Sally Beauty Holdings, Inc.
Form 10-Q
February 04, 2016
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

FOR THE QUARTERLY PERIOD ENDED: DECEMBER 31, 2015

-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, 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 29, 2016, there were 146,178,472 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:

- the highly competitive nature of, and the increasing consolidation of, the beauty products distribution industry;
- anticipating and effectively responding to changes in consumer preferences and buying trends in a timely manner;
- 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 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 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;
- the success of our e-commerce businesses;
- product diversion 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 existing stores, and our ability to increase sales at existing stores;
- opening and operating new stores profitably;
- the volume of traffic to our stores;
- the impact of the health of the economy upon our business;
- the success of our cost control plans;
- 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 or that we may be required to defend our intellectual property rights;
- conducting business outside the United States;
- 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 data security incidents;
- our ability to attract and retain highly skilled management and other personnel;

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- 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 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 our debt;
- the potential impact on us if the financial institutions we deal with become impaired; and
- the costs and effects of litigation.

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 Item 1A. Risk Factors contained in Part I of our Annual Report on Form 10-K for the fiscal year ended September 30, 2015, as filed with the Securities and Exchange Commission, or SEC, and the other periodic reports that we file with the SEC. The events described in the forward-looking statements might not occur or might occur to a different extent or at a different time than we have described. As a result, our actual results may differ materially from the results contemplated by these forward-looking statements. We assume no obligation to publicly update or revise any forward-looking statements.

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WHERE YOU CAN FIND MORE INFORMATION

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

Sally Beauty maintains a website at *www.sallybeautyholdings.com* where investors and other interested parties may obtain, free of charge, press releases and other information as well as gain access to our periodic filings with the SEC. The information contained on this website 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 December 31, 2015 and September 30, 2015, and the consolidated statements of earnings, consolidated statements of comprehensive income and consolidated statements of cash flows for the three months ended December 31, 2015 and 2014 are those of Sally Beauty Holdings, Inc. and its consolidated 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 December 31,	
	2015	2014
Net sales	$ 998,032	$ 964,468
Cost of products sold and distribution expenses	503,983	490,699
Gross profit	494,049	473,769
Selling, general and administrative expenses	339,728	336,954
Depreciation and amortization	23,386	20,579
Operating earnings	130,935	116,236
Interest expense	63,943	29,241
Earnings before provision for income taxes	66,992	86,995
Provision for income taxes	24,749	32,086
Net earnings	$ 42,243	$ 54,909
Earnings per share:		
Basic	$ 0.28	$ 0.35
Diluted	$ 0.28	$ 0.35
Weighted average shares:		
Basic	150,786	156,104
Diluted	152,426	158,545

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, 2015, are an integral part of these financial statements.

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SALLY BEAUTY HOLDINGS, INC. AND SUBSIDIARIES
Consolidated Statements of Comprehensive Income
(In thousands)

(Unaudited)

	Three Months Ended December 31, 2015	Three Months Ended December 31, 2014
Net earnings	$ 42,243	$ 54,909
Other comprehensive (loss) income:		
Foreign currency translation adjustments	(10,221)	(17,301)
Total other comprehensive loss, before tax	(10,221)	(17,301)
Income taxes related to other comprehensive income		
Other comprehensive loss, net of tax	(10,221)	(17,301)
Total comprehensive income	$ 32,022	$ 37,608

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, 2015, are an integral part of these financial statements.

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SALLY BEAUTY HOLDINGS, INC. AND SUBSIDIARIES

Consolidated Balance Sheets

(In thousands, except par value data)

	December 31, 2015 (Unaudited)	September 30, 2015
Assets		
Current assets:		
Cash and cash equivalents	$ 67,447	$ 140,038
Trade accounts receivable, less allowance for doubtful accounts of $1,386 at December 31, 2015 and $1,162 at September 30, 2015	44,376	48,602
Accounts receivable, other	36,559	42,490
Inventory	912,419	885,214
Other current assets	35,603	37,049
Deferred income tax assets, net	33,578	33,709
	1,129,982	1,187,102
Property and equipment, net of accumulated depreciation of $440,650 at December 31, 2015 and $428,501 at September 30, 2015	281,278	270,847
Goodwill	520,148	524,369
Intangible assets, excluding goodwill, net of accumulated amortization of $100,887 at December 31, 2015 and $97,897 at September 30, 2015	97,496	98,848
Other assets	14,222	13,185
Total assets	$ 2,043,126	$ 2,094,351
Liabilities and Stockholders Deficit		
Current liabilities:		
Current maturities of long-term debt	$ 727	$ 755
Accounts payable	280,140	275,917
Accrued liabilities	163,892	208,717
Income taxes payable	10,278	6,310
Total current liabilities	455,037	491,699
Long-term debt	1,782,105	1,786,839
Other liabilities	28,722	27,734
Deferred income tax liabilities, net	98,928	85,900
Total liabilities	2,364,792	2,392,172
Stockholders deficit:		
Common stock, $0.01 par value. Authorized 500,000 shares; 149,564 and 151,898 shares issued and 149,155 and 151,452 shares outstanding at December 31, 2015 and September 30, 2015, respectively	1,492	1,515
Preferred stock, $0.01 par value. Authorized 50,000 shares; none issued		
Additional paid-in capital		
Accumulated deficit	(235,232)	(218,670)
Treasury stock, 121 shares, at cost		(2,961)
Accumulated other comprehensive loss, net of tax	(87,926)	(77,705)
Total stockholders deficit	(321,666)	(297,821)
Total liabilities and stockholders deficit	$ 2,043,126	$ 2,094,351

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, 2015, are an integral part of these financial statements.

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SALLY BEAUTY HOLDINGS, INC. AND SUBSIDIARIES

Consolidated Statements of Cash Flows

(In thousands)

(Unaudited)

	Three Months Ended December 31, 2015	Three Months Ended December 31, 2014
Cash Flows from Operating Activities:		
Net earnings	$ 42,243	$ 54,909
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation and amortization	23,386	20,579
Share-based compensation expense	4,188	7,760
Amortization of deferred financing costs	907	950
Excess tax benefit from share-based compensation	(95)	(17,043)
Loss on extinguishment of debt	33,296	
Deferred income taxes	11,991	8,341
Changes in (exclusive of effects of acquisitions):		
Trade accounts receivable	3,676	3,944
Accounts receivable, other	5,710	5,532
Inventory	(31,818)	(17,616)
Other current assets	1,111	19,943
Other assets	(455)	(572)
Accounts payable and accrued liabilities	(30,343)	(30,363)
Income taxes payable	4,265	(497)
Other liabilities	1,067	1,169
Net cash provided by operating activities	69,129	57,036
Cash Flows from Investing Activities:		
Capital expenditures	(40,575)	(18,800)
Acquisitions, net of cash acquired	(2,250)	
Net cash used by investing activities	(42,825)	(18,800)
Cash Flows from Financing Activities:		
Proceeds from issuance of long-term debt	800,000	
Repayments of long-term debt	(825,971)	(258)
Repurchases of common stock	(62,367)	(7,253)
Debt issuance costs	(12,709)	
Proceeds from exercises of stock options	2,716	37,156
Excess tax benefit from share-based compensation	95	17,043
Net cash (used) provided by financing activities	(98,236)	46,688
Effect of foreign exchange rate changes on cash and cash equivalents	(659)	(818)
Net (decrease) increase in cash and cash equivalents	(72,591)	84,106
Cash and cash equivalents, beginning of period	140,038	106,575
Cash and cash equivalents, end of period	$ 67,447	$ 190,681
Supplemental Cash Flow Information:		
Interest paid (a)	$ 86,633	$ 56,138
Income taxes paid	$ 4,833	$ 4,835

(a) For the three months ended December 31, 2015, 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, 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, 2015, are an integral part of these financial statements.

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Sally Beauty Holdings, Inc. and Subsidiaries

Condensed Notes to Consolidated Financial Statements

(Unaudited)

1. Description of Business and Basis of Presentation

Description of Business

Sally Beauty Holdings, Inc. and its consolidated subsidiaries (Sally Beauty or the Company) sell professional beauty supplies through its Sally Beauty Supply retail stores located in the U.S., Puerto Rico, Canada, Mexico, Chile, Colombia, Peru, 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., Canada, the United Kingdom and certain other countries in Europe, and to franchises in the southern and southwestern regions of the U.S. and in Mexico through the operations of its subsidiary Armstrong McCall, L.P. (Armstrong McCall). A significant number of the Company s products are also 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 manufacturers of the products.

Basis of Presentation

The accompanying consolidated interim financial statements include the accounts of the Company and its subsidiaries. All significant inter-company accounts and transactions have been eliminated in consolidation. In the opinion of management, these consolidated financial statements reflect all adjustments which are of a normal recurring nature and which are necessary to present fairly the Company s consolidated financial position as of December 31, 2015 and September 30, 2015, and its consolidated results of operations and consolidated cash flows for the three months ended December 31, 2015 and 2014.

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, 2015. 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 the interim periods reported upon herein 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

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

In September 2015, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2015-16, *Business Combinations (Topic 805): Simplifying the Accounting for Measurement-Period Adjustments* (ASU 2015-16) which will eliminate the current 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. For public companies, this amendment is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015.

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

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Sally Beauty Holdings, Inc. and Subsidiaries

Condensed Notes to Consolidated Financial Statements

(Unaudited)

In addition, the Company has not yet adopted the following recent accounting pronouncements and does not believe their 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*. In August 2015, the FASB deferred the effective date of this new standard by one year. 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 an amount that depicts the consideration to which the entity expects to be entitled in exchange for each of those goods and services. For a contract that involves more than one performance obligation, the entity must (a) determine or, if necessary, estimate the standalone selling price at inception of the contract for the distinct goods or services underlying each performance obligation and (b) allocate the transaction price to each performance obligation on the basis of the relative standalone selling prices. In addition, under the new guidance, an entity should recognize revenue when (or as) it satisfies each performance obligation under the contract by transferring the promised good or service to the customer. A good or service is deemed transferred when (or as) the customer obtains control of that good or service. The new standard permits the use of 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 application is permitted, but no earlier than December 16, 2016. The Company has not yet selected a transition method.

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. For public companies, this amendment is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015.

4. Fair Value Measurements

The Company s financial instruments consist of cash equivalents, trade and other accounts receivable, accounts payable, foreign currency derivative instruments and debt. The carrying amounts of cash equivalents, 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 and requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. This valuation hierarchy is based upon the transparency of inputs to the valuation of an asset or liability on the measurement date. The three levels of that hierarchy are defined as follows:

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

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

Level 3 - Unobservable inputs for the asset or liability.

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Sally Beauty Holdings, Inc. and Subsidiaries

Condensed Notes to Consolidated Financial Statements

(Unaudited)

Consistent with this hierarchy, the Company categorized certain of its financial assets and liabilities as follows at December 31, 2015 and September 30, 2015 (in thousands):

	As of December 31, 2015			
	Total	**Level 1**	**Level 2**	**Level 3**
Assets				
Foreign exchange contracts (b)	$ 433	$	$ 433	
Total assets	$ 433	$	$ 433	
Liabilities				
Long-term debt (c)	$ 1,844,362	$ 1,841,750	$ 2,612	
Foreign exchange contracts (b)	94		94	
Total liabilities	$ 1,844,456	$ 1,841,750	$ 2,706	

	As of September 30, 2015			
	Total	**Level 1**	**Level 2**	**Level 3**
Assets				
Cash equivalents (a)	$ 46,003	$ 46,003	$	
Foreign exchange contracts (b)	322		322	
Total assets	$ 46,325	$ 46,003	$ 322	
Liabilities				
Long-term debt (c)	$ 1,873,620	$ 1,870,750	$ 2,870	
Foreign exchange contracts (b)	58		58	
Total liabilities	$ 1,873,678	$ 1,870,750	$ 2,928	

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

(b) Foreign exchange contracts (including foreign currency forwards and options) 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 10 for more information about the Company s foreign exchange contracts.

(c) Long-term debt (including current maturities and borrowings under the ABL facility, if any) is carried in the Company s consolidated financial statements at amortized cost of $1,808.9 million at December 31, 2015 and $1,809.4 million at September 30, 2015, less unamortized debt issuance costs of $26.1 million and $21.8 million at December 31, 2015 and September 30, 2015, respectively. 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 9 for more information about the Company s debt.

5. Accumulated Stockholders Equity (Deficit)

In August 2014, we announced that our Board of Directors approved a share repurchase program authorizing us to repurchase up to $1.0 billion of our common stock over a period of approximately three years (the 2014 Share Repurchase Program). The 2014 Share Repurchase Program expires on September 30, 2017.

During the three months ended December 31, 2015 and 2014, the Company repurchased and subsequently retired approximately 2.4 million and 0.2 million shares, respectively, of its common stock under the 2014 Share Repurchase Program at an aggregate cost of $62.4 million and $7.3 million, respectively. We funded these share repurchases with existing cash balances, cash from operations and borrowings under the ABL facility. The Company reduced common stock and additional paid-in capital, in the aggregate, by these amounts. However, as required by GAAP, to the extent that share repurchase amounts exceeded the balance of additional paid-in capital prior to us recording such repurchases, we recorded the excess in accumulated deficit.

At December 31, 2015 and September 30, 2015, accumulated other comprehensive loss consists of cumulative foreign currency translation adjustments of $87.9 million and $77.7 million, respectively, net of income taxes of $2.3 million at both dates. Comprehensive income (loss) reflects changes in accumulated stockholders equity (deficit) from sources other than transactions with stockholders and, as such, includes net earnings and certain other specified components. Currently, the Company s only component of comprehensive income, other than net earnings, is foreign currency translation adjustments, net of income tax.

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Sally Beauty Holdings, Inc. and Subsidiaries

Condensed Notes to Consolidated Financial Statements

(Unaudited)

6. Earnings Per Share

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

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

	Three Months Ended December 31,	
	2015	**2014**
Net earnings	$ 42,243	$ 54,909
Weighted average basic shares	150,786	156,104
Dilutive securities:		
Stock option and stock award programs	1,640	2,441
Weighted average diluted shares	152,426	158,545
Earnings per share:		
Basic	$ 0.28	$ 0.35
Diluted	$ 0.28	$ 0.35

At December 31, 2015 and 2014, options to purchase 3,878,836 shares and 1,259,204 shares, respectively, of the Company s common stock were outstanding but not included in the computations 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 any unrecognized compensation expense related to such options, exceeds the average price per share for the period.

7. Share-Based Payments

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,	
	2015	2014
Share-based compensation expense	$ 4,188	$ 7,760
Income tax benefit related to share-based compensation expense	$ 1,588	$ 2,918

Performance-Based Unit Awards

The Company from time to time grants Performance-Based Unit (Performance Units) awards subject to three-year cliff-vesting provisions, pursuant to the Sally Beauty Holdings, Inc. Amended and Restated 2010 Omnibus Incentive Plan (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 achievement of specified Company performance targets. The Company measures the cost of services received from officers and 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 three months ended December 31, 2015, the Company granted approximately 152,000 Performance Units (target shares) to its officers and employees. Under the terms of these awards, a grantee may earn from 0% to 200% of his or her target

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Sally Beauty Holdings, Inc. and Subsidiaries

Condensed Notes to Consolidated Financial Statements

(Unaudited)

shares, with the ultimate settlement (and expense recognized) dependent on the Company achieving certain specified cumulative performance targets during the three-year period ending on September 30, 2018 (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. 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. For the awards issued during the three months ended December 31, 2015, 40% of the award is contingent on achieving the consolidated sales growth target and 60% is contingent on achieving the return on invested capital target.

The following table presents a summary of the activity for the Company s Performance Unit awards for the three months ended December 31, 2015:

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, 2015		$		
Granted	152		23.45	
Vested				
Forfeited				
Unvested at December 31, 2015	152	$	23.45	2.7

At December 31, 2015, unrecognized compensation costs related to unvested performance unit awards are approximately $3.2 million and are expected to be recognized over the weighted average period of 2.7 years.

Service-Based Awards

The Company measures the cost of services received from employees, directors and consultants, if any, 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 participant becomes eligible for retirement, if earlier.

The Company granted approximately 1.4 million and 1.1 million service-based stock options and approximately 23,000 and 214,000 service-based restricted share awards to its employees during the three months ended December 31, 2015 and 2014, respectively. Upon issuance of such grants, the Company recognized accelerated share-based compensation expense of $1.3 million and $4.8 million in the three months ended December 31, 2015 and 2014, respectively, in connection with certain retirement eligible employees who are eligible to continue vesting awards upon retirement under the provisions of the 2010 Plan. In addition, the Company granted approximately 26,000 and 20,000 service-based restricted stock units to its non-employee directors during the three months ended December 31, 2015 and 2014, respectively.

Stock Option Awards

Each option has an exercise price equal to 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 three or 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 Sally Beauty Holdings, Inc. 2007 Omnibus Incentive 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 three months ended December 31, 2015:

	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, 2015	5,316	$ 21.89	6.8	$ 19,255
Granted	1,420	23.45		
Exercised	(160)	16.97		
Forfeited or expired	(17)	27.49		
Outstanding at December 31, 2015	6,559	$ 22.34	7.1	$ 37,876
Exercisable at December 31, 2015	3,258	$ 19.14	5.6	$ 28,858

The following table summarizes additional information about service-based stock options outstanding at December 31, 2015 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	1,694	4.3	$ 13.18	1,694	$ 13.18
$20.00 30.07	4,865	8.1	25.52	1,564	25.59
Total	6,559	7.1	$ 22.34	3,258	$ 19.14

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 three or 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,	
	2015	2014
Expected life (in years)	5.0	5.0
Expected volatility for the Company s common stock	27.2%	31.0%
Risk-free interest rate	1.5%	1.6%
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 dividend yield used is 0%.

The weighted average fair value at the date of grant of the stock options issued by the Company in the three months ended December 31, 2015 and 2014 was $6.27 and $8.77 per option, respectively. The total intrinsic value of options exercised during the three months ended December 31, 2015 was $1.2 million. The cash proceeds from these option exercises were $2.7 million and the tax benefit realized from these option exercises was $0.4 million.

At December 31, 2015, unrecognized compensation costs related to unvested stock option awards are approximately $15.7 million and are expected to be recognized over the weighted average period of 2.3 years.

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Restricted Stock Awards

The Company from time to time grants service-based restricted stock awards to employees and consultants, if any, 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 three to 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.

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 participant becomes eligible for retirement, 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 three months ended December 31, 2015:

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, 2015	446	$	25.82	2.8
Granted	23		23.45	
Vested	(60)		16.69	
Forfeited				
Unvested at December 31, 2015	409	$	27.03	2.5

At December 31, 2015, unrecognized compensation costs related to unvested restricted stock awards are approximately $4.6 million and are expected to be recognized over the weighted average period of 2.5 years.

Restricted Stock Units

The Company also grants service-based RSU 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 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 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 three months ended December 31, 2015:

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, 2015		$		
Granted	26		23.45	
Vested				
Forfeited				
Unvested at December 31, 2015	26	$	23.45	0.7

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At December 31, 2015, unrecognized compensation costs related to unvested RSUs are approximately $0.5 million and are expected to be recognized over the weighted average period of 0.7 years.

8. Commitments and Contingencies

In the fiscal year ended September 30, 2014, the Company disclosed that it had experienced a data security incident (the 2014 data security incident). In May 2015, the Company disclosed that it had experienced a second illegal intrusion into its payment card systems (together with the 2014 data security incident, the data security incidents). The data security incidents involved the unauthorized installation of malicious software (malware) on our information technology systems, including our point-of-sale systems that, we believe, may have illegally accessed and removed a portion of the payment card data (track 2) for some transactions. The costs that the Company has incurred to date in connection with the data security incidents primarily include professional advisory fees and legal costs and expenses relating to investigating and remediating the data security incidents.

The Company expects to incur additional costs and expenses related to the data security incidents in the future. These costs may result from potential liabilities to 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. For the three months ended December 31, 2015 and 2014, selling, general and administrative expenses reflect expenses of $0.5 million and $0.2 million, respectively, relating to the data security incidents. In addition, at December 31, 2015 the Company had an accrued liability of approximately $2.9 million related to loss contingencies associated with the 2014 data security incident. As of December 31, 2015, the scope of these additional costs, or a range thereof, cannot be reasonably estimated and we do not anticipate these additional costs or liabilities would have a material adverse impact on our business, financial condition and operating results.

9. Short-term Borrowings and Long-term Debt

Details of long-term debt as of December 31, 2015 and September 30, 2015 are as follows (dollars in thousands):

	December 31, 2015	September 30, 2015	Interest Rates(a)
ABL facility(b)	$	$	(i) Prime plus (0.50% to 0.75%) or; (ii) LIBOR(b) plus (1.50% to 1.75%)
Senior notes due Nov. 2019		750,000	6.875%
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			5.625%
Total	$	1,800,000	$	1,800,000	
Plus: capital lease obligations		2,612		2,870	
Less: unamortized debt issuance costs and premium, net(c)		19,780		15,276	
Total debt	$	1,782,832	$	1,787,594	
Less: current maturities		727		755	
Total long-term debt	$	1,782,105	$	1,786,839	

(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 December 31, 2015 and September 30, 2015, unamortized debt issuance costs of $2.2 million and $2.4 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 $6.3 million and $6.5 million as of December 31, 2015 and September 30, 2015, respectively, related to certain notes with an aggregate principal amount of $150.0 million.

In November 2006, the Company, through its subsidiaries (Sally Investment Holdings LLC and Sally Holdings LLC, which we refer to as Sally Investment and Sally Holdings, respectively) incurred $1,850.0 million of indebtedness in connection with the Company s separation from its former parent, The Alberto-Culver Company, which we refer to as Alberto-Culver.

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In the fiscal year 2011, Sally Holdings entered into a five-year asset-based senior secured loan facility (the ABL facility). The availability of funds under the ABL facility is subject to a customary borrowing base comprised of: (i) a specified percentage of our eligible credit card and trade accounts receivable (as defined therein) and (ii) a specified percentage of our eligible inventory (as defined therein), and reduced by (iii) certain customary reserves and adjustments and by certain outstanding letters of credit. The ABL facility includes a $25.0 million Canadian sub-facility for our Canadian operations. In the fiscal year 2013, the Company, Sally Holdings and other parties to the ABL facility entered into an amendment to the ABL facility which, among other things, increased the maximum availability under the ABL Facility to $500.0 million (subject to borrowing base limitations), reduced pricing, relaxed the restrictions regarding the making of Restricted Payments, extended the maturity to July 2018 and improved certain other covenant terms.

At December 31, 2015, there were no borrowings outstanding under the ABL facility and the Company had $478.5 million available for borrowing under the ABL facility, including the Canadian sub-facility. Borrowings under the ABL facility are secured by the accounts, inventory and credit card receivables of our domestic subsidiaries and Canadian subsidiaries (in the case of borrowings under the Canadian sub-facility), together with general intangibles and certain other personal property of our domestic subsidiaries and Canadian subsidiaries (in the case of borrowings under the Canadian sub-facility) relating to the accounts and inventory, as well as deposit accounts of our domestic subsidiaries and Canadian subsidiaries (in the case of borrowings under the Canadian sub-facility) and, solely with respect to borrowings by SBH Finance B.V., intercompany notes owed to SBH Finance B.V. by our foreign subsidiaries. In addition, the terms of the ABL facility contain a commitment fee of 0.25% on the unused portion of the facility.

In the fiscal year 2012, Sally Holdings and Sally Capital Inc. (collectively, the Issuers), both indirectly wholly-owned subsidiaries of the Company issued $750.0 million aggregate principal amount of their 6.875% Senior Notes due 2019 (the senior notes due 2019) and $850.0 million aggregate principal amount of their 5.75% Senior Notes due 2022 (the senior notes due 2022), including $150.0 million of the aggregate principal amount of the senior notes due 2022 issued at par plus a premium. Such premium is being amortized over the term of the notes using the effective interest method. The net proceeds from these debt issuances were used to retire outstanding indebtedness in the aggregate principal amount of approximately $1,391.9 million (substantially all of which was incurred in 2006 in connection with our separation from Alberto-Culver) and for general corporate purposes. As further discussed below, in December 2015, the Company redeemed in full the senior notes due 2019 at a redemption premium equal to 103.438% primarily with the net proceeds from the issuance of the 5.625% Senior Notes due 2025 (the senior notes due 2025).

In the fiscal year 2014, the Issuers issued $200.0 million aggregate principal amount of their 5.5% Senior Notes due 2023 (the senior notes due 2023) at par. The Company used the net proceeds from this debt issuance, approximately $196.3 million, to repay borrowings outstanding under the ABL facility of $88.5 million (which borrowings were primarily used to fund share repurchases) and for general corporate purposes, including share repurchases.

On December 3, 2015, the Issuers issued $750.0 million aggregate principal amount of their senior notes due 2025 at par. The Company used the net proceeds from this debt issuance (approximately $737.3 million) as well as cash from operations and borrowings under the ABL facility, to redeem in full the senior notes due 2019 at a total redemption cost of $775.8 million, including the redemption premium but excluding accrued interest paid upon redemption of such notes. In connection with our redemption of the senior notes due 2019, we recorded a loss on extinguishment of debt in the amount of approximately $33.3 million, including a redemption premium in the amount of approximately $25.8

million and unamortized deferred financing costs of approximately $7.5 million. In connection with the issuance of the senior notes due 2025, the Company incurred and capitalized financing costs of approximately $12.7 million. This amount is reported as a deduction from the senior notes due 2025 on the Company s consolidated balance sheets and is being amortized over the term of the senior notes due 2025 using the effective interest method.

The senior notes due 2022, the senior notes due 2023 and the senior notes due 2025, which we refer to collectively as the Senior Notes or the senior notes due 2022, 2023 and 2025, 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. Interest on the senior notes due 2022, 2023 and 2025 is payable semi-annually, during the Company s first and third fiscal quarters. Please see Note 12 for certain condensed financial statement data pertaining to Sally Beauty, the Issuers, the guarantor subsidiaries and the non-guarantor subsidiaries.

The senior notes due 2022 carry optional redemption features whereby the Company has the option to redeem the notes, in whole or in part, on or after June 1, 2020 at par, plus accrued and unpaid interest, if any, and on or after June 1, 2017 at par plus a premium declining ratably to par, plus accrued and unpaid interest, if any. Prior to June 1, 2017, the notes may be redeemed, in whole or in part, at a redemption price equal to par plus a make-whole premium as provided in the indenture, plus accrued and unpaid interest, if any.

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The senior notes due 2023 carry optional redemption features whereby the Company has the option to redeem the notes, in whole or in part, on or after November 1, 2021 at par, plus accrued and unpaid interest, if any, and on or after November 1, 2018 at par plus a premium declining ratably to par, plus accrued and unpaid interest, if any. Prior to November 1, 2018, the notes may be redeemed, in whole or in part, at a redemption price equal to par plus a make-whole premium as provided in the indenture, plus accrued and unpaid interest, if any. In addition, on or prior to November 1, 2016, the Company has the right to redeem at par plus a specified premium, plus accrued and unpaid interest, if any, up to 35% of the aggregate principal amount of notes originally issued, subject to certain limitations, with the proceeds from certain kinds of equity offerings, as defined in the indenture.

The senior notes due 2025 carry optional redemption features whereby the Company has the option to redeem the notes, in whole or in part, on or after December 1, 2023 at par, plus accrued and unpaid interest, if any, and on or after December 1, 2020 at par plus a premium declining ratably to par, plus accrued and unpaid interest, if any. Prior to December 1, 2020, the notes may be redeemed, in whole or in part, at a redemption price equal to par plus a make-whole premium as provided in the indenture, plus accrued and unpaid interest, if any. In addition, on or prior to December 1, 2018, the Company has the right to redeem at par plus a specified premium, plus accrued and unpaid interest, if any, up to 35% of the aggregate principal amount of notes originally issued, subject to certain limitations, with the proceeds from certain kinds of equity offerings, as defined in the indenture.

Maturities of the Company s long-term debt are as follows as of December 31, 2015 (in thousands):

Twelve months ending December 31:		
2016-2020	$	
Thereafter		1,800,000
	$	1,800,000
Plus: capital lease obligations		2,612
Less: unamortized debt issuance costs and premium, net		19,780
Less: current maturities		727
Total long-term debt	$	1,782,105

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

The ABL facility does not contain any restriction against the incurrence of unsecured indebtedness. However, the ABL facility restricts the incurrence of secured indebtedness if, after giving effect to the incurrence of such secured indebtedness, the Company s Secured Leverage Ratio exceeds 4.0 *to* 1.0. At December 31, 2015, the Company s Secured Leverage Ratio was less than 0.1 *to* 1.0. Secured Leverage Ratio is defined as the ratio of (i) Secured Funded Indebtedness (as defined in the ABL facility) *to* (ii) Consolidated EBITDA (as defined in the ABL facility) for the most recently completed twelve fiscal months.

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

The indentures governing the senior notes due 2022, 2023 and 2025 contain terms which restrict the ability of Sally Beauty s subsidiaries to incur additional indebtedness. However, in addition to certain other material exceptions, the Company may incur additional indebtedness under the indentures if its Consolidated Coverage Ratio, after giving pro forma effect to the incurrence of such indebtedness, exceeds 2.0 *to* 1.0 (Incurrence Test). At December 31, 2015, the Company s Consolidated Coverage Ratio was approximately 6.1 *to* 1.0. Consolidated Coverage Ratio is defined as the ratio of (i) Consolidated EBITDA (as defined in the indentures) for the period containing the most recent four consecutive fiscal quarters, *to* (ii) Consolidated Interest Expense (as defined in the indentures) for such period.

The indentures governing the senior notes due 2022, 2023 and 2025 restrict Sally Holdings and its subsidiaries from making certain dividends and distributions to equity holders and certain other restricted payments (hereafter, a Restricted Payment or Restricted Payments) to us. However, the indentures permit the making of such Restricted Payments if, at the time of the

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making of such Restricted Payment, the Company satisfies the Incurrence Test as described above and the cumulative amount of all Restricted Payments made since the issue date of the applicable senior notes does not exceed the sum of: (i) 50% of Sally Holdings and its subsidiaries cumulative consolidated net earnings since July 1, 2006 (for the senior notes due 2022 the senior notes due and 2023) or since October 1, 2015 (for the senior notes due 2025), *plus* (ii) the proceeds from the issuance of certain equity securities or conversions of indebtedness to equity, in each case, since the issue date of the applicable senior notes *plus* (iii) the net reduction in investments in unrestricted subsidiaries since the issue date of the applicable senior notes *plus* (iv) the return of capital with respect to any sales or dispositions of certain minority investments since the issue date of the applicable senior notes *plus* (v) $350 million (for the senior notes due 2025). Further, in addition to certain other baskets, the indentures permit the Company to make additional Restricted Payments in an unlimited amount if, after giving pro forma effect to the incurrence of any indebtedness to make such Restricted Payment, the Company s Consolidated Total Leverage Ratio (as defined in the indentures) is less than 3.25 *to* 1.00. At December 31, 2015, the Company s Consolidated Total Leverage Ratio was approximately 2.7 *to* 1.0. Consolidated Total Leverage Ratio is defined as the ratio of (i) Consolidated Total Indebtedness (as defined in the indentures) *minus* cash and cash equivalents on-hand up to $100.0 million, in each case, as of the end of the most recently-ended fiscal quarter *to* (ii) Consolidated EBITDA (as defined in the indentures) for the period containing the most recent four consecutive fiscal quarters.

The ABL facility also restricts the making of Restricted Payments. More specifically, under the ABL facility, Sally Holdings may make Restricted Payments if availability under the ABL facility equals or exceeds certain thresholds, and no default then exists under the facility. For Restricted Payments up to $30.0 million during each fiscal year, borrowing availability must equal or exceed the lesser of $75.0 million or 15% of the borrowing base for 45 days prior to such Restricted Payment. For Restricted Payments in excess of that amount, borrowing availability must equal or exceed the lesser of $100.0 million or 20% of the borrowing base for 45 days prior to such Restricted Payment and the Consolidated Fixed Charge Coverage Ratio (as defined below) must equal or exceed 1.1 *to* 1.0. Further, if borrowing availability equals or exceeds the lesser of $150.0 million or 30% of the borrowing base, Restricted Payments are not limited by the Consolidated Fixed Charge Coverage Ratio test. The Consolidated Fixed Charge Coverage Ratio is defined as the ratio of (i) Consolidated EBITDA (as defined in the ABL facility) during the trailing twelve-month period preceding such proposed Restricted Payment *minus* certain unfinanced capital expenditures made during such period and income tax payments paid in cash during such period *to* (ii) fixed charges (as defined in the ABL facility). In addition, during any period that borrowing availability under the ABL facility is less than the greater of $40.0 million or 10% of the borrowing base, the level of the Consolidated Fixed Charge Coverage Ratio that the Company must satisfy is 1.0 *to* 1.0. As of December 31, 2015, the Consolidated Fixed Charge Coverage Ratio was approximately 3.3 *to* 1.0.

When used in this Quarterly Report, the phrase Consolidated EBITDA is intended to have the meaning ascribed to such phrase in the ABL facility or the indentures governing the senior notes due 2022, 2023 and 2025, as appropriate. EBITDA is not a recognized measurement under GAAP and should not be considered a substitute for financial performance and liquidity measures determined in accordance with GAAP, such as net earnings, operating earnings and operating cash flows.

The ABL facility and the indentures governing the senior notes due 2022, 2023 and 2025 contain other covenants regarding restrictions on the disposition of assets, the granting of liens and security interests, the prepayment of certain indebtedness, and other matters and customary events of default, including customary cross-default and/or cross-acceleration provisions. As of December 31, 2015, all the net assets of our consolidated subsidiaries were unrestricted from transfer under our credit arrangements.

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 foreign currency exchange rates and in interest rates) primarily: (a) by closely managing its cash flows from operating and investing activities and the amounts and sources of its debt obligations; (b) by assessing periodically the creditworthiness of its business partners; and (c) through the use of derivative instruments from time to time (including, foreign exchange contracts and interest rate swaps) by Sally Holdings.

The Company from time to time uses foreign exchange contracts (including foreign currency forwards and options), as part of its overall economic risk management strategy, to fix the amount of certain foreign assets and obligations relative to its functional and reporting currency (the U.S. dollar) or relative to the functional currency of certain of its consolidated subsidiaries, or to add stability to cash flows resulting from its net investments (including intercompany notes not permanently invested) and earnings denominated in foreign currencies. The Company s foreign currency exposures at times offset each other,

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sometimes providing a natural hedge against its foreign currency risk. In connection with the remaining foreign currency risk, the Company uses foreign exchange contracts to effectively fix the foreign currency exchange rate applicable to specific anticipated foreign currency-denominated cash flows, thus limiting the potential fluctuations in such cash flows as a result of foreign currency market movements.

The Company from time to time has used interest rate swaps, as part of its overall economic risk management strategy, to add stability to the interest payments due in connection with its debt obligations. At December 31, 2015, our exposure to interest rate fluctuations relates to interest payments under the ABL facility, if any, and the Company held no derivative instruments in connection therewith.

As of December 31, 2015, 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. The Company did not purchase or hold any such derivatives at December 31, 2015.

Non-designated Cash Flow Hedges

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

The Company uses foreign exchange contracts 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 December 31, 2015, we hold foreign currency forwards which enable us to sell approximately 9.6 million ($10.4 million, at the December 31, 2015 exchange rate) at the weighted average contractual exchange rate of 1.1260. The foreign currency forwards discussed in this paragraph are with a single counterparty and expire ratably through September 15, 2016.

The Company also uses foreign exchange contracts to mitigate its exposure to changes in foreign currency exchange rates in connection with certain intercompany balances not permanently invested. As such, at December 31, 2015, we hold: (a) a foreign currency forward which enables us to sell approximately 22.5 million ($24.5 million, at the December 31, 2015 exchange rate) at the contractual exchange rate of 1.0963, (b) a foreign currency forward which enables us to sell approximately $6.5 million Canadian dollars ($4.7 million, at the December 31, 2015 exchange rate) at the contractual exchange rate of 1.3838, (c) a foreign currency forward which enables us to buy approximately $6.5 million Canadian dollars ($4.7 million, at the December 31, 2015 exchange rate) at the contractual exchange rate of 1.3814, (d) a foreign currency forward which enables us to sell approximately 27.8 million Mexican pesos ($1.6 million, at the December 31, 2015 exchange rate) at the contractual exchange rate of 17.2485 and (e) foreign currency forwards which enable us to buy approximately £9.6 million ($14.2 million, at the December 31, 2015 exchange rate) at the weighted average contractual exchange rate of 1.4831. All the foreign currency forwards discussed in this paragraph are with a single counterparty (not the same counterparty as that on the forwards discussed in the preceding paragraph) and expire on or before March 31, 2016.

The Company s foreign exchange contracts are not designated as hedges and do not currently meet the requirements for hedge accounting. Accordingly, the changes in the fair value (i.e., marked-to-market adjustments) of these derivative instruments, which are adjusted quarterly, are recorded in selling, general and administrative expenses in our consolidated statements of earnings. During the three months ended December 31, 2015 and 2014, selling, general and administrative expenses include net gains of $1.0 million and $1.5 million, respectively, in connection with all of the Company s foreign currency derivative instruments, including marked-to-market adjustments.