

Sally Beauty Holdings, Inc.
Form 10-Q
February 07, 2013
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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

FORM 10-Q

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

FOR THE QUARTERLY PERIOD ENDED: DECEMBER 31, 2012

-OR-

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

Commission File No. 1-33145

SALLY BEAUTY HOLDINGS, INC.

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(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of
incorporation or organization)

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 ☒ NO ☐

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ☒ No ☐

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

Large accelerated filer ☒

Accelerated filer ☐

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

Smaller reporting company ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act.) YES ☐ NO ☒

As of January 31, 2013, there were 175,787,761 shares of the issuer's common stock outstanding.

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

Cautionary Notice Regarding Forward-Looking Statements

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

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

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

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

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

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WHERE YOU CAN FIND MORE INFORMATION

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

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

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PART I FINANCIAL INFORMATION

Item 1. Financial Statements.

The following consolidated balance sheets as of December 31, 2012 and September 30, 2012, consolidated statements of earnings, consolidated statements of comprehensive income, and consolidated statements of cash flows for the three months ended December 31, 2012 and 2011 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,	
	2012	2011
Net sales	\$ 905,441	\$ 864,815
Cost of products sold and distribution expenses	461,073	442,958
Gross profit	444,368	421,857
Selling, general and administrative expenses	305,689	293,014
Depreciation and amortization	16,808	15,553
Operating earnings	121,871	113,290
Interest expense	26,725	63,961
Earnings before provision for income taxes	95,146	49,329
Provision for income taxes	36,163	19,195
Net earnings	\$ 58,983	\$ 30,134
Earnings per share:		
Basic	\$ 0.33	\$ 0.16
Diluted	\$ 0.32	\$ 0.16
Weighted average shares:		
Basic	178,346	184,689
Diluted	183,386	190,208

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

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SALLY BEAUTY HOLDINGS, INC. AND SUBSIDIARIES

Consolidated Statements of Comprehensive Income

(In thousands)

(Unaudited)

		Three Months Ended December 31,	
	2012		2011
Net earnings	\$	58,983	\$ 30,134
Other comprehensive income (loss):			
Foreign currency translation adjustments		2,658	(1,880)
Deferred gain on interest rate swaps			2,444
Total other comprehensive income, before tax		2,658	564
Income taxes related to other comprehensive income			(949)
Other comprehensive income (loss), net of tax		2,658	(385)
Total comprehensive income	\$	61,641	\$ 29,749

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

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SALLY BEAUTY HOLDINGS, INC. AND SUBSIDIARIES

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

	December 31, 2012 (Unaudited)	September 30, 2012
Assets		
Current assets:		
Cash and cash equivalents	\$ 147,997	\$ 240,220
Trade accounts receivable, less allowance for doubtful accounts of \$2,652 at December 31, 2012 and \$2,583 at September 30, 2012	53,869	59,496
Accounts receivable, other	44,364	42,260
Income taxes receivable	1,168	23,734
Inventory	752,427	735,356
Prepaid expenses	26,774	29,376
Deferred income tax assets, net	33,458	33,465
Total current assets	1,060,057	1,163,907
Property and equipment, net of accumulated depreciation of \$355,161 at December 31, 2012 and \$352,164 at September 30, 2012	212,787	202,661
Goodwill	533,355	532,331
Intangible assets, excluding goodwill, net of accumulated amortization of \$62,184 at December 31, 2012 and \$59,192 at September 30, 2012	126,020	128,437
Other assets	37,712	38,464
Total assets	\$ 1,969,931	\$ 2,065,800
Liabilities and Stockholders' Deficit		
Current liabilities:		
Current maturities of long-term debt	\$ 1,950	\$ 1,908
Accounts payable	255,252	262,209
Accrued liabilities	150,230	200,267
Income taxes payable	15,214	13,004
Total current liabilities	422,646	477,388
Long-term debt	1,614,759	1,615,322
Other liabilities	23,757	24,232
Deferred income tax liabilities, net	65,961	63,943
Total liabilities	2,127,123	2,180,885
Stockholders' deficit:		
Common stock, \$0.01 par value. Authorized 500,000 shares; 176,391 and 180,548 shares issued and 176,058 and 180,241 shares outstanding at December 31, 2012 and September 30, 2012, respectively	1,761	1,802
Preferred stock, \$0.01 par value. Authorized 50,000 shares; none issued		
Additional paid-in capital	436,300	540,007
Accumulated deficit	(587,258)	(646,241)
Accumulated other comprehensive loss, net of tax	(7,995)	(10,653)
Total stockholders' deficit	(157,192)	(115,085)
Total liabilities and stockholders' deficit	\$ 1,969,931	\$ 2,065,800

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

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

Consolidated Statements of Cash Flows

(In thousands)

(Unaudited)

	Three Months Ended	
	December 31,	
	2012	2011
Cash Flows from Operating Activities:		
Net earnings	\$ 58,983	\$ 30,134
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation and amortization	16,808	15,553
Share-based compensation expense	9,051	8,031
Amortization of deferred financing costs	900	1,646
Excess tax benefit from share-based compensation	(3,824)	(4,085)
Net loss on extinguishment of debt		34,558
Deferred income tax expense	1,749	193
Changes in (exclusive of effects of acquisitions):		
Trade accounts receivable	5,994	4,798
Accounts receivable, other	(2,040)	(2,501)
Income taxes receivable	22,566	
Inventory	(16,324)	(10,128)
Prepaid expenses	2,781	(2,992)
Other assets	(292)	51
Accounts payable and accrued liabilities	(58,649)	(45,501)
Income taxes payable	5,932	12,991
Other liabilities	(477)	1,231
Net cash provided by operating activities	43,158	43,979
Cash Flows from Investing Activities:		
Capital expenditures	(22,949)	(13,838)
Acquisitions, net of cash acquired		(42,751)
Net cash used by investing activities	(22,949)	(56,589)
Cash Flows from Financing Activities:		
Proceeds from issuance of long-term debt		929,200
Repayments of long-term debt	(530)	(909,145)
Repurchases of common stock	(121,933)	
Debt issuance costs		(12,592)
Proceeds from exercises of stock options	5,996	8,993
Excess tax benefit from share-based compensation	3,824	4,085
Net cash (used) provided by financing activities	(112,643)	20,541
Effect of foreign exchange rate changes on cash and cash equivalents	211	113
Net (decrease) increase in cash and cash equivalents	(92,223)	8,044
Cash and cash equivalents, beginning of period	240,220	63,481
Cash and cash equivalents, end of period	\$ 147,997	\$ 71,525
Supplemental Cash Flow Information:		
Interest paid (a)	\$ 52,712	\$ 70,241
Income taxes paid	\$ 6,317	\$ 6,482

(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.

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

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Sally Beauty Holdings, Inc. and Subsidiaries

Condensed Notes to Consolidated Financial Statements

(Unaudited)

1. Description of Business and Basis of Presentation

Description of Business

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

Basis of Presentation

The accompanying consolidated interim financial statements include the accounts of the Company and its subsidiaries. All significant inter-company accounts and transactions have been eliminated in consolidation. In the opinion of management, these consolidated financial statements reflect all adjustments which are of a normal recurring nature and which are necessary to present fairly the Company's consolidated financial position as of December 31, 2012 and September 30, 2012, and its consolidated results of operations and consolidated cash flows for the three months ended December 31, 2012 and 2011.

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

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

2. Significant Accounting Policies

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

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

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

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

In June 2011, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2011-05 which amended Accounting Standards Codification (ASC) Topic 220, *Comprehensive Income*. The Company adopted the provisions of ASU No. 2011-05, as amended, effective October 1, 2012. Accordingly, the components of the Company's other comprehensive income are reported in the accompanying consolidated statements of comprehensive income. The Company's other comprehensive income has historically consisted of foreign currency translation adjustments, as well as deferred gains (losses) on certain interest rate swaps until the expiration of such swaps in May 2012 (Please see Note 10 for more information about the Company's interest rate swaps).

For the three months ended December 31, 2012, other comprehensive income consists exclusively of foreign currency translation adjustments of \$2.7 million. For the three months ended December 31, 2011, other comprehensive income consists of foreign currency translation adjustments of \$1.9 million and deferred gains on certain interest rate swaps of \$2.4 million (before income taxes of \$0.9 million).

At December 31, 2012 and September 30, 2012, accumulated other comprehensive loss consists of cumulative foreign currency translation adjustments of \$8.0 million and \$10.7 million and is net of income taxes of \$2.9 million and \$2.9 million, respectively.

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Sally Beauty Holdings, Inc. and Subsidiaries

Condensed Notes to Consolidated Financial Statements

(Unaudited)

4. Recent Accounting Pronouncements and Accounting Changes

Recent Accounting Pronouncements

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

In July 2012, the FASB issued ASU No. 2012-02, *Testing Indefinite-Lived Intangible Assets for Impairment*, which amended ASC Topic 350, *Intangibles-Goodwill and Other* (ASC 350). This amendment allows an entity to first assess relevant qualitative factors in order to determine whether it is necessary to perform the quantitative impairment test for indefinite-lived intangible assets otherwise required under ASC 350. In effect, the amendment eliminates the need to calculate the fair value of an indefinite-lived intangible asset in connection with the impairment test unless the entity determines, based on the qualitative assessment, that it is more likely than not that the asset is impaired. This amendment is effective for fiscal years beginning after September 15, 2012. Early application is permitted.

Accounting Changes

The Company made no accounting changes during the three months ended December 31, 2012.

5. Fair Value Measurements

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

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

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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.

Consistent with this hierarchy, the Company categorized certain of its financial assets and liabilities as follows at December 31, 2012 (in thousands):

	Total	As of December 31, 2012		
		Level 1	Level 2	Level 3
Assets				