result of a decrease in the number of customer transactions at our SBS stores and a lower growth rate in the number of customer transactions at our BSG stores, primarily in the U.S., partially offset by increases in average transaction size in both operating segments.

Sales from Sally Beauty Supply's non-store channels, which include the catalog and internet-based sales of our Sinelco Group subsidiaries, declined \$2.3 million, or 0.2% of consolidated net sales, in the three months ended June 30, 2017, and sales through our BSG distributor sales consultants decreased by approximately \$2.7 million, or 0.3% of consolidated net sales, compared to the three months ended June 30, 2016. Other sales channels (including sales to our BSG franchise-based businesses, stores that have been open for less than 14 months and incremental sales from businesses acquired in the preceding 12 months) in the aggregate experienced a net decrease in sales of approximately \$0.8 million, or 0.1% of consolidated net sales, compared to the three months ended June 30, 2016.

*Sally Beauty Supply.* Net sales for SBS decreased by \$7.8 million, or 1.3%, for the three months ended June 30, 2017, compared to the three months ended June 30, 2016. Net sales for SBS for the three months ended June 30, 2017, are inclusive of a net negative impact from changes in foreign currency exchange rates of approximately \$9.0 million, or

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1.5% of SBS's net sales. In SBS, company-operated stores that have been open for 14 months or longer experienced a decrease in sales of approximately \$4.3 million, or 0.7% of the segment's net sales. For the three months ended June 30, 2017, SBS's same store sales declined at a rate of 0.8%, compared to a growth rate of 1.3% for the three months ended June 30, 2016, primarily as a result of a decrease in the number of customer transactions at the segment's U.S. stores, partially offset by an increase in average transaction size.

Sales from our non-store channels declined \$2.3 million, or 0.4% of SBS's net sales, in the three months ended June 30, 2017, compared to the three months ended June 30, 2016. Sales from stores that have been open for less than 14 months decreased by approximately \$1.2 million, or 0.2% of the segment's net sales, compared to the three months ended June 30, 2016.

The decrease in SBS's net sales is primarily the result of a decrease in unit volume primarily in the U.S., partially offset by an increase in average unit prices (as a result of selective price increases and the introduction of certain products with higher average unit prices in the preceding 12 months).

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*Beauty Systems Group.* Net sales for BSG increased by \$7.6 million, or 1.9%, for the three months ended June 30, 2017, compared to the three months ended June 30, 2016. BSG's net sales for the three months ending June 30, 2017, are inclusive of a net negative impact from changes in foreign currency exchange rates of approximately \$1.2 million, or 0.3% of BSG's net sales. In BSG, company-operated stores that have been open for 14 months or longer contributed an increase in net sales of approximately \$10.1 million, or 2.5% of the segment's net sales. For the three months ended June 30, 2017, BSG's same store sales increased at a rate of 2.8%, compared to 5.4% for the three months ended June 30, 2016, primarily as a result of a lower growth rate in the number of customer transactions at the segment's U.S. stores. The segment's same store sales growth rate for the three months ended June 30, 2016 was driven primarily by the introduction of certain third-party brands and the expansion of exclusive distribution rights of certain products in certain geographies of the U.S.

Incremental sales through our distributor sales consultants were \$2.7 million, or 0.7% of BSG's net sales, lower in the three months ended June 30, 2017, compared to the three months ended June 30, 2016. Sales through other sales channels (including sales from stores that have been open for less than 14 months, sales to our franchise-based businesses and incremental sales from businesses acquired in the preceding 12 months) in the aggregate increased by approximately \$0.2 million, compared to the three months ended June 30, 2016.

The increase in BSG's net sales is primarily the result of an increase in unit volume (at existing stores and the impact of incremental sales from 39 company-operated stores opened or acquired during the last 12 months) and an increase in average unit prices. The increase in average unit prices were driven by selective price increases, reduced promotional activity and the introduction of certain third-party brands with higher average unit prices in the preceding 12 months.

***Gross Profit***

Consolidated gross profit increased by \$3.7 million, or 0.7%, for the three months ended June 30, 2017, compared to the three months ended June 30, 2016, primarily as a result of higher net sales in BSG and improved gross margins in SBS, as more fully described below, partially offset by lower net sales in our SBS segment. Consolidated gross margin, increased by 40 basis points to 50.4% for the three months ended June 30, 2017, compared to the three months ended June 30, 2016, as more fully described below.

*Sally Beauty Supply.* SBS's gross profit increased by \$0.7 million, or 0.2%, for the three months ended June 30, 2017, compared to the three months ended June 30, 2016, primarily as a result of improved gross margin, partially offset by lower sales. SBS's gross margin increased by 80 basis points to 56.0% for the three months ended June 30, 2017, compared to the three months ended June 30, 2016. The increase in the segment's gross margin was driven primarily by selective price increases and reduced promotional activity, compared to the three months ended June 30, 2016.

*Beauty Systems Group.* BSG's gross profit increased by \$3.0 million, or 1.8%, for the three months ended June 30, 2017, compared to the three months ended June 30, 2016, primarily as a result of higher sales volume. BSG's gross margin was 42.0% for each of the three months ended June 30, 2017 and 2016.



***Selling, General and Administrative Expenses***

Consolidated selling, general and administrative expenses decreased by \$1.5 million, or 0.4%, for the three months ended June 30, 2017, compared to the three months ended June 30, 2016, primarily as a result of cost reduction initiatives. More specifically, the decrease reflects lower advertising expense (\$2.5 million) and lower sales bonuses (\$2.8 million). This decrease was offset in part by incremental expenses (including rent and other occupancy-related expenses) associated with the increase in store count and higher expenses in connection with the Company's self-insurance programs of \$3.5 million. The Company added approximately 114 company-operated stores during the past 12 months, which represents a 2.3% increase in the number of company-operated stores. Selling, general and administrative expenses, as a percentage of net sales, were 33.9% for the three months ended June 30, 2017 compared to 34.0% for the three months ended June 30, 2016.

***Restructuring Charges***

During the three months ended June 30, 2017, the Company incurred restructuring charges of approximately \$5.1 million in connection with the Restructuring Plan, including \$1.5 million in severance and related expenses, facility closure expenses of \$2.7 million and other costs of \$0.8 million. Please see Restructuring Plan above for additional information about the Restructuring Plan.

***Depreciation and Amortization***

Consolidated depreciation and amortization increased by \$3.8 million, or 15.0%, to \$29.3 million for the three months ended June 30, 2017, compared to \$25.4 million for the three months ended June 30, 2016. This increase reflects the incremental depreciation and amortization expenses associated with capital expenditures made in the preceding 12 months mainly in connection with store openings in both operating segments, with store refreshes in SBS, primarily in the U.S., and with ongoing information technology upgrades. This increase was partially offset by the impact of assets that became fully depreciated in the

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preceding 12 months.

**Operating Earnings**

The following table sets forth, for the periods indicated, information concerning our operating earnings for each reportable segment (dollars in thousands):

|                                  | Three Months Ended June 30, |            |                     |         |
|----------------------------------|-----------------------------|------------|---------------------|---------|
|                                  | 2017                        | 2016       | Increase (Decrease) |         |
| <b>Operating Earnings:</b>       |                             |            |                     |         |
| Segment operating earnings:      |                             |            |                     |         |
| SBS                              | \$ 104,880                  | \$ 104,908 | \$ (28)             |         |
| BSG                              | 67,327                      | 65,196     | 2,131               | 3.3%    |
| Segment operating earnings       | 172,207                     | 170,104    | 2,103               | 1.2%    |
| Unallocated corporate expenses   | (34,437)                    | (33,182)   | 1,255               | 3.8%    |
| Restructuring charges            | (5,054)                     |            | 5,054               | 100.0%  |
| Share-based compensation expense | (2,378)                     | (2,838)    | (460)               | (16.2)% |
| Operating earnings               | \$ 130,338                  | \$ 134,084 | \$ (3,746)          | (2.8)%  |

Consolidated operating earnings decreased by \$3.7 million, or 2.8%, for the three months ended June 30, 2017, compared to the three months ended June 30, 2016, primarily as a result of charges related to the Restructuring Plan and higher unallocated corporate expenses, partially offset by improved operating earnings in BSG. Operating earnings as a percentage of net sales, or consolidated operating margin, decreased by 30 basis points, to 13.1%, for the three months ended June 30, 2017, compared to the three months ended June 30, 2016. This decrease reflects net higher consolidated operating expenses as a percentage of consolidated net sales, as more fully discussed below, partially offset by the consolidated gross margin expansion described above.

*Sally Beauty Supply.* SBS's operating earnings were flat for the three months ended June 30, 2017, compared to the three months ended June 30, 2016. SBS's operating earnings reflect lower segment sales, as described above, and the incremental expenses, including rent and other occupancy-related expenses, associated with the increase in store count. SBS added approximately 75 stores during the past 12 months, which represents a 2.0% increase in the number of SBS company-operated stores. In addition, segment operating earnings reflect higher expenses related to recent upgrades to our information technology systems (approximately \$1.7 million), offset by lower sales bonuses (\$2.5 million) and lower advertising expense (\$1.8 million). Segment operating earnings as a percentage of net sales were 17.6% for the three months ended June 30, 2017, compared to the three months ended June 30, 2016. This increase reflects the segment's gross margin expansion described above, partially offset by higher segment operating expenses as a percentage of the segment's net sales, including the expense increases discussed in this paragraph.

*Beauty Systems Group.* BSG's operating earnings increased by \$2.1 million, or 3.3%, for the three months ended June 30, 2017, compared to the three months ended June 30, 2016, primarily a result of increased sales, as described above,

partially offset by the incremental expenses, including rent and other occupancy-related expenses, associated with the increase in store count. BSG added approximately 39 stores during the past 12 months, which represents a 3.4% increase in the number of BSG company-operated stores. Segment operating earnings as a percentage of net sales were 16.7% for the three months ended June 30, 2017, compared to the three months ended June 30, 2016. This increase reflects lower segment operating expenses as a percentage of the segment's net sales.

*Unallocated Corporate Expenses.* Unallocated corporate expenses, which represent certain corporate and shared costs (such as salaries and wages, employee benefits and travel expenses for corporate staff, certain professional fees, certain new business development expenses and corporate governance expenses) that have not been charged to our operating segments, increased by \$1.3 million, or 3.8%, for the three months ended June 30, 2017, compared to the three months ended June 30, 2016. The increase in unallocated corporate expenses reflects a \$3.7 million increase in self-insurance expenses related to the absence of a prior-year credit in certain employee benefit-related liability and lower corporate employee compensation and compensation-related expenses of \$1.0 million. The current year results also benefited from the absence in the current interim period of expenses associated with the data security incidents of \$1.4 million which were included in the three months ended June 30, 2016.

*Restructuring Charges.* During the three months ended June 30, 2017, the Company incurred charges related to the Restructuring Plan of approximately \$5.1 million, including \$1.5 million in severance and related expenses, facility closure expenses of \$2.7 million and other costs of \$0.8 million. Please see *Restructuring Plan* above for additional information about the Restructuring Plan.

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*Share-based Compensation Expense.* Total compensation expenses related to share-based compensation arrangements decreased by \$0.5 million to \$2.4 million for the three months ended June 30, 2017, compared to \$2.8 million for the three months ended June 30, 2016, mainly due to the impact of forfeitures during the three months ended June 30, 2017.

*Interest Expense*

Interest expense was \$27.0 million for the three months ended June 30, 2017, compared to \$26.7 million for the three months ended June 30, 2016. Please see *Liquidity and Capital Resources* below for additional information about the Company's debt.

*Provision for Income Taxes*

The provision for income taxes was \$36.8 million and \$39.5 million, resulting in an effective tax rate of 35.6% and 36.7%, for the three months ended June 30, 2017 and 2016, respectively. The decrease in the effective tax rate was due primarily to recurring and non-recurring U.S. state income tax adjustments in the current interim period.

The annual effective tax rate for the full fiscal year 2017 is currently expected to be in the range of 37.5% to 38.5%, versus a comparable actual tax rate for the full fiscal year 2016 of 37.0%.

*Net Earnings and Diluted Earnings per Share*

As a result of the foregoing, consolidated net earnings decreased by \$1.4 million, or 2.0%, to \$66.5 million for the three months ended June 30, 2017, compared to \$67.9 million for the three months ended June 30, 2016. Net earnings, as a percentage of net sales, decreased by 10 basis points to 6.7% for the three months ended June 30, 2017, compared to the three months ended June 30, 2016. Diluted earnings per share for the three months ended June 30, 2017 were \$0.49 compared to \$0.46 for the three months ended June 30, 2016.

Table of Contents***The Nine Months Ended June 30, 2017 compared to the Nine Months Ended June 30, 2016***

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

|                           | 2017 |           | Nine Months Ended June 30,<br>2016 |           | Increase (Decrease) |                 |
|---------------------------|------|-----------|------------------------------------|-----------|---------------------|-----------------|
| <b>Net sales:</b>         |      |           |                                    |           |                     |                 |
| SBS                       | \$   | 1,760,732 | \$                                 | 1,797,068 | \$                  | (36,336) (2.0)% |
| BSG                       |      | 1,203,390 |                                    | 1,179,192 |                     | 24,198 2.1%     |
| Consolidated net sales    | \$   | 2,964,122 | \$                                 | 2,976,260 | \$                  | (12,138) (0.4)% |
| <b>Gross profit:</b>      |      |           |                                    |           |                     |                 |
| SBS                       | \$   | 982,020   | \$                                 | 990,770   | \$                  | (8,750) (0.9)%  |
| BSG                       |      | 500,433   |                                    | 489,729   |                     | 10,704 2.2%     |
| Consolidated gross profit | \$   | 1,482,453 | \$                                 | 1,480,499 | \$                  | 1,954 0.1%      |
| <b>Gross margin:</b>      |      |           |                                    |           |                     |                 |
| SBS                       |      | 55.8%     |                                    | 55.1%     |                     | 0.7%            |
| BSG                       |      | 41.6%     |                                    | 41.5%     |                     | 0.1%            |
| Consolidated gross margin |      | 50.0%     |                                    | 49.7%     |                     | 0.3%            |

***Net Sales***

Consolidated net sales decreased by \$12.1 million, or 0.4%, for the nine months ended June 30, 2017, compared to the nine months ended June 30, 2016. Consolidated net sales for the nine months ended June 30, 2017, are inclusive of a net negative impact from changes in foreign currency exchange rates of \$35.6 million, or 1.2% of consolidated net sales. Consolidated net sales from company-operated SBS and BSG stores that have been open for 14 months or longer were essentially flat (including an increase in BSG same store sales of \$22.8 million, offset by a decrease in SBS same store sales of \$23.0 million as described below). For the nine months ended June 30, 2017, consolidated same store sales declined at a rate of 0.4% compared to a growth rate of 3.5% for the nine months ended June 30, 2016, primarily as a result of a decrease in the number of customer transactions at our SBS stores and a lower growth rate in the number of customer transactions at our BSG stores, primarily in the U.S., partially offset by increases in average transaction size in both operating segments.

Other sales channels (including sales to BSG franchise-based businesses, sales through BSG distributor sales consultants and incremental sales from businesses acquired in the preceding 12 months) in the aggregate contributed a net increase in sales of approximately \$2.1 million, or 0.1% of consolidated net sales, compared to the nine months ended June 30, 2016. On the other hand, sales from our SBS non-store sales channels (which include the catalog and internet sales of our Sinelco Group subsidiaries) were lower by approximately \$7.0 million, or 0.2% of consolidated net sales, while sales from stores that have been open for less than 14 months declined \$7.0 million, or 0.2% of consolidated net sales, in the nine months ended June 30, 2017, compared to the nine months ended June 30, 2016.

The decrease in consolidated net sales was driven by the net negative impact from changes in foreign currency exchange rates and decreases in unit volume in SBS primarily in the U.S., partially offset by increases in unit volume and average unit prices in BSG, as more fully discussed below.

*Sally Beauty Supply.* Net sales for SBS decreased by \$36.3 million, or 2.0%, for the nine months ended June 30, 2017, compared to the nine months ended June 30, 2016. Net sales for SBS for the nine months ended June 30, 2017, are inclusive of a net negative impact from changes in foreign currency exchange rates of approximately \$35.3 million, or 2.0% of SBS's net sales. In SBS, company-operated stores that have been open for 14 months or longer experienced a decrease in net sales of approximately \$23.0 million, or 1.3% of the segment's net sales, compared to the nine months ended June 30, 2016. For the nine months ended June 30, 2017, the SBS segment's same store sales declined at a rate of 1.3%, compared to a growth rate of 2.0% for the nine months ended June 30, 2016, primarily as a result of a decrease in the number of customer transactions at the segment's U.S. stores.

Sales from SBS's non-store sales channels, which include the catalog and internet sales of our Sinelco Group subsidiaries,

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declined \$7.0 million, or 0.4% of the segment's net sales, in the nine months ended June 30, 2017, compared to the nine months ended June 30, 2016. Stores that have been open for less than 14 months experienced a decrease in sales of approximately \$6.3 million, or 0.3% of the segment's net sales, compared to the nine months ended June 30, 2016.

The decrease in SBS's net sales was the result of the net negative impact from changes in foreign currency exchange rates and decreases in unit volume primarily in the U.S., partially offset by increases in average unit prices (as a result of selective price increases, reduced promotional activity and the introduction of certain products with higher average unit prices in the preceding 12 months).

*Beauty Systems Group.* Net sales for BSG increased by \$24.2 million, or 2.1%, for the nine months ended June 30, 2017, compared to the nine months ended June 30, 2016. BSG's net sales were not materially affected by changes in foreign currency exchange rates during the nine months ended June 30, 2017. In BSG, company-operated stores that have been open for 14 months or longer contributed an increase in net sales of approximately \$22.8 million, or 1.9% of the segment's net sales compared to the nine months ended June 30, 2016. For the nine months ended June 30, 2017, BSG's net sales reflect a 1.4% same store sales growth rate compared to a growth rate of 6.8% for the nine months ended June 30, 2016. BSG's same store sales growth rate for the nine months ended June 30, 2017 reflects a lower growth rate in the number of customer transactions at the segment's stores. The segment's same store sales growth rate for the nine months ended June 30, 2016 was driven primarily by the introduction of certain third-party brands and the expansion of exclusive distribution rights in certain geographies of the U.S.

Other sales channels (including sales from stores that have been open for less than 14 months, sales through our distributor sales consultants, sales to our franchise-based businesses and incremental sales from businesses acquired in the preceding 12 months) in the aggregate experienced a net increase of \$1.4 million, or 0.2% of the segment's net sales, in sales compared to the nine months ended June 30, 2016.

The increase in BSG's net sales is primarily the result of increases in unit volume (at existing stores and the impact of incremental sales from 39 company-operated stores opened or acquired during the last 12 months) and in average unit prices (resulting from changes in product mix, principally as a result of the introduction of certain third-party brands with higher average unit prices in the preceding 12 months).

***Gross Profit***

Consolidated gross profit increased by \$2.0 million, or 0.1%, for the nine months ended June 30, 2017, compared to the nine months ended June 30, 2016, primarily as a result of higher sales in BSG and improved gross margins in both segments (as more fully described below), partially offset by lower net sales in SBS. Consolidated gross margin, increased by 30 basis points to 50.0% for the nine months ended June 30, 2017, compared to the nine months ended June 30, 2016, as more fully described below.

*Sally Beauty Supply.* SBS's gross profit decreased by \$8.8 million, or 0.9%, for the nine months ended June 30, 2017, compared to the nine months ended June 30, 2016, primarily as a result of lower sales, partially offset by gross margin

expansion. SBS's gross margin increased by 70 basis points to 55.8% for the nine months ended June 30, 2017, compared to the nine months ended June 30, 2016. The increase in the segment's gross margin reflects selective price increases and reduced promotional activity primarily in the U.S., compared to the nine months ended June 30, 2016.

*Beauty Systems Group.* BSG's gross profit increased by \$10.7 million, or 2.2%, for the nine months ended June 30, 2017, compared to the nine months ended June 30, 2016, primarily as a result of higher sales volume. BSG's gross margin increased by 10 basis points to 41.6% for the nine months ended June 30, 2017, compared to the nine months ended June 30, 2016 primarily as a result of increased vendor allowances during the first half of the fiscal year 2017.

#### ***Selling, General and Administrative Expenses***

Consolidated selling, general and administrative expenses decreased by \$3.1 million, or 0.3%, for the nine months ended June 30, 2017, compared to the nine months ended June 30, 2016, primarily as a result of cost reduction initiatives. More specifically, the decrease reflects lower advertising expense (\$5.6 million), lower sales bonuses (\$8.3 million) and lower expenses associated with the data security incidents (\$2.5 million). This decrease was partially offset by incremental expenses (including rent and other occupancy-related expenses) associated with the increase in store count, as discussed above, higher employee compensation and compensation-related expenses of \$4.7 million (including incremental wages in connection with SBS and BSG stores added during the past 12 months and wage increases for sales staff at existing SBS and BSG stores, partially offset by the absence during the nine months ended June 30, 2017 of expenses of approximately \$1.3 million incurred in connection with the management transition plan more fully discussed in our Annual Report on Form 10-K for the fiscal year ended September 30, 2016), incremental expenses related to on-going upgrades to our information technology systems (approximately \$1.9 million), incremental professional fees principally associated with corporate information technology and data security initiatives (approximately \$2.1 million) and higher expenses in connection with the Company's self-insurance programs of \$1.9 million. Selling, general and administrative expenses, as a percentage of net sales, were 34.3% for each of the nine months ended June 30, 2017 and 2016.



Table of Contents***Restructuring Charges***

During the nine months ended June 30, 2017, the Company incurred charges related to the Restructuring Plan of approximately \$14.3 million, including \$10.0 million in severance and related expenses, facility closure expenses of \$2.7 million and other costs of \$1.6 million. Please see Restructuring Plan above for additional information about the Restructuring Plan.

***Depreciation and Amortization***

Consolidated depreciation and amortization increased by \$11.4 million, or 15.8%, to \$84.0 million for the nine months ended June 30, 2017, compared to \$72.5 million for the nine months ended June 30, 2016. This increase reflects the incremental depreciation and amortization expenses associated with capital expenditures made in the preceding 12 months mainly in connection with store openings in both operating segments, with store refreshes in the SBS segment, primarily in the U.S., and with ongoing information technology upgrades. This increase was partially offset by the impact of assets that became fully depreciated in the preceding 12 months.

***Operating Earnings***

The following table sets forth, for the periods indicated, information concerning our operating earnings for each reportable segment (dollars in thousands):

|                                  | 2017 |          | Nine Months Ended June 30,<br>2016 |           | Increase (Decrease) |                 |
|----------------------------------|------|----------|------------------------------------|-----------|---------------------|-----------------|
| Operating Earnings:              |      |          |                                    |           |                     |                 |
| Segment operating earnings:      |      |          |                                    |           |                     |                 |
| SBS                              | \$   | 294,245  | \$                                 | 313,792   | \$                  | (19,547) (6.2)% |
| BSG                              |      | 193,630  |                                    | 191,649   |                     | 1,981 1.0%      |
| Segment operating earnings       |      | 487,875  |                                    | 505,441   |                     | (17,566) (3.5)% |
| Unallocated corporate expenses   |      | (98,187) |                                    | (107,952) |                     | (9,765) (9.0)%  |
| Restructuring charges            |      | (14,265) |                                    |           |                     | 14,265 100.0%   |
| Share-based compensation expense |      | (8,590)  |                                    | (10,011)  |                     | (1,421) (14.2)% |
| Operating earnings               | \$   | 366,833  | \$                                 | 387,478   | \$                  | (20,645) (5.3)% |

Consolidated operating earnings decreased by \$20.6 million, or 5.3%, for the nine months ended June 30, 2017, compared to the nine months ended June 30, 2016, primarily as a result of lower net sales in our SBS segment and charges related to the Restructuring Plan, partially offset by lower unallocated corporate expenses and lower share-based compensation expense, as more fully discussed below. Operating earnings as a percentage of net sales, or consolidated operating margin, decreased by 60 basis points, to 12.4%, for the nine months ended June 30, 2017, compared to the nine months ended June 30, 2016. This decrease reflects net higher consolidated operating expenses as a percentage of consolidated net sales, as more fully discussed below, partially offset by the consolidated gross margin expansion described above.

*Sally Beauty Supply.* SBS's segment operating earnings decreased by \$19.5 million, or 6.2%, for the nine months ended June 30, 2017, compared to the nine months ended June 30, 2016. This decrease was primarily a result of lower segment sales as described above and the incremental expenses (including rent and other occupancy-related expenses) associated with the increase in store count, as discussed above. More specifically, the decrease in SBS's segment operating earnings reflects higher employee compensation and compensation-related expenses of \$5.6 million (including incremental wages in connection with stores added during the past 12 months and wage increases for sales staff at existing stores), higher foreign currency transaction losses (\$2.7 million), higher depreciation expense associated primarily with recent store openings and remodels (approximately \$5.0 million) and higher expenses related to recent upgrades to our information technology systems (approximately \$5.3 million). The increase in SBS's expenses was partially offset by lower advertising expense (\$5.5 million). Segment operating earnings as a percentage of net sales decreased 80 basis points, to 16.7%, for the nine months ended June 30, 2017, compared to the nine months ended June 30, 2016. This decrease reflects higher segment operating expenses as a percentage of the segment's net sales, including the expense increases discussed in this paragraph, partially offset by the increase in the segment's gross margin described above.

*Beauty Systems Group.* BSG's segment operating earnings increased by \$2.0 million, or 1.0%, for the nine months ended June 30, 2017, compared to the nine months ended June 30, 2016. The increase in segment operating earnings reflects the increase in segment net sales described above. This increase was partially offset by the incremental expenses (including rent and other occupancy-related expenses) associated with the increase in store count, as discussed above, as well as higher employee compensation and compensation-related expenses of \$6.0 million (including incremental wages in connection with stores added during the past 12 months and wage increases for sales staff at existing stores) and higher expenses related to recent upgrades to our information technology systems of approximately \$2.4 million. Segment operating earnings as a percentage of net sales decreased by 20 basis points, to 16.1%, for the nine months ended June 30, 2017, compared to the nine months ended June 30, 2016. This decrease reflects higher segment operating expenses as a percentage of the segment's net sales, including the expense increases discussed in this paragraph, partially offset by the increase in the segment's gross margin described above.

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*Unallocated Corporate Expenses.* Unallocated corporate expenses, which represent certain corporate costs (such as salaries and wages, employee benefits and travel expenses for corporate staff, certain professional fees, certain new business development expenses and corporate governance expenses) that have not been charged to our operating segments, decreased by \$9.8 million, or 9.0%, for the nine months ended June 30, 2017, compared to the nine months ended June 30, 2016. This decrease was due primarily to lower employee compensation and compensation-related expenses of \$5.4 million (including the absence during the nine months ended June 30, 2017 of expenses of approximately \$1.3 million incurred in connection with the management transition plans more fully discussed in our Annual Report on Form 10-K for the fiscal year ended September 30, 2016), lower expenses associated with the data security incidents of \$2.5 million and lower foreign currency transaction losses of \$2.0 million.

*Restructuring Charges.* During the nine months ended June 30, 2017, the Company incurred charges related to the Restructuring Plan of approximately \$14.3 million, including \$10.0 million in severance and related expenses, facility closure expenses of \$2.7 million and other costs of \$1.6 million. Please see Restructuring Plan above for additional information about the Restructuring Plan.

*Share-based Compensation Expense.* Total compensation expenses related to share-based compensation arrangements decreased by \$1.4 million to \$8.6 million for the nine months ended June 30, 2017, compared to \$10.0 million for the nine months ended June 30, 2016 mainly due to a reduction in awards to retirement-eligible grantees and the impact of forfeitures during the nine months ended June 30, 2017.

***Interest Expense***

Interest expense decreased by \$37.0 million to \$80.6 million for the nine months ended June 30, 2017, compared to \$117.6 million for the nine months ended June 30, 2016. This decrease was principally due to a loss on extinguishment of debt of \$33.3 million that is included in interest expense in connection with the Company's redemption of certain senior notes during the nine months ended June 30, 2016, and to lower interest expense on the senior notes due 2025 compared to the senior notes redeemed. Please see Liquidity and Capital Resources below for additional information about the Company's debt.

***Provision for Income Taxes***

The provision for income taxes was \$106.9 million and \$99.5 million, resulting in an effective tax rate of 37.3% and 36.9%, for the nine months ended June 30, 2017 and 2016, respectively. The increase in the effective tax rate was due primarily to a tax benefit recognized in the nine months ended June 30, 2016, in connection with the enactment of retroactive U.S. legislation reinstating certain tax credits, and a favorable adjustment to non-deductible expenses during the nine months ended June 30, 2016.

***Net Earnings and Diluted Earnings per Share***

As a result of the foregoing, consolidated net earnings increased by \$9.0 million, or 5.3%, to \$179.4 million for the nine months ended June 30, 2017, compared to \$170.3 million for the nine months ended June 30, 2016. Net earnings, as a percentage of net sales, increased by 40 basis points to 6.1% for the nine months ended June 30, 2017, compared to the nine months ended June 30, 2016. Diluted earnings per share for the nine months ended June 30, 2017 were \$1.28 compared to \$1.14 for the nine months ended June 30, 2016.

## Financial Condition

### *June 30, 2017 Compared to September 30, 2016*

Working capital (current assets less current liabilities) decreased by \$45.9 million to \$638.2 million at June 30, 2017, compared to \$684.2 million at September 30, 2016. The ratio of current assets to current liabilities, or current ratio, was 2.18 to 1.00 at June 30, 2017, compared to 2.40 to 1.00 at September 30, 2016. The change in working capital reflects an increase of approximately \$53.4 million in current liabilities, partially offset by an increase of approximately \$7.4 million in current assets. The increase in current assets as of June 30, 2017, reflects a decrease in cash and cash equivalents of \$32.5 million (please see *Liquidity and Capital Resources* below for a description of our sources and uses of cash), an increase in trade accounts receivable and other accounts receivable, in the aggregate, of \$4.4 million, a decrease of \$4.9 million in other current assets and an increase of approximately \$40.3 million in inventory, as discussed below. The increase in current liabilities is principally due to an increase of \$81.5 million in current maturities of long-term debt (please see *Liquidity and Capital Resources, Long-term Debt* below for a description of borrowings under our ABL facility) and an increase in accounts payable of \$20.5 million, partially offset by a decrease of \$48.1 million in accrued liabilities, as discussed below.

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Trade accounts receivable and other accounts receivable, in the aggregate, increased by \$4.4 million to \$88.4 million at June 30, 2017, compared to \$84.0 million at September 30, 2016 due primarily to the timing of collections from customers and vendors of balances outstanding and the impact of foreign currency translation adjustments. Inventory increased by \$40.3 million to \$947.6 million at June 30, 2017, compared to \$907.3 million at September 30, 2016 due primarily to the effect of stores opened (66 net SBS and BSG company-operated stores added during the nine months ended June 30, 2017), and the impact of foreign currency translation adjustments of approximately \$4.1 million. Other current assets decreased by \$4.9 million to \$50.0 million at June 30, 2017, compared to \$54.9 million at September 30, 2016 due primarily to the application of certain income tax receivable balances against income taxes currently payable (\$10.6 million), partially offset by the timing of payments of prepaid expenses in the ordinary course of our business.

Accrued liabilities decreased by \$48.1 million to \$166.5 million at June 30, 2017, compared to \$214.6 million at September 30, 2016, due primarily to the timing of payments of interest on the senior notes due 2022, senior notes due 2023 and senior notes due 2025 (in the aggregate, \$25.5 million) and the settlements with two payment card networks of assessments in connection with the data security incidents in the aggregate amount of \$9.3 million, the timing of payments of employee compensation and benefits (\$11.2 million) and a decrease in other operating accruals in the ordinary course of our business (\$4.1 million), partially offset by an increase in the fair value of foreign exchange contracts in a liability position (\$1.2 million, please see Note 11 of Condensed Notes to Consolidated Financial Statements elsewhere in this Quarterly Report for more information about the Company's foreign exchange contracts). Interest on the senior notes due 2022, senior notes due 2023 and senior notes due 2025 is payable semi-annually, during the Company's first and third fiscal quarters.

Total stockholders' deficit at June 30, 2017, increased by \$76.1 million primarily as a result of our repurchase and subsequent retirement of approximately 13.1 million shares of our common stock for approximately \$286.5 million, partially offset by net earnings of \$179.4 million and share-based compensation expense, the impact of exercises of stock options and other share-based compensation activity, in the aggregate, of \$24.0 million and foreign currency translation adjustments, net of tax, of \$7.0 million.

**Liquidity and Capital Resources**

The Company broadly defines liquidity as our ability to generate sufficient cash flow from operating activities to meet obligations and commitments. In addition, liquidity includes the ability to obtain appropriate debt and equity financing and to convert into cash those assets that are no longer required to meet existing strategic and financial objectives. Therefore, liquidity cannot be considered separately from capital resources that consist of current or potentially available funds for use in achieving long-range business objectives and meeting debt service commitments. Please see Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital Resources in our Annual Report on Form 10-K for the fiscal year ended September 30, 2016 for additional information on our liquidity and capital resources.

The Company is highly leveraged and a substantial portion of its liquidity needs will arise from debt service on its outstanding indebtedness and from funding the costs of operations, working capital, capital expenditures and share repurchases. As a holding company, Sally Beauty depends on its subsidiaries, including Sally Holdings, to distribute funds to it so that it may pay its obligations and expenses. The ability of Sally Beauty's subsidiaries to make such distributions will be subject to their operating results, cash requirements and financial condition and their compliance with relevant laws, and covenants and financial ratios related to their existing or future indebtedness, including covenants restricting Sally Holdings' ability to pay dividends to Sally Beauty. If, as a consequence of these limitations, Sally Beauty cannot receive sufficient distributions from its subsidiaries, it may not be able to meet its obligations to fund general corporate expenses. Please see Risk Factors—*Risks Relating to Our Business*, and *Risks Relating to Our Substantial Indebtedness* in Item 1A of our Annual Report on Form 10-K for the fiscal year ended September 30, 2016.

The Company may from time to time repurchase or otherwise retire or refinance its debt (through its subsidiaries or otherwise) and take other steps to reduce or refinance its debt. These actions may include open market repurchases of its notes or other retirements of outstanding debt. The amount of debt that may be repurchased, or refinanced or otherwise retired, if any, will be determined in the sole discretion of the Board and will depend on market conditions, trading levels of the Company's debt from time to time, the Company's cash position and other considerations.

At June 30, 2017, cash and cash equivalents were \$54.1 million. Based upon the current level of operations and anticipated growth, we anticipate that existing cash balances (excluding certain amounts permanently invested in connection with foreign operations), funds expected to be generated by operations and funds available under the new ABL facility will be sufficient to meet working capital requirements, fund share repurchases and potential acquisitions and finance anticipated capital expenditures, including information technology upgrades and store remodels, over the next 12 months.

However, there can be no assurance that our business will generate sufficient cash flows from operations, that anticipated net sales and operating improvements will be realized, or that future borrowings will be available under the new ABL facility in an amount sufficient to enable us to service our indebtedness or to fund our other liquidity needs. In addition, our ability to meet

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our debt service obligations and liquidity needs are subject to certain risks, which include, but are not limited to, increases in competitive activity, the loss of key suppliers, rising interest rates, the loss of key personnel, the ability to execute our business strategy and general economic conditions. Please see **Risk Factors** in Part I of our Annual Report on Form 10-K for the fiscal year ended September 30, 2016.

We utilize our ABL facility for the issuance of letters of credit, for certain working capital and liquidity needs and to manage normal fluctuations in our operational cash flow. In that regard, we may from time to time draw funds under the ABL facility for general corporate purposes including funding of capital expenditures, acquisitions, interest payments due on our indebtedness and share repurchases. The funds drawn on individual occasions during the nine months ended June 30, 2017 have varied in amounts up to \$51.0 million, total amounts outstanding have ranged from zero up to \$116.0 million and the average daily balance outstanding was \$22.3 million. During the nine months ended June 30, 2017, the weighted average interest rate on our borrowings under the ABL facility was 3.5%. The amounts drawn are generally paid down with cash provided by our operating activities. As of June 30, 2017, there were borrowings of \$81.5 million outstanding under the ABL facility and Sally Holdings had \$398.3 million available for borrowings under the ABL facility, subject to borrowing base limitations, as reduced by outstanding letters of credit. On July 6, 2017 the Company entered into a new Term Loan B and a new ABL facility. Please see *Long-Term Debt* below.

Sally Beauty is a holding company and does not have any material assets or operations other than ownership of equity interests in its 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 Sally Beauty which, in turn, constitute material limitations on the Company's ability to pay dividends and other payments to its stockholders. Please see *Long-Term Debt Covenants* below.

***Share Repurchase Programs***

During the nine months ended June 30, 2017 and 2016, the Company repurchased and subsequently retired approximately 13.1 million and 6.2 million shares, respectively, of its common stock under the 2014 Share Repurchase Program at an aggregate cost of \$286.5 million and \$162.4 million, respectively. The Company funded these share repurchases with existing cash balances, cash from operations and borrowings under the ABL facility. The Company reduced common stock and additional paid-in capital, in the aggregate, by these amounts. However, as required by GAAP, to the extent that share repurchase amounts exceeded the balance of additional paid-in capital prior to the Company recording such repurchases, the Company recorded the excess in accumulated deficit.

As of June 30, 2017, the Company had approximately \$278.6 million of additional share repurchase authorization remaining under the 2014 Share Repurchase Program. Future repurchases of shares of our common stock are expected to be funded with existing cash balances, funds expected to be generated by operations and funds available under the ABL facility.

***Historical Cash Flows***

Historically, our primary source of cash has been funds provided by operating activities and, when necessary, borrowings under our ABL facility. The primary uses of cash have been for share repurchases, capital expenditures, repayments and servicing of long-term debt and

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acquisitions. The following table shows our sources and uses of funds for the nine months ended June 30, 2017 and 2016 (in thousands):

|                                                                               | <b>Nine Months Ended June 30,</b> |             |
|-------------------------------------------------------------------------------|-----------------------------------|-------------|
|                                                                               | <b>2017</b>                       | <b>2016</b> |
| Net cash provided by operating activities                                     | \$ 223,415                        | \$ 248,813  |
| Net cash used by investing activities                                         | (66,529)                          | (110,520)   |
| Net cash used by financing activities                                         | (189,641)                         | (187,093)   |
| Effect of foreign currency exchange rate changes on cash and cash equivalents | 233                               | (241)       |
| Net decrease in cash and cash equivalents                                     | \$ (32,522)                       | \$ (49,041) |

### *Net Cash Provided by Operating Activities*

Net cash provided by operating activities during the nine months ended June 30, 2017 decreased by \$25.4 million to \$223.4 million, compared to \$248.8 million during the nine months ended June 30, 2016, mainly due to net changes in the components of working capital (\$16.4 million) and a decrease in net earnings before depreciation and amortization and loss on extinguishment of debt (\$12.8 million).



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*Net Cash Used by Investing Activities*

Net cash used by investing activities during the nine months ended June 30, 2017 decreased by \$44.0 million to \$66.5 million, compared to \$110.5 million during the nine months ended June 30, 2016. This decrease reflects lower capital expenditures related primarily to SBS store refreshes and lower investments in information technology upgrades in the nine months ended June 30, 2017, compared to the nine months ended June 30, 2016 (\$44.2 million), and less cash used for acquisitions in the nine months ended June 20, 2017 (\$2.3 million), partially offset by a decrease in cash proceeds from the sale of property and equipment (\$2.5 million).

*Net Cash Used by Financing Activities*

Net cash used by financing activities during the nine months ended June 30, 2017 increased by \$2.5 million to \$189.6 million, compared to \$187.1 million during the nine months ended June 30, 2016, due primarily to an increase in share repurchases under the 2014 Share Repurchase Program (\$124.1 million). This increase was partially offset by an increase in borrowings under the ABL facility, a decrease in net repayments of debt and the payment of debt issuance costs, in the aggregate, (\$120.1 million) mainly in connection with our redemption of the senior notes due 2019 and issuance of the senior notes due 2025 in December 2015. This increase was also partially offset by an increase in proceeds from exercises of stock options, net of excess tax benefit/shortfall, resulting from share-based compensation activity of \$1.5 million.

**Long-Term Debt**

*Outstanding Long-Term Debt*

Please see Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations - Liquidity and Capital Resources - *Long-term Debt* and Note 13 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, 2016 and Note 15 of the Condensed Notes to Consolidated Financial Statements included in Item 1 of this Quarterly Report for more information about the Company's debt obligations.

At June 30, 2017, Sally Holdings had a \$500 million, five-year asset-based senior secured loan facility (the ABL facility) with borrowings of \$81.5 million outstanding. In addition, at June 30, 2017, the Company, through its subsidiaries Sally Holdings and Sally Capital Inc. (collectively, the Issuers) has \$1,800.0 million of senior notes outstanding, as summarized in the table below.

As of June 30, 2017, the principal amount of long-term debt (excluding capitalized leases) is as follows (dollars in thousands):

| Principal<br>Amount(a) | Maturity<br>Dates | Interest Rates (b) |
|------------------------|-------------------|--------------------|
|------------------------|-------------------|--------------------|

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|                       |    |           |           |      |                                 |
|-----------------------|----|-----------|-----------|------|---------------------------------|
| ABL facility          | \$ | 81,500    | July 2018 | (i)  | Prime plus (0.50% to 0.75%) or; |
|                       |    |           |           | (ii) | LIBOR (c) plus (1.50% to 1.75%) |
| Senior notes due 2022 |    | 850,000   | June 2022 |      | 5.750%                          |
| Senior notes due 2023 |    | 200,000   | Nov. 2023 |      | 5.500%                          |
| Senior notes due 2025 |    | 750,000   | Dec. 2025 |      | 5.625%                          |
| Total                 | \$ | 1,881,500 |           |      |                                 |

(a) Amounts reported above do not reflect unamortized premium of \$4.8 million related to notes with an aggregate principal amount of \$150.0 million of the 5.75% Senior Notes due 2022 or unamortized debt issuance costs in the aggregate amount of \$21.2 million, at June 30, 2017.

(b) Interest rates shown represent the coupon or contractual rate related to each debt instrument listed.

(c) When used in this Quarterly Report, LIBOR means the London Interbank Offered Rate.

As described more fully in Note 15 included in Item 1 of this Quarterly Report and in *Refinancing of Debt* above, on July 6, 2017, the Company and certain of the Company's subsidiaries entered into an amended and restated \$500 million, asset-based senior secured loan facility. The terms of the new ABL facility are substantially the same as those on the previous ABL credit facility, except for an extension of the maturity to July 6, 2022, improved pricing, a relaxation of the restrictions on Sally Holdings' ability to make certain payments to the Company, and certain other improved terms.

Also on July 6, 2017, Sally Holdings and Sally Capital Inc., both indirect, wholly-owned subsidiaries of the Company, entered into a seven-year term loan credit facility pursuant to which the Borrowers borrowed \$850.0 million. The Term Loan B consists of a variable-rate tranche in the amount of \$550 million which bears interest at LIBOR plus 2.50% or, at the option of the Borrowers, at an alternate base rate plus 1.50%, and a fixed-rate tranche in the aggregate stated principal amount of \$300 million which bears interest at 4.50%. The agreement governing the Term Loan B contains a customary covenant package substantially consistent with the indentures governing the Company's existing senior notes. Borrowings under the Term Loan B are secured

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by a first-priority lien in and upon substantially all of the assets of the Company and its domestic subsidiaries other than the accounts, inventory (and the proceeds thereof) and other assets that secure the ABL facility on a first-priority basis. In addition, the variable-rate tranche contains provisions requiring quarterly repayments of principal in an amount equal to 0.25% of the original stated loan amount for that tranche. The Term Loan B matures on July 5, 2024.

The Company used the proceeds of the Term Loan B, together with cash on hand and borrowings under the new ABL facility to complete the previously-announced redemption of all \$850.0 million aggregate principal amount of the Company's Senior Notes due 2022.

*Long-Term Debt Covenants*

Please see Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital Resources in our Annual Report on Form 10-K for the fiscal year ended September 30, 2016 for additional information on the covenants governing the Company's indebtedness.

The Term Loan B does not contain any financial maintenance covenants and is subject to a covenant package that is substantially consistent with the covenant package governing the Company's outstanding senior notes.

The new ABL facility has covenants that are substantially similar to the covenants governing the prior ABL facility.

We are currently in compliance with the agreements and instruments governing our debt, including our financial covenants. Our ability to comply with these covenants in future periods will depend on our ongoing financial and operating performance, which in turn will be subject to economic conditions and to financial, market and competitive factors, many of which are beyond our control. Further, our ability to comply with these covenants in future periods will also depend substantially on the pricing of our products, our success at implementing cost reduction initiatives and our ability to successfully implement our overall business strategy.

*Capital Requirements*

During the nine months ended June 30, 2017, capital expenditures were approximately \$64.0 million, including amounts incurred but not paid at June 30, 2017 (approximately \$1.2 million). For fiscal year 2017, we anticipate capital expenditures in the range of approximately \$115.0 million to \$120.0 million, excluding acquisitions. These capital expenditures will primarily fund (a) the addition of new stores, (b) the remodel, expansion or relocation of existing stores, (c) upgrades to our distribution centers in the U.S., as well as (d) certain corporate projects in the ordinary course of our business, including ongoing technology upgrades.

**Contractual Obligations**

There have been no material changes outside the ordinary course of our business in any of our contractual obligations since September 30, 2016, including the impact of our July 2017 refinancing of a portion of our debt. In July 2017, the Company redeemed in full its 5.75% senior notes due June 2022 primarily with the net proceeds from the issuance of an \$850.0 million seven-year Term Loan B, cash on hand and borrowings under the new ABL facility.

#### **Off-Balance Sheet Financing Arrangements**

At June 30, 2017 and September 30, 2016, we had no off-balance sheet financing arrangements other than operating leases incurred in the ordinary course of business, and outstanding letters of credit related to inventory purchases and self-insurance programs. Such letters of credit totaled \$20.2 million and \$21.6 million at June 30, 2017 and September 30, 2016, respectively.

#### **Inflation**

We believe inflation has not had a material effect on our results of operations.

#### **Critical Accounting Estimates**

The preparation of financial statements in conformity with GAAP requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses and disclosure of contingent assets and liabilities in the financial statements. Actual results may differ from these estimates. We believe these estimates and assumptions are reasonable. We consider accounting policies to be critical when they require us to make assumptions about matters that are highly uncertain at the time the accounting estimate is made and when different estimates that our management reasonably could have used have a material effect on the presentation of our financial condition, changes in financial condition or results of operations.

Our critical accounting estimates, as described in our Annual Report on Form 10-K for the fiscal year ended September 30, 2016, include the valuation of inventory, vendor rebates and concessions, retention of risk, income taxes, assessment of long-lived assets and intangible assets for impairment and share-based payments. There have been no material changes to our critical accounting estimates or assumptions since September 30, 2016.

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**Recent Accounting Pronouncements and Accounting Changes**

**Recent Accounting Pronouncements**

The Company has not yet adopted and is currently assessing the potential effect of the following pronouncements on its consolidated financial statements:

In November 2015, the Financial Accounting Standards Board ( FASB ) issued Accounting Standards Update ( ASU ) No. 2015-17, *Income Taxes (Topic 740): Balance Sheet Classification of Deferred Income Taxes* ( ASU 2015-17 ) which aims to simplify the classification of deferred taxes on the balance sheet. More specifically, ASU 2015-17 will require that all deferred tax assets and liabilities, and any related valuation allowance, be reported as noncurrent in a classified balance sheet. The new guidance will replace the existing practice of reporting deferred taxes for each tax jurisdiction (or taxing component of a jurisdiction) as (a) a net current asset or liability *and* (b) a net noncurrent asset or liability. The new guidance does not change the existing requirement that only permits offsetting assets and liabilities within the same jurisdiction. For public companies, this amendment is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2016. Early adoption is permitted. The Company has completed a preliminary assessment of the potential impact of adopting ASU 2015-17 on its financial statements. At December 31, 2016, the adoption of ASU 2015-17 would have resulted in a decrease in current assets of \$40.0 million and a decrease in current liabilities of \$1.4 million. In addition, the adoption would have resulted in an increase in noncurrent assets of \$3.0 million and a decrease in noncurrent liabilities of \$35.6 million. The when-adopted impact of this new standard on the Company's financial statements may materially differ from these preliminary estimates, including as a result of changes in tax rates resulting from the enactment of tax legislation in the future.

In February 2016, the FASB issued ASU No. 2016-02, *Leases*, which will require lessees to report on their balance sheets a right-of-use asset and a lease liability in connection with most lease agreements classified as operating leases under the current guidance. Under the new guidance, the lease liability will be measured initially based on the present value of future lease payments, subject to certain conditions. The right-of-use asset will be measured initially based on the amount of the liability, plus certain initial direct costs. The new guidance will further require that leases be classified at inception as either (a) operating leases or (b) finance leases. For operating leases, periodic expense will generally be flat (straight-line) throughout the life of the lease. For finance leases, periodic expense will decline (similar to capital leases under current rules) over the life of the lease. The new standard must be adopted using a modified retrospective transition method. For public companies, this amendment is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. Early adoption is permitted. The Company has completed a preliminary assessment of the potential impact of adopting ASU 2016-02 on its financial statements. As disclosed in the Company's Annual Report on Form 10-K for the fiscal year ended September 30, 2016, adoption of ASU 2016-02 would have resulted in recognition of a right-of-use asset in the estimated amount of approximately \$600.0 million and a lease liability for a similar amount in the Company's consolidated balance sheet as of September 30, 2016. The Company does not believe adoption of ASU 2016-02 will have a material impact on the Company's results of operations. The amount of the right-of-use asset and the lease liability ultimately recognized by the Company may materially differ from this preliminary estimate, including as a result of future organic growth in our business and potential acquisitions.

In March 2016, the FASB issued ASU No. 2016-09, *Improvements to Employee Share-Based Payment Accounting*, intended to simplify various aspects of how share-based payments are recorded and presented on the financial statements. For example, the new guidance will require that all the income tax effect related to share-based payments be recorded in income tax expense. The new guidance further removes the current requirement to delay recognition of a windfall tax benefit until it reduces current taxes payable. In addition, the new standard will require that excess tax benefits and shortfalls from share-based compensation awards be reported in operating activities in the statement of cash flows. For public companies, these amendments are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2016. Early adoption is permitted.

In addition, the Company has not yet adopted the following recent accounting pronouncement and does not believe, based on the Company's preliminary assessment, that its adoption will have a material effect on its consolidated financial position and results of operations:

In May 2014, the FASB issued ASU No. 2014-09, *Revenue from Contracts with Customers* ( ASU 2014-09 ) which will supersede Accounting Standards Codification ( ASC ) Topic 605, *Revenue Recognition*. A core principle of the new guidance is that an entity should measure revenue in connection with its sale of goods and services to a customer based on the consideration to which the entity expects to be entitled in exchange for each of those goods and services. The new standard must be adopted using either the retrospective or cumulative effect transition method. For public companies, this amendment is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2017. Early adoption is permitted. The Company has not yet selected a transition method.

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**Accounting Changes**

In April 2015, the FASB issued ASU No. 2015-05, *Customer's Accounting for Fees Paid in Cloud Computing Arrangement*. This pronouncement provides guidance to determine whether a cloud-based computing arrangement includes a software license. If a cloud-based computing arrangement includes a software license, the customer must account for the software element of the arrangement consistent with the acquisition of other software licenses. Otherwise, the customer must account for the arrangement as a service contract. The new standard permits the use of either the prospective or retrospective transition method. As required, the Company adopted the provisions of ASU No. 2015-05, prospectively, in the first quarter of its fiscal year ending September 30, 2017 and its adoption did not have a material impact on the Company's consolidated financial statements.

In September 2015, the FASB issued ASU No. 2015-16, *Business Combinations (Topic 805): Simplifying the Accounting for Measurement-Period Adjustments* ( ASU 2015-16 ) which eliminates the prior requirement to recognize measurement-period adjustments to provisional amounts retrospectively. Instead, ASU 2015-16 requires the acquirer to recognize measurement-period adjustments, as well as the impact on earnings of changes in depreciation, amortization and similar items (if any) resulting from the change to the provisional amounts, in the period when the amount of each measurement-period adjustment is determined. As required, the Company adopted the provisions of ASU 2015-16 in the first quarter of its fiscal year ending September 30, 2017 and its adoption did not have a material impact on the Company's consolidated financial statements.

In January 2017, the FASB issued ASU No. 2017-01, *Business Combinations (Topic 805): Clarifying the Definition of a Business* ( ASU 2017-01 ). ASU 2017-01 must be applied prospectively and provides a narrower framework to be used to determine if a set of assets and activities constitutes a business compared to the framework under the prior guidance and is generally expected to result in greater consistency in the application of ASC Topic 805, *Business Combinations*. As permitted, the Company adopted ASU 2017-01 in the second quarter of its fiscal year ending September 30, 2017 and its adoption did not have a material impact on the Company's consolidated financial statements.

In January 2017, the FASB issued ASU No. 2017-04, *Intangibles - Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment* ( ASU 2017-04 ), which eliminates step two of the two-step quantitative goodwill impairment test. ASU 2017-04 applies to an entity that elects to use the quantitative method to test goodwill for impairment, but ASU 2017-04 does not eliminate the option to use instead the qualitative method to test goodwill for impairment. Step two of the quantitative impairment test guidance measures the amount of impairment loss and is performed when an entity concludes, as a result of performing step one of the quantitative test, that potential impairment exists. As permitted, the Company adopted ASU 2017-04 in the second quarter of its fiscal year ending September 30, 2017 and its adoption did not have a material impact on the Company's consolidated financial statements.

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**Item 3. Quantitative and Qualitative Disclosures About Market Risk**

As a multinational corporation, we are subject to certain market risks including foreign currency fluctuations, interest rates and government actions. We consider a variety of practices to manage these market risks, including, when deemed appropriate, the occasional use of derivative financial instruments. Currently, we do not purchase or hold any derivative instruments for speculative or trading purposes.

**Foreign currency exchange rate risk**

We are exposed to potential gains or losses from foreign currency fluctuations affecting net investments in subsidiaries (including intercompany balances not permanently invested) and earnings denominated in foreign currencies, as well as exposure resulting from the purchase of merchandise by certain of our subsidiaries in a currency other than their functional currency and from the sale of products and services among the parent company and subsidiaries with a functional currency different from the parent or among subsidiaries with different functional 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, we currently have exposure to the currencies of several other countries located in South America and from time to time we may have exposure to changes in the exchange rate for the British pound sterling versus the Euro in connection with the sale of products and services among certain European subsidiaries of the Company. The recent decision by Britain to leave the European Union and related or other disruptive events in the United Kingdom or the European Union could result in increased foreign currency fluctuation, including fluctuation in currencies in which we operate. For each of the fiscal years 2016, 2015 and 2014, less than 20% of our consolidated net sales were made in currencies other than the U.S. dollar. For the nine months ended June 30, 2017, consolidated net sales are inclusive of an approximately \$35.6 million net negative impact from changes in foreign currency exchange rates and other comprehensive income (loss) reflects approximately \$7.0 million in foreign currency translation adjustments, net of tax. For the nine months ended June 30, 2017, fluctuations in the U.S. dollar exchange rates did not otherwise have a material effect on our consolidated financial condition and consolidated results of operations.

A 10% increase or decrease in the exchange rates for the U.S. dollar versus the foreign currencies to which we have exposure would have impacted our consolidated net sales by approximately 1.7% in the nine months ended June 30, 2017 and would have impacted our consolidated total assets by approximately 2.4% at June 30, 2017.

Our various foreign currency exposures at times offset each other, sometimes providing a natural hedge against foreign currency risk. As more fully disclosed in our Annual Report on Form 10-K for the fiscal year ended September 30, 2016, the Company uses from time to time foreign exchange contracts to mitigate its remaining exposure to changes in foreign currency exchange rates. There have been no material changes to the aggregate notional amount of foreign exchange contracts held by the Company since September 30, 2016. At June 30, 2017, the aggregate net fair value of all foreign exchange contracts was \$1.5 million, consisting of contracts in an asset position of less than \$0.1 million and contracts in a liability position of approximately \$1.5 million.

The Company's foreign currency derivatives are not designated as hedges and do not currently meet the requirements for hedge accounting. 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 a net loss of \$1.4 million and \$0.4 million for the nine months ended June 30, 2017 and 2016, respectively, in connection with all of the Company's foreign currency derivatives instruments, including marked-to-market adjustments.



**Interest rate risk**

We and certain of our subsidiaries are sensitive to interest rate fluctuations primarily as a result of borrowings under our ABL facility from time to time. In order to enhance our ability to manage risk relating to cash flow and interest rate exposure, we and/or our subsidiaries who are borrowers under our ABL facility may from time to time enter into and maintain derivative instruments, such as interest rate swaps or caps, for periods consistent with the related underlying exposures. There were \$81.5 million in borrowings outstanding under the ABL facility outstanding at June 30, 2017. The Company held no interest rate swaps, caps or similar derivative instruments at June 30, 2017.

The Company also has exposure to interest rate fluctuations in connection with the variable-rate tranche of its Term Loan B, as described elsewhere in this Quarterly Report. In order to in part mitigate this exposure, on July 6, 2017, the Company entered into two interest rate caps with an initial aggregate notional amount of \$550 million (the "interest rate caps"). The interest rate caps expire on June 30, 2023 and limit the Company's maximum interest rate in connection with the variable-rate tranche of its Term Loan B (the "hedged cash flows") to 5.5%. The Company intends to designate the interest rate caps as effective cash flow hedges in accordance with GAAP.

We have no exposure to interest rate fluctuations in connection with our senior notes due 2022, 2023 and 2025, as the interest rates on such debt instruments are fixed.

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**Credit risk**

We are exposed to credit risk on certain assets, primarily cash equivalents, short-term investments and accounts receivable. We believe that the credit risk associated with cash equivalents and short-term investments, if any, is largely mitigated by our policy of investing in a diversified portfolio of securities with high credit ratings.

We provide credit to customers in the ordinary course of business and perform ongoing credit evaluations. We believe that our exposure to concentrations of credit risk with respect to trade receivables is largely mitigated by our broad customer base and that our allowance for doubtful accounts is sufficient to cover customer credit risks at June 30, 2017.

**Item 4. Controls and Procedures**

*Controls Evaluation and Related CEO and CFO Certifications.* Our management, with the participation of our principal executive officer ( CEO ) and principal financial officer ( CFO ), conducted an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures as of June 30, 2017. The controls evaluation was conducted by our Disclosure Committee, comprised of senior representatives from our finance, accounting, internal audit, and legal departments under the supervision of our CEO and CFO.

Certifications of our CEO and our CFO, which are required in accordance with Rule 13a-14 of the Exchange Act, are attached as exhibits to this report. This Controls and Procedures section includes the information concerning the controls evaluation referred to in the certifications and it should be read in conjunction with the certifications for a more complete understanding of the topics presented.

*Limitations on the Effectiveness of Controls.* We do not expect that our disclosure controls and procedures will prevent all errors and all fraud. A system of controls and procedures, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the system are met. Because of the limitations in all such systems, no evaluation can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected. Furthermore, the design of any system of controls and procedures is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions, regardless of how unlikely. Because of these inherent limitations in a cost-effective system of controls and procedures, misstatements or omissions due to error or fraud may occur and not be detected.

*Scope of the Controls Evaluation.* The evaluation of our disclosure controls and procedures included a review of their objectives and design, our implementation of the controls and procedures and the effect of the controls and procedures on the information generated for use in this report. In the course of the evaluation, we sought to identify whether we

had any data errors, control problems or acts of fraud and to confirm that appropriate corrective action, including process improvements, was being undertaken if needed. This type of evaluation is performed on a quarterly basis so that conclusions concerning the effectiveness of our disclosure controls and procedures can be reported in our Quarterly Reports on Form 10-Q and our Annual Reports on Form 10-K. Many of the components of our disclosure controls and procedures are also evaluated by our internal audit department, by our legal department and by personnel in our finance organization. The overall goals of these various evaluation activities are to monitor our disclosure controls and procedures on an ongoing basis and to maintain them as dynamic systems that change as conditions warrant.

*Conclusions regarding Disclosure Controls.* Based on the required evaluation of our disclosure controls and procedures, our CEO and CFO have concluded that, as of June 30, 2017, we maintain disclosure controls and procedures that are effective in providing reasonable assurance that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our CEO and CFO, as appropriate to allow timely decisions regarding required disclosure.

*Changes in Internal Control over Financial Reporting.* During our most recent fiscal quarter, there have been no changes in our internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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**PART II OTHER INFORMATION**

**Item 1. Legal Proceedings**

We are involved, from time to time, in various claims and lawsuits incidental to the conduct of our business in the ordinary course. We carry insurance coverage in such amounts in excess of our self-insured retention as we believe to be reasonable under the circumstances and that may or may not cover any or all of our liabilities in respect of these matters. We do not believe that the ultimate resolution of these matters will have a material adverse impact on our consolidated financial position, cash flows or results of operations.

We are subject to a number of U.S., federal, state and local laws and regulations, as well as the laws and regulations applicable in each foreign country or jurisdiction in which we do business. These laws and regulations govern, among other things, the composition, packaging, labeling and safety of the products we sell, the methods we use to sell these products and the methods we use to import these products. We believe that we are in material compliance with such laws and regulations, although no assurance can be provided that this will remain true going forward.

**Item 1A. Risk Factors**

In addition to the other information set forth in this report, you should carefully consider the factors contained in Item 1A. Risk Factors in Part I of our Annual Report on Form 10-K for the fiscal year ended September 30, 2016, which could materially affect our business, financial condition or future results. There have been no material changes from the risk factors disclosed in such Annual Report. The risks described in such Annual Report and herein are not the only risks facing our company.

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

(a) Not applicable

(b) Not applicable

(c) Purchases of Equity Securities by the Issuer and Affiliated Purchasers

The following table provides information about the Company's repurchases of shares of its common stock during the three months ended June 30, 2017:

| <b>Fiscal Period</b>           | <b>Total<br/>Number of<br/>Shares<br/>Purchased<br/>(1)</b> | <b>Average<br/>Price Paid<br/>per Share</b> | <b>Total Number of Shares<br/>Purchased as Part of Publicly<br/>Announced Plans or<br/>Programs (1)(2)</b> | <b>Approximate Dollar<br/>Value of Shares that<br/>May Yet Be Purchased<br/>Under the Plans or<br/>Programs</b> |
|--------------------------------|-------------------------------------------------------------|---------------------------------------------|------------------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------|
| April 1 through April 30, 2017 | 1,413,763                                                   | \$ 19.85                                    | 1,413,763                                                                                                  | \$ 368,179,088                                                                                                  |
| May 1 through May 31, 2017     | 3,490,705                                                   | 19.14                                       | 3,490,705                                                                                                  | 301,382,120                                                                                                     |
| June 1 through June 30, 2017   | 1,263,586                                                   | 18.01                                       | 1,263,586                                                                                                  | 278,626,338                                                                                                     |
| Total this quarter             | 6,168,054                                                   | \$ 19.07                                    | 6,168,054                                                                                                  | \$ 278,626,338                                                                                                  |

(1) The table above does not include 11,991 shares of the Company's common stock surrendered by grantees during the three months ended June 30, 2017 to satisfy tax withholding obligations due upon the vesting of equity-based awards under the Company's share-based compensation plans.

(2) In August 2014, the Company announced that its Board of Directors approved a share repurchase program authorizing the Company to repurchase up to \$1.0 billion of its common stock over an approximate three-year period expiring on September 30, 2017.

### **Item 3. Defaults Upon Senior Securities**

Not applicable

### **Item 4. Mine Safety Disclosures**

Not applicable

### **Item 5. Other Information**

(a) Not applicable

(b) Not applicable

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**Item 6. Exhibits**

| <b>Exhibit No.</b> | <b>Description</b>                                                                                                                                                                                                                                                                                                                                                                                                                                 |
|--------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 3.1                | Third Restated Certificate of Incorporation of Sally Beauty Holdings, Inc., dated January 30, 2014, which is incorporated herein by reference from Exhibit 3.3 to the Company's Current Report on Form 8-K filed on January 30, 2014                                                                                                                                                                                                               |
| 3.2                | Amended and Restated Bylaws of Sally Beauty Holdings, Inc., dated April 26, 2017, which is incorporated herein by reference from Exhibit 3.1 to the Company's Current Report on Form 8-K filed on April 28, 2017                                                                                                                                                                                                                                   |
| 4.1                | Credit Agreement dated July 6, 2017 among the Borrowers, the Parent Guarantors, the Administrative Agent, the Syndication Agent, the Documentation Agent, and the Lenders party thereto (as such terms are defined therein), which is incorporated herein by reference from Exhibit 4.1 to the Company's Current Report on Form 8-K filed on July 6, 2017                                                                                          |
| 4.2                | Amended and Restated Credit Agreement dated July 6, 2017 among the Borrowers, the Guarantors, the Lenders party thereto, the Administrative Agent, the Collateral Agent, the Syndication Agent and the Documentation Agent (as such terms are defined therein), which is incorporated herein by reference from Exhibit 4.2 to the Company's Current Report on Form 8-K filed on July 6, 2017                                                       |
| 31.1               | Rule 13a-14(a)/15d-14(a) Certification of Christian A. Brickman*                                                                                                                                                                                                                                                                                                                                                                                   |
| 31.2               | Rule 13a-14(a)/15d-14(a) Certification of Donald T. Grimes*                                                                                                                                                                                                                                                                                                                                                                                        |
| 32.1               | Section 1350 Certification of Christian A. Brickman*                                                                                                                                                                                                                                                                                                                                                                                               |
| 32.2               | Section 1350 Certification of Donald T. Grimes*                                                                                                                                                                                                                                                                                                                                                                                                    |
| 101                | The following financial information from our Quarterly Report on Form 10-Q for the fiscal quarter ended June 30, 2017, formatted in XBRL (Extensible Business Reporting Language): (i) the Consolidated Statements of Earnings; (ii) the Consolidated Statements of Comprehensive Income; (iii) the Consolidated Balance Sheets; (iv) the Consolidated Statements of Cash Flows; and (v) the Condensed Notes to Consolidated Financial Statements. |

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\* Included herewith

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**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

SALLY BEAUTY HOLDINGS, INC.  
(Registrant)

Date: August 3, 2017

By: /s/ Donald T. Grimes  
Donald T. Grimes  
Senior Vice President, Chief Financial Officer and Chief  
Operations Officer  
For the Registrant and as its Principal Financial Officer