Sally Beauty Holdings, Inc.
Form 10-Q
February 02, 2012
Table of Contents

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: DECEMBER 31, 2011

-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	**36-2257936**
(State or other jurisdiction of incorporation or organization)	(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, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

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

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 January 26, 2012, there were 186,313,513 shares of the issuer s common stock outstanding.

Table of Contents

TABLE OF CONTENTS

Table of Contents

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:

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

- the impact of the health of the economy upon our business;
- the success of our cost control plans;
- protecting our intellectual property rights, particularly our trademarks;
- conducting business outside the United States;
- disruption in our information technology systems;
- severe weather, natural disasters or acts of violence or terrorism;
- the preparedness of our accounting and other management systems to meet financial reporting and other requirements and the upgrade of our existing financial reporting system;
- being a holding company, with no operations of our own, and depending on our subsidiaries for cash;
- our substantial indebtedness;
- the possibility that we may incur substantial additional debt in the future;
- restrictions and limitations in the agreements and instruments governing our debt;
- generating the significant amount of cash needed to service 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 our debt or increasing our interest expense due to our interest rate swap agreements;
- the potential impact on us if the financial institutions we deal with become impaired;
- the costs and effects of litigation;
- the representativeness of our historical consolidated financial information with respect to our future financial position, results of operations or cash flows;
- the voting power of our largest stockholder discouraging third party acquisitions of us at a premium; and
- the interests of our largest stockholder differing from the interests of other holders of our common stock.

Table of Contents

Additional factors that could cause actual events or results to differ materially from the events or results described in the forward-looking statements can be found in our Annual Report on Form 10-K for the fiscal year ended September 30, 2011, as filed with the Securities and Exchange Commission. The events described in the forward-looking statements might not occur or might occur to a different extent or at a different time than we have described. As a result, our actual results may differ materially from the results contemplated by these forward-looking statements. We assume no obligation to publicly update or revise any forward-looking statements.

Table of Contents

WHERE YOU CAN FIND MORE INFORMATION

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

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

Table of Contents

PART I FINANCIAL INFORMATION

Item 1. Financial Statements.

The following consolidated balance sheets as of December 31, 2011 and September 30, 2011, and the consolidated statements of earnings and consolidated statements of cash flows for the three months ended December 31, 2011 and 2010 are those of Sally Beauty Holdings, Inc. and its consolidated subsidiaries.

Table of Contents

SALLY BEAUTY HOLDINGS, INC. AND SUBSIDIARIES
Consolidated Statements of Earnings
(In thousands, except per share data)

(Unaudited)

	Three Months Ended December 31, 2011	2010
Net sales	$ 864,815	$ 793,564
Cost of products sold and distribution expenses	442,958	414,173
Gross profit	421,857	379,391
Selling, general and administrative expenses	293,014	272,908
Depreciation and amortization	15,553	14,111
Operating earnings	113,290	92,372
Interest expense	63,961	29,523
Earnings before provision for income taxes	49,329	62,849
Provision for income taxes	19,195	21,900
Net earnings	$ 30,134	$ 40,949
Net earnings per share:		
Basic	$ 0.16	$ 0.22
Diluted	$ 0.16	$ 0.22
Weighted average shares:		
Basic	184,689	182,462
Diluted	190,208	187,201

The accompanying condensed notes, together with the Notes to Consolidated Financial Statements contained in the Company s Annual Report on Form 10-K for the fiscal year ended September 30, 2011, are an integral part of these financial statements.

Table of Contents

SALLY BEAUTY HOLDINGS, INC. AND SUBSIDIARIES
Consolidated Balance Sheets
(In thousands, except par value data)

	December 31, 2011 (Unaudited)	September 30, 2011
Assets		
Current assets:		
Cash and cash equivalents	$ 71,525	$ 63,481
Trade accounts receivable, less allowance for doubtful accounts of $2,155 at December 31, 2011 and $2,086 at September 30, 2011	58,433	61,996
Accounts receivable, other	36,529	33,530
Inventory	684,357	665,246
Prepaid expenses	29,097	26,360
Deferred income tax assets, net	28,574	28,535
Total current assets	908,515	879,148
Property and equipment, net of accumulated depreciation of $326,269 at December 31, 2011 and $317,677 at September 30, 2011	184,427	182,489
Goodwill	529,258	505,873
Intangible assets, excluding goodwill, net of accumulated amortization of $48,657 at December 31, 2011 and $45,467 at September 30, 2011	137,832	129,658
Other assets	32,666	31,432
Total assets	$ 1,792,698	$ 1,728,600
Liabilities and Stockholders Deficit		
Current liabilities:		
Current maturities of long-term debt	$ 4,736	$ 3,004
Accounts payable	250,282	262,114
Accrued liabilities	152,430	185,509
Income taxes payable	18,813	9,379
Total current liabilities	426,261	460,006
Long-term debt	1,452,484	1,410,111
Other liabilities	27,389	26,154
Deferred income tax liabilities, net	55,089	51,311
Total liabilities	1,961,223	1,947,582
Stockholders deficit:		
Common stock, $0.01 par value. Authorized 500,000 shares; 185,677 and 184,502 shares issued and 185,303 and 184,057 shares outstanding at December 31, 2011 and September 30, 2011, respectively	1,853	1,841
Preferred stock, $0.01 par value. Authorized 50,000 shares; none issued		
Additional paid-in capital	701,952	681,256
Accumulated deficit	(849,171)	(879,305)
Treasury stock, 15 shares at December 31, 2011 and September 30, 2011, at cost	(103)	(103)
Accumulated other comprehensive loss, net of tax	(23,056)	(22,671)
Total stockholders deficit	(168,525)	(218,982)
Total liabilities and stockholders deficit	$ 1,792,698	$ 1,728,600

The accompanying condensed notes, together with the Notes to Consolidated Financial Statements contained in the Company s Annual Report on Form 10-K for the fiscal year ended September 30, 2011, are an integral part of these financial statements.

8

Table of Contents

SALLY BEAUTY HOLDINGS, INC. AND SUBSIDIARIES
Consolidated Statements of Cash Flows
(In thousands)

(Unaudited)

	Three Months Ended December 31, 2011	Three Months Ended December 31, 2010
Cash Flows from Operating Activities:		
Net earnings	$ 30,134	$ 40,949
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation and amortization	15,553	14,111
Share-based compensation expense	8,031	7,838
Amortization of deferred financing costs	1,646	1,773
Excess tax benefit from share-based compensation	(4,085)	(531)
Net loss on disposal of property and equipment	2	38
Net loss on extinguishment of debt	34,558	1,585
Deferred income tax expense	193	392
Changes in (exclusive of effects of acquisitions):		
Trade accounts receivable	4,798	4,439
Accounts receivable, other	(2,501)	(6,757)
Inventory	(10,128)	(9,925)
Prepaid expenses	(2,992)	(612)
Other assets	49	(87)
Accounts payable and accrued liabilities	(45,501)	(42,557)
Income taxes payable	12,991	16,747
Other liabilities	1,231	867
Net cash provided by operating activities	43,979	28,270
Cash Flows from Investing Activities:		
Capital expenditures	(13,852)	(15,230)
Proceeds from sale of property and equipment	14	124
Acquisitions, net of cash acquired	(42,751)	(78,819)
Net cash used by investing activities	(56,589)	(93,925)
Cash Flows from Financing Activities:		
Change in book cash overdraft		2,818
Proceeds from issuance of long-term debt	929,200	222,404
Repayments of long-term debt	(909,145)	(179,343)
Debt issuance costs	(12,592)	(4,667)
Proceeds from exercises of stock options	8,993	2,874
Excess tax benefit from share-based compensation	4,085	531
Net cash provided by financing activities	20,541	44,617
Effect of foreign exchange rate changes on cash and cash equivalents	113	(75)
Net increase (decrease) in cash and cash equivalents	8,044	(21,113)
Cash and cash equivalents, beginning of period	63,481	59,494
Cash and cash equivalents, end of period	$ 71,525	$ 38,381
Supplemental Cash Flow Information:		
Interest paid (a)	$ 70,241	$ 42,855
Income taxes paid, net	$ 6,156	$ 4,891

(a) For the three months ended December 31, 2011, interest paid includes $24.4 million in call premiums paid upon the redemption of certain notes.

The accompanying condensed notes, together with the Notes to Consolidated Financial Statements contained in the Company s Annual Report on Form 10-K for the fiscal year ended September 30, 2011, are an integral part of these financial statements.

Table of Contents

Sally Beauty Holdings, Inc. and Subsidiaries

Condensed Notes to Consolidated Financial Statements

(Unaudited)

1. Description of Business and Basis of Presentation

Description of Business

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

Basis of Presentation

The consolidated interim financial statements include the accounts of the Company and its subsidiaries. All significant inter-company accounts and transactions have been eliminated in consolidation. In the opinion of management, these consolidated financial statements reflect all adjustments which are of a normal recurring nature and which are necessary to present fairly the Company s consolidated financial position as of December 31, 2011 and September 30, 2011, and its consolidated results of operations and consolidated cash flows for the three months ended December 31, 2011 and 2010.

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

2. Significant Accounting Policies

The consolidated interim financial statements included herein are unaudited and have been prepared by the Company pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). Certain information and note disclosures normally included in annual financial statements prepared in accordance with accounting principles generally accepted in the United States (GAAP) have been condensed or omitted pursuant to those rules and regulations, although the Company believes that the disclosures made are adequate to make the information not misleading. These consolidated interim financial statements should be read in conjunction with the financial statements and notes thereto included in the Company s Annual Report on Form 10-K for the fiscal year ended September 30, 2011. The Company adheres to the same accounting policies in the preparation of its interim financial statements. As permitted under GAAP, interim accounting for certain expenses, including income taxes, is based on full year assumptions. Such amounts are expensed in full in the year incurred. For interim financial reporting purposes, income taxes are recorded based upon estimated annual effective income tax rates.

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

3. Recent Accounting Pronouncements and Accounting Changes

Recent Accounting Pronouncements

In December 2010, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2010-28 which amended Accounting Standards Codification (ASC) Topic 350, *Intangibles-Goodwill and Other* (ASC 350). This amendment modified the goodwill impairment test for reporting units with a zero or negative carrying amount, by requiring that Step 2 of the goodwill impairment test be performed for such reporting units if it is more likely than not that an impairment of goodwill exists. The Company adopted this amendment during the first quarter of its fiscal year 2012 and its adoption did not have a material effect on the Company s consolidated financial position, results of operations or cash flows.

In December 2010, the FASB issued ASU No. 2010-29 which amended ASC Topic 805, *Business Combinations*. This amendment requires that a public company that enters into business combinations that are material on an individual or aggregate basis disclose certain pro-forma information for the current and the immediately preceding fiscal year. This amendment also expands the supplemental pro-forma disclosures to include a description of the nature and amount of material, non-recurring pro-forma adjustments directly attributable to such business combination or business combinations. The Company adopted this amendment during the first quarter of its fiscal year 2012 and its adoption did not have a material effect on the Company s consolidated financial position, results of operations or cash flows.

We have not yet adopted and are currently assessing any potential effect of the following recent pronouncements on our consolidated financial statements:

In May 2011, the FASB issued ASU No. 2011-04 which amended ASC Topic 820, *Fair Value Measurements and Disclosures* (ASC 820). When effective, this amendment will change the title of ASC 820 to Fair Value Measurement and will adopt

Table of Contents

Sally Beauty Holdings, Inc. and Subsidiaries

Condensed Notes to Consolidated Financial Statements

(Unaudited)

fair value measurement and disclosure guidance that is generally consistent with the corresponding International Financial Reporting Standards (IFRS) guidance. More specifically, this amendment will change certain requirements for measuring fair value or for disclosing information about fair value measurements or, alternatively, clarify the FASB s intent about the application of existing fair value measurement and disclosure requirements. For public companies, this amendment is effective for interim periods and fiscal years beginning after December 15, 2011. Early application by public companies is not permitted.

In June 2011, the FASB issued ASU No. 2011-05 which amended ASC Topic 220, *Comprehensive Income* (ASC 220). This amendment, which must be applied retrospectively, will allow an entity the option to present the components of net income, as well as total comprehensive income and the components of other comprehensive income, either in a single continuous statement of comprehensive income or in two separate consecutive statements. This amendment also eliminates the option to present the components of other comprehensive income in the statement of stockholders equity but does not change the items that must be reported. In addition, in December 2011, the FASB issued ASU No. 2011-12 which further amended ASC 220. More specifically, this amendment provided for deferral, until further action by the FASB, of the effective date for changes to the presentation of reclassifications of items out of accumulated other comprehensive income required by ASU No. 2011-05. For public companies, these amendments are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2011. Early application is permitted.

In September 2011, the FASB issued ASU No. 2011-08 which amended ASC 350. This amendment will allow an entity to first assess relevant qualitative factors in order to determine whether it is necessary to perform the two-step quantitative goodwill impairment test under ASC 350. In effect, the amendment eliminates the need to calculate the fair value of a reporting unit in connection with the goodwill impairment test unless the entity determines, based on the qualitative assessment, that it is more likely than not that the reporting unit s fair value is less than its carrying amount. This amendment is effective for annual and interim goodwill impairment tests performed in fiscal years beginning after December 15, 2011. Early application is permitted.

Accounting Changes

The Company made no accounting changes during the three months ended December 31, 2011.

4. Fair Value Measurements

The Company s financial instruments consist of cash and cash equivalents, trade and other accounts receivable, accounts payable, interest rate swap agreements, foreign currency option, collar and forward agreements and debt. The carrying amounts of cash and cash equivalents, trade and other accounts receivable and accounts payable approximate fair value due to the short-term nature of these financial instruments.

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

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

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

Level 3 - Unobservable inputs for the asset or liability.

Table of Contents

Sally Beauty Holdings, Inc. and Subsidiaries

Condensed Notes to Consolidated Financial Statements

(Unaudited)

Consistent with this hierarchy, the Company categorized certain of its financial assets and liabilities as follows at December 31, 2011 (in thousands):

	As of December 31, 2011			
	Total	Level 1	Level 2	Level 3
Assets				
Foreign currency forwards (a)	$ 15		$ 15	
Foreign currency collars (a)	746		746	
Total assets	$ 761		$ 761	
Liabilities				
Long-term debt (b)(c)	$ 1,484,606	$ 780,000	$ 704,606	
Hedged interest rate swaps (a)	4,006		4,006	
Foreign currency forwards (a)	27		27	
Total liabilities	$ 1,488,639	$ 780,000	$ 708,639	

Consistent with this hierarchy, the Company categorized certain of its financial assets and liabilities as follows at September 30, 2011 (in thousands):

	As of September 30, 2011			
	Total	Level 1	Level 2	Level 3
Assets				
Foreign currency forwards (a)	$ 424		$ 424	
Foreign currency collars (a)	680		680	
Total assets	$ 1,104		$ 1,104	
Liabilities				
Long-term debt (b)(c)	$ 1,420,337	$ 725,288	$ 695,049	
Hedged interest rate swaps (a)	6,450		6,450	
Foreign currency forwards (a)	528		528	
Total liabilities	$ 1,427,315	$ 725,288	$ 702,027	

(a) Foreign currency options, collars and forwards, and interest rate swaps are valued for purposes of this disclosure using widely accepted valuation techniques, such as discounted cash flow analyses, and reasonable estimates, such as projected market interest rates and projected foreign currency exchange rates, as appropriate. Please see Note 10 for more information about the Company s foreign currency options, collars and forwards, and interest rate swaps.

(b) Long-term debt, which is carried at amortized cost in the Company s consolidated financial statements, 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, except for the senior and senior subordinated notes (prior to their redemption) and the senior notes due 2019 (the new senior notes). The senior and senior subordinated notes (prior to their redemption) were, and the new senior notes are, valued using unadjusted quoted market prices for such debt securities. Please see Note 9 for more information about the Company s debt.

(c) In November 2011, the Company and certain of its domestic subsidiaries issued $750.0 million aggregate principal amount of the Company s 6.875% Senior Notes due 2019. In December 2011, the Company redeemed its senior notes due 2014 and its senior subordinated notes due 2016 with the net proceeds from the 6.875% Senior Notes due 2019. Please see Note 9 for more information about the Company s debt.

Table of Contents

Sally Beauty Holdings, Inc. and Subsidiaries

Condensed Notes to Consolidated Financial Statements

(Unaudited)

5. Net Earnings Per Share

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

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

	Three Months Ended December 31, 2011		Three Months Ended December 31, 2010	
Net earnings	$	30,134	$	40,949
Total weighted average basic shares		184,689		182,462
Dilutive securities:				
Stock option and stock award programs		5,519		4,739
Total weighted average diluted shares		190,208		187,201
Net earnings per share:				
Basic	$	0.16	$	0.22
Diluted	$	0.16	$	0.22

At December 31, 2011 and 2010, options to purchase 1,966,491 shares and 2,999,200 shares, respectively, of the Company s common stock were outstanding but not included in the computation of diluted earnings per share, since these options were anti-dilutive. Anti-dilutive options are: (a) out-of-the-money options (options the exercise price of which is greater than the average price per share of the Company s common stock during the period), and (b) in-the-money options (options the exercise price of which is less than the average price per share of the Company s common stock during the period) for which the sum of assumed proceeds, including unrecognized compensation expense, exceeds the average price per share for the period.

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

Comprehensive income consists of net earnings, foreign currency translation adjustments and deferred gain on interest rate swaps as follows (in thousands):

	Three Months Ended December 31,			
		2011		2010
Net earnings	$	30,134	$	40,949
Other comprehensive income adjustments:				
Foreign currency translation adjustments (a)		(1,880)		691
Deferred gain on interest rate swaps (b)		1,495		1,529
Comprehensive income	$	29,749	$	43,169

(a) There were no income tax amounts related to foreign currency translation adjustments recorded in other comprehensive income for the three months ended December 31, 2011 and 2010.

(b) Amounts are net of income tax of $0.9 million and $1.0 million for the three months ended December 31, 2011 and 2010, respectively.

Table of Contents

Sally Beauty Holdings, Inc. and Subsidiaries

Condensed Notes to Consolidated Financial Statements

(Unaudited)

The components of accumulated other comprehensive (loss) income, net of tax, as of December 31, 2011 and September 30, 2011 are as follows (in thousands):

	December 31, 2011	September 30, 2011
Cumulative foreign currency translation adjustments (a)	$ (20,604)	$ (18,724)
Deferred (losses) on interest rate swaps, net of tax (b)	(2,452)	(3,947)
Total accumulated other comprehensive loss, net of tax	$ (23,056)	$ (22,671)

(a) There were no income tax amounts related to foreign currency translation adjustments at December 31, 2011 and September 30, 2011.

(b) Amounts are net of income tax of $1.6 million and $2.5 million at December 31, 2011 and September 30, 2011, respectively. Please see Note 10 for more information about the Company s interest rate swaps.

7. Share-Based Payments

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

The Company granted approximately 2.0 million and 3.0 million stock options and approximately 32,000 and 199,000 restricted share awards to its employees and consultants during the three months ended December 31, 2011 and 2010, respectively. Upon issuance of such grants, the Company recognized accelerated share-based compensation expense of $5.3 million and $5.0 million in the three months ended December 31, 2011 and 2010, respectively, in connection with certain retirement eligible employees who are eligible to continue vesting awards upon retirement under the provisions of the Sally Beauty Holdings, Inc. 2010 Omnibus Incentive Plan (the 2010 Plan) and certain predecessor share-based plans such as the Sally Beauty Holdings, Inc. 2007 Omnibus Incentive Plan (the 2007 Plan). In addition, the Company granted approximately 26,000 and 43,000 restricted stock units to its non-employee directors during the three months ended December 31, 2011 and 2010, respectively.

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

	Three Months Ended December 31, 2011		Three Months Ended December 31, 2010	
Share-based compensation expense	$	8,031	$	7,838
Income tax benefit related to share-based compensation expense	$	3,116	$	3,041

Stock Options

Each option has an exercise price that equals 100% of the closing market price of the Company s common stock on the date of grant and generally has a maximum term of 10 years. Options generally vest ratably over a four year period and are generally subject to forfeiture until the vesting period is complete, subject to certain retirement provisions contained in the 2010 Plan and certain predecessor share-based compensation plans such as the 2007 Plan.

Table of Contents

Sally Beauty Holdings, Inc. and Subsidiaries

Condensed Notes to Consolidated Financial Statements

(Unaudited)

The following table presents a summary of the activity for the Company s stock option plans for the three months ended December 31, 2011:

	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, 2011	13,778	$ 8.50	6.8	$ 111,571
Granted	1,979	19.21		
Exercised	(1,165)	7.72		
Forfeited or expired	(108)	10.37		
Outstanding at December 31, 2011	14,484	$ 10.01	6.9	$ 160,998
Exercisable at December 31, 2011	8,354	$ 8.27	5.6	$ 107,470

The following table summarizes information about stock options under the Company s option plans at December 31, 2011:

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	Number Outstanding at December 31, 2011 (in Thousands)	Weighted Average Remaining Contractual Term (in Years)	Weighted Average Exercise Price	Number Exercisable at December 31, 2011 (in Thousands)	Weighted Average Exercise Price
$2.00 5.24	2,287	5.8	$ 4.67	1,682	$ 4.46
$7.42 19.21	12,197	7.1	11.02	6,672	9.22
Total	14,484	6.9	$ 10.01	8,354	$ 8.27

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

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

	Three Months Ended December 31, 2011	Three Months Ended December 31, 2010
Expected life (in years)	5.0	5.0
Expected volatility	58.4%	59.0%
Risk-free interest rate	1.1%	1.1%
Dividend yield	0.0%	0.0%

The expected life of options represents the period of time that the options granted are expected to be outstanding and is based on historical experience of employees of the Company who have been granted stock options. For awards prior to the fiscal year 2012, the expected volatility used by the Company was derived using the average volatility of both the Company and similar companies (based on industry sector) since it was not practicable to estimate the Company s expected volatility on a stand-alone basis due to a lack of sufficient trading history. The risk-free interest rate is based on the five-year zero-coupon U.S. Treasury notes as of the date of the grant. Since the Company does not currently expect to pay dividends, the dividend yield used is 0%.

The weighted average fair value of the stock options issued to the Company s grantees at the date of grant in the three months ended December 31, 2011 and 2010 was $9.60 and $5.74 per option, respectively. The total intrinsic value of options exercised

Table of Contents

Sally Beauty Holdings, Inc. and Subsidiaries

Condensed Notes to Consolidated Financial Statements

(Unaudited)

during the three months ended December 31, 2011 was $13.8 million. Cash proceeds from these option exercises were $9.0 million and the tax benefit realized from these option exercises was $5.4 million.

At December 31, 2011, approximately $22.3 million of total unrecognized compensation costs related to unvested stock option awards are expected to be recognized over the weighted average period of 2.8 years.

Stock Awards

Restricted Stock Awards

The Company from time to time grants restricted stock awards to employees and consultants under the 2010 Plan. A restricted stock award is an award of shares of the Company s common stock (which have full voting and dividend rights but are restricted with regard to sale or transfer) the restrictions over which lapse ratably over a specified period of time (generally five years). Restricted stock awards are independent of stock option grants and are generally subject to forfeiture if employment terminates prior to these restrictions lapsing, subject to certain retirement provisions of the 2010 Plan and certain predecessor share-based compensation plans such as the 2007 Plan.

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

The following table presents a summary of the activity for the Company s restricted stock awards for the three months ended December 31, 2011:

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, 2011	445	$ 9.12	3.1
Granted	32	19.21	
Vested	(103)	8.81	

Forfeited				
Unvested at December 31, 2011	374	$	10.07	2.9

At December 31, 2011, approximately $2.5 million of total unrecognized compensation costs related to unvested restricted stock awards are expected to be recognized over the weighted average period of 2.9 years.

Restricted Stock Units

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

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

Table of Contents

Sally Beauty Holdings, Inc. and Subsidiaries

Condensed Notes to Consolidated Financial Statements

(Unaudited)

The following table presents a summary of the activity for the Company s RSUs for the three months ended December 31, 2011:

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, 2011		$		
Granted	26		19.21	
Vested				
Forfeited				
Unvested at December 31, 2011	26	$	19.21	0.8

At December 31, 2011, approximately $0.4 million of total unrecognized compensation costs related to unvested RSUs are expected to be recognized over the weighted average period of 0.8 years.

8. Goodwill and Intangible Assets

The change in the carrying amounts of goodwill by operating segment for the three months ended December 31, 2011 is as follows (in thousands):

		Sally Beauty Supply		**Beauty Systems Group**		**Total**
Balance at September 30, 2011	$	75,536	$	430,337	$	505,873
Additions and purchase price adjustments (a)		14,930		9,189		24,119
Foreign currency translation		(1,830)		1,096		(734)
Balance at December 31, 2011	$	88,636	$	440,622	$	529,258

(a) Please see Note 12 for additional information about businesses acquired.

The following table provides the carrying value for intangible assets with indefinite lives, excluding goodwill, and the gross carrying value and accumulated amortization for intangible assets subject to amortization by operating segment at December 31, 2011 (in thousands):

	Sally Beauty Supply	Beauty Systems Group	Total
Balance at December 31, 2011:			
Intangible assets with indefinite lives:			
Trade names	$ 26,833	$ 33,710	$ 60,543
Total	26,833	33,710	60,543
Intangible assets subject to amortization:			
Gross carrying amount	26,279	99,667	125,946
Accumulated amortization	(7,319)	(41,338)	(48,657)
Net value	18,960	58,329	77,289
Total intangible assets, excluding goodwill, net	$ 45,793	$ 92,039	$ 137,832

As described in Note 12, during the three months ended December 31, 2011, intangible assets subject to amortization in the amount of $11.7 million were recorded in connection with the Company s November 1, 2011 acquisition of Kappersservice Floral B.V. and two related companies (the Floral Group) based on their preliminary estimated fair values.

Table of Contents

Sally Beauty Holdings, Inc. and Subsidiaries

Condensed Notes to Consolidated Financial Statements

(Unaudited)

Amortization expense was $3.2 million and $3.1 million for the three months ended December 31, 2011 and 2010, respectively. As of December 31, 2011, future amortization expense related to intangible assets subject to amortization is estimated to be as follows (in thousands):

Fiscal Year:		
2012	$	9,340
2013		10,805
2014		10,576
2015		10,063
2016		8,928
Thereafter		27,577
	$	77,289

9. Short-term Borrowings and Long-term Debt

Details of long-term debt are as follows (in thousands):

		As of December 31, 2011	**Maturity Dates**		**Interest Rates**
ABL facility	$		Nov. 2015	(i)	Prime plus (1.25% to 1.75%) or;
				(ii)	LIBOR plus (2.25% to 2.75%)
Term loan B		696,856	Nov. 2013	(i)	Prime plus (1.25% to 1.50%) or;
				(ii)	LIBOR plus (2.25% to 2.50%) (a)
Senior notes		750,000	Nov. 2019		6.875%
Other (b)		4,266	2012-2015		4.05% to 7.00%
Total	$	1,451,122			
Capital leases and other	$	6,098			
Less: current portion		(4,736)			
Total long-term debt	$	1,452,484			

(a) At December 31, 2011, the contractual interest rate for the term loan B is 2.55%. The interest rate on $300.0 million of principal outstanding under this loan is fixed by interest rate swaps which expire in May 2012.

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

The Company, through its subsidiaries (Sally Investment Holdings LLC (Sally Investment) and Sally Holdings LLC (Sally Holdings)), incurred $1,850.0 million of indebtedness in connection with the Company s separation from its former parent, Alberto-Culver Company, in November 2006. These borrowings included: (i) drawing on a revolving (asset-based lending (ABL)) credit facility in the amount of $70.0 million, (ii) entering into two senior term loan facilities (term loans A and B) in an aggregate amount of $1,070.0 million and (iii) together (jointly and severally) with another of the Company s indirect subsidiaries, Sally Capital Inc., issuing senior notes in an aggregate amount of $430.0 million and senior subordinated notes in an aggregate amount of $280.0 million. Borrowings under the term loan A facility were paid in full in the fiscal year 2010.

In November 2010, Sally Holdings entered into a new $400 million, five-year revolving credit facility (the new ABL facility or the ABL facility) and terminated its prior ABL credit facility (the prior ABL facility). The terms of the new ABL facility contain a commitment fee of 0.50% on the unused portion of the facility. Borrowings under the senior term loan facilities and the ABL facility are secured by substantially all of our assets, those of Sally Investment, a wholly-owned subsidiary of Sally Beauty and the direct parent of Sally Holdings, those of our domestic subsidiaries and, in the case of the ABL facility, those of our Canadian subsidiaries and a pledge of certain intercompany notes. Borrowings under the ABL facility bear interest at Prime plus 1.25% to 1.75% or LIBOR plus 2.25% to 2.75%. During the three months ended December 31, 2010, in connection with our termination of the prior ABL facility, we expensed approximately $1.6 million in unamortized deferred financing costs. This amount is included in interest expense in the Company s consolidated statements of earnings.

In November 2011, Sally Holdings and Sally Capital Inc. (collectively, the Issuers), both wholly-owned subsidiaries of the Company, the Company and certain of its domestic subsidiaries entered into an agreement pursuant to which the Issuers sold in

Table of Contents

Sally Beauty Holdings, Inc. and Subsidiaries

Condensed Notes to Consolidated Financial Statements

(Unaudited)

a private placement $750.0 million aggregate principal amount of the Issuers 6.875% Senior Notes due 2019 (the Senior Notes). The Senior Notes bear interest at an annual rate of 6.875% and were issued at par. In connection with the issuance of the Senior Notes, the Company incurred and capitalized financing costs of approximately $13.1 million. These deferred financing costs are included in other assets on our consolidated balance sheets and are being amortized over the term of the Senior Notes using the effective interest method.

In December 2011, the Issuers used the net proceeds from their issuance of the Senior Notes: (i) to redeem $430.0 million aggregate principal amount outstanding of the Issuers 9.25% senior notes due 2014, (ii) to redeem $275.0 million aggregate principal amount outstanding of the Issuers 10.50% senior subordinated notes due 2016 (together with the senior notes due 2014, the Old Notes), pursuant to the terms of the indentures governing the Old Notes, and (iii) to pay accrued and unpaid interest on the Old Notes, and fees and expenses incurred in connection with issuance of the Senior Notes and redemption of the Old Notes. During the three months ended December 31, 2011, in connection with the Company s redemption of the Old Notes, the Company recorded a charge to earnings in the amount of approximately $34.6 million, including approximately $24.4 million in call premiums paid and approximately $10.2 million in unamortized deferred financing costs expensed. This amount is included in interest expense in the Company s consolidated statements of earnings.

Borrowings under the senior term loan facilities and the ABL facility are secured by substantially all of our assets, those of Sally Investment, a wholly-owned subsidiary of Sally Beauty and the direct parent of Sally Holdings, those of our domestic subsidiaries and, in the case of the ABL facility, those of our Canadian subsidiaries and a pledge of certain intercompany notes. Borrowings under the term loan B facility may be prepaid at the option of Sally Holdings at any time without premium or penalty and are subject to mandatory prepayment in an amount equal to 50% of excess cash flows (as defined in the agreement governing the senior term loan facilities) for any fiscal year unless a specified leverage ratio is met. Amounts paid pursuant to said provision may be applied, at the option of the Company, against minimum loan repayments otherwise required of us over the twelve-month period following any such payment under the terms of the loan agreement. Additionally, borrowings under the senior term loan facilities would be subject to mandatory prepayment in an amount equal to 100% of the proceeds of specified asset sales that are not reinvested in the business or applied to repay borrowings under the ABL facility.

The Senior Notes are unsecured obligations of the Issuers and are jointly and severally guaranteed by the Company and Sally Investment, and by each material domestic subsidiary of the Company who had guaranteed obligations under Sally Holdings senior credit facilities, existing notes and other indebtedness outstanding prior to issuance of the Senior Notes. Furthermore, the agreements underlying the Company s credit facilities contain terms which significantly restrict the ability of Sally Beauty s subsidiaries to pay dividends or otherwise transfer assets to Sally Beauty. Please see the Company s Annual Report on Form 10-K for the fiscal year ended September 30, 2011, for additional information about the Company s long-term debt.

Maturities of the Company s long-term debt are as follows as of December 31, 2011 (in thousands):

Fiscal Year:		
2012	$	1,840

2013		8,586
2014		690,599
2015		97
2016		
Thereafter		750,000
	$	1,451,122
Capital leases and other		6,098
Less: current portion		(4,736)
Total	$	1,452,484

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

Under the agreements and/or indentures governing the senior term loan facilities and the Senior Notes, Sally Holdings may not make certain restricted payments to us if a default then exists under the credit agreement or the indentures or if its consolidated interest coverage ratio is less than 2.0 to 1.0 at the time of the making of such restricted payment. As of December 31, 2011, its consolidated interest coverage ratio exceeded 2.0 to 1.0. Further, the aggregate amount of restricted payments it is able to make is limited pursuant to various baskets as calculated pursuant to the credit agreement and indentures.

Table of Contents

Sally Beauty Holdings, Inc. and Subsidiaries

Condensed Notes to Consolidated Financial Statements

(Unaudited)

Under our ABL facility, we may pay dividends and make other equity distributions if availability under the facility exceeds certain thresholds and no default then exists under the facility. For dividends and distributions up to $30.0 million during each fiscal year, borrowing availability must exceed the lesser of $80.0 million or 20% of the borrowing base for 45 days prior to such dividend and distribution. For dividends in excess of that amount, we must maintain that same availability and our fixed charge coverage ratio must exceed 1.10 to 1.00. As of December 31, 2011, we met all of these conditions. As of December 31, 2011, the net assets of our consolidated subsidiaries that were unrestricted from transfer under our credit arrangements totaled $513.9 million, subject to certain adjustments. The ABL facility and the senior term loan facilities, as well as the Company s Senior Notes indenture contain customary cross-default and/or cross-acceleration provisions.

10. 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 interest rates and in foreign currency exchange 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 interest rate swaps, and foreign currency options, collars and forwards) by Sally Holdings.

The Company uses interest rate swaps, as part of its overall economic risk management strategy, to add stability to the interest payments due in connection with its term loan obligations. Interest payments related to the senior term loans are impacted by changes in LIBOR. The Company s interest rate swap agreements involve the periodic receipt by Sally Holdings of amounts based on a variable rate in exchange for Sally Holdings making payments based on a fixed rate over the term of the interest rate swap agreements, without exchange of the underlying notional amount.

The Company uses foreign currency options, collars and forwards, as part of its overall economic risk management strategy, to fix the amount of certain foreign assets and obligations relative to its functional and reporting currency (the U.S. dollar) or 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, providing a natural hedge against its foreign currency risk. In connection with the remaining foreign currency risk, the Company uses foreign currency options, collars and forwards to effectively fix the foreign currency exchange rate applicable to specific anticipated foreign currency-denominated cash flows, thus limiting the potential fluctuations in such cash flows resulting from foreign currency market movements.

As of December 31, 2011, the Company did not purchase or hold any derivative instruments for trading or speculative purposes.

Designated Cash Flow Hedges

In 2008, Sally Holdings entered into certain interest rate swap agreements with an aggregate notional amount of $300 million. These agreements expire in May 2012 and are designated and qualify as effective cash flow hedges, in accordance with ASC Topic 815, *Derivatives and Hedging* (ASC 815). Accordingly, changes in the fair value of these derivative instruments (which are adjusted quarterly) are recorded, net of income tax, in accumulated other comprehensive (loss) income (OCI) until the hedged obligation is settled or the swap agreements expire, whichever is earlier. Any hedge ineffectiveness, as this term is used in ASC 815, is recognized in interest expense in our consolidated statements of earnings. No hedge ineffectiveness on cash flow hedges was recognized during the three months ended December 31, 2011 or 2010. Please see the Company s Annual Report on Form 10-K for the fiscal year ended September 30, 2011 for additional information about the Company s interest rate swap agreements.

Amounts reported in OCI related to interest rate swaps are reclassified into interest expense, as a yield adjustment, in the same period in which interest on the Company s hedged variable-rate debt obligations affect earnings. Interest expense resulting from such reclassifications was $2.6 million and $2.5 million during the three months ended December 31, 2011 and 2010, respectively. During the fiscal year ending September 30, 2012, the entire amount reported in OCI ($4.0 million, before income tax) as of December 31, 2011 will be reclassified into interest expense.

Table of Contents

Sally Beauty Holdings, Inc. and Subsidiaries

Condensed Notes to Consolidated Financial Statements

(Unaudited)

Non-designated Cash Flow Hedges

The Company uses foreign currency options and collars, including, at December 31, 2011, collars with an aggregate notional amount of $10.1 million to manage the exposure to the U.S. dollar resulting from certain of our Sinelco Group subsidiaries purchases of merchandise from third-party suppliers. Sinelco s functional currency is the Euro. The foreign currency collar agreements held by the Company at December 31, 2011 have contractual Euro to U.S. dollar exchange rates between 1.4000 and 1.4612 and expire in varying amounts monthly through September 2012.

In addition, the Company currently uses foreign currency forwards to mitigate its exposure to changes in foreign currency exchange rates in connection with certain intercompany balances not permanently invested. At December 31, 2011, we hold: (a) a foreign currency forward which enables us to sell approximately 19.9 million ($25.8 million, at the December 31, 2011 exchange rate) at the contractual exchange rate of 1.2950, (b) foreign currency forwards which enable us to sell, in the aggregate, approximately $4.0 million Canadian dollars ($4.0 million, at the December 31, 2011 exchange rate) at the weighted average contractual exchange rate of 1.0233, (c) a foreign currency forward which enables us to sell approximately 23.8 million Mexican pesos ($1.7 million, at the December 31, 2011 exchange rate) at the contractual exchange rate of 14.016 and (d) a foreign currency forward which enables us to buy approximately £2.5 million ($3.8 million, at the December 31, 2011 exchange rate) at the contractual exchange rate of 1.5434. All of the foreign currency forwards held by the Company at December 31, 2011 expire on or before March 30, 2012.

The Company s foreign currency derivatives are not designated as hedges and do not currently meet the hedge accounting requirements of ASC 815. Accordingly, the changes in fair value of these derivative instruments, which are adjusted quarterly, are recorded in our consolidated statements of earnings. For the three months ended December 31, 2011 and 2010, selling, general and administrative expenses reflect net gains of $1.7 million and $0.6 million, respectively, including marked-to-market adjustments, in connection with all of the Company s foreign currency derivatives.

The table below presents the fair value of the Company s derivative financial instruments as well as their classification on the balance sheet as of December 31, 2011 (in thousands):

Tabular Disclosure of Fair Values of Derivative Instruments

	Asset Derivatives As of December 31, 2011		**Liability Derivatives As of December 31, 2011**	
	Balance Sheet Location	**Fair Value**	**Balance Sheet Location**	**Fair Value**

Derivatives designated as hedging instruments:						
Interest Rate Swaps	Other assets	$		Accrued liabilities	$	4,006
Total derivatives designated as hedging instruments		$			$	4,006
Derivatives not designated as hedging instruments:						
Foreign Currency Collars and Forwards	Prepaid expenses	$	761	Accrued liabilities	$	27
Total derivatives not designated as hedging instruments		$	761		$	27

Table of Contents

Sally Beauty Holdings, Inc. and Subsidiaries

Condensed Notes to Consolidated Financial Statements

(Unaudited)

The table below presents the fair value of the Company s derivative financial instruments as well as their classification on the balance sheet as of September 30, 2011 (in thousands):

Tabular Disclosure of Fair Values of Derivative Instruments

	Asset Derivatives As of September 30, 2011			**Liability Derivatives As of September 30, 2011**		
	Balance Sheet Location	**Fair Value**		**Balance Sheet Location**	**Fair Value**	
Derivatives designated as hedging instruments:						
Interest Rate Swaps	Other assets	$		Accrued liabilities	$	6,450
Total derivatives designated as hedging instruments		$			$	6,450
Derivatives not designated as hedging instruments:						
Foreign Currency Collars and Forwards	Prepaid expenses	$	1,104	Accrued liabilities	$	528
Total derivatives not designated as hedging instruments		$	1,104		$	528

The table below presents the effect of the Company s derivative financial instruments on the statements of earnings for the three months ended December 31, 2011 (in thousands):

Tabular Disclosure of the Effect of Derivative Instruments on the Statement of Earnings for the Three Months Ended December 31, 2011

Derivatives in Cash Flow Hedging Relationships	**Amount of Gain or (Loss) Recognized in OCI on Derivative (Effective Portion), net of tax**		**Location of Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)**	**Amount of Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)**		**Location of Gain or (Loss) Recognized in Income on Derivative (Ineffective Portion and Amount Excluded from Effectiveness Testing)**	**Amount of Gain or (Loss) Recognized in Income on Derivative (Ineffective Portion and Amount Excluded from Effectiveness Testing)**	
Interest Rate Swaps	$	1,495	Interest expense	$	(2,553)	Interest expense	$	

Derivatives Not Designated as Hedging Instruments	Location of Gain or (Loss) Recognized in Income on Derivative	Amount of Gain or (Loss) Recognized in Income on Derivative
Foreign Currency Options, Collars and Forwards	Selling, general and administrative expenses	$ 1,709
Total derivatives not designated as hedging instruments		$ 1,709

Table of Contents

Sally Beauty Holdings, Inc. and Subsidiaries

Condensed Notes to Consolidated Financial Statements

(Unaudited)

The table below presents the effect of the Company s derivative financial instruments on the statements of earnings for the three months ended December 31, 2010 (in thousands):

Tabular Disclosure of the Effect of Derivative Instruments on the Statement of Earnings for the Three Months Ended December 31, 2010

Derivatives in Cash Flow Hedging Relationships	Amount of Gain or (Loss) Recognized in OCI on Derivative (Effective Portion), net of tax	Location of Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)	Amount of Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)	Location of Gain or (Loss) Recognized in Income on Derivative (Ineffective Portion and Amount Excluded from Effectiveness Testing)	Amount of Gain or (Loss) Recognized in Income on Derivative (Ineffective Portion and Amount Excluded from Effectiveness Testing)
Interest Rate Swaps	$ 1,529	Interest expense	$ (2,545)	Interest expense	$

Derivatives Not Designated as Hedging Instruments	Location of Gain or (Loss) Recognized in Income on Derivative	Amount of Gain or (Loss) Recognized in Income on Derivative
Foreign Currency Options and Forwards	Selling, general and administrative expenses	$ 609
Total derivatives not designated as hedging instruments		$ 609

Credit-risk-related Contingent Features

The agreements governing the Company s interest rate swaps contain provisions pursuant to which the Company could be declared in default on its interest rate swap obligations in the event the Company defaulted under certain terms of the loan documents governing the Company s ABL facility. As of December 31, 2011, the fair value of interest rate swaps in a liability position related to these agreements was $4.0 million and the Company was under no obligation to post and had not posted any collateral related to these agreements. If the Company breached any of these provisions, it would be required to settle its obligations under the agreements at their termination value of $4.1 million, including accrued interest and other termination costs.