Sally Beauty Holdings, Inc.
Form 10-Q
August 03, 2017
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

FOR THE QUARTERLY PERIOD ENDED: 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

SALLY BEAUTY HOLDINGS, INC.

(Exact name of registrant as specified in its charter)

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**

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 x No o

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 x No o

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 x	Accelerated filer o
Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o
	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 Section13(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 o No x

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 e 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:

- anticipating 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;

- 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;

- 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* 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.

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SALLY BEAUTY HOLDINGS, INC. AND SUBSIDIARIES

Consolidated Statements of Earnings

(In thousands, except per share data)

(Unaudited)

	Three Months Ended June 30, 2017	Three Months Ended June 30, 2016	Nine Months Ended June 30, 2017	Nine Months Ended June 30, 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
Earnings per share:				
Basic	$ 0.49	$ 0.47	$ 1.28	$ 1.15
Diluted	$ 0.49	$ 0.46	$ 1.28	$ 1.14
Weighted average shares:				
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.

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SALLY BEAUTY HOLDINGS, INC. AND SUBSIDIARIES

Consolidated Statements of Comprehensive Income

(In thousands)

(Unaudited)

	Three Months Ended June 30, 2017	Three Months Ended June 30, 2016	Nine Months Ended June 30, 2017	Nine Months Ended June 30, 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), before tax	17,686	(14,119)	7,044	(16,191)
Income taxes related to other comprehensive 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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SALLY BEAUTY HOLDINGS, INC. AND SUBSIDIARIES

Consolidated Balance Sheets

(In thousands, except par value data)

	June 30, 2017 (Unaudited)	September 30, 2016
Assets		
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
Liabilities and Stockholders Deficit		
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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SALLY BEAUTY HOLDINGS, INC. AND SUBSIDIARIES

Consolidated Statements of Cash Flows

(In thousands)

(Unaudited)

	Nine Months Ended June 30, 2017	Nine Months Ended June 30, 2016
Cash Flows from Operating Activities:		
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
Cash Flows from Investing Activities:		
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)
Cash Flows from Financing Activities:		
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
Supplemental Cash Flow Information:		
Interest paid (a)	$ 103,493	$ 138,563
Income taxes paid	$ 84,319	$ 86,916
Capital expenditures incurred but not paid	$ 1,200	$ 6,848

(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.

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**
Assets				
Foreign exchange contracts (a)	$ 25	$	$ 25	$
Total assets	$ 25	$	$ 25	$
Liabilities				
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**
Assets				
Foreign exchange contracts (a)	$	$	$	$
Total assets	$	$	$	$
Liabilities				
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 June 30,		Nine Months Ended 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, 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 June 30,		Nine Months Ended 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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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:

Performance Unit Awards	Number of Shares (in Thousands)	Weighted Average Fair Value Per Share	Weighted Average Remaining Vesting Term (in Years)
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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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 Outstanding Options (in Thousands)	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (in Years)	Aggregate Intrinsic Value (in 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:

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	Number of Options Outstanding (in Thousands)	Weighted Average Remaining Contractual Term (in Years)	Weighted Average Exercise Price	Number of Options Exercisable (in Thousands)	Weighted Average Exercise 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:

	Nine months ended 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:

Restricted Stock Awards	**Number of Shares (in Thousands)**		**Weighted Average Fair Value Per Share**	**Weighted Average Remaining Vesting Term (in Years)**
Unvested at September 30, 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

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 (in Thousands)**		**Weighted Average Fair Value Per Share**	**Weighted Average Remaining Vesting Term (in 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 September 30,**	**Expense**	**Payments, net of recovery**	**Liability at June 30,**

	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, 2017		September 30, 2016	Interest Rates(a)
ABL facility(b)	$	81,500	$		(i) Prime plus (0.50% to 0.75%) or; (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 purchased 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):

	Asset Derivatives			Liability Derivatives		
	Classification	**June 30, 2017**	**September 30, 2016**	**Classification**	**June 30, 2017**	**September 30, 2016**
Derivatives designated as hedging instruments:						
None						
Derivatives not designated as hedging instruments:						
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		

[redacted]

Foreign exchange contracts	Selling, general and administrative expenses	$ (817)	$ 165

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		

[redacted]

Foreign exchange contracts	Selling, general and administrative expenses	$ (1,449)	$ (434)

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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,

	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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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
Assets						
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
Liabilities and Stockholders (Deficit) Equity						
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
Assets						
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
Liabilities and Stockholders (Deficit) Equity						
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 LLC and Sally Capital Inc.	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Consolidating Eliminations	Sally Beauty Holdings, Inc. and Subsidiaries
Net sales	$	$	$ 814,423	$ 183,620	$	$ 998,043
Related party sales			648		(648)	
Cost of products sold and distribution expenses			398,707	97,345	(648)	495,404
Gross profit			416,364	86,275		502,639
Selling, general and 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 for income taxes	(2,726)	(27,033)	125,878	7,250		103,369
Provision (benefit) for income taxes	(1,058)	(10,500)	44,929	3,459		36,830
Equity in earnings of 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, 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 LLC and Sally Capital Inc.	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Consolidating Eliminations	Sally Beauty Holdings, Inc. and Subsidiaries
Net sales	$	$	$ 811,657	$ 186,504	$	$ 998,161
Related party sales			678		(678)	
Cost of products sold and distribution expenses			399,317	100,546	(678)	499,185
Gross profit			413,018	85,958		498,976
Selling, general and 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 for income taxes	(2,800)	(26,774)	127,651	9,304		107,381
Provision (benefit) for income taxes	(1,088)	(10,399)	48,037	2,912		39,462
Equity in earnings of 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, net of tax				(14,119)		(14,119)
Total comprehensive income (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 LLC and Sally Capital Inc.	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Consolidating Eliminations	Sally Beauty Holdings, Inc. and Subsidiaries
Net sales	$	$	$ 2,429,104	$ 535,018	$	$ 2,964,122
Related party sales			1,991		(1,991)	
Cost of products sold and 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 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