

Sally Beauty Holdings, Inc.  
Form 10-Q  
August 04, 2010  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

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**FORM 10-Q**

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

**FOR THE QUARTERLY PERIOD ENDED: JUNE 30, 2010**

**-OR-**

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

Commission File No. 1-33145

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**SALLY BEAUTY HOLDINGS, INC.**

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(Exact name of registrant as specified in its charter)

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

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

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

**76210**  
(zip code)

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

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Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES 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 (§ 232.405 of this chapter) 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  Accelerated filer   
Non-accelerated filer  Smaller reporting company   
(Do not check if a 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 o NO x

As of July 30, 2010, there were 182,392,484 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 for periods after the separation from Alberto-Culver Company ( Alberto-Culver ) and to Sally Holdings, Inc. and its consolidated subsidiaries for periods prior to the separation from Alberto-Culver 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 used in this report are intended to identify 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 beauty supply 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;
- the operational and financial performance of our Armstrong McCall, L.P. ( Armstrong McCall ) business;
- the success of our internet-based business;
- successfully identifying acquisition candidates or successfully completing desirable acquisitions;
- integrating businesses acquired in the future;
- opening and operating new stores profitably;

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- the impact of a downturn in the economy upon our business;
- the success of our cost control plans;
- protecting our intellectual property rights, specifically our trademarks;
- conducting business outside the United States;
- disruption in our information technology systems;
- natural disasters or acts of 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;
- we are a holding company, with no operations of our own, and we depend on our subsidiaries for cash;
- our substantial indebtedness;
- the possibility that we may incur substantial additional debt;
- 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;

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- changes in interest rates increasing the cost of servicing our debt or increasing our interest expense due to our interest rate swap agreements;
- the potential impact on us if the financial institutions we deal with become impaired;
- the representativeness of our historical consolidated financial information with respect to our future financial position, results of operations or cash flows;
- our reliance upon Alberto-Culver for the accuracy of certain historical services and information;
- the share distribution of Alberto-Culver common stock in our separation from Alberto-Culver not constituting a tax-free distribution;
- actions taken by certain large stockholders adversely affecting the tax-free nature of the share distribution of Alberto-Culver common stock;
- the voting power of our largest stockholder discouraging third-party acquisitions of us at a premium; and
- the interests of our largest stockholder differing from the interests of other holders of our common stock.

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, 2009, 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.sallybeauty.com](http://www.sallybeauty.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 are our consolidated balance sheets as of June 30, 2010 and September 30, 2009, our consolidated statements of earnings for the three and nine months ended June 30, 2010 and 2009 and our consolidated statements of cash flows for the nine months ended June 30, 2010 and 2009. In November 2006, Sally Holdings, Inc. was converted to a Delaware limited liability company, was renamed Sally Holdings LLC, which we refer to as Sally Holdings, and became an indirect wholly-owned subsidiary of Sally Beauty Holdings, Inc. in connection with our separation from Alberto-Culver. In these financial statements and elsewhere in this Quarterly Report on Form 10-Q, we refer to these transactions as the Separation Transactions. See the Company's Annual Report on Form 10-K for the fiscal year ended September 30, 2009 for additional information about the Separation Transactions.



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

## Consolidated Statements of Earnings

(In thousands, except per share data)

(Unaudited)

	Three Months Ended June 30,		Nine Months Ended June 30,	
	2010	2009	2010	2009
Net sales	\$ 742,975	\$ 673,337	\$ 2,168,293	\$ 1,960,424
Cost of products sold and distribution expenses	382,116	355,492	1,129,936	1,036,923
Gross profit	360,859	317,845	1,038,357	923,501
Selling, general and administrative expenses	255,588	223,982	753,856	667,930
Depreciation and amortization	12,667	11,642	36,986	34,860
Operating earnings	92,604	82,221	247,515	220,711
Interest expense	28,255	31,050	85,149	102,692
Earnings before provision for income taxes	64,349	51,171	162,366	118,019
Provision for income taxes	23,233	19,682	60,564	45,876
Net earnings	\$ 41,116	\$ 31,489	\$ 101,802	\$ 72,143
Net earnings per share:				
Basic	\$ 0.23	\$ 0.17	\$ 0.56	\$ 0.40
Diluted	\$ 0.22	\$ 0.17	\$ 0.55	\$ 0.39
Weighted average shares:				
Basic	181,991	181,715	181,940	181,658
Diluted	184,375	183,748	183,963	183,183

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, 2009, are an integral part of these financial statements.

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

## Consolidated Balance Sheets

(In thousands, except par value data)

	June 30, 2010 (Unaudited)	September 30, 2009
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 28,303	\$ 54,447
Trade accounts receivable, less allowance for doubtful accounts of \$2,316 at June 30, 2010 and \$2,266 at September 30, 2009	52,172	43,649
Other receivables	29,924	24,090
Inventory	586,573	559,689
Prepaid expenses	24,026	18,492
Deferred income tax assets	15,620	15,551
Total current assets	736,618	715,918
Property and equipment, net of accumulated depreciation of \$288,162 at June 30, 2010 and \$265,329 at September 30, 2009	163,960	151,252
Goodwill	478,963	494,135
Other intangible assets, net of accumulated amortization of \$30,445 at June 30, 2010 and \$24,357 at September 30, 2009	96,732	78,685
Other assets	40,791	50,742
Total assets	\$ 1,517,064	\$ 1,490,732
<b>Liabilities and Stockholders' Deficit</b>		
Current liabilities:		
Current maturities of long-term debt	\$ 14,477	\$ 24,517
Accounts payable	223,705	193,592
Accrued liabilities	143,449	154,162
Income taxes payable	9,387	1,914
Total current liabilities	391,018	374,185
Long-term debt	1,572,265	1,653,013
Other liabilities	41,822	43,586
Deferred income tax liabilities	35,822	33,599
Total liabilities	2,040,927	2,104,383
Stock options subject to redemption	1,639	1,800
Stockholders' deficit:		
Common stock, \$0.01 par value. Authorized 400,000 shares; 182,378 and 182,189 shares issued and 182,011 and 181,858 shares outstanding at June 30, 2010 and September 30, 2009, respectively	1,820	1,819
Additional paid-in capital	645,862	635,519
Accumulated deficit	(1,135,056)	(1,236,858)
Treasury stock, 14 and 6 shares at June 30, 2010 and September 30, 2009, respectively, at cost	(89)	(33)
Accumulated other comprehensive loss, net of tax	(38,039)	(15,898)
Total stockholders' deficit	(525,502)	(615,451)
Total liabilities and stockholders' deficit	\$ 1,517,064	\$ 1,490,732

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, 2009, 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)

	Nine Months Ended June 30,	
	2010	2009
<b>Cash Flows from Operating Activities:</b>		
Net earnings	\$ 101,802	\$ 72,143
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation and amortization	36,986	34,860
Share-based compensation expense	9,911	6,799
Amortization of deferred financing costs	5,912	6,289
Excess tax (benefit) shortfall from share-based compensation	(59)	204
Net gain on disposal of leaseholds and other property	(33)	(66)
Net loss on extinguishment of debt	766	715
Deferred income taxes	2,386	506
Changes in (exclusive of effects of acquisitions):		
Trade accounts receivable	871	3,986
Other receivables	(5,184)	(1,942)
Inventory	(23,804)	30,683
Prepaid expenses	(5,404)	(2,259)
Other assets	3,183	571
Accounts payable and accrued liabilities	16,977	24,008
Income taxes payable	5,771	(6,538)
Other liabilities	(2,255)	(5,972)
Net cash provided by operating activities	147,826	163,987
<b>Cash Flows from Investing Activities:</b>		
Capital expenditures	(36,011)	(26,290)
Proceeds from sale of property and equipment	110	147
Acquisitions, net of cash acquired	(34,445)	(1,987)
Net cash used by investing activities	(70,346)	(28,130)
<b>Cash Flows from Financing Activities:</b>		
Change in book cash overdraft		(1,586)
Proceeds from issuance of long-term debt	232,000	95,104
Repayments of long-term debt	(334,025)	(223,267)
Proceeds from exercises of stock options	212	491
Excess tax benefit (shortfall) from share-based compensation	59	(204)
Purchases of treasury stock	(56)	(22)
Net cash used by financing activities	(101,810)	(129,484)
Effect of foreign exchange rate changes on cash and cash equivalents	(1,814)	(219)
Net (decrease) increase in cash and cash equivalents	(26,144)	6,154
Cash and cash equivalents, beginning of period	54,447	99,788
Cash and cash equivalents, end of period	\$ 28,303	\$ 105,942
<b>Supplemental Cash Flow Information:</b>		
Interest paid	\$ 100,241	\$ 116,995
Income taxes paid, net	\$ 56,211	\$ 50,817

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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, 2009, 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 and its consolidated subsidiaries sell professional beauty supplies, primarily through its Sally Beauty Supply retail stores in the U.S., Puerto Rico, Mexico, Canada, Chile, Belgium, France, Italy, the United Kingdom and certain other countries in Europe. Additionally, the Company distributes professional beauty products to salons and professional cosmetologists 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 U.S. and in Mexico through the operations of its subsidiary Armstrong McCall. Certain beauty products sold by BSG and Armstrong McCall are sold under exclusive territory agreements with the manufacturers of the products.

Sally Beauty was formed in June 2006 and became the accounting successor company to Sally Holdings, Inc. upon the completion of the Separation Transactions. Please see the Company's Annual Report on Form 10-K for the fiscal year ended September 30, 2009 for more information about the Separation Transactions.

**Basis of Presentation**

The consolidated interim financial statements include the accounts of the Company and its subsidiaries. All significant inter-company accounts and transactions have been eliminated in consolidation. In the opinion of management, these consolidated financial statements reflect all adjustments which are of a normal recurring nature and which are necessary to present fairly the Company's consolidated financial position as of June 30, 2010 and September 30, 2009, its consolidated results of operations for the three and nine months ended June 30, 2010 and 2009 and its consolidated cash flows for the nine months ended June 30, 2010 and 2009.

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

**2. Significant Accounting Policies**

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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, 2009. 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.

The Company's financial instruments consist of cash and cash equivalents, trade and other accounts receivable, accounts payable, interest rate swap agreements, foreign currency options and long-term debt. There were no significant changes in the methods and significant assumptions used to estimate the fair value of the Company's financial instruments since September 30, 2009.

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 aggregate fair value of the interest rate swap agreements held at June 30, 2010 was a net liability of \$15.8 million included in other liabilities in the Company's consolidated balance sheet. Fair value amounts reported for these agreements are based on third-party information and were determined using proprietary models based upon

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Sally Beauty Holdings, Inc. and Subsidiaries

Condensed Notes to Consolidated Financial Statements

(Unaudited)

well-recognized financial principles and reasonable estimates about relevant future market conditions. Please see Note 9 for more information about the Company's interest rate swaps.

The aggregate fair value of all foreign currency option agreements held at June 30, 2010 was a net asset of \$0.5 million included in prepaid expenses in the Company's consolidated balance sheet. Fair value amounts reported for these agreements are based on third-party information and were determined using proprietary models based upon well-recognized financial principles and reasonable estimates about relevant future market conditions. Please see Note 9 for more information about the Company's foreign currency options.

At June 30, 2010, the fair value of the Company's long-term debt (including capital leases) was approximately \$1,582.7 million, while the carrying amount in the Company's consolidated balance sheet was \$1,586.7 million. Fair value amounts reported for long-term borrowings are based on quoted market prices where available or, if not available, based on discounted future cash flows using current market interest rates.

As required by Accounting Standards Codification (ASC) 815, *Derivatives and Hedging*, as amended, the Company records all derivative instruments on its balance sheet at fair value. The accounting for changes in the fair value of derivative instruments depends on the intended use of the derivative, whether the Company has elected to designate a derivative instrument in a hedging relationship and apply hedge accounting, and whether the hedging relationship has satisfied the criteria necessary to apply hedge accounting. Derivative instruments designated and qualifying as a hedge of the exposure to variability in expected future cash flows, or other types of forecasted transactions, are considered cash flow hedges. Hedge accounting generally provides for the matching of the timing of gain or loss recognition on the hedging instrument with the recognition of the impact on earnings of the hedged transaction or transactions. The Company may from time to time enter into derivative contracts that are intended to hedge certain economic risks even though hedge accounting does not apply or the Company elects not to apply hedge accounting to such derivative contracts. Please see Note 9 for more details about the Company's derivative instruments and hedging activities as of June 30, 2010.

The Company has adopted the provisions of ASC 820, *Fair Value Measurements and Disclosures* (ASC 820), as it relates to its financial instruments. ASC 820, as amended, 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)

The Company measures certain financial instruments at fair value on a recurring basis, including interest rate swaps and foreign currency options. In accordance with ASC 820, the Company categorized certain of its financial assets and liabilities, based on priority of the inputs to the valuation technique for the instruments, as follows at June 30, 2010 (in thousands):

	Total	As of June 30, 2010		
		Level 1	Level 2	Level 3
<b>Assets</b>				
Foreign currency options (b)	\$ 458		\$ 458	
Total assets	\$ 458		\$ 458	
<b>Liabilities</b>				
Long-term debt (a)	\$ 1,582,653	\$ 737,625	\$ 845,028	
Hedged interest rate swaps (b)	15,750		15,750	
Total liabilities	\$ 1,598,403	\$ 737,625	\$ 860,778	

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(a) Long-term debt, which is carried at amortized cost in the Company's financial statements, is valued using internal models based on market observable inputs, except for the senior and senior subordinated notes. The senior and senior subordinated notes are valued using quoted market prices for such debt securities.

(b) Interest rate swaps and foreign currency options are valued using internal models based on market observable inputs, including market interest rates and foreign currency exchange rates, as appropriate. Please see Note 9 for more information about the Company's interest rate swaps and foreign currency options.

The Company categorized certain of its financial assets and liabilities, based on priority of the inputs to the valuation technique for the instruments, as follows at September 30, 2009 (in thousands):

	Total	As of September 30, 2009		
		Level 1	Level 2	Level 3
<b>Liabilities</b>				
Long-term debt (a)	\$ 1,655,076	\$ 727,719	\$ 927,357	
Hedged interest rate swaps (b)	15,365		15,365	
Non-hedged interest rate swaps (b)	2,356		2,356	
Total liabilities	\$ 1,672,797	\$ 727,719	\$ 945,078	

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(a) Long-term debt, which is carried at amortized cost in the Company's financial statements, is valued using internal models based on market observable inputs, except for the senior and senior subordinated notes. The senior and senior subordinated notes are valued using quoted market prices for such debt securities.

(b) Interest rate swaps are valued using internal models based on market observable inputs, including market interest rates. Please see Note 9 for more information about the Company's interest rate swaps.

### 3. Recent Accounting Pronouncements

In December 2007, the Financial Accounting Standards Board ( FASB ) revised the accounting standards for business combinations. This new standard (currently contained in ASC 805, *Business Combinations* ( ASC 805 )), among other things, generally requires that an acquirer recognize the assets acquired and liabilities assumed measured at their full fair values on the acquisition date. This practice replaced the practice, under predecessor accounting standards, of allocating the cost of an acquisition to the individual assets acquired and liabilities assumed based on their relative estimated fair values. This new standard further requires that acquisition-related costs be recognized separately from the related acquisition. The Company adopted this standard during the first quarter of its fiscal year 2010. Selling, general and administrative expenses for the nine months ended June 30, 2010 includes approximately \$0.5 million of expenses related to acquisitions.

In April 2008, the FASB amended ASC 350, *Intangibles and Other* ( ASC 350 ). This new accounting standard, currently contained in ASC 350-30-35, specifically amends the factors that should be considered in developing

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Sally Beauty Holdings, Inc. and Subsidiaries

Condensed Notes to Consolidated Financial Statements

(Unaudited)

renewal or extension assumptions used to determine the useful life of a recognized intangible asset. The objective of this amendment is to improve the consistency between the useful life of a recognized intangible asset and the period of expected cash flows used to measure the fair value of the asset. The Company adopted this standard during the first quarter of its fiscal year 2010 and its adoption did not have a material effect on the Company's consolidated financial position, results of operations or cash flows.

In August 2009, the FASB issued Accounting Standards Update (ASU) No. 2009-05 which amended ASC 820 as it relates to the measurement of liabilities at fair value, effective for interim reporting periods beginning after August 26, 2009. More specifically, this amendment provided clarification for liabilities in which a quoted price in an active market for an identical liability is not available. The Company adopted this amendment during the first quarter of its fiscal year 2010 and its adoption did not have a material effect on the Company's consolidated financial position, results of operations or cash flows.

In January 2010, the FASB issued ASU No. 2010-06 which amended ASC 820 as it relates to certain disclosures of fair value measurements. This amendment requires, among other things, (a) disclosure of the sensitivity of an entity's fair value measurements using Level 3 inputs to changes in such inputs, (b) a reconciliation of changes in such fair value measurements and (c) disclosure of transfers between fair value measurements using Level 1 and 2 inputs, if any. The Company adopted this amendment during the second quarter of its fiscal year 2010 and its adoption did not have a material effect on the Company's consolidated financial position, results of operations or cash flows.

The Company adopted the provisions of ASC 855, *Subsequent Events* (ASC 855), during the third quarter of its fiscal year 2009. ASC 855 establishes standards of accounting for and disclosure of transactions and events that occur after the balance sheet date but before the financial statements are issued and requires the disclosure, among other things, of the date through which an entity has evaluated subsequent events. In February 2010, the FASB issued ASU No. 2010-09 which amended ASC 855. This amendment, which was effective upon issuance, removed the requirement for SEC registrants to disclose the date through which such registrants have evaluated subsequent events.

#### 4. Net Earnings Per Share

Basic net earnings per share is calculated by dividing net earnings by the weighted-average number of shares of common stock outstanding during the period. Diluted net earnings per share is calculated similarly but includes potential dilution from the exercise of 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):

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	Three Months Ended June 30,		Nine Months Ended June 30,	
	2010	2009	2010	2009
Net earnings	\$ 41,116	\$ 31,489	\$ 101,802	\$ 72,143
Total weighted-average basic shares	181,991	181,715	181,940	181,658
Dilutive securities:				
Stock option and stock award programs	2,384	2,033	2,023	1,525
Total weighted-average diluted shares	184,375	183,748	183,963	183,183
Earnings per share:				
Basic	\$ 0.23	\$ 0.17	\$ 0.56	\$ 0.40
Diluted	\$ 0.22	\$ 0.17	\$ 0.55	\$ 0.39

Options to purchase 4,151,691 shares and 9,098,291 shares of the Company's common stock were outstanding but were not included in the computation of diluted earnings per share for the three and nine months ended on June 30,

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### Sally Beauty Holdings, Inc. and Subsidiaries

#### Condensed Notes to Consolidated Financial Statements

(Unaudited)

2010, respectively, since these options were anti-dilutive. Options to purchase 6,474,296 shares of the Company's common stock were outstanding but were not included in the computation of diluted earnings per share for the three and nine months ended on June 30, 2009 since these options were anti-dilutive. Anti-dilutive options are 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 in-the-money options for which the sum of assumed proceeds, including unrecognized compensation expense, exceeds the average price per share for the period.

#### 5. Accumulated Comprehensive Income (Loss)

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

	Three Months Ended June 30,		Nine Months Ended June 30,	
	2010	2009	2010	2009
Net earnings	\$ 41,116	\$ 31,489	\$ 101,802	\$ 72,143
Other comprehensive income adjustments:				
Foreign currency translation adjustments (a)	(14,214)	21,653	(21,905)	(17,857)
Deferred (loss) gain on interest rate swaps (b)	(395)	2,968	(236)	(9,241)
Comprehensive income	\$ 26,507	\$ 56,110	\$ 79,661	\$ 45,045

(a) There were no income tax amounts related to foreign currency translation adjustments recorded in other comprehensive income for the three and nine months ended June 30, 2010 and 2009.

(b) Amounts are net of an income tax benefit of \$0.3 million and income tax expense of \$1.9 million for the three months ended June 30, 2010 and 2009, and net of an income tax benefit of \$0.1 million and \$5.8 million for the nine months ended June 30, 2010 and 2009, respectively.

The components of accumulated other comprehensive (loss) income, net of tax, as of June 30, 2010 and September 30, 2009 are as follows (in thousands):

	As of June 30, 2010			As of September 30, 2009		
	Amount Before Tax	Deferred Tax	Net Amount	Amount Before Tax	Deferred Tax	Net Amount
	\$ (28,400)	\$	\$ (28,400)	\$ (6,495)	\$	\$ (6,495)

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Cumulative foreign currency translation adjustments									
Deferred (losses) gains on interest rate swaps (a)	(15,750)	6,111	(9,639)	(15,365)	5,962	(9,403)			
Total accumulated other comprehensive (loss) income, net of tax	\$ (44,150)	\$ 6,111	\$ (38,039)	\$ (21,860)	\$ 5,962	\$ (15,898)			

(a) See Note 9 for more information about our interest rate swaps.

## 6. Share-Based Payments

The Company accounts for stock option and stock awards, which include share-based payment plans, in accordance with ASC 718, *Compensation - Stock Compensation*. Accordingly, the Company measures the cost of employee and consultant services received in exchange for an award of equity instruments based on the fair value of the award on the grant date and recognizes compensation expense on a straight-line basis over the vesting period or to the date a participant becomes eligible for retirement, if earlier. On January 27, 2010, the Company adopted the Sally Beauty Holdings, Inc. 2010 Omnibus Incentive Plan (the 2010 Plan), a share-based compensation plan which allows for the issuance of up to 29.8 million shares of the Company's common stock.

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### Sally Beauty Holdings, Inc. and Subsidiaries

#### Condensed Notes to Consolidated Financial Statements

(Unaudited)

The Company granted approximately 2.9 million and 2.7 million stock options to its employees and consultants during the nine months ended June 30, 2010 and 2009, respectively. The amounts for the nine months ended June 30, 2010 include 2.3 million stock options under the Sally Beauty Holdings 2007 Omnibus Incentive Plan (the 2007 Plan), 0.5 million stock options under the Alberto-Culver Company Employee Stock Option Plan of 2003 (the 2003 Plan) and 0.1 million stock options under the 2010 Plan. Upon issuance of such grants, the Company recognized accelerated share-based compensation expense of \$2.5 million and \$2.0 million in the fiscal years 2010 and 2009, respectively, in connection with certain retirement eligible employees who are eligible to continue vesting awards upon retirement under the terms contained in the 2010 Plan, the 2007 Plan and certain predecessor share-based compensation plans such as the 2003 Plan.

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

	Three Months Ended June 30,		Nine Months Ended June 30,	
	2010	2009	2010	2009
Share-based compensation expense	\$ 2,540	\$ 1,604	\$ 9,911	\$ 6,799
Income tax benefit related to share-based compensation expense	\$ 909	\$ 501	\$ 3,495	\$ 1,981

### Stock Options

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

The following table presents a summary of the activity for the Company's stock option plans for the nine months ended June 30, 2010:

	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, 2009	10,159	\$ 7.43	7.7	\$ 10,678
Granted	2,917	7.46		



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Exercised	(71)		2.99		
Forfeited or expired	(47)		8.62		
Outstanding at June 30, 2010	12,958	\$	7.45	7.5	\$ 16,683
Exercisable at June 30, 2010	5,969	\$	7.57	6.5	\$ 8,705

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## Sally Beauty Holdings, Inc. and Subsidiaries

## Condensed Notes to Consolidated Financial Statements

(Unaudited)

The following table summarizes information about stock options under the Company's option plans at June 30, 2010:

Range of Exercise Prices	Number Outstanding at June 30, 2010 (in Thousands)	Options Outstanding		Options Exercisable	
		Weighted Average Remaining Contractual Term (in Years)	Weighted Average Exercise Price	Number Exercisable at June 30, 2010 (in Thousands)	Weighted Average Exercise Price
\$2.00	1,085	4.0	\$ 2.00	1,085	\$ 2.00
\$5.24 - 9.66	11,873	7.8	7.95	4,884	8.81
Total	12,958	7.5	\$ 7.45	5,969	\$ 7.57

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, which generally vest ratably over a four year period, is expensed on a straight-line basis over the vesting period 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:

	Nine Months Ended June 30,	
	2010	2009
Expected lives (in years)	5.0	5.0
Expected volatility	64.4%	47.9%
Risk-free interest rate	2.4%	2.6%
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, including grants under stock option plans of Alberto-Culver prior to the Separation Transactions. Expected volatility is derived using the average volatility of both the Company and similar companies (based on industry sector) since it is not practicable to estimate the Company's expected volatility on a stand-alone basis due to a lack of sufficient trading history. The risk-free interest rate is based on the zero-coupon U.S. Treasury issue as of the date of the grant. Since the Company does not currently expect to pay dividends, the dividend yield is 0%.

The weighted average fair value of the stock options issued to the Company's grantees at the date of grant in the nine months ended June 30, 2010 and 2009 was \$4.15 and \$2.33 per option, respectively. The total intrinsic value of options exercised during the nine months ended

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June 30, 2010 was \$0.5 million. Cash proceeds from these option exercises were \$0.2 million and the tax benefit realized for the tax deductions from these option exercises was \$0.2 million.

At June 30, 2010, approximately \$12.0 million of total unrecognized compensation costs related to unvested stock option awards are expected to be recognized over the weighted average period of 2.3 years.

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## Sally Beauty Holdings, Inc. and Subsidiaries

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**Stock Awards*****Restricted Stock Awards***

A restricted stock award is an award of shares of the Company's common stock (which have full voting rights but are restricted with regard to sale or transfer), the restrictions over which lapse ratably over a specified period of time (generally five years). Restricted stock awards are independent of stock option grants and are generally subject to forfeiture if employment terminates prior to these restrictions lapsing, subject to certain retirement provisions contained in the 2010 Plan, the 2007 Plan and certain predecessor share-based compensation plans such as the 2003 Plan.

The Company expenses the cost of the restricted stock awards, which is determined to be the fair value of the restricted stock award at the date of grant, on a straight-line basis over the period (the vesting period) in which the restrictions on these stock awards lapse (vesting). For these purposes, the fair value of the restricted stock award is determined based on the closing price of the Company's common stock on the grant date.

The following table presents a summary of the activity for the Company's restricted stock awards for the nine months ended June 30, 2010:

	Number of Shares (in Thousands)	Weighted Average Fair Value Per Share	Weighted Average Remaining Vesting Term (in Years)
<b>Restricted Stock Awards</b>			
Unvested at September 30, 2009	331	\$ 7.45	3.3
Granted	118	7.42	
Vested	(81)	7.71	
Forfeited			
Unvested at June 30, 2010	368	\$ 7.38	3.4

At June 30, 2010, approximately \$2.2 million of total unrecognized compensation costs related to unvested restricted stock awards are expected to be recognized over the weighted average period of 3.4 years.

***Restricted Stock Units ( RSUs )***

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The Company currently grants RSUs which generally vest less than one year from the date of grant pursuant to the 2010 Plan. To date, the Company has only granted RSU awards to its non-employee directors. RSUs represent an unsecured promise of the Company to issue shares of common stock of the Company. Upon vesting, such RSUs are 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.

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

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### Sally Beauty Holdings, Inc. and Subsidiaries

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(Unaudited)

The following table presents a summary of the activity for the Company's RSUs for the nine months ended June 30, 2010:

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, 2009		\$	
Granted	66	7.42	
Vested			
Forfeited			
Unvested at June 30, 2010	66	\$ 7.42	0.3

At June 30, 2010, approximately \$0.1 million of total unrecognized compensation costs related to unvested RSUs are expected to be recognized over the weighted average period of 0.3 years.

## 7. Goodwill and Other Intangibles

During the nine months ended June 30, 2010, intangible assets subject to amortization in the amount of \$22.9 million and \$1.9 million were recorded in connection with the September 2009 acquisitions of Schoeneman Beauty Supply, Inc. and Distribuidora Intersalon Limitada, respectively. In addition, during the nine months ended June 30, 2010, intangible assets with indefinite lives in the amount of \$0.9 million were recorded in connection with the acquisition of Distribuidora Intersalon Limitada. These amounts were previously reported in Goodwill pending the valuation of the assets acquired. Please see Note 17 to our financial statements contained in Item 8 of our Annual Report on Form 10-K for the fiscal year ended September 30, 2009.

The change in the carrying amounts of goodwill by operating segment for the nine months ended June 30, 2010 is as follows (in thousands):

	Sally Beauty Supply	Beauty Systems Group	Total
Balance at September 30, 2009	\$ 73,208	\$ 420,927	\$ 494,135
Additions and purchase price adjustments (a)	18,627	1,664	20,291
Reclassifications	(2,780)	(22,920)	(25,700)
Foreign currency translation	(9,345)	(418)	(9,763)
Balance at June 30, 2010	\$ 79,710	\$ 399,253	\$ 478,963

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(a) Please see Note 11 for additional information about businesses acquired.

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## Sally Beauty Holdings, Inc. and Subsidiaries

## Condensed Notes to Consolidated Financial Statements

(Unaudited)

The following table provides the carrying value for intangible assets with indefinite lives and the gross carrying value and accumulated amortization for intangible assets subject to amortization (which we refer to, in the aggregate, as other intangible assets ) by operating segment at June 30, 2010 (in thousands):

	Sally Beauty Supply	Beauty Systems Group	Total
Balance at June 30, 2010			
Intangible assets with indefinite lives:			
Trade names	\$ 18,987	\$ 33,568	\$ 52,555
Other intangibles		5,700	5,700
Total	18,987	39,268	58,255
Intangible assets subject to amortization:			
Gross carrying amount	8,482	60,440	68,922
Accumulated amortization	(3,357)	(27,088)	(30,445)
Net value	5,125	33,352	38,477
Total other intangible assets, net	\$ 24,112	\$ 72,620	\$ 96,732

Amortization expense was \$2.0 million and \$1.6 million for the three months ended June 30, 2010 and 2009, and \$6.1 million and \$4.5 million for the nine months ended June 30, 2010 and 2009, respectively. As of June 30, 2010, future amortization expense related to intangible assets subject to amortization is estimated to be as follows (in thousands):

<b>Fiscal Year:</b>	
2010	\$ 1,923
2011	7,059
2012	6,118
2013	3,657
2014	4,076
Thereafter	15,644
	\$ 38,477



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## Sally Beauty Holdings, Inc. and Subsidiaries

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**8. Long-Term Debt**

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

	As of June 30, 2010	Maturity dates	Interest Rates
ABL facility	\$ 5,000		(i) Prime plus up to 0.50% or; (ii) LIBOR plus (1.00% to 1.50%)
Term Loan A			
Term Loan B	863,856	Nov. 2013	(i) Prime plus (1.25% to 1.50%) or; (ii) LIBOR plus (2.25% to 2.50%) (a)
Other (b)	6,311	2010-2014	4.05% to 6.75%
Total	\$ 875,167		
Senior notes	\$ 430,000	Nov. 2014	9.25%
Senior subordinated notes	275,000	Nov. 2016	10.50%
Total	\$ 705,000		
Capitalized leases and other	\$ 6,575		
Less: current portion	(14,477)		
Total long-term debt	\$ 1,572,265		

(a) At June 30, 2010, the interest rate for the term loan B is 2.6%.

(b) Represents pre-acquisition debt of Pro-Duo NV and Sinelco Group NV. Please see Note 11.

In connection with the Separation Transactions in November 2006, the Company, through its subsidiaries (Sally Investment Holdings LLC and Sally Holdings), incurred \$1,850.0 million of indebtedness by (i) drawing on a revolving (asset-based lending ( ABL )) facility in the amount of \$70.0 million, (ii) entering into two term loan facilities (term loans A and B) in an aggregate amount of \$1,070.0 million and (iii) together (jointly and severally) with another of the Company's indirect subsidiaries, Sally Capital Inc., issuing senior notes in an aggregate amount of \$430.0 million and senior subordinated notes in an aggregate amount of \$280.0 million.

The term loan facilities and the ABL facility are secured by substantially all of our assets, those of Sally Investment Holdings LLC, a wholly-owned subsidiary of Sally Beauty and the direct parent of Sally Holdings, those of our domestic subsidiaries and, in the case of the ABL facility, those of our Canadian subsidiaries. The senior term loan facilities may be prepaid at the option of Sally Holdings at any time without premium or penalty and are subject to mandatory prepayment in an amount equal to 50% of excess cash flow (as defined in the agreement

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governing the senior term loan facilities) for any fiscal year unless a specified leverage ratio is met. In January 2010, the Company made a mandatory prepayment on the senior term loan facilities in the amount of \$22.3 million. Amounts paid pursuant to said provision may be applied, at the option of the Company, against minimum loan repayments otherwise required of us over the twelve-month period following any such payment under the terms of the loan agreement. Additionally, borrowings under the senior term loan facility would be subject to mandatory prepayment in an amount equal to 100% of the proceeds of specified asset sales that are not reinvested in the business or applied to repay borrowings under the ABL facility.

During the nine months ended June 30, 2010, the Company also made optional prepayments in the aggregate amount of \$82.7 million on its senior term loans. This amount includes \$54.7 million prepaid during the quarter ended June 30, 2010 and, together with the mandatory prepayment discussed in the preceding paragraph, resulted in the prepayment in full of borrowings under the Term Loan A facility. In connection with the mandatory prepayment discussed in the preceding paragraph and the optional prepayments made during the nine months ended June 30, 2010, the Company recorded losses on extinguishment of debt in the aggregate amount of \$0.8 million, which are included in interest expense in the Company's consolidated statements of earnings.

The senior notes and senior subordinated notes are unsecured obligations of the issuers and are jointly and severally guaranteed on a senior basis (in the case of the senior notes) and on a senior subordinated basis (in the case of the

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senior subordinated notes) by each material domestic subsidiary of the Company. Furthermore, the agreements underlying the Company's credit facilities contain terms which significantly restrict the ability of Sally Beauty's subsidiaries to pay dividends or otherwise transfer assets to Sally Beauty. Please see the Company's Annual Report on Form 10-K for the fiscal year ended September 30, 2009, for additional information about the Company's long-term debt.

Maturities of the Company's long-term debt are as follows as of June 30, 2010 (in thousands):

<b>Fiscal Year:</b>		
2010	\$	6,125
2011		10,621
2012		10,250
2013		10,130
2014		838,041
Thereafter		705,000
	\$	1,580,167
Capital leases and other		6,575
Less: current portion		(14,477)
Total	\$	1,572,265

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

Under the agreements and indentures governing the term loan facilities and the notes, Sally Holdings may not make certain restricted payments to us if a default then exists under the credit agreement or the indentures or if its consolidated interest coverage ratio is less than 2.0 to 1.0 at the time of the making of such restricted payment. As of June 30, 2010, its consolidated interest coverage ratio exceeded 2.0 to 1.0. Further, the aggregate amount of restricted payments it is able to make is limited pursuant to various baskets as calculated pursuant to the credit agreement and indentures.

The agreements governing our ABL facility generally permit the making of distributions and certain other restricted payments so long as borrowing availability under the facility equals or exceeds \$60.0 million. If borrowing availability falls below this amount, Sally Holdings may nevertheless make restricted payments to us in the aggregate since the date of the Separation Transactions, together with the aggregate cash amount paid in acquisitions since said date, of not greater than \$50.0 million, together with certain other exceptions. As of June 30, 2010, borrowing availability under the ABL facility exceeded \$60.0 million. As of June 30, 2010, the net assets of our consolidated subsidiaries that were unrestricted from transfer under our credit arrangements totaled \$284.4 million, subject to certain adjustments. The ABL facility and the senior term loan facilities, as well as the Company's 9.25% Senior Notes indenture and its 10.5% Senior Subordinated Notes indenture contain

customary cross-default and/or cross-acceleration provisions.

## **9. Derivative Instruments and Hedging Activities**

### **Risk Management Objectives of Using Derivative Instruments**

The Company is exposed to a wide variety of risks, including risks arising from changing economic conditions. The Company manages its exposure to certain economic risks (including liquidity, credit risk and changes in interest rates) 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 interest rate swaps by Sally Holdings. The Company uses interest rate swaps as part of its overall economic risk management strategy to add stability to the interest payments due in connection with its term loan obligations. Interest payments related to the term loans are impacted by changes in LIBOR. Interest rate swap

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agreements involve the periodic receipt by Sally Holdings of amounts based on a variable rate in exchange for Sally Holdings making payments based on a fixed rate over the term of the interest rate swap agreements, without exchange of the underlying notional amount. As of June 30, 2010, the Company did not purchase or hold any derivative instruments for trading or speculative purposes.

**Designated Cash Flow Hedges**

In May 2008, Sally Holdings entered into two interest rate swap agreements with an aggregate notional amount of \$300 million (each agreement with a notional amount of \$150 million). These agreements expire on May 31, 2012, and are designated and qualify as effective cash flow hedges, in accordance with ASC 815. Accordingly, changes in the fair value of these derivative instruments are recorded quarterly, net of income tax, in accumulated other comprehensive (loss) income ( OCI ) until the hedged obligation is settled or the swap agreements expire, whichever is earlier. Any hedge ineffectiveness, as this term is used in ASC 815, is recognized in interest expense in our consolidated statements of earnings. No hedge ineffectiveness on cash flow hedges was recognized during the nine months ended June 30, 2010 or 2009. Please see the Company's Annual Report on Form 10-K for the fiscal year ended September 30, 2009 for additional information about the Company's interest rate swap agreements.

Amounts reported in OCI related to interest rate swaps are reclassified into interest expense, as a yield adjustment, in the same period in which interest on the Company's variable-rate debt obligations affect earnings. Interest expense resulting from such reclassifications was \$2.5 million and \$2.4 million during the three months ended June 30, 2010 and 2009, and \$7.6 million and \$5.4 million during the nine months ended June 30, 2010 and 2009, respectively. During the twelve months ending June 30, 2011, the Company estimates that an additional \$8.9 million, before income tax, of the amount reported in OCI will be reclassified into interest expense.

**Non-designated Cash Flow Hedges**

In connection with the Separation Transactions in November 2006, Sally Holdings entered into four interest rate swap agreements with an aggregate notional amount of \$500 million. Interest rate swap agreements with an aggregate notional amount of \$150 million expired in November 2008 and interest rate swap agreements with a notional amount of \$350 million expired in November 2009. These interest rate swap agreements were not designated as hedges and, accordingly, the changes in fair value of these interest rate swap agreements (which were adjusted quarterly) were recorded in interest expense in our consolidated statements of earnings. Interest expense includes non-cash income of \$2.5 million of marked-to-market adjustments related to these interest rate swaps for the three months ended June 30, 2009 with no comparable amount for the three months ended June 30, 2010. Interest expense includes non-cash income of \$2.4 million and \$1.7 million of marked-to-market adjustments related to these interest rate swaps for the nine months ended June 30, 2010 and 2009, respectively. Please see the Company's Annual Report on Form 10-K for the fiscal year ended September 30, 2009 for additional information about these interest rate swap agreements.

As a result of the Company's acquisition of Sinelco Group NV ( Sinelco ) on December 16, 2009, the Company, through Sinelco, uses foreign currency options (including, at June 30, 2010, foreign currency put options with an aggregate notional amount of 2.9 million (\$3.6 million, at the June 30, 2010 exchange rate) and foreign currency call options with an aggregate notional amount of 1.8 million (\$2.2 million, at the June 30, 2010 exchange rate)) to manage the exposure to certain non-Euro currencies resulting from Sinelco's purchases of merchandise from third-party suppliers. Sinelco's functional currency is the Euro. These foreign currency option agreements are not designated as hedges and do not meet the hedge accounting requirements of ASC 815. Accordingly, the changes in fair value of these derivative instruments (which are adjusted quarterly) are recorded in our consolidated statements of earnings. Included in selling, general and administrative expenses are gains of \$0.4 million and \$0.7 million related to these foreign currency options, including marked-to-market adjustments, for the three and nine months ended June 30, 2010, respectively. Please see Note 11 for information about the acquisition of Sinelco.

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The table below presents the fair value of the Company's derivative financial instruments as well as their classification on the balance sheet as of June 30, 2010 (in thousands):

**Tabular Disclosure of Fair Values of Derivative Instruments**

	Asset Derivatives As of June 30, 2010		Liability Derivatives As of June 30, 2010	
	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
Derivatives designated as hedging instruments:				
Interest Rate Swaps	Other assets	\$	Other liabilities	\$ 15,750
Total derivatives designated as hedging instruments		\$		\$ 15,750
Derivatives not designated as hedging instruments:				
Foreign Currency Options	Prepaid expenses	\$ 458	Accrued liabilities	\$
Interest Rate Swaps	Prepaid expenses		Accrued liabilities	
Total derivatives not designated as hedging instruments		\$ 458		\$

The table below presents the fair value of the Company's derivative financial instruments as well as their classification on the balance sheet as of September 30, 2009 (in thousands):

**Tabular Disclosure of Fair Values of Derivative Instruments**

	Asset Derivatives As of September 30, 2009		Liability Derivatives As of September 30, 2009	
	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
Derivatives designated as hedging instruments:				
Interest Rate Swaps	Other assets	\$	Other liabilities	\$ 15,365
Total derivatives designated as hedging instruments		\$		\$ 15,365
Derivatives not designated as hedging instruments:				
Interest Rate Swaps	Prepaid expenses	\$	Accrued liabilities	\$ 2,356

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Total derivatives not designated as hedging instruments	\$	\$	2,356
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Sally Beauty Holdings, Inc. and Subsidiaries

Condensed Notes to Consolidated Financial Statements

(Unaudited)

The tables below present the effect of the Company's derivative financial instruments on the statements of earnings for the three months ended June 30, 2010 and 2009 (in thousands):

**Tabular Disclosure of the Effect of Derivative Instruments on the Statement of Earnings for the**

**Three Months Ended June 30, 2010**

<b>Derivatives in Cash Flow Hedging Relationships</b>	<b>Amount of Gain or (Loss) Recognized in OCI on Derivative (Effective Portion), net of tax</b>	<b>Location of Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)</b>	<b>Amount of Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)</b>	<b>Location of Gain or (Loss) Recognized in Income on Derivative (Ineffective Portion and Amount Excluded from Effectiveness Testing)</b>	<b>Amount of Gain or (Loss) Recognized in Income on Derivative (Ineffective Portion and Amount Excluded from Effectiveness Testing)</b>
Interest Rate Swaps	\$ (395)	Interest expense	\$ (2,491)	Interest expense	\$

<b>Derivatives Not Designated as Hedging Instruments</b>	<b>Location of Gain or (Loss) Recognized in Income on Derivative</b>	<b>Amount of Gain or (Loss) Recognized in Income on Derivative</b>
Foreign Currency Options	Selling, general and administrative expenses	\$ 439
Interest Rate Swaps	Interest expense	
Total derivatives not designated as hedging instruments		\$ 439

**Tabular Disclosure of the Effect of Derivative Instruments on the Statement of Earnings for the**

**Three Months Ended June 30, 2009**

<b>Derivatives in Cash Flow Hedging Relationships</b>	<b>Amount of Gain or (Loss) Recognized in OCI on Derivative (Effective Portion)</b>	<b>Location of Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)</b>	<b>Amount of Gain or (Loss) Reclassified from Accumulated OCI into Income</b>	<b>Location of Gain or (Loss) Recognized in Income on Derivative (Ineffective Portion and Amount Excluded from Effectiveness Testing)</b>	<b>Amount of Gain or (Loss) Recognized in Income on Derivative (Ineffective Portion and Amount Excluded from Effectiveness Testing)</b>
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	Portion), net of tax		(Effective Portion)		Amount Excluded from Effectiveness Testing)
Interest Rate Swaps	\$ 2,968	Interest expense	\$ (2,397)	Interest expense	\$

Derivatives Not Designated as Hedging Instruments	Location of Gain or (Loss) Recognized in Income on Derivative	Amount of Gain or (Loss) Recognized in Income on Derivative
Interest Rate Swaps	Interest expense	\$ (964)

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(Unaudited)

The tables below present the effect of the Company's derivative financial instruments on the statements of earnings for the nine months ended June 30, 2010 and 2009 (in thousands):

**Tabular Disclosure of the Effect of Derivative Instruments on the Statement of Earnings for the**

**Nine Months Ended June 30, 2010**

<b>Derivatives in Cash Flow Hedging Relationships</b>	<b>Amount of Gain or (Loss) Recognized in OCI on Derivative (Effective Portion), net of tax</b>	<b>Location of Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)</b>	<b>Amount of Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)</b>	<b>Location of Gain or (Loss) Recognized in Income on Derivative (Ineffective Portion and Amount Excluded from Effectiveness Testing)</b>	<b>Amount of Gain or (Loss) Recognized in Income on Derivative (Ineffective Portion and Amount Excluded from Effectiveness Testing)</b>
Interest Rate Swaps	\$ (236)	Interest expense	\$ (7,562)	Interest expense	\$

<b>Derivatives Not Designated as Hedging Instruments</b>	<b>Location of Gain or (Loss) Recognized in Income on Derivative</b>	<b>Amount of Gain or (Loss) Recognized in Income on Derivative</b>
Foreign Currency Options	Selling, general and administrative expenses	\$ 700
Interest Rate Swaps	Interest expense	(24)
Total derivatives not designated as hedging instruments		\$ 676

**Tabular Disclosure of the Effect of Derivative Instruments on the Statement of Earnings for the**

**Nine Months Ended June 30, 2009**

<b>Derivatives in Cash Flow Hedging Relationships</b>	<b>Amount of Gain or (Loss) Recognized in OCI on Derivative (Effective Portion)</b>	<b>Location of Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)</b>	<b>Amount of Gain or (Loss) Reclassified from Accumulated OCI into Income</b>	<b>Location of Gain or (Loss) Recognized in Income on Derivative (Ineffective Portion and Amount Excluded from Effectiveness Testing)</b>	<b>Amount of Gain or (Loss) Recognized in Income on Derivative (Ineffective Portion and Amount Excluded from Effectiveness Testing)</b>
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	Portion), net of tax		(Effective Portion)		Amount Excluded from Effectiveness Testing)
Interest Rate Swaps	\$ (9,241)	Interest expense	\$ (5,410)	Interest expense	\$

Derivatives Not Designated as Hedging Instruments	Location of Gain or (Loss) Recognized in Income on Derivative	Amount of Gain or (Loss) Recognized in Income on Derivative
Interest Rate Swaps	Interest expense	\$ (7,152)

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Sally Beauty Holdings, Inc. and Subsidiaries

Condensed Notes to Consolidated Financial Statements

(Unaudited)

**Credit-risk-related Contingent Features**

The agreements governing the Company's interest rate swaps contain provisions pursuant to which the Company could be declared in default on its interest rate swap obligations in the event the Company defaulted under certain terms of the loan documents governing the Company's ABL facility. As of June 30, 2010, the fair value of interest rate swaps in a liability position related to these agreements was \$15.8 million and the Company was under no obligation to post and had not posted any collateral related to these agreements. If the Company breached any of these provisions, it would be required to settle its obligations under the agreements at their termination value of \$16.2 million, including accrued interest and other termination costs.

The Company's foreign operations expose the Company to fluctuations in foreign currency exchange rates and foreign interest rates. These fluctuations may impact, among other things, the amount of the Company's future cash flows in terms of the Company's functional currency, the U.S. dollar. As a result of the Company's acquisition of Sinelco on December 16, 2009, the Company, through Sinelco, uses foreign currency options to manage the exposure to certain non-Euro currencies resulting from Sinelco's purchases of merchandise from third-party suppliers. Sinelco's functional currency is the Euro. Please see Note 11 for information about the acquisition of Sinelco.

The counterparties to all our derivative instruments are deemed by the Company to be of substantial resources and strong creditworthiness. However, these transactions result in exposure to credit risk in the event of default by a counterparty. The recent financial crisis affecting the banking systems and financial markets resulted in many well-known financial institutions becoming less creditworthy or having diminished liquidity which could expose us to an increased level of counterparty credit risk. In the event that a counterparty defaults in its obligation under our derivative instruments, we could incur substantial financial losses. However, at the present time, no such losses are deemed probable.

**10. Income Taxes**

The Company and its subsidiaries file consolidated income tax returns in the U.S. federal jurisdiction and most state jurisdictions, as well as in various foreign jurisdictions.

The transactions separating us from Alberto-Culver were intended to qualify as a reorganization under Section 368(a)(1)(D) of the Internal Revenue Code of 1986, as amended (the "Code") and a distribution eligible for non-recognition under Sections 355(a) and 361(c) of the Code. In connection with the share distribution of Alberto-Culver common stock in the Separation Transactions, we received: (i) a private letter ruling from the IRS and (ii) an opinion of Sidley Austin LLP, counsel to Alberto-Culver, in each case, to the effect that the transactions qualify as a reorganization under Section 368(a)(1)(D) of the Code and a distribution eligible for non-recognition under Sections 355(a) and 361(c) of the Code. Certain internal restructurings also occurred at or immediately prior to the Separation Transactions. As a result of the internal

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restructurings and Separation Transactions, the Company inherited the federal tax identification number of the old Alberto-Culver parent for U.S. federal income tax purposes.

The Company and Alberto-Culver entered into a tax allocation agreement as part of the Separation Transactions. The agreement provides generally that the Company is responsible for its pre-separation income tax liabilities, calculated on a stand-alone basis, and Alberto-Culver is responsible for the remainder. In the event additional U.S. federal income tax liability related to the period prior to the Separation Transactions was determined, the Company will be jointly and severally liable for these taxes, and there can be no assurance that Alberto-Culver would be able to fulfill its indemnification obligations to the Company under the tax allocation agreement if Alberto-Culver was determined to be responsible for these taxes thereunder.

In addition, as the successor entity to Alberto-Culver after the Separation Transactions, the Company relies upon the prior year federal income tax returns of Alberto-Culver and accounting methods established therein for certain calculations that affect the Company's current consolidated U.S. federal income tax liability.

The IRS has initiated an examination of the Company's consolidated federal income tax returns for the fiscal years ended September 30, 2008 and 2007. The IRS had previously audited the Company's consolidated federal income tax returns through the tax year ended September 30, 2006, thus our statute remains open from the year ended

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### Sally Beauty Holdings, Inc. and Subsidiaries

#### Condensed Notes to Consolidated Financial Statements

(Unaudited)

September 30, 2007 forward. Our foreign subsidiaries are impacted by various statutes of limitations, which are generally open from 2004 forward. Generally, states' statutes in the United States are open for tax reviews from 2005 forward.

## 11. Acquisitions

On December 16, 2009, the Company acquired Sinelco, a wholesale distributor of professional beauty products based in Ronse, Belgium, for approximately 25.2 million (approximately \$36.6 million). Sinelco serves over 1,500 customers through a product catalog and website and has sales throughout Europe. Goodwill of \$17.2 million was recorded as a result of this acquisition. In addition, during the nine months ended June 30, 2010, the Company completed several other individually immaterial acquisitions at an aggregate cost of \$5.3 million and recorded goodwill in the amount of \$3.1 million. The valuation of the assets acquired and liabilities assumed in connection with all acquisitions completed during the nine months ended June 30, 2010 was based on their estimated fair values at the acquisition date. The final valuation of the assets acquired and liabilities assumed will be completed during the fiscal year 2010.

## 12. Business Segments

The Company's business is organized into two separate segments: (i) Sally Beauty Supply, a domestic and international chain of cash and carry retail stores which offers professional beauty supplies to both salon professionals and retail customers and (ii) BSG, including its franchise-based business Armstrong McCall, a full service beauty supply distributor which offers professional brands of beauty products directly to salons through its own sales force and professional only stores (including franchise stores) in generally exclusive geographical territories in North America and parts of Europe.

Sales between segments, which were eliminated in consolidation, were not material during the periods ended June 30, 2010 and 2009. Segment data for the three and nine months ended June 30, 2010 and 2009 is as follows (in thousands):

	Three months ended		Nine months ended	
	June 30,		June 30,	
	2010	2009	2010	2009
Net sales:				
Sally Beauty Supply	\$ 467,428	\$ 434,732	\$ 1,359,377	\$ 1,257,607
BSG	275,547	238,605	808,916	702,817
Total net sales	\$ 742,975	\$ 673,337	\$ 2,168,293	\$ 1,960,424
Earnings before provision for income taxes:				

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Segment operating profit:

Sally Beauty Supply	\$	85,116	\$	76,748	\$	235,743	\$	212,413
BSG		30,086		25,632		81,709		66,227
Total segment operating profit		115,202		102,380		317,452		278,640
Unallocated corporate expenses (a)		(20,058)		(18,555)		(60,026)		(51,130)
Share-based compensation expense		(2,540)		(1,604)		(9,911)		(6,799)
Interest expense		(28,255)		(31,050)		(85,149)		(102,692)
Earnings before provision for income taxes	\$	64,349	\$	51,171	\$	162,366	\$	118,019

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



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**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.**

This section discusses management's view of the financial condition, results of operations and cash flows of Sally Beauty and its consolidated subsidiaries. This section should be read in conjunction with the audited consolidated financial statements and the related notes included in our Annual Report on Form 10-K for the fiscal year ended September 30, 2009, as well as the Risk Factors section contained in that Annual Report, and information contained elsewhere in this Quarterly Report, including the consolidated interim financial statements and condensed notes to those statements. This Management's Discussion and Analysis of Financial Condition and Results of Operations section may contain forward-looking statements. See Cautionary Notice Regarding Forward-Looking Statements, included at the beginning of this Quarterly Report for a discussion of the uncertainties, risks and assumptions associated with these forward-looking statements that could cause results to differ materially from those reflected in such forward-looking statements.

**Highlights For the Nine Months Ended June 30, 2010:**

- Our consolidated same store sales increased by 4.4% for the nine months ended June 30, 2010;
- Our consolidated net sales for the nine months ended June 30, 2010, increased by \$207.9 million, or 10.6%, to \$2,168.3 million compared to \$1,960.4 million for the nine months ended June 30, 2009;
- Net sales reported for the nine months ended June 30, 2010, reflect approximately \$21.1 million, or 1.1%, in positive impact from changes in foreign exchange rates;
- Our consolidated gross profit for the nine months ended June 30, 2010, increased \$114.9 million, or 12.4%, to \$1,038.4 million compared to \$923.5 million for the nine months ended June 30, 2009. As a percentage of net sales, gross profit increased 80 basis points to 47.9% for the nine months ended June 30, 2010 compared to 47.1% for the nine months ended June 30, 2009;
- Our consolidated operating earnings for the nine months ended June 30, 2010, increased \$26.8 million, or 12.1%, to \$247.5 million compared to \$220.7 million for the nine months ended June 30, 2009;
- Net earnings increased \$29.7 million, or 41.1%, to \$101.8 million for the nine months ended June 30, 2010 compared to \$72.1 million for the nine months ended June 30, 2009;
- Cash provided by operations decreased by \$16.2 million to \$147.8 million for the nine months ended June 30, 2010 compared to \$164.0 million for the nine months ended June 30, 2009; and
- On December 16, 2009, we acquired Sinelco Group NV (Sinelco), a wholesale distributor of professional beauty products based in Ronse, Belgium, for approximately \$25.2 million (approximately \$36.6 million).

**Overview**

*Description of Business*

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We operate primarily through two business units, Sally Beauty Supply and BSG. Through Sally Beauty Supply and BSG (which operates stores under the CosmoProf service mark), we operated a multi-channel platform of 3,802 stores and supplied 184 franchised stores in North America, South America and selected European countries, as of June 30, 2010. We are the largest distributor of professional beauty supplies in the U.S. based on store count. Within BSG, we also have one of the largest networks of professional distributor sales consultants in North America, with approximately 1,055 professional distributor sales consultants who sell directly to salons and salon professionals. We provide our customers with a wide variety of leading third-party branded and exclusive-label professional beauty supplies, including hair care products, styling appliances, skin and nail care products and other beauty items. Sally Beauty Supply stores target retail consumers and salon professionals while BSG exclusively targets salons and salon professionals. For the nine months ended June 30, 2010, our consolidated net sales and operating earnings were \$2,168.3 million and \$247.5 million, respectively.

As of June 30, 2010, Sally Beauty Supply operated 2,947 company-operated retail stores, 2,383 of which are located in the U.S. (with the remainder in the United Kingdom and certain other countries in Europe, Canada, Puerto Rico, Mexico and Chile) and supplied 26 franchised stores located outside the U.S. We believe Sally Beauty Supply is the largest open-line distributor of professional beauty supplies in the U.S. based on store count. Sally Beauty Supply stores in the U.S. range in size between 1,200 square feet and 1,700 square feet and are primarily located in strip shopping centers. The product selection in Sally Beauty Supply stores ranges between 4,000 and 8,000 SKUs of beauty products and includes products for hair care, skin and nail care, beauty sundries and electrical appliances targeting retail consumers and salon professionals. Sally Beauty Supply stores carry leading third-party brands such as Clairol, Revlon and Conair, as well as an extensive selection of exclusive-label merchandise.

As of June 30, 2010, BSG had 855 company-operated stores, supplied 158 franchised stores and had a sales force of approximately 1,055 professional distributor sales consultants selling exclusively to salons and salon professionals in substantially all states in the U.S. and in portions of Canada, Puerto Rico, Mexico and certain European countries.

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We believe BSG is the largest full-service distributor of professional beauty supplies in the U.S. BSG stores average approximately 2,700 square feet and are primarily located in secondary strip shopping centers. Through BSG's large store base and sales force, BSG is able to access a significant portion of the highly fragmented U.S. salon channel. The product selection in BSG stores, ranging between 4,000 and 9,000 SKUs of beauty products, includes hair care and color, skin and nail care, beauty sundries and electrical appliances and targets salons and salon professionals. BSG carries leading professional beauty product brands intended for use in salons and for resale by the salon to consumers. Certain BSG products are sold under exclusive distribution agreements with suppliers whereby BSG is designated as the sole distributor for a product line within certain geographic territories.

***Industry and Business Trends***

We operate within the large and growing U.S. professional beauty supply industry. Potential growth in the industry is expected to be driven by increases in hair color, hair loss prevention and hair styling products. We believe the following key industry and business trends and characteristics will influence our business and our financial results going forward:

- *High level of marketplace fragmentation.* The U.S. salon channel is highly fragmented with over 250,000 salons. Given the fragmented and small-scale nature of the salon industry, we believe that salon operators will continue to depend on full-service/exclusive distributors and open-line channels for a majority of their beauty supply purchases.
- *Growth in booth renting and frequent stocking needs.* Salon professionals primarily rely on just-in-time inventory due to capital constraints and a lack of warehouse and shelf space at salons. In addition, booth renters, who comprise a significant percentage of total U.S. salon professionals, are often responsible for purchasing their own supplies. Historically, booth renters have significantly increased as a percentage of total salon professionals, and we expect this trend to continue. Given their smaller individual purchases and relative lack of financial resources, booth renters are likely to be dependent on frequent trips to professional beauty supply stores, like BSG and Sally Beauty Supply. We expect that these factors will continue to drive demand for conveniently located professional beauty supply stores.
- *Increasing use of exclusive-label products.* We offer a broad range of private label and control label products, which we generally refer to collectively as exclusive-label products. Private label products are brands for which we own or license the trademark and, in some instances, the formula. Control label products are brands that are owned by the manufacturer, but for which we have been granted sole distribution rights. Generally, our exclusive-label products have higher gross margins than the leading third-party branded products, and we believe this area offers potential growth. Please see Risk Factors - We depend upon manufacturers who may be unable to provide products of adequate quality or who may be unwilling to continue to supply products to us in Item 1A of our Annual Report on Form 10-K for the fiscal year ended September 30, 2009.
- *Favorable demographic and consumer trends.* We expect the aging baby-boomer population to drive future growth in professional beauty supply sales through an increase in the usage of hair color and hair loss products. Additionally, continuously changing fashion-related trends that drive new hair styles are expected to result in continued demand for hair styling products. Changes in consumer tastes and fashion trends can have an impact on our financial performance. Our continued success depends in large part on our ability to anticipate, gauge and react in a timely and effective manner to changes in consumer spending patterns and preferences for beauty products. We continuously adapt our marketing and merchandising initiatives for Sally Beauty Supply in an effort to expand our market reach or to respond to changing consumer preferences. If we are unable to anticipate and respond to trends in the marketplace for beauty products and changing consumer demands, our business could suffer.

- *International growth strategies.* A key element of our growth strategy depends on our ability to capitalize on growth in the international marketplace and to grow our current level of non-U.S. operations. For example, on December 16, 2009, we acquired Sinelco Group NV ( Sinelco ), a wholesale distributor of professional beauty products with sales throughout Europe. In addition, on September 4, 2009, we acquired Distribuidora Intersalon Limitada, a leading distributor of premier beauty supply products with 16 stores located in Chile. These acquisitions furthered our expansion plans in Europe and Latin America, key targets of Sally Beauty Supply's international growth initiative. We intend to continue to identify and evaluate non-U.S. acquisition targets. Our ability to grow our non-U.S. operations, integrate our new non-U.S. acquisitions and successfully pursue additional non-U.S. acquisitions may be affected by business, legal, regulatory and economic risks. Please see Risk Factors - We may not be able to successfully identify

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acquisition candidates and complete desirable acquisitions, If we acquire any businesses in the future they could prove difficult to integrate, disrupt our business or have an adverse effect on our results of operations and Our ability to conduct business in international marketplaces may be affected by legal, regulatory and economic risks in Item 1A of our Annual Report on Form 10-K for the fiscal year ended September 30, 2009.

- *Continuing consolidation.* There is continuing consolidation among professional beauty product distributors and professional beauty product manufacturers. We plan to continue to examine ways in which we can benefit from this trend, including reviewing opportunities to shift business within the professional beauty products channel from competitive distributors to the BSG network as well as seeking opportunistic, value-added acquisitions which complement our long-term growth strategy. We believe that suppliers are increasingly likely to focus on larger distributors and retailers with a broader scale and retail footprint. We also believe that we are well positioned to capitalize on this trend as well as participate in the ongoing consolidation at the distributor/retail level. However, changes often occur in our relationships with suppliers that may materially affect the net sales and operating earnings of our business segments. Consolidation among suppliers could exacerbate the effects of these relationship changes and could increase pricing pressures. For example, as we announced in December 2006, our largest supplier, L Oreal, moved a material amount of revenue out of the BSG nationwide distribution network and into competitive regional distribution networks. More recently, L Oreal acquired distributors competing with BSG in the southeastern and west coast of the U.S. and, as a result, directly competes with BSG in certain geographic areas. If L Oreal acquired other distributors or suppliers that conduct significant business with BSG, we could lose related revenue. There can be no assurance that there will not be further loss of revenue over time by BSG (including within its franchise-based business) due to potential losses of additional products (both from L Oreal and from other suppliers) as well as from the increased competition from L Oreal-affiliated distribution networks. Please see Risk Factors - The beauty products distribution industry is highly competitive and is consolidating and We depend upon manufacturers who may be unable to provide products of adequate quality or who may be unwilling to continue to supply products to us in Item 1A of our Annual Report on Form 10-K for the fiscal year ended September 30, 2009.

- *Relationships with suppliers.* Sally Beauty Supply/BSG and their suppliers are dependent on each other for the distribution of beauty products. We do not manufacture the brand name or exclusive-label products we sell. We purchase our products from a limited number of manufacturers. As is typical in distribution businesses, these relationships are subject to change from time to time (including the expansion or loss of distribution rights in various geographies and the addition or loss of product lines). Since we purchase products from many manufacturers on an at-will basis, under contracts which can generally be terminated without cause upon 90 days notice or less or which expire without express rights of renewal, such manufacturers could discontinue sales to us at any time or upon the expiration of the distribution period. Some of our contracts with manufacturers may be terminated by such manufacturers if we fail to meet specified minimum purchase requirements. In such cases, we do not have contractual assurances of continued supply, pricing or access to new products and vendors may change the terms upon which they sell. Infrequently, a supplier will seek to terminate a distribution relationship through legal action. Changes in our relationships with suppliers occur often and could positively or negatively impact our net sales and operating profits. Although we focus on developing new revenue and cost management initiatives to mitigate the negative effects resulting from unfavorable changes in our supplier relationships, there can be no assurance that our efforts will continue to completely offset the loss of these or other distribution rights. Please see Risk Factors We depend upon manufacturers who may be unable to provide products of adequate quality or who may be unwilling to continue to supply products to us in Item 1A of our Annual Report on Form 10-K for the fiscal year ended September 30, 2009.

We expect to continue to expand our product line offerings and to gain additional distribution rights over time through either further negotiation with suppliers or by strategic acquisitions of existing distributors. Although we are focused on developing new revenue and cost management initiatives, there can be no assurance that our efforts will partially or completely offset any potential loss of distribution rights in the future. Please see Risk Factors We depend upon manufacturers who may be unable to provide products of adequate quality or who may be unwilling to continue to supply products to us in Item 1A of our Annual Report on Form 10-K for the fiscal year ended September 30, 2009.

- *High level of competition.* Sally Beauty Supply competes with other domestic and international beauty product wholesale and retail outlets, including local and regional open-line beauty supply stores, professional-only beauty supply stores, salons, mass merchandisers, drug stores and supermarkets, as well as



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sellers on the internet and salons retailing hair care items. BSG competes with other domestic and international beauty product wholesale and retail suppliers and manufacturers selling professional beauty products directly to salons and individual salon professionals. We also face competition from authorized and unauthorized retailers and internet sites offering professional salon-only products. The increasing availability of unauthorized professional salon products in large format retail stores such as drug stores, grocery stores and others could also have a negative impact on our business. Please see *Risk Factors* The beauty products distribution industry is highly competitive and is consolidating in Item 1A of our Annual Report on Form 10-K for the fiscal year ended September 30, 2009.

- *Economic conditions.* We appeal to a wide demographic consumer profile and offer a broad selection of beauty products sold directly to retail consumers and salons and salon professionals. Historically, these factors have provided us with reduced exposure to downturns in economic conditions in the countries in which we operate. However, a downturn in the economy, especially for an extended period of time, could adversely impact consumer demand of discretionary items such as beauty products and salon services, particularly affecting our electrical products category and our full-service sales business. In addition, higher freight costs resulting from increases in the cost of fuel, especially for an extended period of time, may impact our expenses at levels that we cannot pass through to our customers. These factors could have a material adverse effect on our business, financial condition and results of operations. Please see *Risk Factors* A further downturn in the economy may affect consumer purchases of discretionary items such as beauty products and salon services, which could have a material adverse effect on our business, financial condition and results of operations in Item 1A of our Annual Report on Form 10-K for the fiscal year ended September 30, 2009.

- *Controlling expenses.* Another important aspect of our business is our ability to control costs, especially in our BSG business segment, by right-sizing the business and maximizing the efficiency of our structure. In late fiscal year 2009, we completed implementation of an approximately \$22.0 million capital spending program to consolidate warehouses and reduce administrative expenses related to BSG's distribution network optimization program resulting in annualized cost savings of approximately \$10.0 million beginning with this fiscal year. Please see *Risk Factors* We are not certain that our ongoing cost control plans will continue to be successful in Item 1A of our Annual Report on Form 10-K for the fiscal year ended September 30, 2009.

- *Opening new stores.* Our future growth strategy depends in part on our ability to open and profitably operate new stores in existing and additional geographic areas. The capital requirements to open a U.S. - based Sally Beauty Supply or BSG store, excluding inventory, average approximately \$70,000 and \$80,000, respectively, with the capital requirements for international stores costing less or substantially more depending upon the marketplace. However, in response to economic conditions and to allow flexibility to capitalize on potential real estate revaluations in key locations, in the fiscal year 2009 we slowed our new store openings. We may not be able to open all of the new stores we plan to open and any new stores we open may not be profitable, any of which could have a material adverse impact on our financial condition or results of operations. Please see *Risk Factors* If we are unable to profitably open and operate new stores, our business, financial condition and results of operations may be adversely affected in Item 1A of our Annual Report on Form 10-K for the fiscal year ended September 30, 2009.

- *Changes to our information technology systems.* As our operations grow in both size and scope, we will continuously need to improve and upgrade our information systems and infrastructure while maintaining the reliability and integrity of our systems and infrastructure. The expansion of our systems and infrastructure will require us to commit substantial financial, operational and technical resources in advance of any increase in the volume of our business, with no assurance that the volume of business will increase. For example, in fiscal year 2009, we began upgrading our distribution information systems (in connection with our capital spending program to consolidate warehouses, as discussed above), upgrading our AS400 iSeries servers and installing Hyperion software to enhance our financial reporting system. These and any other required upgrades to our information systems and information technology (or new technology), now or in the future, will require that our management and resources be diverted from our core business to assist in completion of these projects. There can be no assurance that the time and resources our management will need to devote to these upgrades, service outages or delays due to the installation of any new or upgraded technology (and customer issues therewith), or the impact on the reliability of our data from any new or upgraded technology will not have a material adverse effect on our financial reporting, business, financial condition or results of operations. Please see *Risk Factors* We may be adversely affected by any





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disruption in our information technology systems in Item 1A of our Annual Report on Form 10-K for the fiscal year ended September 30, 2009.

***Our Separation from Alberto-Culver***

In November 2006, Sally Holdings, Inc. was converted to a Delaware limited liability company, was renamed Sally Holdings LLC and became an indirect wholly-owned subsidiary of Sally Beauty in connection with our separation from Alberto-Culver. In this Quarterly Report on Form 10-Q, we refer to these transactions as the Separation Transactions. Sally Beauty was formed in June 2006 and became the accounting successor company to Sally Holdings, Inc. upon the completion of the Separation Transactions. See the Company's Annual Report on Form 10-K for the fiscal year ended September 30, 2009 for more information about the Separation Transactions.

***Other Significant Items***

*Derivative Instruments*

The Company is exposed to a wide variety of risks, including risks arising from changing economic conditions. The Company manages its exposure to certain economic risks (including liquidity, credit risk and changes in interest rates) 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 interest rate swaps by Sally Holdings. The Company uses interest rate swaps as part of its overall economic risk management strategy to add stability to the interest payments due in connection with its term loan obligations. Interest payments related to the term loans are impacted by changes in LIBOR. Interest rate swap agreements involve the periodic receipt by Sally Holdings of amounts based on a variable rate in exchange for Sally Holdings making payments based on a fixed rate over the term of the agreements without exchange of the underlying notional amount.

In November 2006, Sally Holdings entered into four interest rate swap agreements with an aggregate notional amount of \$500 million. Interest rate swap agreements with an aggregate notional amount of \$150 million expired in November 2008 and agreements with a notional amount of \$350 million expired in November 2009. These interest rate swap agreements did not qualify as hedges and, therefore, the changes in fair value of these agreements were recorded in interest expense in our consolidated statements of earnings.

Additionally, in May 2008, Sally Holdings entered into two interest rate swap agreements with an aggregate notional amount of \$300 million. These interest rate swap agreements expire in May 2012 and are designated as effective hedges, consistent with ASC 815. Accordingly, adjustments to reflect the change in the fair values of these interest rate swap agreements are recorded in accumulated other comprehensive (loss) income, net of tax, until the hedged obligation is settled or the swap agreements expire, whichever is earlier. Any ineffectiveness is recognized in interest expense in the consolidated statements of earnings. Please see Item 3 Quantitative and Qualitative Disclosures about Market Risk Interest rate risk and Note 14 of the Notes to Consolidated Financial Statements in Item 8 - Financial Statements and Supplementary Data contained in our Annual Report on Form 10-K for the fiscal year ended September 30, 2009.

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The Company is exposed to potential gains or losses from foreign currency fluctuations affecting our net investments in subsidiaries and earnings denominated in foreign currencies. The Company's primary exposures are to changes in exchange rates for the U.S. dollar versus the British pound sterling, the Canadian dollar, the Euro, the Chilean peso, and the Mexican peso. The Company's various foreign currency exposures at times offset each other providing a natural hedge against foreign currency risk.

As a result of the Company's acquisition of Sinelco on December 16, 2009, the Company, through Sinelco, uses foreign currency options (including, at June 30, 2010, foreign currency put options with an aggregate notional amount of 2.9 million (\$3.6 million, at the June 30, 2010 exchange rate) and foreign currency call options with an aggregate notional amount of 1.8 million (\$2.2 million, at the June 30, 2010 exchange rate)) to manage the exposure to certain non-Euro currencies resulting from Sinelco's purchases of merchandise from third-party suppliers. Sinelco's functional currency is the Euro. These foreign currency option agreements are not designated as hedges and do not meet the hedge accounting requirements of ASC 815. Accordingly, the changes in fair value of these derivative instruments (which are adjusted quarterly) are recorded in our consolidated statements of earnings. Included in selling, general and administrative expenses are gains of \$0.4 million and \$0.7 million related to these foreign currency options, including marked-to-market adjustments, for the three and nine months ended June 30,

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2010, respectively. During the nine months ended June 30, 2010, these derivative instruments did not have a material impact on results of operations or cash flows.

Our counterparties in the Company's interest rate swaps and foreign currency options are deemed to be of substantial resources and strong creditworthiness. However, these transactions result in exposure to credit risks in the event of default by a counterparty. The recent financial crisis affecting the banking systems and financial markets has resulted in many well-known financial institutions becoming less creditworthy or having diminished liquidity, which could expose us to an increased level of counterparty risk. In the event that a counterparty defaults in its obligation under our derivative instruments, we could incur substantial financial loss. At June 30, 2010, the aggregate fair value of all our interest rate swaps was a net liability of \$15.8 million and the aggregate fair value of all our foreign currency options was a net asset of \$0.5 million.

### Results of Operations

The following table shows the condensed results of operations of our business for the three and nine months ended June 30, 2010 and 2009 (in thousands):

	Three Months Ended		Nine Months Ended	
	June 30,		June 30,	
	2010	2009	2010	2009
Net sales	\$ 742,975	\$ 673,337	\$ 2,168,293	\$ 1,960,424
Cost of products sold and distribution expenses	382,116	355,492	1,129,936	1,036,923
Gross profit	360,859	317,845	1,038,357	923,501
Total other operating costs and expenses	268,255	235,624	790,842	702,790
Operating earnings	92,604	82,221	247,515	220,711
Interest expense	28,255	31,050	85,149	102,692
Earnings before provision for income taxes	64,349	51,171	162,366	118,019
Provision for income taxes	23,233	19,682	60,564	45,876
Net earnings	\$ 41,116	\$ 31,489	\$ 101,802	\$ 72,143

The following table shows the condensed results of operations of our business for the three and nine months ended June 30, 2010 and 2009, expressed as a percentage of net sales for each respective period shown:

	Three Months Ended		Nine Months Ended	
	June 30,		June 30,	
	2010	2009	2010	2009
Net sales	100.0%	100.0%	100.0%	100.0%
Cost of products sold and distribution expenses	51.4%	52.8%	52.1%	52.9%
Gross profit	48.6%	47.2%	47.9%	47.1%
Total other operating costs and expenses	36.1%	35.0%	36.5%	35.8%
Operating earnings	12.5%	12.2%	11.4%	11.3%
Interest expense	3.8%	4.6%	3.9%	5.3%
Earnings before provision for income taxes	8.7%	7.6%	7.5%	6.0%

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Provision for income taxes	3.2%	2.9%	2.8%	2.3%
Net earnings	5.5%	4.7%	4.7%	3.7%

Table of Contents**Key Operating Metrics**

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

	Three Months Ended June 30,		Nine Months Ended June 30,	
	2010	2009	2010	2009
Net sales:				
Sally Beauty Supply	\$ 467,428	\$ 434,732	\$ 1,359,377	\$ 1,257,607
BSG	275,547	238,605	808,916	702,817
Consolidated	\$ 742,975	\$ 673,337	\$ 2,168,293	\$ 1,960,424
Gross profit	\$ 360,859	\$ 317,845	\$ 1,038,357	\$ 923,501
Gross profit margin	48.6%	47.2%	47.9%	47.1%
Selling, general and administrative expenses	\$ 255,588	\$ 223,982	\$ 753,856	\$ 667,930
Depreciation and amortization	\$ 12,667	\$ 11,642	\$ 36,986	\$ 34,860
Earnings before provision for income taxes:				
Segment operating profit:				
Sally Beauty Supply	\$ 85,116	\$ 76,748	\$ 235,743	\$ 212,413
BSG	30,086	25,632	81,709	66,227
Segment operating profit	115,202	102,380	317,452	278,640
Unallocated expenses	(20,058)	(18,555)	(60,026)	(51,130)
Share-based compensation expense	(2,540)	(1,604)	(9,911)	(6,799)
Operating earnings	92,604	82,221	247,515	220,711
Interest expense	(28,255)	(31,050)	(85,149)	(102,692)
Earnings before provision for income taxes	\$ 64,349	\$ 51,171	\$ 162,366	\$ 118,019
Segment operating profit margin:				
Sally Beauty Supply	18.2%	17.7%	17.3%	16.9%
BSG	10.9%	10.7%	10.1%	9.4%
Consolidated operating profit margin	12.5%	12.2%	11.4%	11.3%
Number of stores at end-of-period (including franchises):				
Sally Beauty Supply			2,973	2,879
BSG			1,013	942
			3,986	3,821
Same store sales growth (a)				
Sally Beauty Supply	3.6%	3.2%	3.9%	1.7%
BSG	7.4%	0.6%	5.9%	1.2%
Consolidated	4.6%	2.6%	4.4%	1.6%

- (a) Same stores are defined as company-operated stores that have been open for at least 14 months as of the last day of a month. Our same store sales calculation includes internet-based sales but does not generally include sales from stores relocated.

Table of Contents***The Three Months Ended June 30, 2010 compared to the Three Months Ended June 30, 2009***

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

	2010	Three Months Ended June 30,		Increase
		2009		
<b>Net sales:</b>				
Sally Beauty Supply	\$ 467,428	\$ 434,732	\$ 32,696	7.5%
BSG	275,547	238,605	36,942	15.5%
Consolidated net sales	\$ 742,975	\$ 673,337	\$ 69,638	10.3%
<b>Gross profit:</b>				
Sally Beauty Supply	\$ 249,520	\$ 224,752	\$ 24,768	11.0%
BSG	111,339	93,093	18,246	19.6%
Consolidated gross profit	\$ 360,859	\$ 317,845	\$ 43,014	13.5%
<b>Gross profit margin:</b>				
Sally Beauty Supply	53.4%	51.7%	1.7%	
BSG	40.4%	39.0%	1.4%	
Consolidated gross profit margin	48.6%	47.2%	1.4%	

***Net Sales***

Consolidated net sales increased by \$69.6 million, or 10.3%, for the three months ended June 30, 2010, compared to the three months ended June 30, 2009. Company-operated stores that have been open for at least 14 months contributed an increase of approximately \$41.8 million, or 6.2%, and sales from businesses acquired in the preceding 12 months contributed approximately \$25.1 million, or 3.7%, more to consolidated net sales for the three months ended June 30, 2010, compared to the three months ended June 30, 2009. Other sales channels (including sales through our BSG distributor sales consultants and our BSG franchise-based businesses and from stores that have been open for less than 14 months), in the aggregate, contributed an increase of \$2.7 million, or 0.4%, compared to the three months ended June 30, 2009. Consolidated net sales for the three months ended June 30, 2010, are inclusive of approximately \$0.4 million in net positive impact from changes in foreign exchange rates.

***Sally Beauty Supply.*** Net sales for Sally Beauty Supply increased by \$32.7 million, or 7.5%, for the three months ended June 30, 2010, compared to the three months ended June 30, 2009. In the Sally Beauty Supply segment, company-operated stores that have been open for at least 14 months contributed an increase of approximately \$27.3 million, or 6.3%, and sales from businesses acquired in the preceding 12 months contributed approximately \$5.6 million, or 1.3%, more for the three months ended June 30, 2010, compared to the three months ended June 30, 2009. Other sales channels (including sales from stores that have been open for less than 14 months and non-store sales), in the aggregate, experienced a minor decline in sales compared to the three months ended June 30, 2009. Net sales for Sally Beauty Supply for the three months ended June 30, 2010, are inclusive of approximately \$2.5 million in negative impact from changes in foreign exchange rates.

***Beauty Systems Group.*** Net sales for BSG increased by \$36.9 million, or 15.5%, for the three months ended June 30, 2010, compared to the three months ended June 30, 2009. In the BSG segment, company-operated stores that have been open for at least 14 months contributed an

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increase of approximately \$14.5 million, or 6.1% and sales from stores that have been open for less than 14 months contributed an increase of approximately \$1.8 million, or 0.8%, while sales from businesses acquired in the preceding 12 months contributed approximately \$19.5 million, or 8.2%, more for the three months ended June 30, 2010, compared to the three months ended June 30, 2009. Other

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sales channels (including sales through our distributor sales consultants and our franchise-based businesses), in the aggregate, contributed an increase of \$1.1 million, or 0.4%, compared to the three months ended June 30, 2009. Net sales for BSG for the three months ended June 30, 2010, are inclusive of approximately \$2.9 million in positive impact from changes in foreign exchange rates.

**Gross Profit**

Consolidated gross profit increased by \$43.0 million, or 13.5%, for the three months ended June 30, 2010, compared to the three months ended June 30, 2009, principally due to higher sales volume and improved gross margins in both business segments as more fully described below.

*Sally Beauty Supply.* Sally Beauty Supply's gross profit increased by \$24.8 million, or 11.0%, for the three months ended June 30, 2010, compared to the three months ended June 30, 2009, principally as a result of higher sales volume and improved gross margins. Sally Beauty Supply's gross profit as a percentage of net sales increased to 53.4% for the three months ended June 30, 2010, compared to 51.7% for the three months ended June 30, 2009. This increase was principally the result of a shift in product and customer mix (including an increase in sales of exclusive-label products and other higher-margin products) and continued benefits from low-cost sourcing initiatives. This increase was net of a \$0.8 million negative impact from changes in foreign exchange rates.

*Beauty Systems Group.* BSG's gross profit increased by \$18.2 million, or 19.6%, for the three months ended June 30, 2010, compared to the three months ended June 30, 2009, principally as a result of higher sales volume and improved gross margins. BSG's gross profit as a percentage of net sales was 40.4% for the three months ended June 30, 2010, compared to 39.0% for the three months ended June 30, 2009. This increase was principally the result of a favorable change in the sales mix across the business. This increase also reflects a \$1.3 million positive impact from changes in foreign exchange rates.

**Selling, General and Administrative Expenses**

Consolidated selling, general and administrative expenses increased by \$31.6 million, or 14.1%, to \$255.6 million for the three months ended June 30, 2010, compared to \$224.0 million for the three months ended June 30, 2009. This increase was attributable to incremental expenses (including employee compensation, rent and other occupancy-related expenses) resulting from stores opened and from businesses acquired in the preceding 12 months, as well as higher share-based compensation expense of \$0.9 million and higher advertising expenses in the Sally Beauty Supply segment of \$2.3 million. Selling, general and administrative expenses, as a percentage of net sales, were 34.4% for the three months ended June 30, 2010, compared to 33.3% for the three months ended June 30, 2009.

**Depreciation and Amortization**

Consolidated depreciation and amortization was \$12.7 million for the three months ended June 30, 2010, compared to \$11.6 million for the three months ended June 30, 2009. This increase reflects the incremental expenses associated with businesses acquired in the last 12 months and depreciation related to capital expenditures mainly in connection with store openings in both operating segments, partially offset by the impact of assets that became fully depreciated in the preceding 12 months.





Table of Contents**Operating Earnings**

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

	<b>Three Months Ended June 30,</b>				
	<b>2010</b>		<b>2009</b>		<b>Increase</b>
<b>Operating Earnings:</b>					
<b>Segment operating profit:</b>					
Sally Beauty Supply	\$	85,116	\$	76,748	\$ 8,368 10.9%
BSG		30,086		25,632	4,454 17.4%
Segment operating profit		115,202		102,380	12,822 12.5%
Unallocated expenses		(20,058)		(18,555)	1,503 8.1%
Share-based compensation expense		(2,540)		(1,604)	936 58.4%
Operating earnings	\$	92,604	\$	82,221	\$ 10,383 12.6%

Consolidated operating earnings increased by \$10.4 million, or 12.6%, to \$92.6 million for three months ended June 30, 2010, compared to \$82.2 million for the three months ended June 30, 2009. The increase in consolidated operating earnings was due primarily to an increase in the operating profits of both segments, partially offset by higher unallocated corporate expenses and share-based compensation expense, as discussed below. Operating earnings, as a percentage of net sales, were 12.5% for the three months ended June 30, 2010, compared to 12.2% for the three months ended June 30, 2009.

*Sally Beauty Supply.* Sally Beauty Supply's segment operating earnings increased by \$8.4 million, or 10.9%, to \$85.1 million for three months ended June 30, 2010, compared to \$76.7 million for the three months ended June 30, 2009. The increase in Sally Beauty Supply's segment operating earnings was primarily a result of increased sales volume and improved gross margins, partially offset by higher advertising costs of approximately \$2.3 million and the incremental costs related to approximately 94 additional company-operated stores (stores opened or acquired during the past twelve months) operating during the three months ended June 30, 2010. Segment operating earnings, as a percentage of net sales, were 18.2% for the three months ended June 30, 2010, compared to 17.7% for the three months ended June 30, 2009. The increase, in Sally Beauty Supply's operating earnings as a percentage of segment net sales, was primarily a result of gross margin improvements.

*Beauty Systems Group.* BSG's segment operating earnings increased by \$4.5 million, or 17.4%, to \$30.1 million for the three months ended June 30, 2010, compared to \$25.6 million for the three months ended June 30, 2009. Segment operating earnings, as a percentage of net sales, increased to 10.9% for the three months ended June 30, 2010, compared to 10.7% for the three months ended June 30, 2009. The increase in BSG operating earnings was primarily a result of gross margin improvements, the incremental operating earnings of businesses acquired and stores opened, and to ongoing cost reduction initiatives (including cost savings realized from the warehouse optimization program that began in the fiscal year 2007).

*Unallocated expenses.* Unallocated expenses, which represent corporate costs (such as payroll, employee benefits and travel expenses for corporate staff, certain professional fees and corporate governance expenses) that have not been charged to our operating segments, increased by \$1.5 million, or 8.1%, to \$20.1 million for the three months ended June 30, 2010, compared to \$18.6 million for the three months ended June 30, 2009. This increase was due primarily to higher employee compensation and compensation-related expenses of approximately \$0.7 million and a change in foreign currency transactions of approximately \$0.9 million resulting principally from intercompany notes not permanently invested.

*Share-based Compensation Expense.* Total compensation cost charged against income for share-based compensation arrangements increased \$0.9 million to \$2.5 million for the three months ended June 30, 2010, compared to \$1.6 million for the three months ended June 30, 2009. This increase was mainly due to the higher fair value at the grant date of stock option awards during the fiscal year 2010, compared to stock option awards during the fiscal year 2009.

***Interest Expense***

Interest expense decreased \$2.8 million to \$28.3 million for the three months ended June 30, 2010, compared to \$31.1 million for the three months ended June 30, 2009. Interest expense for the three months ended June 30, 2009

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is net of interest income of \$0.1 million. The decrease in interest expense was primarily attributable to lower outstanding principal balances on our ABL facility and senior term loans and lower prevailing LIBOR interest rates, partially offset by non-cash income of \$2.5 million of marked-to-market adjustments for certain interest rate swaps (please see Note 9 of the Condensed Notes to Consolidated Financial Statements contained in Item 1 of this report) in the three months ended June 30, 2009 with no comparable amount in 2010.

***Provision for Income Taxes***

Provision for income taxes was \$23.2 million during the three months ended June 30, 2010, compared to \$19.7 million for the three months ended June 30, 2009. Income taxes for the interim periods ended June 30, 2010 and 2009 have been included in the accompanying financial statements on the basis of an estimated annual effective rate. The estimated annual effective tax rate (excluding discrete items) is 37.8% for the fiscal year 2010, versus a comparable actual tax rate of 39.3% for the full fiscal year 2009. The decrease in the estimated annual effective tax rate primarily relates to a decrease in losses subject to a valuation allowance.

The actual tax rate for the three months ended June 30, 2010 is less than the estimated annual effective tax rate (excluding discrete items) for the fiscal year 2010 primarily because of the impact of discrete tax items recorded in the three months ended June 30, 2010.

***Net Earnings***

As a result of the foregoing, consolidated net earnings increased by \$9.6 million, or 30.6%, to \$41.1 million for the three months ended June 30, 2010, compared to \$31.5 million for the three months ended June 30, 2009. Net earnings, as a percentage of net sales, were 5.5% for the three months ended June 30, 2010, compared to 4.7% for the three months ended June 30, 2009.

***The Nine Months Ended June 30, 2010 compared to the Nine Months Ended June 30, 2009***

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

	2010	Nine Months Ended June 30,		Increase	
		2009			
Net sales:					
Sally Beauty Supply	\$ 1,359,377	\$ 1,257,607	\$ 101,770		8.1%
BSG	808,916	702,817	106,099		15.1%
Consolidated net sales	\$ 2,168,293	\$ 1,960,424	\$ 207,869		10.6%
Gross profit:					
Sally Beauty Supply	\$ 720,724	\$ 652,445	\$ 68,279		10.5%
BSG	317,633	271,056	46,577		17.2%
Consolidated gross profit	\$ 1,038,357	\$ 923,501	\$ 114,856		12.4%

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Gross profit margin:			
Sally Beauty Supply	53.0%	51.9%	1.1%
BSG	39.3%	38.6%	0.7%
Consolidated gross profit margin	47.9%	47.1%	0.8%

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*Net Sales*

Consolidated net sales increased by \$207.9 million, or 10.6%, for the nine months ended June 30, 2010, compared to the nine months ended June 30, 2009. Company-operated stores that have been open for at least 14 months contributed an increase of approximately \$140.8 million, or 7.2%, and sales from businesses acquired in the preceding 12 months contributed approximately \$62.1 million, or 3.2%, more to consolidated sales for the nine months ended June 30, 2010, compared to the nine months ended June 30, 2009. Other sales channels (including sales through our BSG distributor sales consultants and our BSG franchise-based businesses and from stores that have been open for less than 14 months), in the aggregate, contributed an increase of \$5.0 million, or 0.2%, compared to the nine months ended June 30, 2009. Consolidated net sales for the nine months ended June 30, 2010, are inclusive of approximately \$21.1 million in positive impact from changes in foreign exchange rates.

*Sally Beauty Supply.* Net sales for Sally Beauty Supply increased by \$101.8 million, or 8.1%, for the nine months ended June 30, 2010, compared to the nine months ended June 30, 2009. In the Sally Beauty Supply segment, company-operated stores that have been open for at least 14 months contributed an increase of approximately \$101.4 million, or 8.1%. Net sales for Sally Beauty Supply for the nine months ended June 30, 2010, are inclusive of approximately \$9.5 million in positive impact from changes in foreign exchange rates.

*Beauty Systems Group.* Net sales for BSG increased by \$106.1 million, or 15.1%, for the nine months ended June 30, 2010, compared to the nine months ended June 30, 2009. Company-operated stores that have been open for at least 14 months contributed an increase of approximately \$39.4 million, or 5.6%, sales from stores that have been open for less than 14 months contributed an increase of approximately \$4.1 million, or 0.6%, and sales from businesses acquired in the preceding 12 months contributed approximately \$61.8 million, or 8.8%, more to net sales for the nine months ended June 30, 2010, compared to the nine months ended June 30, 2009. Other sales channels (including sales through our distributor sales consultants and our franchise-based businesses), in the aggregate, contributed an increase of \$0.8 million, or 0.1%, compared to the nine months ended June 30, 2009. Net sales for BSG for the nine months ended June 30, 2010, are inclusive of approximately \$11.6 million in positive impact from changes in foreign exchange rates.

*Gross Profit*

Consolidated gross profit increased by \$114.9 million, or 12.4%, for the nine months ended June 30, 2010, compared to the nine months ended June 30, 2009, principally due to higher sales volume and improved gross margins in both business segments as more fully described below.

*Sally Beauty Supply.* Sally Beauty Supply's gross profit increased by \$68.3 million, or 10.5%, for the nine months ended June 30, 2010, compared to the nine months ended June 30, 2009, principally as a result of higher sales volume and improved gross margins. Sally Beauty Supply's gross profit as a percentage of net sales increased to 53.0% for the nine months ended June 30, 2010, compared to 51.9% for the nine months ended June 30, 2009. This increase was the result of a shift in product and customer mix (including an increase in sales of exclusive-label products and other higher-margin products) and continued benefits from low-cost sourcing initiatives. This increase also reflects a \$4.8 million favorable impact from changes in foreign exchange rates.

*Beauty Systems Group.* BSG's gross profit increased by \$46.6 million, or 17.2%, for the nine months ended June 30, 2010, compared to the nine months ended June 30, 2009, principally as a result of higher sales volume and improved gross margins. BSG's gross profit as a percentage of net sales increased to 39.3% for the nine months ended June 30, 2010, compared to 38.6% for the nine months ended June 30, 2009. This increase

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was principally the result of a favorable change in the sales mix across the business. This increase also reflects a \$5.0 million favorable impact from changes in foreign exchange rates.

### *Selling, General and Administrative Expenses*

Consolidated selling, general and administrative expenses increased by \$85.9 million, or 12.9%, to \$753.9 million for the nine months ended June 30, 2010, compared to \$667.9 million for the nine months ended June 30, 2009. This increase was attributable to incremental expenses (including employee compensation, rent and other occupancy-related expenses) resulting from stores opened and from businesses acquired in the preceding 12 months, as well as higher share-based compensation expense of \$3.1 million, higher advertising expenses in the Sally Beauty Supply segment of \$6.0 million and acquisition related expenses of \$0.5 million. Please see [Recent Accounting Pronouncements](#) below for more information about the Company's treatment of acquisition related expenses.

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Selling, general and administrative expenses, as a percentage of net sales, were 34.8% for the nine months ended June 30, 2010, compared to 34.1% for the nine months ended June 30, 2009.

***Depreciation and Amortization***

Consolidated depreciation and amortization was \$37.0 million for the nine months ended June 30, 2010, compared to \$34.9 million for the nine months ended June 30, 2009. This increase reflects the incremental expenses associated with businesses acquired in the last 12 months and depreciation related to capital expenditures mainly in connection with store openings in both operating segments, partially offset by the impact of assets that became fully depreciated in the preceding 12 months.

***Operating Earnings***

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

	2010		Nine Months Ended June 30, 2009		Increase	
Operating Earnings:						
Segment operating profit:						
Sally Beauty Supply	\$	235,743	\$	212,413	\$	23,330 11.0%
BSG		81,709		66,227		15,482 23.4%
Segment operating profit		317,452		278,640		38,812 13.9%
Unallocated expenses		(60,026)		(51,130)		8,896 17.4%
Share-based compensation expense		(9,911)		(6,799)		3,112 45.8%
Operating earnings	\$	247,515	\$	220,711	\$	26,804 12.1%

Consolidated operating earnings increased by \$26.8 million, or 12.1%, to \$247.5 million for the nine months ended June 30, 2010, compared to \$220.7 million for the nine months ended June 30, 2009. The increase in consolidated operating earnings was due primarily to an increase in the operating profits of both segments, partially offset by higher unallocated corporate expenses and share-based compensation expense, as discussed below. Operating earnings, as a percentage of net sales, were 11.4% for the nine months ended June 30, 2010, compared to 11.3% for the nine months ended June 30, 2009.

*Sally Beauty Supply.* Sally Beauty Supply's segment operating earnings increased by \$23.3 million, or 11.0%, to \$235.7 million for the nine months ended June 30, 2010, compared to \$212.4 million for the nine months ended June 30, 2009. The increase in Sally Beauty Supply's segment operating earnings was primarily a result of increased sales volume and improved gross margins, partially offset by higher advertising costs of approximately \$6.0 million and the incremental costs related to approximately 94 additional company-operated stores (stores opened or acquired during the past twelve months) operating during the nine months ended June 30, 2010. Segment operating earnings, as a percentage of net sales, increased to 17.3% for the nine months ended June 30, 2010, compared to 16.9% for the nine months ended June 30, 2009. The increase in Sally Beauty Supply's operating earnings, as a percentage of segment net sales, was primarily a result of gross margin improvements.



*Beauty Systems Group.* BSG's segment operating earnings increased by \$15.5 million, or 23.4%, to \$81.7 million for the nine months ended June 30, 2010, compared to \$66.2 million for the nine months ended June 30, 2009. Segment operating earnings, as a percentage of net sales, increased to 10.1% for the nine months ended June 30, 2010, compared to 9.4% for the nine months ended June 30, 2009. The increase in BSG operating earnings was primarily a result of gross margin improvements, the incremental operating earnings of businesses acquired and stores opened, and to ongoing cost reduction initiatives (including cost savings realized from the warehouse optimization program that began in the fiscal year 2007).

*Unallocated expenses.* Unallocated expenses, which represent corporate costs (such as payroll, employee benefits and travel expenses for corporate staff, certain professional fees and corporate governance expenses) that have not been charged to our operating segments, increased by \$8.9 million, or 17.4%, to \$60.0 million for the nine months ended June 30, 2010, compared to \$51.1 million for the nine months ended June 30, 2009. This increase was due primarily to higher employee compensation and compensation-related expenses of approximately \$4.4 million, a change in foreign currency transactions of approximately \$1.8 million resulting principally from intercompany notes

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not permanently invested, other corporate expenses of approximately \$2.2 million related primarily to recent upgrades to our information technology systems, and acquisition related expenses of approximately \$0.5 million (representing legal, professional fees and other expenses).

*Share-based Compensation Expense.* Total compensation cost charged against income for share-based compensation arrangements increased \$3.1 million to \$9.9 million for the nine months ended June 30, 2010, compared to \$6.8 million for the nine months ended June 30, 2009. This increase was due to the higher fair value at the grant date of stock option awards during the nine months ended June 30, 2010, compared to stock option awards during the nine months ended June 30, 2009.

***Interest Expense***

Interest expense decreased \$17.5 million to \$85.1 million for the nine months ended June 30, 2010, compared to \$102.7 million for the nine months ended June 30, 2009. Interest expense is net of interest income of \$0.1 million and \$0.3 million for the nine months ended June 30, 2010 and 2009, respectively. The decrease in interest expense was primarily attributable to lower outstanding principal balances on our ABL facility and senior term loans and to lower prevailing LIBOR interest rates and to a \$0.6 million favorable change in the fair value of certain interest rate swaps (please see Note 9 of the Condensed Notes to Consolidated Financial Statements contained in Item 1 of this report).

***Provision for Income Taxes***

Provision for income taxes was \$60.6 million during the nine months ended June 30, 2010, compared to \$45.9 million for the nine months ended June 30, 2009. Income taxes for the interim periods ended June 30, 2010 and 2009 have been included in the accompanying financial statements on the basis of an estimated annual effective rate. The estimated annual effective tax rate (excluding discrete items) is 37.8% for the fiscal year 2010, versus a comparable actual tax rate of 39.3% for the full fiscal year 2009. The decrease in the estimated annual effective tax rate primarily relates to a decrease in losses subject to a valuation allowance.

The actual tax rate for the nine months ended June 30, 2010 is lower than the estimated annual effective tax rate (excluding discrete items) for the fiscal year 2010 primarily because of the impact of discrete tax items recorded in the nine months ended June 30, 2010.

***Net Earnings***

As a result of the foregoing, consolidated net earnings increased by \$29.7 million, or 41.1%, to \$101.8 million for the nine months ended June 30, 2010, compared to \$72.1 million for the nine months ended June 30, 2009. Net earnings, as a percentage of net sales, were 4.7% for the nine months ended June 30, 2010, compared to 3.7% for the nine months ended June 30, 2009.

**Financial Condition**

*June 30, 2010 Compared to September 30, 2009*

Working capital (current assets less current liabilities) increased \$3.9 million to \$345.6 million at June 30, 2010, compared to \$341.7 million at September 30, 2009. The ratio of current assets to current liabilities was 1.88 to 1.00 at June 30, 2010, compared to 1.91 to 1.00 at September 30, 2009. The increase in working capital reflects an increase of \$20.7 million in current assets and an increase of \$16.8 million in current liabilities. The increase in current assets as of June 30, 2010 includes an increase of \$26.9 million in inventory levels, an increase of \$8.5 million in trade accounts receivable, an increase of \$5.8 million in other receivables and an increase of \$5.5 million in prepaid expenses, partially offset by a reduction of \$26.1 million in cash and cash equivalents. The increase in current liabilities as of June 30, 2010 includes an increase of \$19.4 million in accounts payable and accrued liabilities and an increase of \$7.5 million in income taxes payable, partially offset by a reduction of \$10.0 million in current maturities of long-term debt.

Inventory increased \$26.9 million to \$586.6 million at June 30, 2010, compared to \$559.7 million at September 30, 2009 due primarily to the effect of stores opened and businesses acquired in the preceding 12 months, partially offset by the effect of foreign currency translation adjustments of approximately \$8.9 million. Trade accounts receivable increased \$8.5 million to \$52.2 million at June 30, 2010, compared to \$43.6 million at September 30, 2009 due primarily to the increase in sales activity and to businesses acquired. Other receivables increased \$5.8 million to \$29.9 million at June 30, 2010, compared to \$24.1 million at September 30, 2009 due primarily to accrued

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vendor rebates and to businesses acquired. Prepaid expenses increased \$5.5 million to \$24.0 million at June 30, 2010, compared to \$18.5 million at September 30, 2009 due primarily to the timing of store rent and business insurance prepayments and to businesses acquired.

Accounts payable increased \$30.1 million to \$223.7 million at June 30, 2010, compared to \$193.6 million at September 30, 2009 due primarily to businesses acquired and the timing of payments to suppliers in connection with recent purchases of merchandise inventory. Accrued liabilities decreased \$10.7 million to \$143.4 million at June 30, 2010, compared to \$154.2 million at September 30, 2009 due primarily to the timing of payments of interest on long-term debt, partially offset by businesses acquired. Income taxes payable increased by \$7.5 million to \$9.4 million at June 30, 2010, compared to \$1.9 million at September 30, 2009 due primarily to increased earnings and businesses acquired.

Long-term debt, including current portion, decreased \$90.8 million to \$1,586.7 million at June 30, 2010, compared to \$1,677.5 million at September 30, 2009 due primarily to prepayments of \$105.0 million (including a mandatory prepayment of \$22.3 million please see Liquidity and Capital Resources below) on our senior Term Loan A, partially offset by the pre-acquisition indebtedness, including capital leases, of Sinelco.

Total stockholders' deficit, for the nine months ended June 30, 2010, decreased by \$89.9 million primarily as a result of net earnings of \$101.8 million and an increase in additional paid-in capital of \$10.3 million resulting from share-based compensation expense and the exercise of stock options, partially offset by foreign currency translation adjustments of \$21.9 million.

**Liquidity and Capital Resources**

We broadly define liquidity as our ability to generate sufficient cash flow from operating activities to meet our obligations and commitments. In addition, liquidity includes the ability to obtain appropriate debt and equity financing and to convert into cash those assets that are no longer required to meet existing strategic and financial objectives. Therefore, liquidity cannot be considered separately from capital resources that consist of current or potentially available funds for use in achieving long-range business objectives and meeting debt service commitments. Please see our Annual Report on Form 10-K for the fiscal year ended September 30, 2009 for additional information on liquidity and capital resources.

Following the completion of the Separation Transactions, we are highly leveraged and a substantial portion of our liquidity needs will arise from debt service on indebtedness incurred primarily in connection with the Separation Transactions and from funding the costs of operations, working capital and capital expenditures. As a holding company, we depend on our subsidiaries, including Sally Holdings, to distribute funds to us so that we may pay our obligations and expenses. Please see Risk Factors Risks Relating to Our Business, and Risks Relating to Our Substantial Indebtedness in Item 1A of our Annual Report on Form 10-K for the fiscal year ended September 30, 2009.

The senior term loan facilities may be prepaid at the option of Sally Holdings at any time without premium or penalty and are subject to mandatory prepayment in an amount equal to 50% of excess cash flow (as defined in the agreement governing the term loan facilities) for any fiscal year unless a specified leverage ratio is met. In January 2010, the Company made a mandatory prepayment on the senior term loan facilities in the amount of \$22.3 million. Amounts paid pursuant to said provision may be applied, at the option of Sally Holdings, against minimum loan repayments otherwise required of it over the twelve-month period following any such payment under the terms of the loan agreement.

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During the nine months ended June 30, 2010, the Company also made optional prepayments in the aggregate amount of \$82.7 million on its senior term loans. This amount includes \$54.7 million prepaid during the quarter ended June 30, 2010 and, together with the mandatory prepayment discussed in the preceding paragraph, resulted in the prepayment in full of borrowings under the Term Loan A facility. In connection with the mandatory prepayment discussed in the preceding paragraph and the optional prepayments made during the nine months ended June 30, 2010, the Company recorded losses on extinguishment of debt in the aggregate amount of \$0.8 million, which are included in interest expense in the Company's consolidated statements of earnings.

Based upon the current level of operations and anticipated growth, we anticipate that existing cash balances, funds expected to be generated by operations and funds available under the ABL facility will be sufficient to meet our working capital requirements and to finance anticipated capital expenditures and potential acquisitions over the next 12 months.

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There can be no assurance that our business will generate sufficient cash flows from operations, that anticipated net sales growth and operating improvements will be realized or that future borrowings will be available under our ABL facility in an amount sufficient to enable us to service our indebtedness or to fund our other liquidity needs. In addition, our ability to meet our debt service obligations and liquidity needs are subject to certain risks, which include, but are not limited to, increases in competitive activity, the loss of key suppliers, rising interest rates, the loss of key personnel, the ability to execute our business strategy and general economic conditions. Please see "Risk Factors" in Item 1A of our Annual Report on Form 10-K for the year ended September 30, 2009.

We utilize our ABL facility for the issuance of letters of credit, as well as to manage normal fluctuations in operational cash flow. In that regard, we may from time to time draw funds under the revolving credit facility for general corporate purposes including acquisitions and interest payments due on our indebtedness. The funds drawn on individual occasions during the nine months ended June 30, 2010 have varied in amounts of up to \$30.0 million, with total amounts outstanding ranging from zero up to \$53.5 million. The amounts drawn are generally paid down with cash provided by our operating activities.

As of June 30, 2010, Sally Holdings had \$341.5 million available for additional borrowings under our ABL facility, subject to borrowing base limitations, as reduced by outstanding letters of credit.

We may from time to time repurchase or otherwise retire our debt and take other steps to reduce our debt or otherwise improve our balance sheet. These actions may include open market repurchases of our notes, prepayments of our term loans or other retirements of outstanding debt. The amount of debt that may be repurchased or otherwise retired, if any, would be decided upon at the sole discretion of our Board of Directors and will depend on market conditions, trading levels of the Company's debt from time to time, the Company's cash position and other considerations.

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

Under the agreements and indentures governing the term loan facilities and the notes, Sally Holdings may not make certain restricted payments to us if a default then exists under the credit agreement or the indentures or if its consolidated interest coverage ratio is less than 2.0 to 1.0 at the time of the making of such restricted payment. As of June 30, 2010, its consolidated interest coverage ratio exceeded 2.0 to 1.0. Further, the aggregate amount of restricted payments it is able to make is limited pursuant to various baskets as calculated pursuant to the credit agreement and indentures.

The agreements governing our ABL facility generally permit the making of distributions and certain other restricted payments so long as borrowing availability under the facility equals or exceeds \$60.0 million. If borrowing availability falls below this amount, Sally Holdings may nevertheless make restricted payments to us in the aggregate since the date of the Separation Transactions, together with the aggregate cash amounts paid in acquisitions since said date, of not greater than \$50.0 million, together with certain other exceptions. As of June 30, 2010, borrowing availability under the ABL facility exceeded \$60.0 million. As of June 30, 2010, the net assets of our consolidated subsidiaries that were unrestricted from transfer under our credit arrangements totaled \$284.4 million, subject to certain adjustments. The ABL facility and the senior term loan facilities, as well as the Company's 9.25% Senior Notes indenture and its 10.5% Senior Subordinated Notes indenture contain customary cross-default and/or cross-acceleration provisions.

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On December 16, 2009, the Company acquired Sinelco, a wholesale distributor of professional beauty products based in Ronse, Belgium, for approximately 25.2 million (approximately \$36.6 million). Sinelco serves over 1,500 customers through a product catalog and website and has sales throughout Europe. Goodwill of \$17.2 million was recorded as a result of this acquisition. In addition, during the nine months ended June 30, 2010, the Company completed several other individually immaterial acquisitions at an aggregate cost of \$5.3 million and recorded goodwill in the amount of \$3.1 million. We funded these acquisitions with cash from operations and borrowings under our ABL facility. As of June 30, 2010, borrowings under our ABL facility were \$5.0 million.

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Our primary source of cash has been from funds provided by operating activities and borrowings under our ABL facility for the nine months ended June 30, 2010 and 2009. Historically, our primary use of cash has been for acquisitions, capital expenditures and repayments of debt. The following table shows our sources and uses of funds for the nine months ended June 30, 2010 and 2009 (in thousands):

	Nine Months Ended June 30,	
	2010	2009
Net cash provided by operating activities	\$ 147,826	\$ 163,987
Net cash used by investing activities	(70,346)	(28,130)
Net cash used by financing activities	(101,810)	(129,484)
Effect of foreign exchange rates on cash and cash equivalents	(1,814)	(219)
Net (decrease) increase in cash and cash equivalents	\$ (26,144)	\$ 6,154

#### *Net Cash Provided by Operating Activities*

Net cash provided by operating activities (which excludes cash used for acquisitions completed during the period) during the nine months ended June 30, 2010 decreased by \$16.2 million to \$147.8 million, compared to \$164.0 million during the nine months ended June 30, 2009. The decrease was primarily due to changes in inventory levels of approximately \$54.5 million (resulting from reductions in inventory levels in the nine months ended June 30, 2009 and increases in inventory levels in the nine months ended June 30, 2010) and in accounts payable and accrued liabilities of approximately \$7.0 million, partially offset by changes in income taxes payable of \$12.3 million, and by an improvement in earnings of approximately \$29.7 million for the nine months ended June 30, 2010 compared to the nine months ended June 30, 2009.

#### *Net Cash Used by Investing Activities*

Net cash used by investing activities during the nine months ended June 30, 2010 increased by \$42.2 million to \$70.3 million, compared to \$28.1 million during the nine months ended June 30, 2009. This increase was due to an increase of \$32.5 million in cash used for acquisitions, net of cash acquired, and a \$9.7 million increase in capital expenditures (primarily as a result of more store openings) for the nine months ended June 30, 2010 compared to the nine months ended June 30, 2009.

#### *Net Cash Used by Financing Activities*

Net cash used by financing activities during the nine months ended June 30, 2010 decreased by \$27.7 million to cash used of \$101.8 million, compared to \$129.5 million during the nine months ended June 30, 2009. The decrease was primarily due to net repayments of debt of \$102.0 million, including the prepayment in full of our Term Loan A, during the nine months ended June 30, 2010 compared to \$128.2 million during the nine months ended June 30, 2009.

### **Capital Requirements**



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During the nine months ended June 30, 2010, capital expenditures were \$36.0 million. For fiscal year 2010, we anticipate total capital expenditures in the range of approximately \$45.0 million to \$50.0 million, excluding acquisitions. We expect that capital expenditures will be primarily for the addition of new stores and the remodeling, expansion and/or relocation of existing stores in the ordinary course of our business as well as certain corporate projects.

### **Contractual Obligations**

There have been no material changes outside the ordinary course of business in any of our contractual obligations since September 30, 2009.

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

At June 30, 2010 and September 30, 2009, we had no off-balance sheet financing arrangements other than operating leases incurred in the ordinary course of business, as well as outstanding letters of credit related to inventory purchases and self insurance programs. Such letters of credit totaled \$14.3 million and \$13.4 million at June 30, 2010 and September 30, 2009, respectively.

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**Inflation**

We believe that inflation currently does not have a material effect on our results of operations.

**Critical Accounting Policies and Estimates**

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

Our critical accounting policies, as described in our Annual Report on Form 10-K for the fiscal year ended September 30, 2009, include but are not limited to the valuation of inventory, vendor concessions, retention of risk, income taxes, long-lived assets impairment assessment and share-based payments. There have been no material changes to our critical accounting policies, estimates or assumptions since September 30, 2009.

As required by ASC 815, *Derivatives and Hedging*, as amended, the Company records all derivative instruments on its balance sheet at fair value. The accounting for changes in the fair value of derivative instruments depends on the intended use of the derivative, whether the Company has elected to designate a derivative instrument in a hedging relationship and apply hedge accounting and whether the hedging relationship has satisfied the criteria necessary to apply hedge accounting. Derivative instruments designated and qualifying as a hedge of the exposure to variability in expected future cash flows, or other types of forecasted transactions, are considered cash flow hedges. Hedge accounting generally provides for the matching of the timing of gain or loss recognition on the hedging instrument with the recognition of the impact on earnings of the hedged transaction or transactions. The Company may from time to time enter into derivative contracts that are intended to hedge certain economic risks even though hedge accounting does not apply or the Company elects not to apply hedge accounting to such derivative contracts.

The Company has adopted the provisions of ASC 820 as it relates to its financial instruments. ASC 820, as amended, 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

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principally from or corroborated by observable market data; and

Level 3 - Unobservable inputs for the asset or liability.

The Company measures certain financial instruments at fair value on a recurring basis, including interest rate swaps and foreign currency options. In accordance with ASC 820, the Company categorized certain of its financial assets and liabilities based on priority of the inputs to the valuation technique for the instruments, as follows (in thousands):

	Total	As of June 30, 2010		
		Level 1	Level 2	Level 3
<b>Assets</b>				
Foreign currency options (b)	\$ 458		\$ 458	
Total assets	\$ 458		\$ 458	
<b>Liabilities</b>				
Long-term debt (a)	\$ 1,582,653	\$ 737,625	\$ 845,028	
Hedged interest rate swaps (b)	15,750		15,750	
Total liabilities	\$ 1,598,403	\$ 737,625	\$ 860,778	

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- (a) Long-term debt, which is carried at amortized cost in the Company's financial statements, is valued using internal models based on market observable inputs, except for the senior and senior subordinated notes. The senior and senior subordinated notes are valued using quoted market prices for such debt securities.
- (b) Interest rate swaps and foreign currency options are valued using internal models based on market observable inputs, including market interest rates and foreign currency exchange rates, as appropriate. Please see Note 9 of the Condensed Notes to Consolidated Financial Statements contained in Item 1 of this report for more information about the Company's interest rate swaps and foreign currency options.

**Recent Accounting Pronouncements**

In December 2007, the FASB revised the accounting standards for business combinations. This new standard (currently contained in ASC 805, *Business Combinations* (ASC 805)), among other things, generally requires that an acquirer recognize the assets acquired and liabilities assumed measured at their full fair values on the acquisition date. This practice replaced the practice, under predecessor accounting standards, of allocating the cost of an acquisition to the individual assets acquired and liabilities assumed based on their relative estimated fair values. This new standard further requires that acquisition-related costs be recognized separately from the related acquisition. The Company adopted this standard during the first quarter of its fiscal year 2010. Selling, general and administrative expenses for the nine months ended June 30, 2010 includes approximately \$0.5 million of expenses related to acquisitions.

In April 2008, the FASB amended ASC 350, *Intangibles and Other* (ASC 350). This new accounting standard, currently contained in ASC 350-30-35, specifically amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset. The objective of this amendment is to improve the consistency between the useful life of a recognized intangible asset and the period of expected cash flows used to measure the fair value of the asset. The Company adopted this standard during the first quarter of its fiscal year 2010 and its adoption did not have a material effect on the Company's consolidated financial position, results of operations or cash flows.

In August 2009, the FASB issued ASU No. 2009-05 which amended ASC 820 as it relates to the measurement of liabilities at fair value, effective for interim reporting periods beginning after August 26, 2009. More specifically, this amendment provided clarification for liabilities in which a quoted price in an active market for an identical liability is not available. The Company adopted this amendment during the first quarter of its fiscal year 2010 and its adoption did not have a material effect on the Company's consolidated financial position, results of operations or cash flows.

In January 2010, the FASB issued ASU No. 2010-06 which amended ASC 820 as it relates to certain disclosures of fair value measurements. This amendment requires, among other things, (a) disclosure of the sensitivity of an entity's fair value measurements using Level 3 inputs to changes in such inputs, (b) a reconciliation of changes in such fair value measurements and (c) disclosure of transfers between fair value measurements using Level 1 and 2 inputs, if any. The Company adopted this amendment during the second quarter of its fiscal year 2010 and its adoption did not have a material effect on the Company's consolidated financial position, results of operations or cash flows.

The Company adopted the provisions of ASC 855, *Subsequent Events* (ASC 855), during the third quarter of its fiscal year 2009. ASC 855 establishes standards of accounting for and disclosure of transactions and events that occur after the balance sheet date but before the financial statements are issued and requires the disclosure, among other things, of the date through which an entity has evaluated subsequent events. In February 2010, the FASB issued ASU No. 2010-09 which amended ASC 855. This amendment, which was effective upon issuance, removed

the requirement for SEC registrants to disclose the date through which such registrants have evaluated subsequent events.

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

As a multinational corporation, we are subject to certain market risks including foreign currency fluctuations, interest rates and government actions. We consider a variety of practices to manage these market risks, including, when deemed appropriate, the occasional use of derivative financial instruments.

**Foreign currency exchange rate risk**

We are exposed to potential gains or losses from foreign currency fluctuations affecting our net investments in subsidiaries and earnings denominated in foreign currencies. Our primary exposures are to changes in exchange rates for the U.S. dollar versus the British pound sterling, the Canadian dollar, the Euro, the Chilean peso, and the Mexican peso. Our various foreign currency exposures at times offset each other providing a natural hedge against foreign currency risk. For fiscal year 2009, 2008 and 2007, approximately 16%, 18% and 16%, respectively, of our sales were made in currencies other than the U.S. dollar. Consolidated net sales for the nine months ended June 30, 2010, reflect approximately \$21.1 million in positive impact from changes in foreign currency exchange rates. In addition, for the nine months ended June 30, 2010, other comprehensive income reflects \$21.9 million in foreign currency translation adjustments. Fluctuations in the U.S. dollar exchange rates did not otherwise have a material effect on our consolidated financial condition and consolidated results of operations.

As a result of the Company's acquisition of Sinelco on December 16, 2009, the Company, through Sinelco, uses foreign currency options (including, at June 30, 2010, foreign currency put options with an aggregate notional amount of \$2.9 million (\$3.6 million, at the June 30, 2010 exchange rate) and foreign currency call options with an aggregate notional amount of \$1.8 million (\$2.2 million, at the June 30, 2010 exchange rate)) to manage the exposure to certain non-Euro currencies resulting from Sinelco's purchases of merchandise from third-party suppliers. Sinelco's functional currency is the Euro. These foreign currency option agreements are not designated as hedges and do not meet the hedge accounting requirements of ASC 815. Accordingly, the changes in fair value of these derivative instruments (which are adjusted quarterly) are recorded in our consolidated statements of earnings. Included in selling, general and administrative expenses are gains of \$0.4 million and \$0.7 million related to these foreign currency options, including marked-to-market adjustments, for the three and nine months ended June 30, 2010, respectively. During the nine months ended June 30, 2010, these derivative instruments did not have a material impact in results of operations or cash flows.

A 10% increase or decrease in the exchange rates for the U.S. dollar versus the foreign currencies to which we have exposure would have impacted consolidated net sales by approximately 1.7% in the nine months ended June 30, 2010 and would have impacted consolidated net assets by 2.5% at June 30, 2010.

**Interest rate risk**

As a result of the debt financing incurred in connection with the Separation Transactions, we are subject to interest rate market risk in connection with our long-term debt. The principal interest rate exposure relates to amounts borrowed under the term loans and the ABL facility. Based on the approximately \$868.9 million of aggregate borrowings under the Company's term loans and the ABL facility as of June 30, 2010, a change in the estimated interest rate up or down by 1/8% would increase or decrease earnings before provision for income taxes by approximately \$1.1

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million on an annual basis, without considering the effect of any interest rate swap agreements we may have from time to time.

We and certain of our subsidiaries are sensitive to interest rate fluctuations. In order to enhance our ability to manage risk relating to cash flow and interest rate exposure, we and/or our other subsidiaries who are borrowers under the ABL facility may from time to time enter into and maintain derivative instruments, such as interest rate swap agreements, for periods consistent with the related underlying exposures. We do not purchase or hold any derivative instruments for speculative or trading purposes.

In November 2006, we entered into four interest rate swap agreements with an aggregate notional amount of \$500 million. Interest rate swap agreements with an aggregate notional amount of \$150 million expired in November 2008 and agreements with a notional amount of \$350 million expired in November 2009. These interest rate swap agreements did not qualify as hedges and, therefore, the change in the fair value of these agreements, which were adjusted quarterly, were recorded in interest expense in the Company's results of operations.

In May 2008, we entered into two additional interest rate swap agreements with an aggregate notional amount of \$300 million (each agreement with a notional amount of \$150 million). These agreements expire on May 31, 2012 and enable us to convert a portion of our variable interest rate obligations to fixed rate obligations with interest ranging from 5.818% to 6.090%. These agreements are designated as effective cash flow hedges, in accordance

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with ASC 815. Accordingly, changes in the fair value of these derivative instruments are recorded quarterly, net of income tax, in accumulated other comprehensive (loss) income ( OCI ) until the hedged obligation is settled or the swap agreements expire, whichever is earlier. Any hedge ineffectiveness, as this term is used in ASC 815, is recognized in interest expense in our consolidated statements of earnings.

**Credit risk**

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

We provide credit to customers in the ordinary course of business and perform ongoing credit evaluations. We believe that our exposure to concentrations of credit risk with respect to trade receivables is largely mitigated by our broad customer base. We believe our allowance for doubtful accounts, as of June 30, 2010, is sufficient to cover customer credit risks.

**Item 4. Controls and Procedures.**

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

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

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

*Scope of the Controls Evaluation.* The evaluation of our disclosure controls and procedures included a review of their objectives and design, our implementation of the controls and procedures and the effect of the controls and procedures on the information generated for use in this report. In the course of the evaluation, we sought to identify whether we had any data errors, control problems or acts of fraud and to confirm that appropriate corrective action, including process improvements, was being undertaken if needed. This type of evaluation is performed on a



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quarterly basis so that conclusions concerning the effectiveness of our disclosure controls and procedures can be reported in our Quarterly Reports on Form 10-Q and our Annual Reports on Form 10-K. Many of the components of our disclosure controls and procedures are also evaluated by our internal audit department, our legal department and by personnel in our finance organization. The overall goals of these various evaluation activities are to monitor our disclosure controls and procedures on an ongoing basis and to maintain them as dynamic systems that change as conditions warrant.

*Conclusions regarding Disclosure Controls.* Based on the required evaluation of our disclosure controls and procedures, our CEO and CFO have concluded that, as of June 30, 2010, we maintain disclosure controls and procedures that are effective in providing reasonable assurance that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our CEO and CFO, as appropriate to allow timely decisions regarding required disclosure.

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*Changes in Internal Control over Financial Reporting.* During our last fiscal quarter, there have been no changes in our internal control over financial reporting identified in connection with the evaluation described above that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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**PART II OTHER INFORMATION**

**Item 1. Legal Proceedings.**

There were no material legal proceedings pending against us or our subsidiaries as of June 30, 2010. We are involved in various claims and lawsuits incidental to the conduct of our business in the ordinary course. We carry insurance coverage in such amounts in excess of our self-insured retention as we believe to be reasonable under the circumstances and that may or may not cover any or all of our liabilities in respect of claims and lawsuits. We do not believe that the ultimate resolution of these matters will have a material adverse impact on our consolidated financial position, cash flows or results of operations.

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

On February 25, 2008, we disclosed in a Current Report on Form 8-K that on February 21, 2008, L Oreal filed a lawsuit in the Superior Court of the State of California in and for the County of San Diego Central Division naming, among others, SD Hair, Ltd. and Hair of Nevada, LLC (collectively, SD Hair), franchisees of our subsidiary Armstrong McCall division ( AMLP ) of our BSG business unit, as defendants. The suit alleged, among other things, that SD Hair breached its franchise agreement with AMLP by diverting (selling) Matrix branded products to unauthorized buyers, and that L Oreal is entitled to make claims against SD Hair under the franchise agreement as a third-party beneficiary of that agreement. On March 24, 2008, SD Hair filed a cross-complaint in the same case naming AMLP and BSG as cross-defendants, seeking, among other things, i) declaratory relief from BSG and AMLP in the form of a judicial finding that SD Hair is not in breach of its franchise agreement and that L Oreal has no rights as a third-party beneficiary to SD Hair's franchise agreement, and ii) injunctive relief in the form of a judicial order compelling AMLP and BSG to take appropriate legal action against L Oreal to enforce SD Hair's claimed rights under AMLP's Matrix distribution agreement. We have answered the cross-complaint.

On July 30, 2009, we disclosed in a Current Report on Form 8-K that L Oreal filed a Second Amended Complaint in connection with the previously disclosed lawsuit described above. The Second Amended Complaint alleges, among other things, that AMLP, certain of its employees and others were involved in selling Matrix branded products to unauthorized buyers and that certain of its employees (and others) engaged in improper business transactions for personal benefit during 2005 through 2007. L Oreal seeks money damages, certain injunctive relief and a declaration that L Oreal is entitled to terminate the 1981 Matrix Distributor Agreement now in effect between L Oreal and AMLP. None of the employees involved in the allegations are executive officers of the Company. Substantially all of these allegations were made known by L Oreal to the Company prior to the filing of the Second Amended Complaint. L Oreal also provided the Company with documents allegedly supporting the allegations.

As a result of these allegations made by L Oreal, many of which are incorporated into the Second Amended Complaint, the Audit Committee of the Board of Directors of the Company engaged independent special counsel to investigate whether certain employees engaged in improper business transactions for personal benefit. After extensive review, the Audit Committee and independent special counsel found insufficient evidence to support a conclusion that Company employees entered into improper transactions for personal benefit.

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On September 8, 2009, AMLP and BSG filed a cross-complaint against L Oreal. In the cross-complaint, AMLP and BSG allege that L Oreal does not have a genuine interest in stopping diversion, and that L Oreal's anti-diversion policies have been discriminatorily applied to AMLP and BSG. AMLP further alleges that L Oreal is using diversion as a pretext to attempt to terminate the 1981 Matrix Distributor Agreement. L Oreal has answered the cross-complaint and the matter is currently set for jury trial on February 18, 2011.

### **Items 1A. Risk Factors.**

In addition to the other information set forth in this report, you should carefully consider the factors contained in Part I, Item 1A. Risk Factors in our Annual Report on Form 10-K for the fiscal year ended September 30, 2009, which could materially affect our business, financial condition or future results. There have been no material changes from the risk factors disclosed in our Annual Report. The risks described in that report are not the only risks facing our company.

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

(a) Not applicable

(b) Not applicable

(c) Not applicable

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

Not applicable

**Item 4. Submission of Matters to a Vote of Security Holders.**

Not applicable

**Item 5. Other Information.**

(a) Not applicable

(b) Not applicable

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#### Item 6. Exhibits

<b>Exhibit No.</b>	<b>Description</b>
2.1	Investment Agreement, dated as of June 19, 2006, among Alberto-Culver Company, New Aristotle Company, Sally Holdings, Inc., New Sally Holdings, Inc. and CDRS Acquisition LLC, which is incorporated herein by reference from Exhibit 2.1 to Amendment No. 3 to the Company's Registration Statement on Form S-4 (File No. 333-136259) filed on October 10, 2006
2.2	First Amendment to the Investment Agreement, dated as of October 3, 2006, among Alberto-Culver Company, New Aristotle Company, Sally Holdings, Inc., New Sally Holdings, Inc. and CDRS Acquisition LLC, which is incorporated herein by reference from Exhibit 2.2 to Amendment No. 3 to the Company's Registration Statement on Form S-4 (File No. 333-136259) filed on October 10, 2006
2.3	Second Amendment to the Investment Agreement, dated as of October 26, 2006, among Alberto-Culver Company, New Aristotle Company, Sally Holdings, Inc., New Sally Holdings, Inc. and CDRS Acquisition LLC, which is incorporated herein by reference from Exhibit 2.02 to the Company's Current Report on Form 8-K filed on October 30, 2006
2.4	Separation Agreement, dated as of June 19, 2006, among Alberto-Culver Company, Sally Holdings, Inc., New Sally Holdings, Inc. and New Aristotle Holdings, Inc., which is incorporated herein by reference from Exhibit 2.3 to Amendment No. 3 to the Company's Registration Statement on Form S-4 (File No. 333-136259) filed on October 10, 2006
2.5	First Amendment to the Separation Agreement, dated as of October 3, 2006, among Alberto-Culver Company, Sally Holdings, Inc., New Sally Holdings, Inc. and New Aristotle Holdings, Inc., which is incorporated herein by reference from Exhibit 2.4 to Amendment No. 3 to the Company's Registration Statement on Form S-4 (File No. 333-136259) filed on October 10, 2006
2.6	Second Amendment to the Separation Agreement, dated as of October 26, 2006, among Alberto-Culver Company, Sally Holdings, Inc., New Sally Holdings, Inc. and New Aristotle Holdings, Inc., which is incorporated herein by reference from Exhibit 2.01 to the Company's Current Report on Form 8-K filed on October 30, 2006
2.7	Agreement and Plan of Merger by and among Beauty Systems Group LLC, Lady Lynn Enterprises, Inc., Schoeneman Beauty Supply, Inc., the Shareholders and F. Dale Schoeneman, dated September 30, 2009, which is incorporated herein by reference from Exhibit 10.27 to the Company's Annual Report on Form 10-K filed on November 19, 2009
3.1	Amended and Restated Certificate of Incorporation of Sally Beauty Holdings, Inc., dated November 16, 2006, which is incorporated herein by reference from Exhibit 4.1 to the Company's Registration Statement on Form S-8 filed on November 20, 2006
3.2	Third Amended and Restated Bylaws of Sally Beauty Holdings, Inc., dated October 23, 2008, which is incorporated herein by reference from Exhibit 3.1 to the Company's Current Report on Form 8-K filed on October 23, 2008
4.1	Stockholders Agreement, dated as of November 16, 2006, by and among the Company, CDRS Acquisition LLC, CD&R Parallel Fund VII, L.P. and the other stockholders party thereto, which is incorporated herein by reference from Exhibit 4.8 to the Company's Current Report on Form 8-K filed on November 22, 2006
4.2	First Amendment to the Stockholders Agreement, dated as of December 13, 2006, between the Company and CDRS Acquisition LLC and Carol L. Bernick, as representative of the other stockholders, which is incorporated herein by reference from Exhibit 4.2 to the Company's Annual Report on Form 10-K filed on December 22, 2006
4.3	Indenture, dated as of November 16, 2006, by and among Sally Holdings LLC and Sally Capital Inc., as Co-Issuers, the Subsidiary Guarantors from time to time parties thereto, and Wells Fargo Bank, National Association, as Trustee, governing the 9.25% Senior Notes due 2014, which is incorporated herein by reference from Exhibit 4.1 to the Company's Current Report on Form 8-K filed on November 22, 2006

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- 4.4 First Supplemental Indenture, dated as of May 30, 2007, by and among Sally Holdings LLC and Sally Capital Inc., as co-Issuers, the Subsidiary Guarantors named therein, and Wells Fargo Bank, National Association, as trustee, governing the 9.25% Senior Notes due 2014, which is incorporated herein by reference from Exhibit 4.2 from the Registration Statement on Form S-4 (File No. 333-144427) of Sally Holdings LLC and Sally Capital Inc. filed on July 9, 2007

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- 4.5 Indenture, dated as of November 16, 2006, by and among Sally Holdings LLC and Sally Capital Inc., as Co-Issuers, the Subsidiary Guarantors from time to time parties thereto, and Wells Fargo Bank, National Association, as Trustee, governing the 10.5% Senior Subordinated Notes due 2016, which is incorporated herein by reference from Exhibit 4.2 to the Company's Current Report on Form 8-K filed on November 22, 2006
- 4.6 First Supplemental Indenture, dated as of May 30, 2007, by and among Sally Holdings LLC and Sally Capital Inc., as co-Issuers, the Subsidiary Guarantors named therein, and Wells Fargo Bank, National Association, as trustee, governing the 10.5% Senior Subordinated Notes due 2016, which is incorporated herein by reference from Exhibit 4.4 from the Registration Statement on Form S-4 (File No. 333-144427) of Sally Holdings LLC and Sally Capital Inc. filed on July 9, 2007
- 4.7 Exchange and Registration Rights Agreement, dated as of November 16, 2006, by and among Sally Holdings LLC, Sally Capital Inc., the Subsidiary Guarantors parties thereto, Merrill Lynch, Pierce, Fenner & Smith, Incorporated and the other financial institutions named therein, relating to the 9.25% Senior Notes due 2014, which is incorporated herein by reference from Exhibit 4.3 to the Company's Current Report on Form 8-K filed on November 22, 2006
- 4.8 Exchange and Registration Rights Agreement, dated as of November 16, 2006, by and among Sally Holdings LLC, Sally Capital Inc., the Subsidiary Guarantors parties thereto, Merrill Lynch, Pierce, Fenner & Smith, Incorporated and the other financial institutions named therein, relating to the 10.5% Senior Subordinated Notes due 2016, which is incorporated herein by reference from Exhibit 4.4 to the Company's Current Report on Form 8-K filed on November 22, 2006
- 4.9 Credit Agreement, dated November 16, 2006, with respect to a Term Loan Facility, by and among Sally Holdings LLC, the several lenders from time to time parties thereto, and Merrill Lynch Capital Corporation, as Administrative Agent and Collateral Agent, which is incorporated herein by reference from Exhibit 4.5.1 to the Company's Current Report on Form 8-K filed on November 22, 2006
- 4.10 Guarantee and Collateral Agreement, dated as of November 16, 2006, made by Sally Investment Holdings LLC, Sally Holdings LLC and certain subsidiaries of Sally Holdings LLC in favor of Merrill Lynch Capital Corporation, as Administrative Agent and Collateral Agent, which is incorporated herein by reference from Exhibit 4.5.2 to the Company's Current Report on Form 8-K filed on November 22, 2006
- 4.11 Credit Agreement, dated November 16, 2006, with respect to an Asset-Based Loan Facility, among Sally Holdings LLC, Beauty Systems Group LLC, Sally Beauty Supply LLC, any Canadian Borrower from time to time party thereto, certain subsidiaries of Sally Holdings LLC, the several lenders from time to time parties thereto, Merrill Lynch Capital, a division of Merrill Lynch Business Financial Services Inc., as Administrative Agent and Collateral Agent, and Merrill Lynch Capital Canada Inc., as Canadian Agent and Canadian Collateral Agent, which is incorporated herein by reference from Exhibit 4.6.1 to the Company's Current Report on Form 8-K filed on November 22, 2006
- 4.12 U.S. Guarantee and Collateral Agreement, dated as of November 16, 2006, made by Sally Investment Holdings LLC, Sally Holdings LLC and certain subsidiaries of Sally Holdings LLC in favor of Merrill Lynch Capital, a division of Merrill Lynch Business Financial Services Inc., as Administrative Agent and Collateral Agent, which is incorporated herein by reference from Exhibit 4.6.2 to the Company's Current Report on Form 8-K filed on November 22, 2006
- 4.13 Canadian Guarantee and Collateral Agreement, dated as of November 16, 2006, made by Sally Beauty (Canada) Corporation, Beauty Systems Group (Canada), Inc., Sally Beauty Canada Holdings Inc. and certain of their respective subsidiaries in favor of Merrill Lynch Capital Canada Inc., as Canadian Agent and Canadian Collateral Agent, which is incorporated herein by reference from Exhibit 4.6.3 to the Company's Current Report on Form 8-K filed on November 22, 2006
- 4.14 Intercreditor Agreement, dated as of November 16, 2006, by and between Merrill Lynch Capital Corporation, as Administrative Agent and Collateral Agent under the Term Loan Facility, and Merrill Lynch Capital, a division of Merrill Lynch Business Financial Services Inc., as Administrative Agent and Collateral Agent under the Asset-Based Loan Facility, which is incorporated herein by reference from Exhibit 4.7 to the Company's Current Report on Form 8-K filed on November 22, 2006
- 4.15



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Assignment and Acceptance of that certain Credit Agreement, dated as of November 16, 2006, among Sally Holdings LLC, Beauty Systems Group LLC, Sally Beauty Supply LLC, the Canadian Borrowers (as defined in the Credit Agreement), the several banks and other financial institutions from time to time parties thereto, Merrill Lynch Capital, a division of Merrill Lynch Business Financial Services Inc., as administrative agent and collateral agent for the Lenders and Merrill Lynch Capital Canada, Inc., as Canadian agent and Canadian collateral agent for the Lenders, which is incorporated herein by reference from Exhibit 4.15 to the Company's Annual Report on Form 10-K filed on November 19, 2009

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10.1	Amended and Restated Letter Agreement between Clayton, Dubilier & Rice, LLC ( CD&R ) and the Company with respect to the provision of services by CD&R to the Company s Board of Directors dated as of February 24, 2010, which is incorporated herein by reference from Exhibit 10.1 to the Company s Quarterly Report on Form 10-Q filed on May 4, 2010
31.1	Rule 13(a)-14(a)/15(d)-14(a) Certification of Gary G. Winterhalter*
31.2	Rule 13(a)-14(a)/15(d)-14(a) Certification of Mark J. Flaherty*
32.1	Section 1350 Certification of Gary G. Winterhalter*
32.2	Section 1350 Certification of Mark J. Flaherty*
101	Pursuant to Rule 406T of Regulation S-T, the following financial information from our Quarterly Report on Form 10-Q for the fiscal quarter ended June 30, 2010, formatted in XBRL (Extensible Business Reporting Language) and furnished electronically herewith: (i) the Consolidated Statements of Earnings; (ii) the Consolidated Balance Sheets; (iii) the Consolidated Statements of Cash Flows; and (iv) the Condensed Notes to Consolidated Financial Statements, tagged as blocks of text.

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\* Included herewith

Certain schedules and exhibits have been omitted pursuant to Item 601(b)(2) of Regulation S-K. The Company agrees to furnish supplementally to the Securities and Exchange Commission a copy of any omitted schedule or exhibit upon request.

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**SIGNATURES**

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

SALLY BEAUTY HOLDINGS, INC.  
(Registrant)

Date: August 4, 2010

By: */s/ Mark J. Flaherty*  
Mark J. Flaherty  
Senior Vice President and Chief Financial Officer  
For the Registrant and as its Principal Financial Officer