

WHAT'S OUR BEAUTY SECRET?

SALLY BEAUTY HOLDINGS, INC. /
20
16 / ANNUAL REPORT



WE BELIEVE THAT BEAUTY

IS NOT ONE-SIZE-FITS-ALL.

THAT'S WHY IT IS OUR MISSION

TO PROVIDE OUR CUSTOMERS

WITH A PERSONALIZED SHOPPING

EXPERIENCE WHERE WE SHARE OUR

UNIQUE BEAUTY SECRETS & EMPOWER

HER TO FIND HER BEAUTIFUL.



About Sally Beauty Holdings, Inc.

Sally Beauty Holdings, Inc. (NYSE: SBH) is an international specialty retailer and distributor of professional beauty products, with annual revenues of \$4.0 billion and net earnings of \$223 million. The Company operates primarily through two business units, Sally Beauty Supply and Beauty Systems Group (BSG), and is the largest distributor of professional beauty supplies in the U.S. based on store count. We provide our customers with a wide variety of leading third-party branded and exclusive-label professional beauty supplies, including hair color and hair care products, styling tools, skin and nail care products, and other beauty items.

The Sally Beauty Supply and Beauty Systems Group businesses sell and distribute through over 5,119 stores, including 182 franchised units, throughout the United States (including Puerto Rico), Canada, Mexico, Chile, Colombia, Peru, the United Kingdom, Ireland, Belgium, France, Germany, the Netherlands and Spain. Approximately 83% of consolidated net sales are from customers located in the U.S.

Sally Beauty Supply has 3,781 stores worldwide, of which 2,917 are located in the U.S., with the remaining 864 stores located outside of the U.S. Sally Beauty stores offer up to 8,000 SKUs of professional beauty products for hair care, hair color, styling tools and nails through leading third-party brands and exclusive-label professional product lines. Sally Beauty Supply's customer base includes retail consumers and salon professionals.

The Beauty Systems Group business has 1,338 stores, including 164 franchise stores. BSG also has one of the largest networks of professional distributor sales consultants in North America, with approximately 936 consultants. The BSG stores and sales consultants sell up to 9,500 SKUs of merchandise that include professionally branded hair color and hair care products, styling tools and nail products that are sold exclusively to professional stylists and salons for use and resale to their customers.

Operating Segments (as of September 30, 2016)

Sally Beauty

An open-line and exclusive-label beauty products retailer offering professional beauty products to both retail consumers and salon professionals

- + Began operations in 1964
- + 3,781 stores worldwide
 - 2,917 in the U.S.
 - 864 outside of the U.S.
- + Annual sales of \$2.4 billion; gross profit margin of 55.2%
- + Average store size 1,700 square feet
- + Comprehensive product assortment approximately 8,000 SKUs

Beauty Systems Group

A leading full-service beauty products distributor offering professional beauty products exclusively to professional stylists and salons for use and resale to their customers

- + 1,338 stores in North America
 - 1,174 Company-operated
 - 164 Franchise
- + 936 direct distributor sales consultants
- + Annual sales of \$1.6 billion; gross profit margin of 41.5%
- + Average store size 2,700 square feet
- + Comprehensive product assortment approximately 9,500 SKUs
- + Broad selection of third-party branded professional beauty products not available in retail



FOR MORE INFORMATION ABOUT SALLY BEAUTY HOLDINGS, INC.,
PLEASE VISIT WWW.SALLYBEAUTYHOLDINGS.COM

Table of Contents

Fiscal year 2016 held in-store initiatives and continued investments in state-of-the-art customer relationship management for our Sally Beauty business. Beauty Systems Group introduced new brands and exclusive distribution that continued to drive sales growth and strong bottom-line performance.

3

Letter to
Shareholders

8

Fiscal
Highlights

10

Financial
Highlights

BEAUTY
FOR
ALL.

Dear Fellow Shareholders,

Last year, I described our efforts to transform our business through investments in our stores, technology, merchandising, marketing capabilities, packaging and talent. Fiscal 2016 was an extension of those efforts, as we continued to make the investments necessary to strengthen our competitive position and enhance the customer experience.

In our **Sally Beauty** business, we completed several of our in-store initiatives and continued to invest in state-of-the-art customer relationship management (CRM).

- + Store refresh completed in approximately 1,500 Sally stores which included new flooring, LED lighting and up-to-date graphics.
- + Completed the merchandising displays including the hair care solutions studio, hair color education center, brush and comb category.
- + Completed the redesign of our owned-brand packaging/labeling to better compete with the third-party professional brands.

Most of our in-store investments are now behind us, and we are shifting our focus towards creating ways to communicate our unique value proposition and evolve our in-store selling model to better support our customers.

Our **Beauty Systems Group (BSG)** had another great year. The introduction of new brands and exclusive distribution continued to drive sales growth and strong bottom-line performance. The BSG team continued to make terrific progress on expanding our CRM capabilities. Through CRM, we can create customized messages to our customers based on their shopping patterns and

unique needs. In FY 2017, the team is launching a new mobile application for our stylist customers. The app is a comprehensive business tool for the independent stylist, and includes a link to our e-commerce platform.

In summary, we remain confident in our ability to drive performance in Sally Beauty and believe BSG's strong results will continue. We remain committed to making investments in the business that will drive growth and long-term value for our shareholders.

HIGHLIGHTS OF FISCAL YEAR 2016

- + Opened our 5,000th store, ending the year with 5,119 stores
- + Strong performance in Beauty Systems Group continued
- + Reached profitability in Sally's European business
- + Completed most of the in-store investments in Sally Beauty
- + Generated consolidated operating cash flow of \$351 million
- + Repurchased \$207 million, or 7.8 million shares, of common stock





FINANCIAL RESULTS IN FISCAL YEAR 2016

During FY 2016, our consolidated net sales reached \$4.0 billion, growth of 3.1 percent over the prior year. This sales increase was driven by the addition of 152 net new stores, as well as growth of 2.9 percent in global same store sales. Gross profit ended the year at \$2.0 billion, for growth of 3.5 percent. This resulted in gross profit margin of 49.7 percent, up 20 basis points from the prior year. Diluted earnings per share were \$1.50, up 70 basis points from FY 2015. We generated \$351 million in net operating cash flow, which funded our investments in company growth and our stock repurchase program.

GROWING GLOBALLY

We continued to grow our store base and increased our footprint by 3.1 percent (152 stores). We now operate 4,132 Sally and BSG stores in the United States. Outside of the U.S., we operate 987 stores in 12 countries: Canada, Mexico, Chile, Peru, Colombia, the United Kingdom, Ireland, Belgium, France, Germany, the Netherlands and Spain. In FY 2017, we believe we can achieve consolidated store growth of 2 to 3 percent.

BUSINESS SEGMENT FINANCIAL RESULTS

Sally Beauty Supply

Net sales at our Sally Beauty Supply segment reached \$2.4 billion, an increase of 1.5 percent. Sales growth was driven by 108 net new stores and same store sales growth of 1.7 percent. The unfavorable impact of foreign currency exchange offset sales growth by 200 basis points.



40 basis points over FY 2015. Segment operating earnings were \$410 million, down 0.6 percent from \$412 million in FY 2015. Segment operating margins were 17.3 percent of sales, down 40 basis points primarily due to higher investments in information technology and labor cost inflation. Sally Beauty Supply ended the fiscal year with 3,781 stores worldwide: 2,917 in the U.S. and Puerto Rico, and the remaining 864 stores in Canada, Mexico, Chile, Peru, Colombia, the United Kingdom, Ireland, Belgium, France, Germany, the Netherlands and Spain. Beauty Club Card memberships increased 12 percent to reach 9.9 million members.

Beauty Systems Group

Our Beauty Systems Group segment had sales growth of 5.5 percent, to reach \$1.6 billion. This performance can be attributed to a 5.5 percent growth in same store sales and the addition of 44 net new stores. BSG's gross margin rose 20 basis points from FY 2015 to 41.5 percent. Operating earnings grew 10.1 percent over the prior year to \$254 million. Operating margins improved by 60 basis points to reach a high of 16.0 percent of sales. This strong operating performance was primarily due to continued operating leverage and gross margin expansion. BSG ended the fiscal year with 1,338 stores, including 164 franchise stores, an increase of 44 stores over FY 2015. Distributor sales consultants totaled 936 at year-end.

introduce new brands to the stores. In addition, we will continue to find new and creative ways to communicate our unique value proposition through digital and social media as well as traditional media. And finally, we will roll out a new selling model to our store associates and provide them with tools to better serve our customers. In BSG, we expect to gain channel share through acquisitions and brand exclusivity. We will continue our efforts to become the indisputable partner of choice for stylist and salon customers and manufacturers through innovative ideas like the stylist mobile application and CRM.

For 2017, our operating goal is to drive profitable sales growth. We expect revenue improvement from consolidated same store sales growth and organic store openings. Gross margin expansion is anticipated and should offset higher SG&A expenses. In addition, I have challenged the team to reallocate spending to the highest return initiatives and rationalize expenditures.

As always, thank you for your support.

Best Regards,



Chris Brickman
President and Chief Executive Officer

SUMMARY

The first tenet of our corporate values is *We Put the Customer First*, and that is exactly what we intend to do in fiscal 2017. We built our FY 2017 strategies and plans to focus on our customers' needs. In Sally, the team will build upon the next phase of customer conversion and engagement. We intend to leverage our CRM capabilities and

Fiscal 2016 Highlights

International
store base grew
by 7.3%

Sally completed
several in-store
initiatives

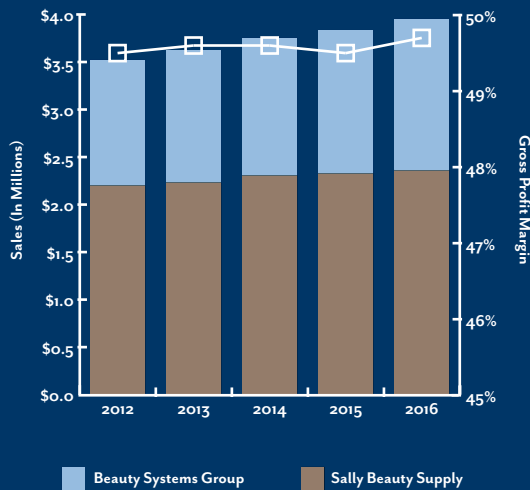
BSG continued
to win brands
and exclusive
distribution

Global Footprint

(Store Count as of September 30, 2016)

	Sally Beauty Supply	Beauty Systems Group	Total Company
North America			
United States	2,876	1,213	4,089
Puerto Rico	41	2	43
Canada	124	100	224
Mexico	215	23	238
North America Total	3,256	1,338	4,594
International			
United Kingdom	253	–	253
Belgium	51	–	51
Chile	41	–	41
Colombia	7	–	7
Peru	19	–	19
Ireland	9	–	9
France	72	–	72
Germany	18	–	18
Netherlands	30	–	30
Spain	25	–	25
International Total	525	–	525
Total Store Count	3,781	1,338	5,119
BSG Direct Sales Consultants	–	936	936
Non-U.S. Stores	864	123	987
U.S. Stores	2,917	1,215	4,132
Total Stores	3,781	1,338	5,119

**Consolidated Sales
and Gross Profit Margin**

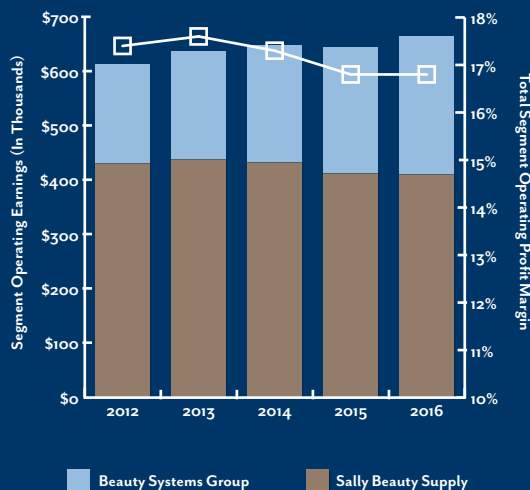


THE NUMBER ONE TENET
OF OUR CORPORATE
VALUES IS **WE PUT**

THE CUSTOMER FIRST,

AND THAT IS EXACTLY
WHAT WE INTEND
TO DO IN FISCAL 2017.

**Segment Operating Earnings
and Segment Operating Profit Margin**



Financial Highlights

Dollars in thousands, except per share amounts

Fiscal Year Ended September 30

Financial Highlights	2016	2015	2014	2013	2012
Net sales					
Sally Beauty Supply	\$ 2,364,531	\$ 2,329,523	\$ 2,308,743	\$ 2,230,028	\$ 2,198,468
Beauty Systems Group	\$ 1,588,087	\$ 1,504,820	\$ 1,444,755	\$ 1,392,188	\$ 1,325,176
Total Company Sales	\$ 3,952,618	\$3,834,343	\$ 3,753,498	\$ 3,622,216	\$3,523,644

Consolidated gross profit	\$ 1,963,940	\$ 1,897,851	\$ 1,860,172	\$ 1,795,263	\$ 1,743,259
Gross profit margin	49.7%	49.5%	49.6%	49.6%	49.5%
Operating earnings	\$ 498,297	\$ 495,326	\$ 506,996	\$ 520,362	\$ 499,355
Operating earnings margin	12.6%	12.9%	13.5%	14.4%	14.2%
Consolidated net earnings	\$ 222,942	\$ 235,087	\$ 245,993	\$ 261,151	\$ 233,064
Net earnings per basic share	\$1.51	\$1.50	\$1.54	\$1.52	\$1.27
Net earnings per diluted share	\$1.50	\$1.49	\$1.51	\$1.48	\$1.24
Cash flow from operations	\$ 351,005	\$ 300,787	\$ 315,972	\$ 310,454	\$297,582

Operating Highlights					
Same store sales growth ⁽¹⁾					
Sally Beauty Supply	1.7%	1.7%	1.3%	-0.6%	6.5%
Beauty Systems Group	5.5%	5.7%	3.5%	4.2%	6.1%
Consolidated Same Store Sales Growth	2.9%	2.9%	2.0%	0.8%	6.4%

Number of stores (end of period)					
Sally Beauty Supply	3,781	3,673	3,563	3,424	3,309
Beauty Systems Group	1,338	1,294	1,265	1,245	1,190
Consolidated Store Count	5,119	4,967	4,828	4,669	4,499

Professional Distributor Sales Consultants	936	958	981	982	1,044
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(1) Same stores are defined as company-operated stores that have been open for 14 months or longer as of the last day of a month.

2016

10-K

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-K

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

FOR THE FISCAL YEAR ENDED: SEPTEMBER 30, 2016

-OR-

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

For the transition period from _____ to _____

Commission File No. 1-33145

SALLY BEAUTY HOLDINGS, INC.

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of
incorporation or organization)

36-2257936

(I.R.S. Employer Identification No.)

3001 Colorado Boulevard

Denton, Texas

(Address of principal executive offices)

76210

(Zip Code)

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

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock, par value \$.01 per share	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined under Rule 405 of the Securities Act. YES ☒ NO ☐

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. YES ☐ NO ☒

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES ☒ NO ☐

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☐

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 ☐ NO ☒

The aggregate market value of registrant's common stock held by non-affiliates of the registrant, based upon the closing price of a share of the registrant's common stock on March 31, 2016 was approximately \$4,716,726,000. At November 9, 2016, there were 144,109,429 shares of the registrant's common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's Proxy Statement relating to the registrant's 2017 Annual Meeting of Stockholders are incorporated by reference into Part III of this Annual Report on Form 10-K where indicated.

TABLE OF CONTENTS

	<u>Page</u>
PART I	
ITEM 1. BUSINESS	1
ITEM 1A. RISK FACTORS	19
ITEM 1B. UNRESOLVED STAFF COMMENTS	36
ITEM 2. PROPERTIES	37
ITEM 3. LEGAL PROCEEDINGS	38
ITEM 4. MINE SAFETY DISCLOSURES	38
PART II	
ITEM 5. MARKET FOR REGISTRANT’S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES	39
ITEM 6. SELECTED FINANCIAL DATA	42
ITEM 7. MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS	44
ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK	79
ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA	81
ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE	81
ITEM 9A. CONTROLS AND PROCEDURES	81
ITEM 9B. OTHER INFORMATION	82
PART III	
ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE ..	83
ITEM 11. EXECUTIVE COMPENSATION	83
ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS	83
ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE	84
ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES	84
PART IV	
ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES	85

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

CAUTIONARY NOTICE REGARDING FORWARD-LOOKING STATEMENTS

Statements in this Annual Report on Form 10-K 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 expressions may also 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:

- anticipating and effectively responding to changes in consumer and professional stylist preferences and buying trends in a timely manner;
- the success of our strategic initiatives, including our store refresh program and increased marketing efforts, to enhance the customer experience, attract new customers, drive brand awareness and improve customer loyalty;
- our ability to efficiently manage and control our costs and the success of our cost control plans;
- the highly competitive nature of, and the increasing consolidation of, the beauty products distribution industry;
- the timing and acceptance of new product introductions;
- shifts in product mix sold during any period;
- potential fluctuation in our same store sales and quarterly financial performance;
- our dependence upon manufacturers who may be unwilling or unable to continue to supply products to us;
- our dependence upon manufacturers who have developed or could develop their own distribution businesses which compete directly with ours;
- the possibility of material interruptions in the supply of products by our third-party manufacturers or distributors or increases in the prices of the products we purchase from our third-party manufacturers or distributors;
- products sold by us being found to be defective in labeling or content;
- compliance with current laws and regulations or becoming subject to additional or more stringent laws and regulations;
- the success of our e-commerce businesses;
- diversion of professional products sold by Beauty Systems Group to mass retailers or other unauthorized resellers;
- the operational and financial performance of our Armstrong McCall, L.P. franchise-based business, which we refer to as Armstrong McCall;
- successfully identifying acquisition candidates and successfully completing desirable acquisitions;
- integrating acquired businesses;

- the success of our initiatives to expand into new geographies;
- the success of our existing stores, and our ability to increase sales at existing stores;
- opening and operating new stores profitably;
- the volume of traffic to our stores;
- the impact of the health of the economy upon our business;
- conducting business outside the United States;
- the impact of Britain's vote to leave the European Union and related or other disruptive events in the European Union or other geographies in which we conduct business;
- rising labor and rental costs;
- protecting our intellectual property rights, particularly our trademarks;
- the risk that our products may infringe on the intellectual property rights of others;
- successfully updating and integrating our information technology systems;
- disruption in our information technology systems;
- a significant data security breach, including misappropriation of our customers', employees' or suppliers' confidential information, and the potential costs related thereto;
- the negative impact on our reputation and loss of confidence of our customers, suppliers and others arising from a significant data security breach;
- the costs and diversion of management's attention required to investigate and remediate a data security breach and to continuously upgrade our information technology security systems to address evolving cyber-security threats;
- the ultimate determination of the extent or scope of the potential liabilities relating to our past or any future data security incidents;
- our ability to attract and retain highly skilled management and other personnel;
- severe weather, natural disasters or acts of violence or terrorism;
- the preparedness of our accounting and other management systems to meet financial reporting and other requirements and the upgrade of our existing financial reporting system;
- being a holding company, with no operations of our own, and depending on our subsidiaries for our liquidity needs;
- our ability to execute and implement our share repurchase program;
- our substantial indebtedness;
- the possibility that we may incur substantial additional debt, including secured debt, in the future;
- restrictions and limitations in the agreements and instruments governing our debt;
- generating the significant amount of cash needed to service all of our debt and refinancing all or a portion of our indebtedness or obtaining additional financing;
- changes in interest rates increasing the cost of servicing our debt; and
- the costs and effects of litigation.

The events described in the forward-looking statements might not occur or might occur to a different extent or at a different time than we have described. As a result, our actual results may differ materially from the results contemplated by these forward-looking statements. We assume no obligation to publicly update or revise any forward-looking statements.

PART I

ITEM 1. BUSINESS

Introduction

Sally Beauty Holdings, Inc. is an international specialty retailer and distributor of professional beauty supplies with operations primarily in North America, South America and Europe. We believe the Company is the largest distributor of professional beauty supplies in the U.S. based on store count. At September 30, 2016, we operated primarily through two business units, Sally Beauty Supply and Beauty Systems Group (BSG), and, through Sally Beauty Supply and BSG, we operated a multi-channel platform of 4,937 company-operated stores and supplied 182 franchised stores. Within BSG, we also have one of the largest networks of professional distributor sales consultants in North America, with approximately 936 professional distributor sales consultants who sell directly to salons and salon professionals. Sally Beauty Supply targets retail consumers and salon professionals, while BSG exclusively targets salons and salon professionals. Through Sally Beauty Supply and BSG, we have store locations in the United States (including Puerto Rico), Canada, Mexico, Chile, Colombia, Peru, the United Kingdom, Ireland, Belgium, France, Germany, the Netherlands and Spain. We provide our customers with a wide variety of leading third-party branded and exclusive-label professional beauty supplies, including hair color products, hair care products, styling appliances, skin and nail care products and other beauty items. For each of the fiscal years ended September 30, 2016, 2015 and 2014, over 80% of our consolidated net sales were from customers located in the U.S. For the fiscal year ended September 30, 2016, our consolidated net sales and operating earnings were \$3,952.6 million and \$498.3 million, respectively.

Professional Beauty Supply Industry Distribution Channels

The professional beauty supply industry serves end-users through four distribution channels: full-service/exclusive distribution, open-line distribution, direct and mega-salon stores.

Full-Service/Exclusive

This channel exclusively serves salons and salon professionals and distributes “professional-only” products for use in salons and resale to consumers in salons. Many brands are distributed through exclusive arrangements with suppliers by geographic territory. We believe that BSG is a leading full-service distributor in the U.S. In addition, we offer our BSG products for sale to salons and salon professionals through the Company’s websites (including www.cosmoprofbeauty.com, www.cosmoprofequipment.com and www.loxabbeauty.com).

Open-Line

This channel serves retail consumers and salon professionals through retail stores and the internet. This channel is served by a large number of localized retailers and distributors, with only a few having a regional presence and significant channel share. We believe that Sally Beauty Supply is the largest open-line distributor in the U.S. with its nationwide network of retail stores. In addition, the Company’s websites (including www.sallybeauty.com) and other e-commerce platforms provide retail consumers and salon professionals access to product offerings and information beyond our retail stores.

Direct

This channel focuses on direct sales to salons and salon professionals by large manufacturers. This is the dominant form of distribution in Europe, but represents a smaller channel in the U.S. due to the highly fragmented nature of the U.S. salon industry, which makes direct distribution cost prohibitive for many manufacturers.

Mega-Salon Stores

In this channel, large-format salons are supplied directly by manufacturers due to their large scale.

Key Industry and Business Trends

We operate within the large and growing professional beauty supply industry primarily in the U.S., but also in 12 additional countries across North America, South America and Europe. 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 industry is highly fragmented with approximately 295,000 salons and barbershops. 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 chair 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, chair renters (formerly referred to as booth renters) and suite renters, who now comprise a significant percentage of total U.S. salon professionals, are often responsible for purchasing their own supplies. Historically, the number of chair renters and suite renters has 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, chair renters and suite 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 an extensive range of exclusive-label professional beauty products, predominantly in our Sally Beauty Supply segment. As our lines of exclusive-label products have matured and become better known in our retail stores, we have seen an increase in sales of these products. Generally, our exclusive-label products have higher gross margins for us than the leading third-party branded products and, accordingly, we believe that growth in our sales of these products will likely enhance our overall gross margins. Furthermore, we believe that we provide our customers with a unique value proposition by offering compelling exclusive-label brands that we believe to be of the same quality as leading third-party branded products at an attractive price. Please see “Risk Factors—*We may be unable to anticipate and effectively respond to changes in consumer preferences and buying trends in a timely manner*” 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.*”

Favorable consumer trends. Our industry is characterized by continuously changing fashion-related trends that drive new styles, including hair and nail styles, and continuing demand for beauty products. In addition, we expect the aging baby-boomer population in the U.S. to continue to drive sales growth in certain professional beauty product categories, including through an increase in the usage of hair color and hair loss products. Our continued success depends largely 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 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. Please see “Risk Factors—*We may be unable to anticipate and effectively respond to changes in consumer preferences and buying trends in a timely manner.*”

International growth strategies. A key element of our growth strategy is to capitalize on international growth opportunities and to grow our current level of non-U.S. operations. For example, our number of international company-operated stores increased from 679 stores to 946 stores during the last five years. In addition, we have completed a number of international acquisitions over the past several years that

increased our European and South American footprint. We intend to continue to identify and evaluate non-U.S. acquisition and/or organic international growth opportunities. Our ability to grow our non-U.S. operations, integrate our new non-U.S. acquisitions and successfully pursue additional non-U.S. acquisition and/or organic international growth opportunities may be affected by business, legal, regulatory and economic risks. Please see “Risk Factors—*We may not be able to successfully identify acquisition candidates or successfully 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.*”

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 the evaluation of opportunities to shift business from competing 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 and 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, if L’Oreal or any of our other suppliers acquired other distributors or suppliers that conduct significant business with BSG, we could lose related revenue. There can be no assurance that BSG will not lose revenue over time (including within its franchise-based business) due to potential losses of product lines as well as from the increased competition from distribution networks affiliated with any of our suppliers. 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.*”

Relationships with suppliers. Sally Beauty Supply and BSG, and their respective suppliers are dependent on each other for the distribution of beauty products. We do not manufacture any of the products we sell, including our exclusive-label products, and purchase these products from a limited number of manufacturers. As is typical in distribution businesses (particularly in our industry), these relationships are subject to change from time to time (which often results in the expansion or loss of distribution rights, including exclusive rights, in various geographies and the addition or loss of product lines). Since we purchase products from many of those 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, vendors may change the terms upon which they sell to us, as we do not have contractual assurances for the continued supply of products, pricing terms or access to the vendor’s new products. 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 earnings. We expect to continue to expand our product line offerings and to gain additional distribution rights over time through either further negotiation with current and prospective suppliers or by acquisitions of existing distributors. Although we focus on developing new revenue and cost management initiatives to mitigate the negative effects resulting from any 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.*”

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, mass merchandisers, on-line retailers, drug stores and supermarkets, as well as salons retailing hair care items. Although Sally Beauty Supply positions itself to be competitive on price, its primary focus is to be a source of professional advice, solutions and salon-quality products, rather than a discount leader. 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. Although we believe BSG positions itself to be competitive on price, its primary focus is to provide a comprehensive selection of branded products to the salon professional. 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. We primarily compete with these competitors on price, selection, convenience and customer service. Our continued success is dependent on our ability to successfully compete with our competitors and the success of our strategic initiatives to enhance the customer experience, drive brand awareness and improve customer loyalty. Please see “Risk Factors—*The beauty products distribution industry is highly competitive and is consolidating.*”

Economic conditions. We appeal to a wide demographic consumer profile and offer an extensive selection of professional 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 styling tools product category and our full-service sales business. In addition, higher freight costs including those 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—*The health of the economy in the geographies we serve 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.*”

Controlling expenses. An important aspect of our business is our ability to control costs by right-sizing and maximizing the efficiency of our business, particularly in an environment of increasing labor and real estate costs. We currently expect significant labor and rental cost increases to continue for the foreseeable future as we compete for talent and attractive retail locations with other retailers. Please see “Risk Factors—*We are not certain that our ongoing cost control plans will continue to be successful.*”

Opening new stores. The success of our growth strategy in the future depends in part on our ability to open and profitably operate new stores in existing and additional geographic areas and, more specifically, in international geographies as international growth becomes an increasing driver of our future growth and the U.S. marketplace becomes more saturated. While the capital requirements to open a Sally Beauty Supply or BSG store, excluding inventory, vary from geography to geography, such capital requirements have historically been relatively low in the U.S. and Canada. 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 business, 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.*”

Changes to our information technology systems. As our operations have grown in both size and scope and as cyber-attacks and security intrusions involving retailers have become more frequent, we have improved and upgraded our information systems and infrastructure while maintaining the reliability and integrity of those systems and infrastructure. These improvements have included putting in place a standardized

enterprise resource planning (“ERP”) system for both our domestic and international operations, upgrading our e-commerce platforms and our customer relationship management (CRM) technology and the adoption of payment terminals with encryption technology in order to enhance the security of our credit card payment systems. As we continue to grow and the prevalence and sophistication of cyber-attacks continues to increase, we will continuously need to improve and upgrade our information technology systems and, as a result, we anticipate incurring additional costs in the future in connection with these continuous upgrades and improvements. Please see “Risk Factors—*We may be adversely affected by any disruption in our information technology systems*” and “*Unauthorized access to confidential information and data on our information technology systems and security and data breaches could materially adversely affect our business, financial condition and operating results.*”

Business Segments, Geographic Area Information and Seasonality

We operate in two business segments: (i) Sally Beauty Supply, an open-line and exclusive-label retailer of professional beauty supplies offering professional beauty supplies to both retail consumers and salon professionals primarily in North America, South America and Europe, and (ii) BSG, including its franchise-based business Armstrong McCall, a full-service beauty supply distributor offering professional brands directly to salons and salon professionals through our own sales force and professional-only stores, many in exclusive geographical territories, primarily in North America, the United Kingdom and certain other European countries. For each of the fiscal years ended September 30, 2016, 2015 and 2014, Sally Beauty Supply accounted for approximately 60% and BSG accounted for approximately 40% of the Company’s consolidated net sales.

Financial information about business segments and geographic area information is incorporated herein by reference to the “Business Segments and Geographic Area Information,” Note 18 of the “Notes to Consolidated Financial Statements” in “Item 8—Financial Statements and Supplementary Data” contained elsewhere in this Annual Report.

Neither the sales nor the product assortment for Sally Beauty Supply or BSG are generally seasonal in nature.

Sally Beauty Supply

As of September 30, 2016, Sally Beauty Supply operated 3,763 company-operated retail stores (generally under the Sally Beauty banner), 2,917 of which are located in the U.S., with the remaining 846 company-operated retail stores located in Canada, Mexico, Chile, Colombia, Peru, the United Kingdom, Ireland, Belgium, France, Germany, the Netherlands and Spain. Sally Beauty Supply also supplied 18 franchised stores located in the United Kingdom, Belgium and certain other European countries. Our Sally Beauty stores carry an extensive selection of professional beauty supplies for both retail customers and salon professionals, featuring an average of 8,000 stock keeping units, or SKUs, of beauty products across product categories including hair color, hair care, skin and nail care, beauty sundries and styling tools. Our Sally Beauty stores carry leading third-party brands such as Clairol®, CHI®, China Glaze®, OPI® and Conair®, as well as an extensive selection of exclusive-label merchandise. We believe that Sally Beauty Supply has differentiated itself from its competitors through its customer value proposition based on delivering an extensive selection of leading third-party branded and exclusive-label professional beauty products at attractive prices through knowledgeable sales associates and convenient store locations.

Store Design and Operations

Our Sally Beauty stores are designed to create an appealing shopping environment that embraces the retail consumer and salon professional and highlights its extensive product offering. In the U.S. and Canada, our Sally Beauty stores average approximately 1,700 square feet in size, are located primarily in strip shopping centers and generally follow a consistent format, allowing customers familiarity between Sally Beauty

locations. Store formats, including average size and product selection, for our Sally Beauty stores outside the U.S. and Canada vary by marketplace.

Our Sally Beauty stores are organized by product type in ways that allow its customers to easily navigate through its stores and that encourage cross-selling and impulse buying through the use of strategic product placement and displays that highlight new products and key promotional items.

During the past two years, we implemented store refresh initiatives designed to enhance the consumer experience at our Sally Beauty stores, primarily in the U.S, by upgrading the look, feel and “shopability” of our stores. As part of these initiatives we have added a “nail studio” display and a hair color education center, and have recently reset key merchandising sections across our Sally Beauty stores in the U.S., including the hair care and the brushes and combs categories, in order to improve the visibility of these products. In addition, we have recently installed new floors, LED lighting and updated signage at a number of our U.S. Sally Beauty stores. Our store refresh initiatives are intended to provide our customers with a brighter and more engaging store that is easier to navigate than before the refreshes. At September 30, 2016, we have refreshed approximately 1,450 of our stores and expect to continue our initiatives to update the look and feel of our U.S. stores. At September 30, 2016, we have 2,917 company-operated Sally Beauty stores in the U.S., including approximately 300 newer company-operated stores that will not undergo refreshing in the near future. The average capital requirement to complete our store refreshes is approximately \$20,000 to \$25,000 per store.

Merchandise

Our Sally Beauty stores carry an extensive selection of third-party branded and exclusive-label professional beauty supplies. Sally Beauty Supply manages each category by product and by SKU and uses centrally developed plan-o-guides to maintain a consistent merchandise presentation across its store base (primarily in the U.S. and Canada). Through its information systems, Sally Beauty Supply actively monitors each store’s performance by category. We believe Sally Beauty Supply’s tailored merchandise strategy enables it to meet local demands and helps drive customer traffic into its stores. Additionally, Sally Beauty Supply’s information systems (implemented in its North American and in substantially all its European locations) enable it to track and automatically replenish inventory levels, generally on a weekly basis, allowing it to maintain high levels of in-stock, in-demand merchandise, including both regular-priced and promotional items. Please see Liquidity and Capital Resources in “Item 7—Management’s Discussion and Analysis of Financial Condition and Results of Operations” contained elsewhere in this Annual Report.

Sally Beauty Supply’s pricing strategy is differentiated by customer segment. Professional salon customers are generally entitled to a price lower than that received by retail customers. However, Sally Beauty Supply does offer discounts to retail customers through its customer loyalty program (please see “*Marketing and Advertising*” below).

The following table sets forth the approximate percentage of Sally Beauty Supply's sales by major product category:

	Fiscal Year Ended September 30,		
	2016	2015	2014
Hair color	25.3%	24.7%	23.4%
Hair care	21.5%	22.1%	22.2%
Skin and nail care	15.5%	15.8%	16.5%
Styling tools	15.1%	14.7%	15.5%
Salon supplies and accessories	7.1%	8.0%	8.0%
Multicultural products	7.6%	7.0%	7.1%
Other beauty items	7.9%	7.7%	7.3%
Total	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>

Note: Certain amounts for the prior fiscal years presented in the table above have been reclassified to conform to the current fiscal year's presentation. In addition, certain product categories have been updated to reflect current business practices.

Leading Third-Party Branded Products

Sally Beauty Supply offers an extensive selection of hair care products, nail care products, beauty sundries and appliances, featuring leading third-party brands such as Clairol®, CHI®, China Glaze®, OPI® and Conair®. In addition, Sally Beauty Supply offers an extensive selection of exclusive-label merchandise. We believe that carrying an extensive selection of the latest premier branded merchandise is critical to maintaining long-term relationships with our customers. The merchandise Sally Beauty Supply carries includes products from one or more of the leading manufacturers in each category. Sally Beauty Supply's objective is not only to carry leading brands, but also to carry a full range of third-party branded and exclusive-label products within each category. As beauty trends continue to evolve, we expect to offer the changing professional beauty product assortment necessary to meet the needs of retail consumers and salon professionals.

Exclusive-Label Products

Sally Beauty Supply offers an extensive selection of exclusive-label professional beauty products. We believe that our exclusive-label products are of equal quality as higher-priced leading third-party brands and provide customers with an attractive alternative to these higher-priced products, further strengthening our value proposition. Exclusive-label products accounted for approximately 46% of Sally Beauty Supply's product sales in the U.S. during the fiscal year 2016. Generally, our exclusive-label products have higher gross margins for us than the leading third-party branded products, and we believe this area offers continued growth potential. Sally Beauty Supply maintains exclusive-label products in substantially all its product categories. Sally Beauty Supply intends to continue to invest in the growth of its exclusive-label brands and to actively promote these products in an effort to strengthen this category of products, while also making these brands more distinctive and well-known. For example, in the fiscal year 2016, we have completed the repackaging of a substantial portion of our exclusive-label products in an effort to further enhance the appeal of these products to our customers.

Marketing and Advertising

Sally Beauty Supply's marketing programs are designed to drive customer traffic on the short-term and, on the long-term, brand preference by differentiating the Company as a source of professional advice, solutions and salon-quality products at competitive prices, all backed by our "Love It or Return It"

guarantee. Our marketing programs differentiate between our two distinct customer groups: retail customers and salon professionals.

We continuously adapt our marketing initiatives and adjust our media mix and messaging with the goal of achieving the highest possible return on our marketing and advertising dollars. We target existing and potential customers through an integrated marketing approach designed to touch the customer through every medium he or she engages in, including direct mail, email, social media, text, digital advertising, print advertising (including full page ads in fashion magazines) and television (primarily in the U.S.), through our *Project Runway* partnership.

During the past year, we transformed our *sallybeauty.com* website from a largely transactional-based website to a content rich experience that offers customers the ability to research styles, trends and products, which we believe has significantly increased the number of visitors to our site and improved our online sales. We currently offer an average of 9,500 SKUs of our Sally Beauty Supply products for sale through our website (*www.sallybeauty.com*) and believe that our website enhances our other efforts intended to promote consumer awareness of Sally Beauty Supply's products, including through the use of educational videos and the presentation of relevant beauty tips and extensive product information. We frequently update the design of our website in an effort to enhance its appeal to our existing and prospective customers. In addition to generating e-commerce sales, we believe our website is an important vehicle to reach consumers researching beauty products online who could potentially visit our stores as a result of their experience with our website. Please see "Risk Factors—Our e-commerce businesses may be unsuccessful or, if successful, may divert sales from our stores."

Sally Beauty Supply's customer loyalty and CRM programs, primarily in the U.S. and Canada, allow Sally Beauty Supply the opportunity to collect valuable point-of-sale customer data in order to increase its understanding of customers' needs and enhance our ability to market to them in more personalized and relevant ways. The Sally "Beauty Club" is a loyalty program for customers who are not salon professionals. Beauty Club members, generally after paying a nominal annual fee, are eligible to receive a discounted price on almost every non-sale item. Members can also earn rewards and are eligible to receive direct mail, text messages and e-mail communications that contain special offers, beauty tips and new product information. We have recently improved the sophistication of our CRM capabilities to better respond to our customers' behavior in an effort to drive the customer experience and increase sales.

In addition, Sally Beauty Supply's "ProCard" is a loyalty program for licensed salon professionals. ProCard members are eligible to receive discounts on all beauty products sold at Sally Beauty Supply's stores and website, as well as special offerings available only to salon professionals. Outside the U.S. and Canada, our customer loyalty and marketing programs vary by marketplace.

Store Locations

Sally Beauty Supply selects geographic areas and store sites on the basis of demographic information, the quality and nature of neighboring tenants, store visibility and location accessibility. Sally Beauty Supply seeks to locate stores primarily in strip malls, which are occupied by other high traffic retailers including grocery stores, mass merchants and home centers.

Sally Beauty Supply balances its store expansion between new and existing marketplaces, with future store growth expected primarily in non-U.S. geographies. In its existing marketplaces, Sally Beauty Supply adds stores as necessary to provide additional coverage. In new marketplaces, Sally Beauty Supply generally seeks to expand in geographically contiguous areas to leverage its experience. We believe that Sally Beauty Supply's knowledge of local marketplaces is an important part of its success.

The following table provides a history of Sally Beauty Supply's store count (including franchised stores) during the last three fiscal years:

	Fiscal Year Ended September 30,		
	2016	2015	2014
Stores open at beginning of period	3,673	3,563	3,424
Net store openings during period(a)	108	110	135
Stores acquired during period	—	—	4
Stores open at end of period	<u>3,781</u>	<u>3,673</u>	<u>3,563</u>

(a) For the fiscal year 2015, net store openings reflect the closure of 15 underperforming stores in Germany.

Beauty Systems Group

As of September 30, 2016, BSG operated 1,174 company-operated retail stores (generally under the CosmoProf banner) with 1,074 located in the U.S. and the remaining 100 company-operated retail stores located in Canada. In addition, as of September 30, 2016, BSG supplied 164 franchised stores and had a sales force of approximately 936 professional distributor sales consultants in the U.S., Canada, Mexico and certain European countries. We believe BSG is the largest full-service distributor of professional beauty supplies in North America, exclusively targeting salons and salon professionals. Through BSG's large store base and sales force, including its franchise-based business Armstrong McCall, BSG is able to access a significant portion of the highly fragmented U.S. professional beauty salon services industry. BSG and Armstrong McCall stores provide a comprehensive selection of professional beauty products, featuring an average of 9,500 SKUs of merchandise, that include hair color, hair care, skin and nail care, beauty sundries and styling tools. BSG is also the exclusive source for certain well-known third-party branded products pursuant to BSG's exclusive distribution agreements with certain suppliers within specified geographic territories.

Store Design and Operations

BSG stores, including its franchise-based Armstrong McCall stores, are designed to create a professional shopping environment that embraces the salon professional and highlights its extensive product offering. Company-operated BSG stores, average approximately 2,600 square feet and are primarily located in secondary strip shopping centers. BSG store layouts are designed to provide optimal variety and options to the salon professional. Stores are segmented into distinctive areas arranged by product type with certain areas dedicated to leading third-party brands; such as Paul Mitchell®, Wella®, Sebastian®, Goldwell®, Joico® and Aquage®. The selection of these and other brands varies by territory.

Professional Distributor Sales Consultants

As of September 30, 2016, BSG had a network of approximately 936 professional distributor sales consultants ("DSC" or "DSCs"), which exclusively served salons and salon professionals.

In order to provide a knowledgeable sales consultant team, BSG actively recruits individuals with industry knowledge or sales experience, as we believe that sales consultants with broad product knowledge and direct sales experience will be more successful in driving sales. In addition, BSG provides training to new sales consultants beginning with a two-week training program, followed by a program of continuing media-based training delivered through audio, video and web-based e-learning. The program is designed to develop product knowledge as well as techniques on how best to serve salon professionals. In addition to selling professional beauty products, our sales consultants offer in-salon training for professionals and

salon owners in areas such as new styles, techniques and business practices. An important component of sales consultants' compensation is sales commissions. BSG's commission system is designed to drive sales, as well as focus consultants on selling products that are best suited to individual salons and salon professionals.

We believe that our emphasis on recruitment, training, and sales-based compensation results in a sales force that distinguishes itself from other full-service/exclusive-channel distributors and the employment of sales consultants is an effective way to serve salons and salon professionals.

The following table sets forth the approximate percentage of BSG sales attributable to each major distribution channel:

	Fiscal Year Ended September 30,		
	2016	2015	2014
Company-operated stores	67.1%	66.4%	65.6%
Professional distributor sales consultants (full-service)	24.9%	25.1%	25.6%
Franchise stores	8.0%	8.5%	8.8%
Total	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>

Merchandise

BSG stores carry an extensive selection of third-party branded products, featuring an average of 9,500 SKUs of beauty products, including hair color and care, skin and nail care, styling tools and other beauty items. Some products are available in bulk packaging for higher volume salon needs. Through BSG's information systems, each store's product sales performance is actively monitored, allowing maintenance of an optimal merchandise mix. Additionally, BSG's information systems track and automatically replenish inventory levels on a weekly basis, enabling BSG to maintain sufficient levels of product in stock. BSG's primary focus is to provide a comprehensive selection of branded products to the salon professional at competitive prices. BSG is also the exclusive source for certain well-known third-party branded products pursuant to BSG's exclusive arrangements with certain suppliers within specified geographic territories. Increasing our distribution of well-known brands is an important aspect of our growth strategy for BSG, and BSG has recently acquired distribution rights for important brands in new geographies and extended contracts with several key existing vendors. We believe that carrying an extensive selection of branded merchandise is critical to maintaining relationships with our professional customers. Please see Liquidity and Capital Resources in "Item 7—Management's Discussion and Analysis of Financial Condition and Results of Operations" contained elsewhere in this Annual Report.

The following table sets forth the approximate percentage of BSG's sales attributable by major product category:

	Fiscal Year Ended September 30,		
	2016	2015	2014
Hair color	35.4%	32.7%	30.8%
Hair care	34.3%	34.5%	35.0%
Skin and nail care	8.9%	9.5%	9.9%
Styling tools	4.5%	5.0%	5.5%
Promotional items(a)	10.1%	10.7%	11.8%
Other beauty items	6.8%	7.6%	7.0%
Total	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>

(a) Promotional items consist of sales from other categories that are sold on a value-priced basis.

Marketing and Advertising

BSG's marketing program is designed primarily to promote its extensive selection of brand name products at competitive prices and to educate, motivate and empower its customers to grow professionally. BSG communicates on a frequent basis with its customers and potential customers, and distributes promotional material through multiple communication channels, including trade shows, educational events, store personnel, professional distributor sales consultants, print mail, e-mail, text and social media. In addition, we offer an average of 15,000 SKUs (primarily in the U.S. and excluding Loxa Beauty) of professional beauty products for sale through our websites (www.cosmoprofequipment.com and www.cosmoprofbeauty.com). We believe that our websites enhance our other efforts intended to promote awareness of BSG's products by salons, salon professionals and retail customers, as appropriate. Please see "Risk Factors—Our e-commerce businesses may be unsuccessful or, if successful, may divert sales from our stores." Some BSG stores also host monthly manufacturer-sponsored classes for salon professionals. These classes are held at BSG stores and led by manufacturer-employed educators. Salon professionals, after paying a small fee to attend, can learn about new products and beauty trends. We believe these classes also increase brand awareness and potentially drive sales in BSG stores. Furthermore, our recent improvements to our CRM capabilities have enabled us to more effectively communicate with our BSG customers.

Loxa Beauty

BSG's www.loxabbeauty.com is a website designed to connect salon professionals with their customers and offers approximately 5,000 SKUs of manufacturer-authorized professional beauty products (including leading third-party brands such as Paul Mitchell®, Rusk®, Sebastian®, CHI®, and Joico®). Loxa Beauty enables consumers to receive expert advice online from salon professionals of their choice while crediting the chosen salon professional with any resulting product sale. The salon professionals are able to assist their client in the selection of the best salon products for their clients' particular needs while earning sales commissions when their clients order products using the Loxa Beauty website. We believe that this sales channel has good growth potential for BSG over the next several years. Please see "Risk Factors—Our e-commerce businesses may be unsuccessful or, if successful, may divert sales from our stores."

Store Locations

BSG stores are primarily located in secondary strip shopping centers resulting in relatively lower operational costs per square foot than our retail stores. Although BSG stores are located in visible and convenient locations, we believe salon professionals are generally less sensitive about store location than our retail customers.

The following table provides a history of BSG's store count (including franchised stores) during the last three fiscal years:

	Fiscal Year Ended September 30,		
	2016	2015	2014
Stores open at beginning of period	1,294	1,265	1,245
Net store openings during period	29	29	17
Stores acquired during period	15	—	3
Stores open at end of period	<u>1,338</u>	<u>1,294</u>	<u>1,265</u>

- (1) Stores acquired in the fiscal year 2016 represents 15 stores owned by Peerless Beauty and Barber Supply Company ("Peerless Beauty") prior to the Company's acquisition of certain assets from Peerless Beauty in September 2016.

Competitive Strengths

We believe the following competitive strengths differentiate us from our competitors and will help drive our future growth:

The Largest Professional Beauty Supply Distributor in the U.S. with Multi-Channel Platform

We believe that Sally Beauty Supply and BSG together comprise the largest distributor of professional beauty products in the U.S. by store count. Our leading channel positions and multi-channel platform afford us several advantages, including strong positioning with suppliers, the ability to better service the highly fragmented beauty supply marketplace, economies of scale and the ability to capitalize on the ongoing consolidation in our sector. Through our multi-channel platform, we are able to generate and grow revenues across broad, diversified geographies, and customer segments using varying product assortments. In the U.S., we offer from 8,000 SKUs (at a typical Sally Beauty store) to 15,000 SKUs (at a BSG website, excluding Loxa Beauty) of professional beauty products through Sally Beauty Supply and BSG, respectively, to a broad potential customer base that includes retail consumers, salons and barbershops in the U.S.

Differentiated Customer Value Proposition

We believe that we offer our customers a strong value proposition based on providing salon-quality products and solutions at attractive prices that is unique from our competitors. Our stores are conveniently located and offer a wide selection of professional beauty products (including leading third-party branded and exclusive-label merchandise), high levels of in-stock merchandise, beauty solutions and know-how delivered by our knowledgeable salespeople and competitive pricing. We also offer a comprehensive selection of ethnic products, which is tailored by store, based on market demographics and category performance. We believe that the wide selection of these products at our stores further differentiates Sally Beauty Supply from its competitors. In addition, as discussed above, Sally Beauty Supply also offers a customer loyalty program, the Beauty Club, whereby generally for a nominal annual fee members receive discounts on products, earn rewards and are eligible to receive direct mail and email communications that contain special offers, beauty tips, and new product information. Our BSG professional distributor sales consultants benefit from their customers having access to the BSG store systems as customers have the ability to pick up the products they need between visits from our professional distributor sales consultants. We believe that our differentiated customer value proposition and strong brands drive customer loyalty and high repeat traffic, contributing to our success and growth.

Attractive Store Economics

We believe that our stores generate attractive returns on invested capital. In the U.S. and Canada, the capital requirements to open a Sally Beauty Supply or BSG store, excluding inventory, average approximately \$75,000 to \$80,000. Our Sally Beauty stores average approximately 1,700 square feet and BSG stores average approximately 2,600 square feet in size in the U.S. and Canada. Strong average sales per square foot combined with minimal staffing requirements, lower rent and other occupancy costs and expenses and limited initial capital outlay typically result in positive contribution margins within a few months to a year of opening, and cash payback on investment within approximately two to three years. Due to such attractive investment returns and relatively high operating profit contributions per store, during the past five fiscal years Sally Beauty Supply and BSG have opened an aggregate of 595 and 157 net new stores, respectively, excluding the effect of acquisitions. In addition, each Sally Beauty Supply and BSG store (in the U.S. and Canada) contains an average of \$70,000 and \$135,000, respectively, of merchandise inventory. Outside the U.S. and Canada, our store format, sizes, inventory levels and capital requirements vary by marketplace, but we believe these stores also generate compelling unit economics. In addition, over the past two years, we have refreshed approximately 1,450 Sally Beauty stores in the U.S. at an average cost of approximately \$20,000 to \$25,000 per store, and believe these stores are well-positioned to benefit from these recent improvements.

Our Strategy

We believe there are significant opportunities to increase our sales and profitability through the further implementation of our operating strategy and by growing our store base in existing and additional geographic areas, both organically and through strategic acquisitions. Key elements of our growth strategy are to:

Increase Overall Traffic and Sales Productivity at Our Existing Stores

Over the past year, we have implemented a number of initiatives designed to significantly improve the customer experience at Sally Beauty Supply and BSG in an effort to attract new customers to our stores and improve sales productivity at our existing stores. For example, as part of these initiatives we upgraded key merchandising sections across our U.S. Sally Beauty stores, including by installing an interactive “nail studios” display and a color education center. We have recently reset key merchandising sections across our Sally Beauty stores in the U.S., including the brushes, cutlery and accessories category, in order to improve the visibility of these products. In addition, we have installed new hardwood floors, LED lighting and updated signage at approximately 1,450 of our U.S. Sally Beauty stores. In addition to these physical store improvements, we also focused our marketing efforts on a consistent marketing campaign designed to touch our customer through every medium they engage in and by, among other things, leveraging our CRM programs to more effectively communicate with our customers, including by tailoring our marketing efforts to reach a wider selection of prospective customers and otherwise promoting recognition of the “Sally” brand among consumers. We believe that these initiatives will help drive increased customer traffic to our stores and increase their sales productivity.

In addition to these strategic initiatives, we also plan to grow same store sales by improving our merchandise mix, introducing new products (including third-party brands and exclusive-label products), growing our sales of exclusive-label products and enhancing our customer loyalty programs. To grow sales and increase customer loyalty in Sally Beauty Supply, we intend to continue to develop and introduce exclusive-label products through product innovation, to continue to introduce new third-party products and to promote our wide selection of product offerings at a value. We believe the enhancements to our customer loyalty programs at Sally Beauty Supply and BSG, will allow us to further collect valuable point-of-sale customer data and to increase our understanding of customers’ needs, in an effort to grow sales to existing customers.

Expand Our Store Base

During the past five fiscal years, Sally Beauty Supply and BSG have opened an aggregate of 595 and 157 net new stores, respectively, excluding the effect of acquisitions. Because of the limited initial capital outlay, rapid payback and attractive return on capital, we intend to continue to expand our store base. We believe there are growth opportunities for us to open or acquire additional stores in North America, Europe, and Central and South America. We believe such opportunities are especially strong in Europe, and Central and South America. We expect new store openings in existing and new areas to be an important aspect of our future growth opportunities, and intend to continue our annual organic store growth at approximately 2.0% to 3.0% of our total stores for at least the next few years including, in our Sally Beauty Supply segment, growth in store count of approximately 2.0% in the U.S. and higher growth outside the U.S. Despite the relatively low opening costs, 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, either of which could have a material adverse impact on our financial condition or results of operations. There are several factors that could affect our ability to open and profitably operate new stores, including proximity to existing stores that may reduce the new store's sales or the sales of existing stores.

Grow Internationally

International sales represent approximately 24% of Sally Beauty Supply's net sales and we believe there is a significant opportunity for future growth internationally. As of September 30, 2016, we had 946 Sally Beauty Supply and BSG company-operated stores and supplied 41 franchise stores across 12 countries outside the United States: Canada, Mexico, Chile, Colombia, Peru, the United Kingdom, Ireland, Belgium, France, Germany, the Netherlands and Spain. We believe our platform provides us with the foundation to continue to expand internationally. In particular, we are currently focused on profitably growing our business in Europe and in Central and South America. We are also focused on improving our business in each of our non-U.S. geographies, and have made a series of recent leadership changes in these countries to improve our operating discipline and growth strategy.

Increase Operating Efficiency and Profitability

We believe there are opportunities to increase the profitability of our operations by growing our exclusive-label brands, improving sourcing, shifting customer mix, continuing our cost-cutting initiatives and by further expanding our e-commerce channel. We continue to develop and promote our higher margin exclusive-label products and increase exclusive-label product sales, which we believe will enhance our overall gross margins and operating results. In addition, we have undertaken a full review of our merchandise procurement strategy and continue to focus on our procurement practices. This initiative has helped identify lower-cost alternative sources of supply in certain product categories from countries with lower manufacturing costs. We continue to focus on changing our customer mix by increasing the number of retail customers, as a percentage of total customers, within our stores at Sally Beauty Supply. Sales to retail customers generally result in higher gross margin for us.

We are also focused on growing our online sales. We currently offer approximately 9,500 SKUs of our Sally Beauty Supply products for sale through our website (www.sallybeauty.com) and offer approximately 15,000 SKUs of our BSG products for sale principally through BSG's websites for beauty professionals (www.cosmoprofbeauty.com and www.cosmoprofequipment.com), in addition to approximately 5,000 SKUs of BSG product through our website for retail customers (www.loxabeauty.com). We have upgraded our e-commerce platforms over the past year to transform these platforms from largely transactional-based sites to more content-rich sites to drive traffic to these sites and improve sales from these sites. We believe that electronic commerce, or e-commerce, will help drive improved operating earnings over the long term, as a percentage of net sales, for both business segments since e-commerce generally lacks the incremental operating expenses (including rent and other occupancy expenses, payroll, and certain shipping and

handling expenses) associated with traditional brick-and-mortar stores. Please see “Risk Factors—*Our e-commerce businesses may be unsuccessful or, if successful, may divert sales from our stores.*”

Pursue Strategic Acquisitions and New Territories for Organic Growth

We have completed more than 40 acquisitions during our last 10 full fiscal years. We believe that our experience in identifying attractive acquisition targets, our proven acquisition integration process and our highly scalable infrastructure have created a strong platform for potential future acquisitions. Recent acquisitions have included:

- In the fiscal year 2016, we acquired certain assets and business operations of Peerless Beauty and Barber Supply Company, distributors of professional beauty products with 15 stores located in Utah and Idaho;
- In the fiscal year 2015, we acquired certain assets and the business of a former exclusive distributor of John Paul Mitchell Systems beauty products with sales primarily in Iowa;
- In the fiscal year 2014, we acquired certain assets and business operations of Arctic Beauty, Inc., a professional-only distributor of beauty products operating in the state of Alaska;
- In the fiscal year 2013, we acquired certain assets and business operations of Essential Salon, a professional-only distributor of beauty products operating in the northeastern region of the United States; and
- In the fiscal year 2012, we acquired the Floral Group, a distributor of professional beauty products then with 19 stores located in the Netherlands and certain assets and the business of a former exclusive distributor of John Paul Mitchell Systems beauty products with sales primarily in Ohio and West Virginia.

We intend to continue to identify and evaluate acquisition targets and organic growth opportunities both domestically and internationally, with a focus on expanding our exclusive BSG territories and allowing Sally Beauty Supply to enter new geographic areas, principally outside the U.S. Please see “Risk Factors—*We may not be able to successfully identify acquisition candidates or successfully complete desirable acquisitions.*”

Competition

Although there are a limited number of direct competitors to our business, the beauty industry is highly competitive. In each geographic area in which we operate, we experience competition from domestic and international businesses often with more resources, including mass merchandisers, on-line retailers, drug stores, supermarkets and other chains offering similar or substitute beauty products at comparable prices. Our business also faces competition from department stores, as well as from authorized and unauthorized retailers and internet sites offering professional beauty products. In addition, our business competes with local and regional open-line beauty supply stores and full-service distributors selling directly to salons and salon professionals through both professional distributor sales consultants and outlets open only to salons and salon professionals. Our business also faces increasing competition from certain manufacturers that use their own sales forces to distribute their professional beauty products directly or that align themselves with our competitors. Some of these manufacturers are vertically integrating through the acquisition of distributors and stores. In addition, these manufacturers may acquire additional brands that we currently distribute and attempt to shift these products to their own distribution channels. Please see “Risk Factors—*The beauty products distribution industry is highly competitive and is consolidating*” for additional information about our competition.

Customer Service

We strive to complement our extensive merchandise selection and innovative store design with superior customer service. We actively recruit individuals with cosmetology experience that are not only knowledgeable about the products we sell, but are able to deliver practical beauty advice and solutions to our customers, which we believe strengthens customer loyalty. Additionally, Sally Beauty Supply recruits individuals with retail experience because we believe their general retail knowledge can be leveraged in the beauty supply industry. We believe that employees' knowledge of the products and ability to demonstrate and explain the advantages of the products increases sales and that their prompt, knowledgeable service fosters the confidence and loyalty of customers and differentiates our business from other professional beauty supply distributors.

Most of our stores are staffed with a store manager, and two or three full-time or part-time sales associates. BSG stores are generally also staffed with an assistant manager. The operations of each store are supervised by a district manager, who reports to a territory manager. A significant number of our store managers and assistant store managers are licensed in the cosmetology field. Additionally, in certain geographic areas in the U.S., a significant number of our store personnel, including store managers and assistant store managers, speak Spanish as a second language. We believe that these skills enhance our store personnel's ability to serve our customers.

Relationships with Suppliers

We purchase our merchandise directly from manufacturers through supply contracts and by purchase orders. For the fiscal year 2016, our five largest suppliers, Coty, Inc. (including certain business units formerly owned by The Procter & Gamble Company, or P&G), the Professional Products Division of L'Oreal USA S/D, Inc., or L'Oreal, John Paul Mitchell Systems, Conair Corporation and Shiseido Cosmetics (America) Limited, accounted for approximately 38% of our consolidated merchandise purchases. Products are purchased from these and many other manufacturers on an at-will basis or under contracts which can be terminated without cause upon 90 days' notice or less or expire without express rights of renewal. Such manufacturers could discontinue sales to us at any time or upon short notice. If any of these suppliers discontinued selling or were unable to continue selling to us, there could be a material adverse effect on our business and results of operations.

As is typical in the distribution businesses, relationships with suppliers 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). For example, in 2016, Coty Inc., a leading supplier of fragrances, color cosmetics, and skin and body products, acquired the fragrances, color cosmetics, and hair color divisions of P&G and Coty, Inc. was our largest supplier. In each of the fiscal years 2014 and 2015, P&G was our largest supplier. There can be no assurances as to the impact, if any, that this acquisition will have on our ability to continue to source products from these divisions at current prices and volumes. Changes in our relationships with suppliers occur often, and could positively or negatively impact our net sales and operating earnings. 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.*" However, we believe that we can be successful in mitigating negative effects resulting from unfavorable changes in the relationships between us and our suppliers through, among other things, the development of new or expanded supplier relationships.

Distribution

As of September 30, 2016, we operated mainly through 17 distribution centers, eight of which predominantly serviced Sally Beauty Supply and nine of which predominantly serviced BSG.

Our purchasing and distribution system is designed to minimize the delivered cost of merchandise and maximize the level of merchandise in-stock in stores. This distribution system also allows for monitoring of

delivery times and maintenance of appropriate inventory levels. Product deliveries are typically made to our stores on a weekly basis, primarily in the U.S. and Canada. Each distribution center has a quality control department that monitors products received from suppliers. We utilize proprietary software systems to provide computerized warehouse locator and inventory support.

Information Technology Systems

Our information technology systems are essential to our efforts to process customer sales transactions, manage inventory levels, conduct business with our suppliers and other business partners, and record, summarize and analyze the results of our operations. These systems contain, among other things, material operational, financial and administrative information related to the marketing, distribution and store operations functions of our business. The information contained in our information technology systems, among other things, supports processing of customer payments and automatic replenishment of in-store inventory, and provides support for product purchase decisions. A significant portion of these systems have been developed internally, and as a result our options are limited in seeking third-party assistance with the operation and upgrade of these systems. 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, we are in the process of implementing a standardized enterprise resource planning (“ERP”) system for both our domestic and international operations over the next few years, which will integrate legacy systems and provide enhanced functionality. In addition, we recently implemented a point-of-sale system upgrade in our Sally Beauty Supply operations in the U.S. and have begun to implement a point-of-sale system upgrade in our BSG operations in the U.S. which we believe will provide significant benefits, including enhanced tracking of customer sales and store inventory activity. Further, following the previously disclosed data security incidents, we have taken and are continuing to take actions to further strengthen the security of our information technology systems, including a recent initiative to adopt payment terminals with end-to-end encryption technology in order to enhance the security of our credit card payment systems. We have also taken steps to upgrade our e-commerce platforms and improve the sophistication of our CRM technology. These and any other required upgrades to our information systems and information technology (or new technology), now or in the future, may require significant costs and divert our management’s attention and other resources 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 or security 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 disruption in our information technology systems.*”

In addition, as part of our operations, we receive and maintain information about our customers, employees and other third parties. We have physical, technical and procedural safeguards in place that are designed to protect information and protect against security and data breaches as well as fraudulent transactions and other activities. Despite these safeguards and our other security processes and protections, we have been a victim of cyber-attacks and data security breaches, including breaches that resulted in the unauthorized installation of malware on our information technology systems that may have placed at risk certain payment card data for some transactions. Furthermore, there can be no assurances that we will not suffer another cyber-attack or data security breach in the future and, if we do, whether our physical, technical and procedural safeguards will adequately protect us against such attacks and breaches. Please see “Risk Factors—*Unauthorized access to confidential information and data on our information technology systems and security and data breaches could materially adversely affect our business, financial condition and operating results.*”

Employees

The following table sets forth certain information about the Company's employees:

	Year Ended September 30,		
	2016	2015	2014
Salaried	7,945	7,760	7,820
Hourly	6,465	5,975	5,020
Part-time(a)	15,255	14,595	14,630
Balance at end of period	<u>29,665</u>	<u>28,330</u>	<u>27,470</u>

- (a) Part-time employees enable us to supplement store staffing schedules, particularly in North America.

Certain subsidiaries in Mexico have collective bargaining agreements covering warehouse and store personnel which expire at various times over the next several years. We believe that we have good relationships with our employees worldwide.

Management

For information concerning our directors and executive officers, please see "Directors, Executive Officers and Corporate Governance" in Item 10 of this Annual Report.

Regulation

We are subject to a wide variety of laws and regulations, which historically have not had a material effect on our business. For example, in the U.S., most of the products sold and the content and methods of advertising and marketing utilized are subject to both federal and state regulations administered by a host of federal and state agencies, including, in each case, one or more of the following: the Food and Drug Administration, or FDA, the Federal Trade Commission, or FTC, and the Consumer Products Safety Commission. The transportation and disposal of many of our products are also subject to federal and state regulation. State and local agencies regulate many aspects of our business. In marketplaces outside of the U.S., regulation is also comprehensive and focused upon product labeling and safety issues. Please see "Risk Factors—*We could be adversely affected if we do not comply with current laws and regulations or if we become subject to additional or more stringent laws and regulations.*"

As of September 30, 2016, Sally Beauty Supply supplied 18 and BSG supplied 164 franchised stores located in the U.S., Mexico and certain countries in Europe. As a result of these franchisor-franchisee relationships, we are subject to regulation when offering and selling franchises in the applicable countries. The applicable laws and regulations affect our business practices, as franchisor, in a number of ways, including restrictions placed upon the offering, renewal, termination and disapproval of assignment of franchises. To date, these laws and regulations have not had a material effect upon our operations.

Trademarks and Other Intellectual Property Rights

Our trademarks, certain of which are material to our business, are registered or legally protected in the U.S., Canada and other countries in which we operate. Together with our subsidiaries, we own approximately 215 trademark registrations in the U.S., and approximately 925 trademark registrations outside the U.S. We also rely upon trade secrets and know-how to develop and maintain our competitive position. We protect intellectual property rights through a variety of methods, including reliance upon trademark, patent and trade secret laws and confidentiality agreements with many vendors, employees, consultants and others who have access to our proprietary information. The duration of our trademark

registrations is generally 10 or 15 years, depending on the country in which a mark is registered, and generally the registrations can be renewed. The scope and duration of intellectual property protection varies by jurisdiction and by individual product. Please see “Risk Factors—*If we are unable to protect our intellectual property rights, specifically our trademarks and service marks, our ability to compete could be negatively impacted*” and “*We may have to defend our rights in intellectual property that we use in certain of our products, and we could be found to infringe the intellectual property rights of others, which could be disruptive and expensive to our business.*”

Access to Public Filings

Our Annual Report on Form 10-K, our Quarterly Reports on Form 10-Q and our Current Reports on Form 8-K, and amendments to such reports are available, without charge, on our website, www.sallybeautyholdings.com, as soon as reasonably possible after they are filed electronically with the Securities and Exchange Commission, or SEC, under the Exchange Act. We will provide copies of such reports to any person, without charge, upon written request to our Investor Relations Department at 3001 Colorado Blvd, Denton, TX 76210. The information found on our website shall not be considered to be part of this or any other report filed with or furnished to the SEC.

In addition to our website, you may read and copy public reports we file with or furnish to the SEC at the SEC’s Public Reference Room at 100 F Street, NE, Washington, DC 20549. You may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC maintains an internet site that contains our reports, proxy and information statements, and other information that we file electronically with the SEC at www.sec.gov.

ITEM 1A. RISK FACTORS

The following describes risks that we believe to be material to our business. If any of the following risks or uncertainties actually occurs, our business, financial condition and operating results could be materially and adversely affected. This report also contains forward-looking statements and the following risks could cause our actual results to differ materially from those anticipated in such forward-looking statements.

Risks Relating to Our Business

The beauty products distribution industry is highly competitive and is consolidating.

The beauty products distribution industry is highly fragmented and competitive, and there are few significant barriers to entry into the marketplaces for most of the types of products and services we sell. 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, on-line retailers, drug stores and supermarkets. BSG competes with other domestic and international beauty product wholesale and retail suppliers and with manufacturers selling professional beauty products directly to salons and individual salon professionals. We also face competition from authorized and unauthorized retailers as well as e-commerce retailers offering professional salon-only and other products. The availability of diverted professional salon products in unauthorized large format retail stores such as drug stores, grocery stores and others could also have a negative impact on our business. The primary competitive factors in the beauty products distribution industry are the price at which we purchase branded and exclusive-label products from manufacturers and the price at which we resell them to our customers, the quality, perceived value, consumer brand name recognition, packaging and mix of the products we sell, customer service, the efficiency of our distribution network, and the availability of desirable store locations. Competitive conditions may limit our ability to maintain prices or may require us to reduce prices in efforts to retain business or channel share. Some of our competitors have greater financial and other resources than we do and are less leveraged than our business, and may therefore be able to spend more aggressively on advertising and promotional activities and respond more

effectively to changing business and economic conditions. We expect existing competitors, business partners and new entrants to the beauty products distribution industry to constantly revise or improve their business models in response to challenges from competing businesses, including ours. If these competitors introduce changes or developments that we cannot address in a timely or cost-effective manner, our business may be adversely affected.

In addition, our industry is consolidating, which may give our competitors increased negotiating leverage with suppliers and greater marketing resources, resulting in a more effective ability to compete with us. For instance, we may lose customers if those competitors which have broad geographic reach attract additional salons (individual and chain) that are currently BSG customers, or if professional beauty supply manufacturers align themselves with our competitors. For example, one of BSG's largest suppliers, L'Oreal, has been able to shift a material amount of revenue out of the BSG nationwide distribution network and into its own regional distribution networks that compete with us. L'Oreal directly competes with BSG and there can be no assurance that there will not be further revenue losses over time at BSG, due to potential losses of additional L'Oreal related products as well as from the increased competition from L'Oreal-affiliated distribution networks. If L'Oreal (or another direct competitor) were to acquire or otherwise merge with another manufacturer which conducts business with BSG, and L'Oreal (or such other direct competitor) decided to distribute products from that manufacturer using its own distribution network, we could lose revenue from the sale of these products as well. Not only does consolidation in distribution pose risks from competing distributors, but it may also place more leverage in the hands of those manufacturers, resulting in smaller margins on products sold through our network.

If we are unable to compete effectively in our marketplace or if competitors divert our customers away from our networks, it would adversely impact our business, financial condition and results of operations.

We may be unable to anticipate and effectively respond to changes in consumer preferences and buying trends in a timely manner.

Our success depends in part on our ability to anticipate, gauge and react in a timely manner to changes in consumer spending patterns and preferences for specific beauty products. If we do not timely identify and properly respond to evolving trends and changing consumer demands for beauty products in the geographies in which we compete, our sales may decline significantly. Furthermore, we may accumulate additional inventory and be required to mark down unsold inventory to prices that are significantly lower than normal prices, which would adversely impact our margins and could further adversely impact our business, financial condition and results of operations. Additionally, approximately 46% of our Sally Beauty Supply product sales come from our exclusive-label brands. The development and promotion of these exclusive-label brands and products often occur well before these products are sold in our stores. As a result, the success of these exclusive-label brands and products is largely dependent on our ability to develop brands and products that meet future consumer preferences at prices that are acceptable to our customers. Furthermore, we may have to spend a significant amount on the advertising and marketing of our exclusive-label brands to drive customer awareness of these brands. There can be no assurance that any new exclusive-label brand or product will meet consumer preferences, gain acceptance among our customer base or generate sales to become profitable or to cover the costs of its development and promotion, which would also adversely impact our margins and could adversely impact our business, financial condition and results of operations.

In addition, we depend on our inventory management and information technology systems in order to replenish inventories and deliver products to store locations in response to customer demands. Any systems-related problems could result in difficulties satisfying the demands of customers which, in turn, could adversely affect our sales and profitability. In addition, our failure to manage inventory levels appropriately during any period could adversely affect our results of operations and profitability. We also rely on vendor relationships to provide us with access to the latest beauty products that meet the changing demands of our customers. If we are unable to maintain these relationships, our ability to meet these

demands will be impaired. Please see below “—*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.*”

We expect continuously changing fashion-related trends and consumer tastes to influence future demand for beauty products. Changes in consumer tastes and fashion trends can have an impact on our financial performance. If we are unable to anticipate and respond to trends in the marketplace for beauty products and changing consumer demands, our business could suffer.

Our future success depends in part on our ability to successfully implement our strategic initiatives to improve the customer experience, attract new customers and improve the sales productivity of our stores.

In fiscal year 2015, we began the implementation of a number of strategic initiatives designed to improve the customer experience at Sally Beauty Supply and BSG in an effort to attract new customers to our stores, improve sales productivity at our existing stores and effectively compete with our competitors. As part of these initiatives, we have refreshed approximately 1,450 of our Sally Beauty stores in the U.S. by upgrading the “look and feel” of our stores and upgrading key merchandising sections across all our Sally Beauty stores, including the installation of interactive “nail studios” and “eyelash and brow studios,” a hair color education center and improvements to the check-out areas of our stores. We intend to continue these physical improvements in our stores in the fiscal year 2017. In addition to these physical store improvements, we also focused our marketing efforts on a consistent marketing campaign designed to touch our customer through every medium they engage in and by leveraging our CRM programs to more effectively communicate with our customers. There can be no assurance that these strategic initiatives will attract new customers to our stores or improve sales productivity at our existing stores. Furthermore, we are investing significant resources in these initiatives and the costs of the initiatives may outweigh their benefits. If these strategic initiatives are not successful, our same store sales will suffer and our growth prospects, financial results, profitability and cash flows will also be adversely impacted.

We are not certain that our ongoing cost control plans will continue to be successful.

Our ability to grow profitably depends in large part on our ability to successfully control or reduce our operating expenses. In furtherance of this strategy, we have engaged in ongoing activities to reduce or control costs, some of which are complicated and require us to expend significant resources to implement. Despite these cost control plans, we anticipate that our labor and rental costs will continue to increase for the foreseeable future as we compete for talent and attractive retail locations with other retailers. Furthermore, we have also made significant investments in our strategic initiatives, including our store refresh initiatives and various marketing initiatives, which have resulted in cost increases in recent periods. While we expect these costs to diminish in future periods, such costs may continue at elevated levels for future periods. We cannot assure you that our strategic initiatives and cost control efforts will result in the increased profitability, cost savings or other benefits that we expect, which could have a material adverse effect on our business, financial condition and results of operations.

Our comparable store sales and quarterly financial performance may fluctuate for a variety of reasons.

Our comparable store sales, which we refer to as same store sales, and quarterly results of operations have fluctuated in the past and we expect them to continue to fluctuate in the future. A variety of factors affect our comparable store sales and quarterly financial performance, including:

- the success of our strategic initiatives to improve the customer experience at our existing stores and attract new customers to our stores;
- changes in our merchandising strategy or mix;
- the performance of our new stores;
- our ability to increase sales and meet forecasted levels of profitability at our existing stores;

- our ability to anticipate and effectively respond to changing consumer preferences and buying trends in the geographies that our stores serve;
- the effectiveness of our inventory management processes and systems;
- the timing and concentration of new store openings, including additional human resource requirements and related pre-opening and other start-up costs;
- costs and disruptions associated with our store refresh program;
- the effect of our integration of acquired businesses and stores over time;
- the varying cost and profitability of new stores opened in the U.S. and in other countries;
- a portion of a typical new store's sales (or sales we make over our e-commerce channels) coming from customers who previously shopped at other existing stores;
- expenditures on our distribution system;
- the timing and effectiveness of our marketing activities, particularly our ability to drive new retail traffic into our stores and our Sally Beauty Club and ProCard promotions at an acceptable cost;
- seasonal fluctuations due to weather conditions;
- our e-commerce channels diverting sales from our stores;
- actions by our existing or new competitors;
- fluctuations over time in the cost to us of products we sell; and
- worldwide economic conditions and, in particular, the retail sales environment in the U.S.

Accordingly, our results for any one fiscal quarter are not necessarily indicative of the results to be expected for any other quarter, and comparable store sales for any particular future period may not continue to increase at the same rates as we have recently experienced and may even decrease, which could have a material adverse effect on our business, financial condition and results of operations.

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.

We do not manufacture any products we sell, and instead purchase our products from recognized brand manufacturers and private label fillers. We depend on a limited number of manufacturers for a significant percentage of the products we sell. During the fiscal year 2016, our five largest suppliers were Coty, Inc. (including certain business units formerly owned by The Procter & Gamble Company, or P&G), the Professional Products Division of L'Oreal USA S/D, Inc., or L'Oreal, John Paul Mitchell Systems, Conair Corporation, and Shiseido Cosmetics (America) Limited and accounted for approximately 38% of our consolidated merchandise purchases. In addition, three of those suppliers represented approximately 37% of BSG's merchandise purchases during the fiscal year 2016. In the fiscal year 2015, BSG reached agreement with one of those suppliers, L'Oreal, to extend the right of BSG to distribute Matrix® and certain other L'Oreal products in the U.S., subject to certain conditions, through December 2018. In 2016, Coty Inc., a leading supplier of fragrances, color cosmetics, and skin and body products acquired the fragrances, color cosmetics, and hair color divisions of P&G and Coty, Inc was our largest supplier. In each of the fiscal years 2014 and 2015, P&G was our largest supplier. There can be no assurances as to the impact, if any, that Coty's acquisition of the fragrances, color cosmetics, and hair color divisions of P&G will have on our ability to continue to source products from these divisions at current prices and volumes.

Since we purchase products from many manufacturers and fillers under at-will contracts and contracts which can be terminated without cause upon 90 days' notice or less, or which expire without express rights of renewal, manufacturers and fillers could discontinue sales to us immediately or upon short notice. Some

of our contracts with manufacturers may be terminated if we fail to meet specified minimum purchase requirements. If minimum purchase requirements are not met, we do not have contractual assurances of continued supply. In lieu of termination, a manufacturer may also change the terms upon which it sells, for example, by raising prices or broadening distribution to third parties. Infrequently, a supplier will seek to terminate a distribution relationship through legal action. For these and other reasons, we may not be able to acquire desired merchandise in sufficient quantities or on acceptable terms in the future.

Changes in Sally Beauty Supply's and BSG's relationships with suppliers occur often, and could positively or negatively impact the net sales and operating earnings of both business segments. Some of our suppliers may seek to decrease their reliance on distribution intermediaries, including full-service/exclusive and open-line distributors like BSG and Sally Beauty Supply, by promoting their own distribution channels, as discussed above. These suppliers may offer advantages, such as lower prices, when their products are purchased from distribution channels they control. If our access to supplier-provided products were to diminish relative to our competitors or we were not able to purchase products at the same prices as our competitors, our business could be materially and adversely affected. Also, consolidation among suppliers may increase their negotiating leverage, thereby providing them with competitive advantages that may increase our costs and reduce our revenues, adversely affecting our business, financial condition and results of operations. Therefore, there can be no assurance that the impact of these developments, if they were to occur, will not adversely impact revenue to a greater degree than we currently expect or that our efforts to mitigate the impact of these developments will be successful. If the impact of these developments is greater than we expect or our efforts to mitigate the impact of these developments are not successful, this could have a material adverse effect on our business, financial condition or results of operations.

Although we plan to mitigate the negative effects resulting from potential unfavorable changes in our relationships with suppliers, there can be no assurance that our efforts will partially or completely offset the loss of these distribution rights.

Any significant interruption in the supply of products by manufacturers and fillers could disrupt our ability to deliver merchandise to our stores and customers in a timely manner, which could have a material adverse effect on our business, financial condition and results of operations.

Manufacturers and exclusive-label fillers of beauty supply products are subject to certain risks that could adversely impact their ability to provide us with their products on a timely basis, including inability to procure ingredients, industrial accidents, environmental events, strikes and other labor disputes, union organizing activity, disruptions in logistics or information systems, loss or impairment of key manufacturing sites, product quality control, safety, licensing requirements and other regulatory issues, as well as natural disasters and other external factors over which neither they nor we have control. In addition, we directly source many of our exclusive-label products, including, but not limited to, styling tools, salon equipment, sundries and other promotional products, from foreign third-party manufacturers and many of our vendors also use overseas sourcing to manufacture some or all of their products. Any event causing a sudden disruption of manufacturing or imports from such foreign countries, including the imposition of additional or increased import restrictions, duties or tariffs, political instability, labor disputes, local business practices, legal or economic restrictions on overseas suppliers' ability to produce and deliver products or acts of war or terrorism, could materially harm our operations to the extent they affect the production, shipment or receipt of merchandise. Our operating results depend to some extent on the orderly operation of our receiving and distribution processes, which depend on manufacturers' adherence to shipping schedules and our effective management of our distribution facilities and capacity.

If a material interruption of supply occurs, or a significant manufacturer or filler ceases to supply us or materially decreases its supply to us, we may not be able to acquire products with similar quality and consumer brand name recognition as the products we currently sell or to acquire such products in sufficient quantities to meet our customers' demands or on favorable terms to our business, any of which could adversely impact our business, financial condition and results of operations.

Fluctuations in the price, availability and quality of inventory may result in higher cost of goods, which we may not be able to pass on to the customers.

Our suppliers are increasingly passing on higher production costs, which may impact our ability to maintain or grow our margins. The price and availability of raw materials may be impacted by demand, regulation, weather and other factors. Additionally, manufacturers have and may continue to have increases in other manufacturing costs, such as transportation, labor and benefit costs. These increases in production costs result in higher merchandise costs to us. We may not always be able to pass on those cost increases to our customers, which could have a material adverse effect on our results of operations and financial condition.

If products sold by us are found to be defective in labeling or content, our credibility and that of the brands we sell may be harmed, marketplace acceptance of our products may decrease, and we may be exposed to liability in excess of our products liability insurance coverage and manufacturer indemnities.

We do not control the production process for the products we sell. We may not be able to identify a defect in a product we purchase from a manufacturer or exclusive-label filler before we offer such product for resale. In many cases, we rely on representations of manufacturers and fillers about the products we purchase for resale regarding the composition, manufacture and safety of the products, as well as the compliance of our product labels with government regulations. Our sale of certain products exposes us to potential product liability claims, recalls or other regulatory or enforcement actions initiated by federal, state or foreign regulatory authorities or through private causes of action. Such claims, recalls or actions could be based on allegations that, among other things, the products sold by us are misbranded, contain contaminants or impermissible ingredients, provide inadequate instructions regarding their use or misuse, or include inadequate warnings concerning flammability or interactions with other substances. Claims against us could also arise as a result of the misuse by purchasers of such products or as a result of their use in a manner different than the intended use. We may be required to pay for losses or injuries actually or allegedly caused by the products we sell and to recall any product we sell that is alleged to be or is found to be defective.

Any actual defects or allegations of defects in products sold by us could result in adverse publicity and harm our credibility or the credibility of the manufacturer, which could adversely affect our business, financial condition and results of operations. Although we may have indemnification rights against the manufacturers of many of the products we distribute and rights as an “additional insured” under the manufacturers’ insurance policies, it is not certain that any manufacturer or insurer will be financially solvent and capable of making payment to any party suffering loss or injury caused by products sold by us. Further, some types of actions and penalties, including many actions or penalties imposed by governmental agencies and punitive damages awards, may not be remediable through reliance on indemnity agreements or insurance. Furthermore, potential product liability claims may exceed the amount of indemnity or insurance coverage or be excluded under the terms of an indemnity agreement or insurance policy and claims for indemnity or reimbursement by us may require us to expend significant resources and may take years to resolve. If we are forced to expend significant resources and time to resolve such claims or to pay material amounts to satisfy such claims, it could have an adverse effect on our business, financial condition and results of operations.

We could be adversely affected if we do not comply with current laws and regulations or if we become subject to additional or more stringent laws and regulations.

We are subject to a number of federal, state and local laws and regulations in the U.S., as well as applicable laws and regulations in each foreign marketplace in which we do business. These laws and regulations govern the composition, packaging, labeling and safety of the products we sell, as well as the methods we use to sell and import these products. Non-compliance with applicable laws and regulations of governmental authorities, including the FDA and similar authorities in other jurisdictions, by us or the manufacturers and fillers of the products sold by us could result in fines, product recalls and enforcement actions, and otherwise restrict our ability to market certain products, which could adversely affect our business, financial condition and results of operations.

In addition, the laws and regulations applicable to us or manufacturers of the products sold by us may become more stringent. For example, the State of California, where we operate a number of stores, currently enforces legislation commonly referred to as “Proposition 65” that requires that “clear and reasonable” warnings be given to consumers who are exposed to chemicals known to the State of California to cause cancer or reproductive toxicity. Although we have sought to comply with Proposition 65 requirements, there can be no assurance that we will not be adversely affected by litigation or other actions relating to Proposition 65 or future legislation that is similar or related thereto. Continued legal compliance with new and existing regulations, such as Proposition 65 and other federal or state-level safe consumer product regulations, could require the review and possible reformulation or relabeling of certain products, as well as the possible removal of some products from the marketplace. Failure to comply with these new and existing regulations could result in significant fines or damages, in addition to costs and expenses to defend claims related thereto. Legal compliance could also lead to considerably higher internal regulatory costs. Manufacturers may try to recover some or all of any increased costs of compliance by increasing the prices at which we purchase products, and we may not be able to recover some or all of such increased cost in our own prices to our customers. We are also subject to state and local laws and regulations that affect our franchisor-franchisee relationships. Increased compliance costs and the loss of sales of certain products due to more stringent or new laws and regulations could adversely affect our business, financial condition and results of operations.

Laws and regulations impact our business in many areas that have no direct relation to the products we sell. For example, as a public company, we are subject to a number of laws and regulations related to the disclosure of financial and other information about us, as well as the issuance and sale of our securities. Another area of intense regulation is that of the relationships we have with our employees, including, for example, compliance with many different wage and hour and nondiscrimination related regulatory schemes and, in the U.S., compliance with the 2010 Patient Protection and Affordable Care Act. Violation of any of the laws or regulations governing our business or the assertion of individual or class-wide claims could have an adverse effect on our business, financial condition and results of operations.

Our e-commerce businesses may be unsuccessful or, if successful, may divert sales from our stores.

We offer many of our beauty products for sale through our websites in the U.S. (such as www.sallybeauty.com, www.cosmoprofbeauty.com, www.cosmoprofequipment.com and www.loxabeauty.com) and abroad. As a result, we encounter risks and difficulties frequently experienced by internet-based businesses, including risks related to our ability to attract and retain customers on a cost-effective basis and our ability to operate, support, expand and develop our e-commerce operations, websites and software and other related operational systems. Although we believe that our participation in both e-commerce and physical store sales is a distinct advantage for us due to synergies and the potential for new customers, supporting product offerings through both of these channels could create issues that have the potential to adversely affect our results of operations. For example, if our e-commerce businesses successfully grow, they may do so in part by attracting existing customers, rather than new customers, who choose to purchase products from us online rather than from our physical stores, thereby reducing the financial performance of our stores. In addition, offering different products through each channel could cause conflicts and cause some of our current or potential internet customers to consider competing distributors of beauty products. In addition, offering products through our e-commerce channels (particularly directly to consumers through our professional business) could cause some of our current or potential vendors to consider competing internet offerings of their products either directly or through competing distributors. As we continue to grow our e-commerce businesses, the impact of attracting existing rather than new customers, of conflicts between product offerings online and through our stores, and of opening up our channels to increased internet competition could have a material adverse impact on our business, financial condition and results of operations, including future growth and same store sales. Furthermore, our recent initiatives to upgrade our e-commerce platforms may not be successful in driving traffic to our websites and increasing our online sales in the long term, which could adversely impact our net sales.

Diversion of professional products sold by BSG could have an adverse impact on our revenues.

The majority of the products that BSG sells, including those sold by our Armstrong McCall franchisees, are meant to be used exclusively by salons and individual salon professionals or sold exclusively to their retail consumers. However, despite our efforts to prevent diversion, incidents of product diversion occur, whereby our products are sold by these purchasers (and possibly by other bulk purchasers such as franchisees) to wholesalers and ultimately to general merchandise retailers, among others. These retailers, in turn, sell such products to consumers. The diverted product may be old, tainted or damaged and sold through unapproved outlets, all of which could diminish the value of the particular brand. In addition, such diversion may result in lower net sales for BSG should consumers choose to purchase diverted products from retailers rather than purchasing from our customers, or choose other products altogether because of the perceived loss of brand prestige.

In the BSG arena, product diversion is generally prohibited under our manufacturers' contracts, and we are often under a contractual obligation to stop selling to salons, salon professionals and other bulk purchasers which engage in product diversion. If we fail to comply with our anti-diversion obligations under these manufacturers' contracts, including any known diversion of products sold through our Armstrong McCall franchisees, these contracts could be adversely affected or even terminated. In addition, our investigation and enforcement of our anti-diversion obligations may result in reduced sales to our customer base, thereby decreasing our revenues and profitability.

BSG's financial results are affected by the financial results of BSG's franchised-based business (Armstrong McCall).

BSG receives revenue from its sale of products to Armstrong McCall franchisees. Accordingly, a portion of BSG's financial results is to an extent dependent upon the operational and financial success of these franchisees, including their implementation of BSG's strategic plans. If sales trends or economic conditions worsen for Armstrong McCall's franchisees, their financial results may worsen. Additionally, the failure of Armstrong McCall franchisees to renew their franchise agreements, any requirement that Armstrong McCall restructure its franchise agreements in connection with such renewals, or any failure of Armstrong McCall to meet its obligations under its franchise agreements, could result in decreased revenues for BSG or create legal issues with our franchisees or with manufacturers.

We may not be able to successfully identify acquisition candidates or successfully complete desirable acquisitions.

In the past several years, we have completed multiple acquisitions and we intend to pursue additional acquisitions in the future. We actively review acquisition prospects that we believe would complement our existing lines of business, increase the size and geographic scope of our operations or otherwise offer profitable growth and operating efficiency opportunities. There can be no assurance that we will continue to identify suitable acquisition candidates.

If suitable candidates are identified, we may be unable to reach agreeable acquisition terms with such candidates or may not have access to sufficient funds to fund such acquisitions. We compete against many other companies, some of which are larger and have greater financial and other resources than we do. Increased competition for acquisition candidates could result in fewer acquisition opportunities and higher acquisition prices. In addition, we are highly leveraged and the agreements governing our indebtedness contain limits on our ability to incur additional debt to pay for acquisitions. We may be unable to finance acquisitions that would increase our growth or improve our financial and competitive position. To the extent that debt financing is available to finance acquisitions, our net indebtedness could increase as a result of any acquisitions. Internationally, regulatory requirements, trade barriers and due diligence difficulties, among other considerations, make acquiring suitable foreign candidates more difficult, time-consuming and expensive. See below “– Our ability to conduct business in international marketplaces may be affected by legal, regulatory and economic risks.”

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.

Any acquisitions that we do make may be difficult to integrate profitably into our business and may entail numerous risks, including:

- difficulties in assimilating acquired operations, stores or products, including the loss of key employees from acquired businesses;
- difficulties and costs associated with integrating and evaluating the distribution or information systems and/or internal control systems of acquired businesses;
- difficulties in competing with existing stores or business or diverting sales from our existing stores or business;
- expenses associated with the amortization of identifiable intangible assets;
- problems retaining key technical, operational and administrative personnel;
- diversion of management's attention from our core business, including loss of management focus on marketplace developments;
- complying with foreign regulatory requirements, including multi-jurisdictional competition rules and restrictions on trade/imports;
- enforcement of intellectual property rights in foreign countries;
- adverse effects on existing business relationships with suppliers and customers, including the potential loss of suppliers of the acquired businesses;
- operating inefficiencies and negative impact on profitability;
- entering geographic areas or channels in which we have limited or no prior experience; and
- those related to general economic and political conditions, including legal and other barriers to cross-border investment in general, or by U.S. companies in particular.

In addition, during the acquisition process, we may fail or be unable to discover some of the liabilities of businesses that we acquire. These liabilities may result from a prior owner's noncompliance with applicable laws and regulations. Acquired businesses may also not perform as we expect or we may not be able to obtain the expected financial improvements in the acquired businesses.

If we are unable to profitably open and operate new stores, our business, financial condition and results of operations may be adversely affected.

Our future growth strategy depends in part on our ability to open and profitably operate new stores in existing and additional geographic areas and, more specifically, in international geographies as international growth becomes an increasing driver of our future growth. While the capital requirements to open a Sally Beauty Supply or BSG store, excluding inventory, vary from geography to geography, such capital requirements have historically been relatively low in the U.S. and Canada. Despite these relatively low opening costs, 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, either of which could have a material adverse impact on our financial condition or results of operations. There are several factors that could affect our ability to open and profitably operate new stores, including:

- the inability to identify and acquire suitable sites or to negotiate acceptable leases for such sites;
- proximity to existing stores that may reduce the new store's sales or the sales of existing stores;

- difficulties in adapting our distribution and other operational and management systems to an expanded network of stores;
- the level of sales made through our e-commerce channels and the potential that sales through our e-commerce channels will divert sales from our stores;
- the potential inability to obtain adequate financing to fund expansion because of our high leverage and limitations on our ability to issue equity under our credit agreements, among other things;
- increased (and sometimes unanticipated) costs associated with opening stores in international locations;
- difficulties in obtaining any governmental and third-party consents, permits and licenses;
- limitations on capital expenditures which may be included in financing documents that we enter into; and
- difficulties in adapting existing operational and management systems to the requirements of national or regional laws and local ordinances.

In addition, as we continue to open new stores, our management, as well as our financial, distribution and information systems, and other resources will be subject to greater demands. If our personnel and systems are unable to successfully manage this increased burden, our results of operations may be materially affected.

Our ability to conduct business outside the United States may be affected by legal, regulatory and economic risks.

Our ability to enter and capitalize on growth in new international marketplaces and to grow or maintain our current level of operations in our existing international marketplaces is subject to risks associated with our international operations. These risks include: the increased cost of real estate in mall locations in South America, unexpected changes in regulatory requirements, trade barriers to some international marketplaces, economic and foreign currency fluctuations, potential difficulties in enforcing contracts, difficulty in identifying manufacturers or sourcing quality products, increasing levels of violence or terrorism, an inability to properly protect assets (including intellectual property), an inability to collect receivables, potential tax liabilities associated with repatriating funds from foreign operations and difficulties and costs of staffing, managing and accounting for foreign operations.

The potential impact of Britain's recent vote to leave the European Union and any related or other disruptive events affecting the European Union or other geographies in which we conduct business

Our results of operations may be materially affected by any adverse impact resulting from Britain's recent vote to leave the European Union (commonly referred to as "Brexit"). The Brexit vote may result in increased uncertainty throughout the region and could adversely affect business activity, political stability and economic conditions throughout Europe. The uncertainty concerning the timing and terms of the exit could also have a negative impact on future growth for the UK and/or other European economies and cause further strengthening of the U.S. dollar against foreign currencies in which we conduct business. The strengthening of the U.S. dollar relative to the British pound and euro may adversely affect our results of operations as we translate sales and other results denominated in foreign currency into U.S. dollars for our financial statements. During periods of strengthening dollar, our reported international sales and earnings could be reduced because foreign currencies may translate into fewer U.S. dollars.

The health of the economy in the geographies we serve 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.

Our results of operations may be materially affected by conditions in the global capital markets and the economy generally, both in the U.S. and internationally. Concerns over inflation, employment, tax laws, energy costs, geopolitical issues, terrorism, the availability and cost of credit, the mortgage market, sovereign and private banking systems, sovereign deficits and increasing debt burdens and the real estate and other financial markets in the U.S. and Europe have contributed to increased volatility and diminished expectations for the U.S. and certain foreign economies. We appeal to a wide demographic consumer profile and offer an extensive selection of beauty products sold directly to retail consumers and salons and salon professionals. Continued uncertainty in the economy could adversely impact consumer purchases of discretionary items such as beauty products, as well as adversely impact the frequency of salon services performed by professionals using products purchased from us. Factors that could affect consumers' willingness to make such discretionary purchases include: general business conditions, levels of employment, interest rates, tax rates, the availability of consumer credit and consumer confidence in future economic conditions. In the event of a prolonged economic downturn or acute recession, consumer spending habits could be adversely affected and we could experience lower than expected net sales. The economic climate could also adversely affect our vendors. The occurrence of any of these events could have a material adverse effect on our business, financial condition and results of operations.

Our net sales depend on a volume of traffic to our stores, and a reduction in traffic to, or the closing of, the other destination retailers in the shopping areas where our stores are located could significantly reduce our sales and leave us with excess inventory, which could have a material adverse effect on our business, financial condition, profitability and cash flows.

Most of our stores are located in strip malls, which are occupied by other high traffic retailers including grocery stores, mass merchants and home centers. Sales at these stores are derived, in part, from the volume of traffic generated by the other destination retailers and the anchor stores in these shopping areas where our stores are located. Customer traffic to these shopping areas may be adversely affected by the closing of such destination retailers or anchor stores, or by a reduction in traffic to such stores resulting from a regional or global economic downturn, a general downturn in the local area where our store is located, or a decline in the desirability of the shopping environment of a particular strip mall. Such a reduction in customer traffic would reduce our sales and leave us with excess inventory, which could have a material adverse effect on our business, financial condition and results of operations. We may respond by increasing markdowns, initiating marketing promotions, or transferring product to other stores to reduce excess inventory, which would further decrease our gross profits and net income.

If we are unable to protect our intellectual property rights, specifically our trademarks and service marks, our ability to compete could be negatively impacted.

The success of our business depends to a certain extent upon the value associated with our intellectual property rights. We own certain trademark and service mark rights used in connection with our business including, but not limited to, "Sally," "Sally Beauty," "Sally Beauty Supply," "Sally Beauty Club Card," "BSG," "CosmoProf," "Proclub," "Armstrong McCall," "ion," "Beyond the Zone" and "Salon Services." We protect our intellectual property rights through a variety of methods, including, but not limited to, applying for and obtaining trademark protection in the U.S., Canada and other countries throughout the world in which our business operates. We also rely on trade secret laws, in addition to confidentiality agreements with vendors, employees, consultants and others who have access to our proprietary information. While we intend to vigorously protect our trademarks against infringement, we may not be successful. In addition, the laws of certain foreign countries may not protect our intellectual property rights

to the same extent as the laws of the U.S. The costs required to protect our intellectual property rights and trademarks are expected to continue to be substantial.

We may have to defend our rights in intellectual property that we use in certain of our products, and we could be found to infringe the intellectual property rights of others, which could be disruptive and expensive to our business.

The industry in which we operate is characterized by the need for a large number of copyrights, trade secrets and trademarks and by frequent litigation based on allegations of infringement or other violations of intellectual property rights. A third party may at any time assert that our products violate such party's intellectual property rights. Successful intellectual property claims against us could result in significant financial liabilities and/or prevent us from selling certain of our products. In addition, the resolution of infringement claims may require us to redesign our products, to obtain licenses to use intellectual property belonging to third parties, which may not be attainable on reasonable terms, or to cease using the intellectual property altogether. Moreover, any intellectual property claim, regardless of its merits, could be expensive and time-consuming to defend against and could divert the attention of management. As a result, claims based on allegations of infringement or other violations of intellectual property rights, regardless of outcome, could have a material adverse effect on our business, financial condition and results of operations.

We may be adversely affected by any disruption in our information technology systems.

Our operations are dependent upon our information technology systems, which encompass all of our major business functions. We rely upon such information technology systems to manage and replenish inventory, to fill and ship customer orders on a timely basis, to coordinate our sales activities across all of our products and services, to coordinate our administrative activities and to protect confidential information that we receive and maintain about our customers, employees and other third parties. A substantial disruption in our information technology systems for any prolonged time period (arising from, for example, system capacity limits from unexpected increases in our volume of business, outages or delays in our service) could result in delays in receiving inventory and supplies or filling customer orders and adversely affect our customer service and relationships. Our systems might be damaged or interrupted by natural or man-made events (caused by us, by our service providers or others) or by computer viruses, physical or electronic break-ins and similar disruptions affecting the internet. Such delays, problems or costs may have a material adverse effect on our business, financial condition and results of operations.

As our operations grow in both size and scope, we continuously need to improve and upgrade our systems and infrastructure while maintaining their reliability and integrity. The expansion of our systems and infrastructure will require us to commit substantial financial, operational and technical resources before the volume of our business increases, with no assurance that the volume of business will increase. For example, we are in the process of implementing a standardized ERP system for both our domestic and international operations over the next few years. Our domestic ERP system implementation is designed to integrate legacy systems and to provide enhanced functionality throughout our enterprise functions, including finance and accounting, supply chain and distribution, merchandising, human resources and payroll. In addition, we are currently implementing new point-of-sale systems in a number of our divisions, which we anticipate will provide significant benefits, including enhanced tracking of customer sales. The development and implementation of the new ERP and point-of-sale systems and any other future upgrades to our systems and information technology may require significant costs and divert our management's attention and other resources from our core business. There are also no assurances that these new systems and upgrades will provide us with the anticipated benefits and efficiencies. Many of our systems are proprietary, and as a result our options are limited in seeking third-party help with the operation and upgrade of those systems. There can be no assurance that the time and resources our management will need to devote to operations and upgrades, any delays due to the installation of any upgrade (and customer issues therewith), any resulting service outages, or the impact on the reliability of our data from

any upgrade or any legacy system, will not have a material adverse effect on our business, financial condition or results of operations.

Unauthorized access to confidential information and data on our information technology systems and security and data breaches could materially adversely affect our business, financial condition and operating results.

As part of our operations, we receive and maintain information about our customers, employees and other third parties. We have physical, technical and procedural safeguards in place that are designed to protect information and protect against security and data breaches as well as fraudulent transactions and other activities. Despite these safeguards and our other security processes and protections, we cannot be assured that all of our systems and processes are free from vulnerability to security breaches (through cyber-attacks, which are evolving and becoming increasingly sophisticated, physical breach or other means) or inadvertent data disclosure by third parties or us. A significant data security breach, including misappropriation of our customers' or employees' confidential information, could result in significant costs to us, which may include, among others, potential liabilities to payment card networks for reimbursements of credit card fraud and card reissuance costs, including fines and penalties, potential liabilities from governmental or third party investigations, proceedings or litigation, legal, forensic and consulting fees and expenses, costs and diversion of management attention required for investigation and remediation actions, and the negative impact on our reputation and loss of confidence of our customers, suppliers and others, any of which could have a material adverse impact on our business, financial condition and operating results.

In response to the data security incidents, we have taken and are continuing to take actions to further strengthen the security of our information technology systems, including a recent initiative to adopt payment terminals with end-to-end encryption technology in order to enhance the security of our credit card payment systems. Nevertheless, there can be no assurance that our security upgrades will be effective, that we will not suffer a similar criminal attack in the future, that unauthorized parties will not gain access to confidential information, or that any such incident will be discovered promptly. In particular, we understand that the techniques used by criminals to obtain unauthorized access to sensitive data change frequently and often are not recognized until launched against a target; accordingly, we may be unable to anticipate these techniques or implement adequate preventative measures. The failure to promptly detect, determine the extent of and appropriately respond to a significant data security breach could have a material adverse impact on our business, financial condition and operating results.

We have experienced data security incidents and are not yet able to determine the full extent or scope of the potential liabilities relating to these data security incidents.

In the fiscal year ended September 30, 2014, we disclosed that we had experienced a data security incident (the "2014 data security incident"). In the fiscal year ended September 30, 2015, we disclosed that we had experienced a second data security incident (the "2015 data security incident" and together with the 2014 data security incident, the "data security incidents"). The data security incidents involved the unauthorized installation of malicious software (malware) on our information technology systems, including our point-of-sale systems that, we believe may have placed at risk certain payment card data for some transactions. The costs that the Company has incurred to date in connection with the data security incidents include assessments from payment card networks, professional advisory fees, legal costs and expenses relating to investigating and remediating the data security incidents. We may have also suffered reputational harm due to multiple data security incidents and may incur additional costs and expenses related to the data security incidents in the future. As detailed above, these costs may result from potential additional liabilities to payment card networks, governmental or third party investigations, proceedings or litigation, legal and other fees necessary to defend against any potential liabilities or claims, and further investigatory and remediation costs. We are unable at this time to determine the probability of or to reasonably estimate the magnitude of these potential liabilities. The potential liabilities or other remedies

against us related to the data security incidents may have a material adverse impact on our business, financial condition and operating results.

If we fail to attract and retain highly skilled management and other personnel, our business, financial condition and results of operations may be harmed.

Our success has depended, and will continue to depend, in large part on our ability to attract and retain senior executives, who possess extensive knowledge, experience and managerial skill applicable to our business. In February 2015, Christian A. Brickman was appointed the Company's President and Chief Executive Officer (CEO) pursuant to an executive management transition plan previously approved by our Board of Directors ("the Board"). Mr. Brickman succeeded Mr. Gary G. Winterhalter as the Company's CEO. In July 2015, the Board appointed Mark Spinks as President of our BSG business unit. Mr. Spinks succeeded Mr. John R. Golliher. In January 2016, the Board appointed Sharon M. Leite as President of our Sally Beauty Supply business unit. Prior to Ms. Leite's appointment, the position of President of Sally Beauty Supply had been vacant since May 2014. In September 2016, Mr. Mark J. Flaherty resigned from his position as Senior Vice President and Chief Financial Officer. Immediately following his resignation, Janna S. Minton, the Company's Group Vice President, Chief Accounting Officer and Controller, was appointed and began serving as our interim principal financial officer.

Any significant leadership change or executive management transition involves inherent risk and any failure to ensure the effective transfer of knowledge and a smooth transition could hinder our strategic planning, execution and future performance. In addition, from time to time, key executive personnel leave our Company and we may not be successful in attracting, integrating and retaining the personnel required to grow and operate our business profitably. While we strive to mitigate the negative impact associated with the loss of a key executive employee, an unsuccessful transition or loss could significantly disrupt our operations and have a material adverse effect on our business, financial condition or results of operations.

We are also dependent on training, motivating and managing our store employees that interact with our customers on a daily basis. Competition for these types of qualified employees is intense and the failure to attract, retain and properly train qualified and motivated employees could result in decreased customer satisfaction, loss of customers, and lower sales.

The occurrence of natural disasters or acts of violence or terrorism could adversely affect our operations and financial performance.

The occurrence of natural disasters or acts of violence or terrorism could result in physical damage to our properties, the temporary closure of stores or distribution centers, the temporary lack of an adequate work force, the temporary or long-term disruption in the supply of products (or a substantial increase in the cost of those products) from domestic or foreign suppliers, the temporary disruption in the delivery of goods to our distribution centers (or a substantial increase in the cost of those deliveries), the temporary reduction in the availability of products in our stores, and/or the temporary reduction in visits to stores by customers. If one or more natural disasters or acts of violence or terrorism were to impact our business, we could, among other things, incur significantly higher costs and longer lead times associated with distributing products. Furthermore, insurance costs associated with our business may rise significantly in the event of a large scale natural disaster or act of violence or terrorism.

We are a holding company with no operations of our own, and we depend on our subsidiaries for cash.

We are a holding company and do not have any material assets or operations other than ownership of equity interests of our subsidiaries. Our operations are conducted almost entirely through our subsidiaries, and our ability to generate cash to meet our obligations or to pay dividends is highly dependent on the earnings of, and receipt of funds from, our subsidiaries through dividends or intercompany loans. The ability of our subsidiaries to generate sufficient cash flow from operations to allow us and them to make

scheduled payments on our obligations will depend on their future financial performance, which will be affected by a range of economic, competitive and business factors, many of which are outside of our control. We cannot assure you that the cash flow and earnings of our operating subsidiaries will be adequate for our subsidiaries to service their debt obligations. If our subsidiaries do not generate sufficient cash flow from operations to satisfy corporate obligations, we may have to: undertake alternative financing plans (such as refinancing), restructure debt, sell assets, reduce or delay capital investments, or seek to raise additional capital. We cannot assure you that any such alternative refinancing would be possible, that any assets could be sold, or, if sold, of the timing of the sales and the amount of proceeds realized from those sales, that additional financing could be obtained on acceptable terms, if at all, or that additional financing would be permitted under the terms of our various debt instruments then in effect. Our inability to generate sufficient cash flow to satisfy our obligations, or to refinance our obligations on commercially reasonable terms, would have an adverse effect on our business, financial condition and results of operations.

Furthermore, we and our subsidiaries may incur substantial additional indebtedness in the future that may severely restrict or prohibit our subsidiaries from making distributions, paying dividends or making loans to us.

Litigation costs and the outcome of litigation could have a material adverse effect on our business and any loss contingency accruals may not be adequate to cover actual losses.

From time to time, we are subject to litigation claims through the ordinary course of our business operations regarding, but not limited to, employment matters, security of consumer and employee personal information, contractual relations with suppliers, marketing and infringement of trademarks and other intellectual property rights. Litigation to defend ourselves against these patent infringement claims and other claims by third parties, or to enforce any rights that we may have against third parties, may be necessary, which could result in substantial costs and diversion of our resources, causing a material adverse effect on our business, financial condition, profitability and cash flows. We establish accruals for potential liability arising from legal proceedings when potential liability is probable and the amount of the loss can be reasonably estimated based on currently available information. We may still incur legal costs for a matter even if we have not accrued a liability. In addition, actual losses may be higher than the amount accrued for a certain matter, or in the aggregate. An unfavorable resolution of a legal proceeding or claim could materially adversely impact our business, financial condition, profitability and cash flows. There can be no assurance that any pending or future litigation will not have a material adverse effect on our business, financial condition, profitability and cash flows.

Our previously announced share repurchase program could affect the price of our common stock and increase volatility and may be suspended or terminated at any time, which may result in a decrease in the trading price of our common stock.

Repurchases pursuant to our share repurchase program could affect our stock price and increase its volatility. The existence of a share repurchase program could also cause our stock price to be higher than it would be in the absence of such a program and could potentially reduce the market liquidity for our stock. There can be no assurance that any share repurchases will enhance stockholder value because the market price of our common stock may decline below the levels at which we repurchased shares of common stock. Although our share repurchase program is intended to enhance long-term stockholder value, short-term stock price fluctuations could reduce the program's effectiveness. Furthermore, the program does not obligate the Company to repurchase any dollar amount or number of shares of common stock, and may be suspended or discontinued at any time and any suspension or discontinuation could cause the market price of our stock to decline.

Risks Relating to Our Substantial Indebtedness

We have substantial debt and may incur substantial additional debt, which could adversely affect our financial health, our ability to obtain financing in the future and our ability to react to changes in our business.

As of September 30, 2016, certain of our subsidiaries, including Sally Holdings LLC, which we refer to as Sally Holdings, had an aggregate principal amount of approximately \$1,784.0 million of outstanding debt, including capital lease obligations, and a total debt to equity ratio of –6.5:1.00.

Our substantial debt could have important consequences. For example, it could:

- make it more difficult for us to satisfy our obligations to our lenders, resulting in possible defaults on and acceleration of such indebtedness;
- limit our ability to obtain additional financing for working capital, capital expenditures, acquisitions, debt service requirements or general corporate purposes;
- require us to dedicate a substantial portion of our cash flow from operations to the payment of principal and interest on our indebtedness, thereby reducing the availability of such cash flows to fund working capital, capital expenditures, share repurchases and other general corporate purposes;
- restrict the ability of our subsidiaries to pay dividends or otherwise transfer assets to us, which could limit our ability to conduct repurchases of our own equity securities or pay dividends to our stockholders, thereby limiting our ability to enhance stockholder value through such transactions;
- increase our vulnerability to general adverse economic and industry conditions, including interest rate fluctuations (because a portion of our borrowings are at variable rates of interest), including borrowings under our asset-based senior secured loan facility, which we refer to as the “ABL facility”;
- place us at a competitive disadvantage compared to our competitors with proportionately less debt or comparable debt at more favorable interest rates and that, as a result, may be better positioned to withstand economic downturns;
- limit our ability to refinance indebtedness or cause the associated costs of such refinancing to increase; and
- limit our flexibility to adjust to changing market conditions and ability to withstand competitive pressures, or prevent us from carrying out capital spending that is necessary or important to our growth strategy and efforts to improve operating margins or our business.

Any of the foregoing impacts of our substantial indebtedness could have a material adverse effect on our business, financial condition and results of operations.

Despite our current indebtedness levels, we and our subsidiaries may be able to incur substantially more debt, including secured debt, which could further exacerbate the risks associated with our substantial indebtedness.

We and our subsidiaries may incur substantial additional indebtedness in the future. The terms of the instruments governing our indebtedness do not fully prohibit us or our subsidiaries from doing so. As of September 30, 2016, our ABL facility provided us commitments for additional borrowings of up to approximately \$478.4 million, subject to borrowing base limitations. If new debt is added to our current debt levels, the related risks that we face would increase, and we may not be able to meet all our debt obligations. In addition, the agreements governing our ABL facility as well as the indentures governing our senior notes due 2022, senior notes due 2023 and senior notes due 2025, which we refer to collectively as “the Notes” or “the senior notes due 2022, 2023 and 2025”, do not prevent us from incurring obligations that do not constitute indebtedness.

The agreements and instruments governing our debt contain restrictions and limitations that could significantly impact our ability to operate our business.

The ABL facility contains covenants that, among other things, restrict Sally Holdings and its subsidiaries' ability to:

- change their line of business;
- engage in certain mergers, consolidations and transfers of all or substantially all of their assets;
- make certain dividends, share repurchases and other distributions;
- make acquisitions of all of the business or assets of, or stock representing beneficial ownership of, any person;
- dispose of certain assets;
- make voluntary prepayments on the Notes or make amendments to the terms thereof;
- prepay certain other debt or amend specific debt agreements;
- change the fiscal year of Sally Holdings or its direct parent; and
- create or incur negative pledges.

In addition, if Sally Holdings fails to maintain a specified minimum level of borrowing capacity under the ABL facility, it will then be obligated to maintain a specified fixed-charge coverage ratio. Our ability to comply with these covenants in future periods will depend on our ongoing financial and operating performance, which in turn will be subject to economic conditions and to financial, market and competitive factors, many of which are beyond our control. Our ability to comply with these covenants in future periods will also depend substantially on the pricing of our products, our success at implementing cost reduction initiatives and our ability to successfully implement our overall business strategy.

The indentures governing the Notes also contain restrictive covenants that, among other things, limit our ability and the ability of Sally Holdings and its restricted subsidiaries to:

- dispose of assets;
- incur additional indebtedness (including guarantees of additional indebtedness);
- pay dividends, repurchase stock or make other distributions;
- prepay subordinated debt;
- create liens on assets;
- make investments (including joint ventures);
- engage in mergers, consolidations or sales of all or substantially all of Sally Holdings' assets;
- engage in certain transactions with affiliates; and
- permit restrictions on Sally Holdings' subsidiaries' ability to pay dividends.

The restrictions in the indentures governing our Notes and the terms of our ABL facility may prevent us from taking actions that we believe would be in the best interest of our business and may make it difficult for us to successfully execute our business strategy or effectively compete with companies that are not similarly restricted. We may also incur future debt obligations that might subject us to additional restrictive covenants that could affect our financial and operational flexibility. We cannot assure you that our subsidiaries, which are borrowers under these agreements, will be granted waivers or amendments to these agreements if they are unable to comply with these agreements, or that we will be able to refinance our debt on terms acceptable to us, or at all.

Our ability to comply with the covenants and restrictions contained in the ABL facility and the indentures for the Notes may be affected by economic, financial and industry conditions beyond our control. The breach of any of these covenants and restrictions could result in a default under either the ABL facility or the indentures that would permit the applicable lenders or note holders, as the case may be, to declare all amounts outstanding thereunder to be due and payable, together with accrued and unpaid interest. If we are unable to repay debt, lenders having secured obligations, such as the lenders under the ABL facility, could proceed against the collateral securing the debt. In any such case, our subsidiaries may be unable to borrow under the ABL facility and may not be able to repay the amounts due under the Notes. This could have serious consequences to our financial condition and results of operations and could cause us to become bankrupt or insolvent.

Our ability to generate the significant amount of cash needed to service all of our debt and our ability to refinance all or a portion of our indebtedness or obtain additional financing depends on many factors beyond our control.

Our ability to make scheduled payments on, or to refinance our obligations under, our debt will depend on our financial and operating performance, which, in turn, will be subject to prevailing economic and competitive conditions and to the financial and business factors, many of which may be beyond our control, described under “—Risks Relating to Our Business” above.

If our cash flow and capital resources are insufficient to fund our debt service obligations, we may be forced to reduce or delay capital expenditures, sell assets, seek to obtain additional equity capital or restructure our debt. In the future, our cash flow and capital resources may not be sufficient for payments of interest on and principal of our debt, and such alternative measures may not be successful and may not permit us to meet our scheduled debt service obligations.

We cannot assure you that we will be able to refinance any of our indebtedness or obtain additional financing, particularly because of our high levels of debt and the debt incurrence restrictions imposed by the agreements governing our debt, as well as prevailing market conditions. In the absence of such operating results and resources, we could face substantial liquidity problems and might be required to dispose of material assets or operations to meet our debt service and other obligations. Our ABL facility and the indentures governing the Notes restrict our ability to dispose of assets and use the proceeds from any such dispositions. We cannot assure you we will be able to consummate those sales, or if we do, what the timing of the sales will be or whether the proceeds that we realize will be adequate to meet debt service obligations when due.

The impairment of certain financial institutions could adversely affect us.

We have exposure to different financial institutions in their capacities as lenders in our ABL facility, depositories of our corporate cash balances and counterparties on our foreign currency hedging transactions. All of these transactions expose us to credit risk in the event of default of the financial institution(s). If these financial institutions become impaired or insolvent, this could have serious consequences to our financial condition and results of operations.

ITEM 1B. UNRESOLVED STAFF COMMENTS

Not applicable.

ITEM 2. PROPERTIES

Substantially all of our store and warehouse locations are leased while our corporate headquarters and five warehouses/distribution centers are owned. The average store lease is for a term of five years with customary renewal options. The following table provides the number of stores in the U.S. and globally, as of September 30, 2016:

<u>Location</u>	<u>Sally Beauty Supply</u>		<u>Beauty Systems Group</u>	
	<u>Company-Operated</u>	<u>Franchise</u>	<u>Company-Operated</u>	<u>Franchise</u>
United States (excluding Puerto Rico)	2,876	—	1,072	141
Puerto Rico	41	—	2	—
International:				
United Kingdom	249	4	—	—
Mexico	215	—	—	23
Canada	124	—	100	—
France	69	3	—	—
Belgium	45	6	—	—
Chile	41	—	—	—
Netherlands	30	—	—	—
Spain	25	—	—	—
Other	48	5	—	—
Total International	<u>846</u>	<u>18</u>	<u>100</u>	<u>23</u>
Total Store Count	<u>3,763</u>	<u>18</u>	<u>1,174</u>	<u>164</u>

The following table provides locations for our significant offices and warehouses and corporate headquarters, as of September 30, 2016:

<u>Location</u>	<u>Type of Facility</u>	<u>Sq. Feet</u>	<u>Business Segment</u>
Company-Owned Properties:			
Denton, Texas	Corporate Headquarters	N/A	(1)(2)
Reno, Nevada	Warehouse	253,000	(1)
Columbus, Ohio	Warehouse	246,000	(1)
Jacksonville, Florida	Warehouse	237,000	(1)
Denton, Texas	Office, Warehouse	114,000	(1)
Marinette, Wisconsin	Office, Warehouse	99,000	(2)
Leased Properties:			
Greenville, Ohio	Office, Warehouse	246,000	(2)
Fresno, California	Warehouse	200,000	(2)
Blackburn, Lancashire, England . .	Warehouse	195,000	(1)
Spartanburg, South Carolina	Warehouse	190,000	(2)
Pottsville, Pennsylvania	Office, Warehouse	140,000	(2)
Clackamas, Oregon	Warehouse	104,000	(2)
Ronse, Belgium	Office, Warehouse	91,000	(1)
Gent, Belgium	Office, Warehouse	83,000	(1)
Guadalupe, Nuevo Leon, Mexico .	Warehouse	78,000	(1)
Calgary, Alberta, Canada	Warehouse	62,000	(2)
Mississauga, Ontario, Canada . . .	Office, Warehouse	60,000	(2)
Lincoln, Nebraska	Warehouse	54,000	(2)

(1) Sally Beauty Supply

(2) BSG

ITEM 3. LEGAL PROCEEDINGS

We are involved, from time to time, 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 these matters. 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 U.S., federal, state and local laws and regulations, as well as the laws and regulations applicable in each foreign country or jurisdiction 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.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Market for the Registrant's Common Equity

Market Information

Our common stock is listed on the New York Stock Exchange, Inc., or the NYSE, under the symbol "SBH." The following table sets forth the high and low sales prices of our common stock during the fiscal years ended September 30, 2016 and 2015.

<u>Quarter Ended</u>	<u>High</u>	<u>Low</u>
Fiscal Year 2016:		
September 30, 2016	\$30.73	\$25.58
June 30, 2016	\$32.75	\$27.48
March 31, 2016	\$32.93	\$24.69
December 31, 2015	\$28.70	\$21.94
Fiscal Year 2015:		
September 30, 2015	\$32.41	\$23.39
June 30, 2015	\$34.72	\$29.75
March 31, 2015	\$35.27	\$28.61
December 31, 2014	\$31.77	\$27.05

Holders

As of November 9, 2016, there were 879 stockholders of record of our common stock.

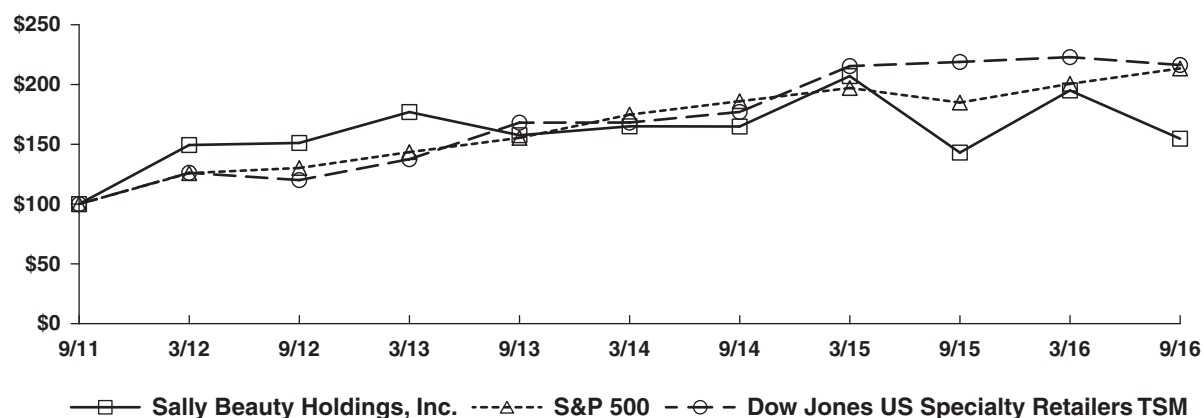
Dividends

We have not declared or paid dividends at any time during the two fiscal years prior to the date of this Annual Report.

We currently anticipate that we will retain future earnings to support our growth strategy, to repay outstanding debt or fund share repurchases. We do not anticipate paying regular cash dividends on our common stock in the foreseeable future. Any payment of future cash dividends will be at the discretion of our Board of Directors and will depend upon, among other things, future earnings, operations, capital requirements, our general financial condition, contractual restrictions (including those present in the agreements and instruments governing our debt) and general business conditions. We depend on our subsidiaries for cash and unless we receive dividends, distributions, advances, transfers of funds or other cash payments from our subsidiaries, we will be unable to pay any cash dividends on our common stock in the future. However, none of our subsidiaries are obligated to make funds available to us for the payment of dividends. Further, the terms of our subsidiaries' debt agreements and instruments significantly restrict the ability of our subsidiaries to make certain restricted payments to us. Finally, we and our subsidiaries may incur substantial additional indebtedness in the future that may severely restrict or prohibit our subsidiaries from making distributions, paying dividends or making loans to us. Please see "Risk Factors—Risks Relating to Our Substantial Indebtedness" and Note 13 of the "Notes to Consolidated Financial Statements" in "Item 8—Financial Statements and Supplementary Data."

Performance Graph

The following illustrates the comparative total return among Sally Beauty, the S&P 500 Index and the Dow Jones U.S. Specialty Retailers Index assuming that \$100 was invested on September 30, 2011 and that dividends, if any, were reinvested for the fiscal year included in the data:



The Dow Jones U.S. Specialty Retailers Index (NYSE: DJUSRS) is a non-managed index and provides a comprehensive view of issuers which are primarily in the retail sector in the United States. The Company's common stock is included in this index.

	9/11	3/12	9/12	3/13	9/13	3/14	9/14	3/15	9/15	3/16	9/16
Sally Beauty Holdings, Inc.	100.00	149.40	151.14	176.99	157.59	165.06	164.88	207.05	143.07	195.06	154.70
S&P 500	100.00	125.89	130.20	143.47	155.39	174.83	186.05	197.08	184.91	200.60	213.44
Dow Jones US Specialty Retailers TSM	100.00	126.16	120.08	137.55	168.11	168.20	177.08	215.42	218.88	222.92	216.33

This data assumes that \$100 was invested on September 30, 2011 in the Company's common stock and in each of the indexes shown and that all dividends were reinvested. The Company did not declare dividends during the period covered by this table. Stockholder returns shown should not be considered indicative of future stockholder returns.

Purchases of Equity Securities by the Issuer and Affiliated Purchasers

The following table provides information about the Company's repurchases of shares of its common stock during the three months ended September 30, 2016:

Fiscal Period	Total Number of Shares Purchased(1)	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs(1)(2)	Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs
July 1 through July 31, 2016	—	\$ —	—	\$610,074,000
August 1 through August 31, 2016 . . .	940,221	26.80	940,221	584,873,796
September 1 through September 30, 2016	<u>733,024</u>	<u>26.94</u>	<u>733,024</u>	<u>565,128,893</u>
Total this quarter . .	<u>1,673,245</u>	<u>\$26.86</u>	<u>1,673,245</u>	<u>\$565,128,893</u>

- (1) The table above does not include 20,805 shares of the Company's common stock surrendered by grantees during the three months ended September 30, 2016 to satisfy tax withholding obligations due upon the vesting of equity-based awards under the Company's share-based compensation plans.
- (2) In August 2014, we announced that the Board had approved a share repurchase program authorizing us to repurchase up to \$1.0 billion of our common stock over an approximate three-year period expiring on September 30, 2017.

ITEM 6. SELECTED FINANCIAL DATA

The following table presents selected financial data of Sally Beauty for each of the years in the five-year period ended September 30, 2016 (dollars in thousands, except per share data):

	Fiscal Year Ended September 30,				
	2016	2015	2014	2013	2012
Results of operations information:					
Net sales	\$3,952,618	\$3,834,343	\$3,753,498	\$3,622,216	\$3,523,644
Cost of products sold and distribution expenses	1,988,678	1,936,492	1,893,326	1,826,953	1,780,385
Gross profit	1,963,940	1,897,851	1,860,172	1,795,263	1,743,259
Selling, general and administrative expenses(a)	1,365,986	1,313,134	1,273,513	1,202,709	1,179,206
Depreciation and amortization	99,657	89,391	79,663	72,192	64,698
Operating earnings	498,297	495,326	506,996	520,362	499,355
Interest expense(b)	144,237	116,842	116,317	107,695	138,412
Earnings before provision for income taxes	354,060	378,484	390,679	412,667	360,943
Provision for income taxes	131,118	143,397	144,686	151,516	127,879
Net earnings	\$ 222,942	\$ 235,087	\$ 245,993	\$ 261,151	\$ 233,064
Earnings per share					
Basic	\$ 1.51	\$ 1.50	\$ 1.54	\$ 1.52	\$ 1.27
Diluted	\$ 1.50	\$ 1.49	\$ 1.51	\$ 1.48	\$ 1.24
Weighted average shares, basic	147,179	156,353	159,933	171,682	183,420
Weighted average shares, diluted	148,803	158,226	163,419	176,159	188,610
Operating data:					
Number of stores (at end of period):					
Sally Beauty Supply	3,781	3,673	3,563	3,424	3,309
Beauty Systems Group	1,338	1,294	1,265	1,245	1,190
Consolidated	5,119	4,967	4,828	4,669	4,499
Professional distributor sales consultants (at end of period)	936	958	981	982	1,044
Same store sales growth (decline)(c):					
Sally Beauty Supply	1.7%	1.7%	1.3%	(0.6)%	6.5%
Beauty Systems Group	5.5%	5.7%	3.5%	4.2%	6.1%
Consolidated	2.9%	2.9%	2.0%	0.8%	6.4%
Financial condition information (at end of period):					
Working capital	\$ 684,162	\$ 695,403	\$ 640,612	\$ 473,164	\$ 686,519
Cash, cash equivalents and short-term investments	86,622	140,038	106,575	47,115	240,220
Property, plant and equipment, net	319,558	270,847	238,111	229,540	202,661
Total assets	2,132,063	2,094,351	2,004,319	1,924,493	2,036,788
Long-term debt, excluding current maturities(d)	1,783,294	1,786,839	1,785,013	1,587,092	1,586,310
Stockholders' deficit(e)	\$ (276,166)	\$ (297,821)	\$ (347,053)	\$ (303,479)	\$ (115,085)

(a) Selling, general and administrative expenses for the fiscal years 2016, 2015, 2014, 2013 and 2012 include share-based compensation expenses of \$12.6 million, \$16.8 million, \$22.1 million, \$19.2 million and \$16.9 million, respectively. In the fiscal years 2016 and 2012, selling, general and administrative expenses reflect charges of \$12.8 million and \$10.2 million, respectively, resulting from loss contingencies.

(b) In the fiscal years 2016 and 2012, interest expense reflects a loss on extinguishment of debt of \$33.3 million and \$37.8 million, respectively, related to our refinancing of certain outstanding senior debt in the ordinary course of our business. Please see Note 13 of the "Notes to Consolidated Financial Statements" in "Item 8—Financial Statements and Supplementary Data" for additional information about the Company's debt.

- (c) For the purpose of calculating our same store sales metrics, we compare the current period sales for stores open for 14 months or longer as of the last day of a month with the sales for these stores for the comparable period in the prior fiscal year. Our same store sales are calculated in constant dollars and include internet-based sales (which are not material for each of the periods presented) and the effect of store expansions, if applicable, but do not generally include the sales from stores relocated until 14 months after the relocation. The sales from stores acquired are excluded from our same store sales calculation until 14 months after the acquisition.
- (d) At September 30, 2016, 2015, 2014, 2013 and 2012, long-term debt is net of unamortized debt issuance costs of \$23.7 million, \$21.8 million, \$25.7 million, \$25.6 million and \$29.0 million, respectively.
- (e) Stockholders' deficit for the fiscal years 2016, 2015, 2014 and 2013 reflects the repurchase and subsequent retirement of 7.8 million shares, 8.1 million shares, 12.6 million shares and 18.9 million shares of our common stock at a cost of \$207.3 million, \$227.6 million, \$333.3 million and \$509.7 million, respectively, under share repurchase programs approved by the Company's Board of Directors.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following section discusses management's view of the financial condition as of September 30, 2016 and 2015, and the results of operations and cash flows for the three fiscal years in the period ended September 30, 2016, of Sally Beauty. This section should be read in conjunction with the audited consolidated financial statements of Sally Beauty and the related notes included elsewhere in this Annual Report. This Management's Discussion and Analysis of Financial Condition and Results of Operations section may contain forward-looking statements. Please see "Cautionary Notice Regarding Forward-Looking Statements" 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 of the Fiscal Year Ended September 30, 2016:

- Our consolidated net sales from company-operated stores that have been open for 14 months or longer, which we refer to as same store sales, increased by 2.9% for both the fiscal year ended September 30, 2016 and the fiscal year ended September 30, 2015;
- Our consolidated net sales for the fiscal year ended September 30, 2016 increased by \$118.3 million, or 3.1%, to \$3,952.6 million compared to the fiscal year ended September 30, 2015. Consolidated net sales for the fiscal year ended September 30, 2016, are inclusive of a net negative impact from changes in foreign currency exchange rates of \$56.4 million, or 1.5% of consolidated net sales;
- Our consolidated gross profit for the fiscal year ended September 30, 2016 increased by \$66.1 million, or 3.5%, to \$1,963.9 million compared to the fiscal year ended September 30, 2015. As a percentage of net sales, gross profit was 49.7% for the fiscal year ended September 30, 2016, compared to 49.5% for the fiscal year ended September 30, 2015;
- Our consolidated operating earnings for the fiscal year ended September 30, 2016 increased by \$3.0 million, or 0.6%, to \$498.3 million compared to the fiscal year ended September 30, 2015. As a percentage of net sales, operating earnings decreased by 30 basis points to 12.6% for the fiscal year ended September 30, 2016, compared to 12.9% for the fiscal year ended September 30, 2015;
- Our consolidated net earnings decreased by \$12.1 million, or 5.2%, to \$222.9 million compared to the fiscal year ended September 30, 2015. As a percentage of net sales, net earnings decreased by 50 basis points to 5.6% for the fiscal year ended September 30, 2016, compared to 6.1% for the fiscal year ended September 30, 2015;
- During the fiscal year ended September 30, 2016, Sally Beauty Supply and BSG opened or acquired 108 and 37 net new stores, respectively, excluding franchised stores. As of September 30, 2016, we have refreshed approximately 1,450 of our Sally Beauty stores in the U.S. and expect to continue our initiatives to update the look and feel of our U.S. stores;
- Cash provided by operations increased by \$50.2 million, or 16.7%, to \$351.0 million for the fiscal year ended September 30, 2016, compared to \$300.8 million for the fiscal year ended September 30, 2015;
- During the fiscal year ended September 30, 2016, the Company redeemed in full its 6.875% senior notes due 2019 primarily with the net proceeds from its December 2015 issuance of \$750.0 million principal amount of its 5.625% senior notes due 2025. For the fiscal year ended September 30, 2016, the Company recorded a loss on extinguishment of debt of \$33.3 million in connection therewith;
- During the fiscal year ended September 30, 2016, we repurchased and subsequently retired approximately 7.8 million shares of our common stock under the share repurchase program

approved by our Board of Directors (the “Board”) in August 2014, at an aggregate cost of \$207.3 million; and

- We experienced a data security incident in fiscal year 2014 (the “2014 data security incident”) and experienced a second data security incident in fiscal year 2015 (the “2015 data security incident” and, together with the 2014 data security incident, the “data security incidents”). For the fiscal year ended September 30, 2016 and 2015, selling, general and administrative expenses reflect expenses of \$14.6 million and \$5.6 million (net of related insurance recovery of \$0.6 million), respectively, related to the data security incidents.

Overview

Description of Business

At September 30, 2016, we operated primarily through two business units, Sally Beauty Supply and Beauty Systems Group, or BSG. We believe the Company is the largest open-line distributor of professional beauty supplies in the U.S. based on store count. As of September 30, 2016, through Sally Beauty Supply and BSG, we had a multi-channel platform of 4,937 company-operated stores and supplied 182 franchised stores primarily in North America and selected South American and European countries. Within BSG, we also have one of the largest networks of professional distributor sales consultants in North America. We provide our customers with a wide variety of leading third-party branded and exclusive-label professional beauty supplies, including hair color products, hair care products, styling appliances, skin and nail care products and other beauty items. Our Sally Beauty stores target retail consumers and salon professionals, while BSG exclusively targets salons and salon professionals. For the year ended September 30, 2016, our consolidated net sales and operating earnings were \$3,952.6 million and \$498.3 million, respectively.

As of September 30, 2016, Sally Beauty Supply operated 3,763 company-operated retail stores (generally, under the Sally Beauty banner), 2,917 of which are located in the U.S., with the remaining 846 company-operated stores located in Canada, Mexico, Chile, Colombia, Peru, the United Kingdom, Ireland, Belgium, France, Germany, the Netherlands and Spain. Sally Beauty Supply also supplied 18 franchised stores located in the United Kingdom, Belgium and certain other European countries. In the U.S. and Canada, our Sally Beauty stores average approximately 1,700 square feet in size and are located primarily in strip shopping centers. Our Sally Beauty stores carry an extensive selection of professional beauty supplies for both retail customers and salon professionals, featuring an average of 8,000 SKUs of beauty products across product categories including hair color, hair care, skin and nail care, beauty sundries and styling tools. Our Sally Beauty stores carry leading third-party brands, such as Clairol®, CHI®, China Glaze®, OPI® and Conair®, as well as an extensive selection of exclusive-label merchandise. Store formats, including average size and product selection, for Sally Beauty Supply outside the U.S. and Canada vary by marketplace. For the year ended September 30, 2016, Sally Beauty Supply’s net sales and segment operating earnings were \$2,364.5 million and \$409.8 million, respectively, representing 60% and 62% of our consolidated net sales and consolidated operating earnings before unallocated corporate expenses and share-based compensation expense, respectively.

We believe BSG is the largest full-service distributor of professional beauty supplies in North America, exclusively targeting salons and salon professionals. As of September 30, 2016, BSG had 1,174 company-operated stores, supplied 164 franchised stores and had a sales force of approximately 936 professional distributor sales consultants selling exclusively to salons and salon professionals in the U.S., Canada, Mexico and certain European countries. Company-operated BSG stores, which primarily operate under the CosmoProf banner, average approximately 2,600 square feet in size and are primarily located in secondary strip shopping centers. BSG stores provide a comprehensive selection of beauty products featuring an average of 9,500 SKUs that include hair color and care, skin and nail care, beauty sundries and styling tools. Through BSG’s large store base and sales force, BSG is able to access a significant portion of the highly fragmented U.S. salon industry. BSG stores carry leading third-party brands such as

Paul Mitchell®, Wella®, Sebastian®, Goldwell®, Joico® and Aquage®, intended for use in salons and for resale by the salons to consumers. BSG is also the exclusive source for certain well-known third-party branded products pursuant to exclusive distribution agreements with certain suppliers within specified geographic territories. For the year ended September 30, 2016, BSG's net sales and segment operating earnings were \$1,588.1 million and \$254.5 million, respectively, representing 40% and 38% of our consolidated net sales and consolidated operating earnings before unallocated corporate expenses and share-based compensation expense, respectively.

Key Industry and Business Trends

We operate primarily within the large and growing U.S. beauty supply industry. We believe that a number of key industry and business trends and characteristics will influence our business and our financial results going forward. These key trends and characteristics are discussed elsewhere in this Annual Report. Please see “Key Industry and Business Trends” in Item 1 of this Annual Report.

Recent Acquisitions

We completed several individually immaterial acquisitions during the fiscal years 2016, 2015 and 2014 at the aggregate cost of approximately \$26.1 million, \$7.1 million and \$4.9 million, respectively. We recorded intangible assets subject to amortization of \$10.1 million, \$2.2 million and \$1.4 million in connection with these acquisitions completed in the fiscal years 2016, 2015 and 2014, respectively. In addition, we recorded goodwill in the amount of \$12.8 million, \$2.8 million and \$2.6 million, the majority of which is expected to be deductible for tax purposes, in connection with these individually immaterial acquisitions. We funded these acquisitions primarily with cash from operations and borrowings under the ABL facility. The valuation of the assets acquired and liabilities assumed in connection with these acquisitions was based on their fair values at the acquisition date.

Share Repurchase Programs

In August 2014, we announced that the Board had approved a share repurchase program authorizing us to repurchase up to \$1.0 billion of our common stock over an approximate three-year period expiring on September 30, 2017 (the “2014 Share Repurchase Program”).

During the fiscal years ended September 30, 2016 and 2015, we repurchased and subsequently retired approximately 7.8 million and 8.1 million shares, respectively, of our common stock under the 2014 Share Repurchase Program at a cost of \$207.3 million and \$227.6 million, respectively. In addition, during the fiscal year ended September 30, 2014, we repurchased and retired approximately 12.6 million shares of our common stock under the 2013 Share Repurchase Program (a share repurchase program approved by our Board in March 2013 and terminated in connection with the authorization of the 2014 Share Repurchase Program) at a cost of \$333.3 million. We reduced common stock and additional paid-in capital, in the aggregate, by these amounts. However, as required by GAAP, to the extent that the share repurchase amounts exceeded the balance of additional paid-in capital prior to such repurchases, we recorded the excess in accumulated deficit. We funded these share repurchases with cash from operations, borrowings under the ABL facility and a portion of the cash proceeds from our October 2013 debt issuance.

Data Security Incidents

In the fiscal year 2014, we disclosed that we had experienced a data security incident (the “2014 data security incident”). In the fiscal year 2015, we disclosed that we had experienced a second data security incident (the “2015 data security incident” and, together with the 2014 data security incident, the “data security incidents”). The data security incidents involved the unauthorized installation of malicious software (malware) on our information technology systems, including our point-of-sale systems that, we believe may have placed at risk certain payment card data for some transactions. The costs that the

Company has incurred to date in connection with the data security incidents include assessments by payment card networks, professional advisory fees, legal costs and expenses relating to investigating and remediating the data security incidents.

For the fiscal years ended September 30, 2016, 2015 and 2014, selling, general and administrative expenses reflect expenses of \$14.6 million, \$5.6 million (net of related insurance recovery of \$0.6 million) and \$2.5 million, respectively, related to the data security incidents, including an accrued liability of approximately \$2.9 million related to loss contingencies associated with the 2014 data security incident recorded during the fiscal year ended September 30, 2015 and an accrued liability of approximately \$12.8 million related to loss contingencies associated with the 2015 data security incident recorded during the fiscal year ended September 30, 2016. As of September 30, 2016, the Company has an aggregate accrued liability relating to the data security incidents of \$15.6 million. The Company's estimated probable losses related to the claims made by the payment card networks in connection with the data security incidents are based on currently available information. The Company disputes the validity of these claims and intends to contest them. Estimates related to these claims may change as new information becomes available or circumstances change.

We expect to incur additional costs and expenses related to the data security incidents in future periods. These costs may result from potential additional liabilities to payment card networks, governmental or third party investigations, proceedings or litigation and legal and other fees necessary to defend against any potential liabilities or claims, and further investigatory and remediation costs. As of September 30, 2016, the scope of these additional costs, or a range thereof, cannot be reasonably estimated and, while we do not anticipate these additional costs or liabilities would have a material adverse impact on our business, financial condition and operating results, these additional costs could be significant. Please see "Risk Factors—We may be adversely affected by any disruption in our information technology systems," "Unauthorized access to confidential information and data on our information technology systems and security and data breaches could materially adversely affect our business, financial condition and operating results" and "We have experienced data security incidents and are not yet able to determine the full extent or scope of the potential liabilities relating to these data security incidents."

Germany Restructuring

In the fiscal year 2015, the Board approved an initiative to restructure our Sally Beauty Supply operations in Germany (the "Germany restructuring"), which included the closing of 15 underperforming retail stores and two supporting administrative offices. This initiative is part of our ongoing cost rationalization efforts designed to increase the profitability of our Sally Beauty Supply segment's international operations. After completion of the Germany restructuring, which was substantially completed during the fourth quarter of the fiscal year 2015, we have continued to operate 18 retail stores in Germany.

In connection with the Germany restructuring we incurred pre-tax expenses in the aggregate amount of approximately €4.7 million (\$5.3 million, at the weighted average exchange rate during the relevant period), including costs associated with lease obligations, asset impairments, employee severance, and other business transition and exit costs. Of this amount, approximately €2.2 million (\$2.5 million, at the weighted average exchange rate during the relevant period) were non-cash expenses resulting from asset impairments. In addition, approximately €0.4 million (\$0.4 million, at the weighted average exchange rate during the relevant period) represent one-time employee severance payments. The Germany restructuring expenses are included in cost of products sold and distribution expenses (€1.2 million, \$1.4 million, at the weighted average exchange rate during the relevant period) and in selling, general and administrative expenses (€3.5 million, \$3.9 million, at the weighted average exchange rate during the relevant period) in the Company's consolidated statements of earnings for the fiscal year 2015, based on the nature of the costs incurred.

Other Significant Items

Derivative Instruments

As a multinational corporation, we are subject to certain market risks including changes in market interest rates and foreign currency fluctuations. We may consider a variety of practices in the ordinary course of our business to manage these market risks including, when deemed appropriate, the use of derivative instruments such as foreign currency forwards and options (hereafter, “foreign exchange contracts”) and interest rate swaps. Currently, we do not purchase or hold any derivative instruments for speculative or trading purposes.

Foreign Currency Derivative Instruments

We are exposed to potential gains or losses from foreign currency fluctuations affecting net investments in subsidiaries (including intercompany balances not permanently invested) and earnings denominated in foreign currencies, as well as exposure resulting from the purchase of merchandise by certain of our subsidiaries in a currency other than their functional currency and from the sale of products and services among the parent company and subsidiaries with a functional currency different from the parent or among subsidiaries with different functional currencies. Our primary exposures are to changes in exchange rates for the U.S. dollar versus the Euro, the British pound sterling, the Canadian dollar, the Chilean peso and the Mexican peso. In addition, from time to time we may have exposure to changes in the exchange rate for the British pound sterling versus the Euro in connection with the sale of products and services among certain European subsidiaries of the Company. The recent vote by Britain to leave the European Union and related or other disruptive events in the European Union could result in increased foreign currency fluctuation, including fluctuation in currencies in which we operate. Our various foreign currency exposures at times offset each other, sometimes providing a natural hedge against foreign currency risk. In connection with the remaining foreign currency risk, the Company from time to time uses foreign exchange contracts to effectively fix the foreign currency exchange rate applicable to specific anticipated foreign currency-denominated cash flows, thus limiting the potential fluctuations in such cash flows resulting from foreign currency market movements.

The Company uses foreign exchange contracts to manage the exposure to the U.S. dollar resulting from certain of its Sinelco Group subsidiaries’ purchases of merchandise from third-party suppliers. Sinelco’s functional currency is the Euro. As such, at September 30, 2016, we hold foreign currency forwards which enable us to sell approximately €16.0 million (\$18.0 million, at the September 30, 2016 exchange rate) at the weighted average contractual exchange rate of 1.1219. The foreign currency forwards discussed in this paragraph are with a single counterparty and expire ratably through September 15, 2017.

The Company also uses foreign exchange contracts to mitigate its exposure to changes in foreign currency exchange rates in connection with certain intercompany balances not permanently invested. As such, at September 30, 2016, we hold: (a) a foreign currency forward which enables us to sell approximately €22.4 million (\$25.1 million, at the September 30, 2016 exchange rate) at the contractual exchange rate of 1.1267, (b) a foreign currency forward which enables us to sell approximately \$4.1 million Canadian dollars (\$3.1 million, at the September 30, 2016 exchange rate) at the contractual exchange rate of 1.3121, (c) foreign currency forwards which enable us to buy approximately \$15.5 million Canadian dollars (\$11.8 million, at the September 30, 2016 exchange rate) at the weighted average contractual exchange rate of 1.3078, (d) a foreign currency forward which enables us to sell approximately 17.9 million Mexican pesos (\$0.9 million, at the September 30, 2016 exchange rate) at the contractual exchange rate of 19.4605 and (e) a foreign currency forward which enables us to buy approximately £7.2 million (\$9.3 million, at the September 30, 2016 exchange rate) at the contractual exchange rate of 1.3030. All the foreign currency forwards discussed in this paragraph are with a single counterparty (not the same counterparty as that on the forwards discussed in the preceding paragraph) and expire on or before December 30, 2016.

The Company's foreign exchange contracts are not designated as hedges and do not currently meet the requirements for hedge accounting. Accordingly, the changes in the fair value (i.e., marked-to-market adjustments) of these derivative instruments (which are adjusted quarterly) are recorded in selling, general and administrative expenses in our consolidated statements of earnings. During the fiscal year ended September 30, 2016, selling, general and administrative expenses included a net loss of \$1.1 million in connection with all of the Company's foreign exchange contracts, including marked-to-market adjustments. Please see "Item 7A—Quantitative and Qualitative Disclosures about Market Risk—Foreign currency exchange rate risk" and Note 14 of the "Notes to Consolidated Financial Statements" in Item 8—"Financial Statements and Supplementary Data" contained elsewhere in this Annual Report.

Share-Based Compensation Awards

The Company from time to time may grant performance-based unit awards and service-based awards to its employees and directors under the Sally Beauty Holdings, Inc. Amended and Restated 2010 Omnibus Incentive Plan (the "2010 Plan"). As such, during the fiscal year ended September 30, 2016, the Company granted approximately 152,000 performance-based restricted stock units ("Performance Unit" or "Performance Units") to its employees under the 2010 Plan. Under the terms of the Performance Unit award, a grantee may earn from 0% to 200% of his or her target units, with the ultimate number of units earned upon settlement (and the expense recognized) dependent on the Company's level of achievement with respect to certain specified cumulative performance targets during the three-year period ending on September 30, 2018 (the "Performance Period") and satisfaction of the employee service condition. Periodic expense for Performance Unit awards, which is estimated quarterly, is based on the Company's projected performance during the Performance Period compared to the performance targets contained in the award. In addition, during the fiscal years ended September 30, 2016, 2015 and 2014, the Company granted approximately 1.5 million, 1.2 million and 1.6 million service-based stock options, respectively, and approximately 40,000, 222,000 and 247,000 service-based restricted stock awards, respectively, to its employees under the 2010 Plan. Furthermore, during the fiscal years ended September 30, 2016, 2015 and 2014, the Company also granted approximately 28,000, 20,000 and 27,000 service-based restricted stock units, respectively, to its non-employee directors under the 2010 Plan.

For the fiscal years 2016, 2015 and 2014, total share-based compensation expense charged against earnings in connection with all share-based compensation awards, and included in selling, general and administrative expenses, was \$12.6 million, \$16.8 million and \$22.1 million, respectively, and resulted in an increase in additional paid-in capital by the same amounts. For the fiscal year 2014, share-based compensation expense reflects an expense of \$3.5 million in connection with the executive management transition plan disclosed in May 2014. Share-based compensation expense for the fiscal years 2016, 2015 and 2014 included \$1.3 million, \$4.8 million and \$8.8 million (including the expense of \$3.5 million in connection with the executive management transition plan), respectively, of accelerated expense related to certain retirement eligible employees who are eligible to continue vesting in awards upon retirement under the terms of the 2010 Plan. For the fiscal years 2016, 2015 and 2014, the total income tax benefit recognized in the consolidated statements of earnings from all share-based compensation plans in which our employees participate or participated was \$4.8 million, \$6.3 million and \$8.2 million, respectively, and resulted in the recognition of deferred tax assets by generally the same amounts. Our consolidated statements of cash flows reflect, for the fiscal years 2016, 2015 and 2014, excess tax benefits of \$1.3 million, \$22.1 million and \$14.6 million, respectively, from share-based compensation award activity, including employee exercises of stock options, as financing cash flows. As of September 30, 2016, we had \$8.5 million of unrecognized compensation expense related to unvested stock option awards that is expected to be charged to expense over the weighted average period of 1.8 years, and \$3.0 million of unrecognized compensation expense related to unvested restricted stock awards that is expected to be charged to expense over the weighted average period of 1.9 years.

Deferred Income Tax Assets

The Company recognizes deferred income taxes for the future tax consequences attributable to differences between the financial statement carrying amounts of assets and liabilities and their respective tax bases. Deferred tax assets (and liabilities) are measured using enacted tax rates expected to apply to taxable income in the years in which temporary differences are estimated to be recovered (or settled). The Company has recorded a valuation allowance to account for uncertainties regarding recoverability of certain deferred tax assets, primarily foreign loss carry-forwards. Management believes that it is more-likely-than-not that the results of future operations will generate sufficient taxable income to realize the deferred tax assets, net of such valuation allowance.

Other Items

In the fiscal year ended September 30, 2016, the Company redeemed in full its 6.875% senior notes due 2019 primarily with the net proceeds from its December 2015 issuance of \$750.0 million principal amount of its 5.625% senior notes due 2025. For the fiscal year ended September 30, 2016, the Company recorded a loss on extinguishment of debt of \$33.3 million, including a call premium of \$25.8 million and unamortized debt issuance costs of \$7.5 million expensed, in connection therewith.

For the fiscal year 2015, cost of products sold and distribution expenses reflect €1.2 million (\$1.4 million, at the weighted average exchange rate during the relevant period) and selling, general and administrative expenses reflect €3.5 million (\$3.9 million, at the weighted average exchange rate during the relevant period) in expenses related to the Germany restructuring, based on the nature of the costs incurred.

For the fiscal years ended September 30, 2016, 2015 and 2014, selling, general and administrative expenses also reflect expenses of \$14.6 million, \$5.6 million (net of related insurance recovery of \$0.6 million) and \$2.5 million, respectively, consisting of costs related to the data security incidents discussed above. For the fiscal year ended September 30, 2016, these amounts include an accrued liability related to potential litigation costs and expenses associated with the 2014 data security incident of approximately \$2.9 million and associated with the 2015 data security incident of approximately \$12.8 million.

In addition, for the fiscal year 2014, selling, general and administrative expenses reflect expense of \$3.5 million for a share-based compensation award in connection with the executive management transition plan disclosed in May 2014.

Results of Operations

The following table shows the condensed results of operations of our business for the fiscal years ended September 30, 2016, 2015 and 2014 (in millions):

	Fiscal Year Ended September 30,		
	2016	2015	2014
Net sales	\$3,952.6	\$3,834.4	\$3,753.5
Cost of products sold and distribution expenses	1,988.7	1,936.5	1,893.3
Gross profit	1,963.9	1,897.9	1,860.2
Total other operating costs and expenses	1,465.6	1,402.6	1,353.2
Operating earnings	498.3	495.3	507.0
Interest expense	144.2	116.8	116.3
Earnings before provision for income taxes	354.1	378.5	390.7
Provision for income taxes	131.2	143.4	144.7
Net earnings	<u>\$ 222.9</u>	<u>\$ 235.1</u>	<u>\$ 246.0</u>

The following table shows the condensed results of operations of our business for the fiscal years ended September 30, 2016, 2015 and 2014, expressed as a percentage of net sales for each respective period:

	Fiscal Year Ended September 30,		
	2016	2015	2014
Net sales	100.0%	100.0%	100.0%
Cost of products sold and distribution expenses	50.3%	50.5%	50.4%
Gross profit	49.7%	49.5%	49.6%
Total other operating costs and expenses	37.1%	36.6%	36.1%
Operating earnings	12.6%	12.9%	13.5%
Interest expense	3.6%	3.0%	3.1%
Earnings before provision for income taxes	9.0%	9.9%	10.4%
Provision for income taxes	3.4%	3.8%	3.8%
Net earnings	5.6%	6.1%	6.6%

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):

	Fiscal Year Ended September 30,		
	2016	2015	2014
Net sales:			
Sally Beauty Supply	\$2,364,531	\$2,329,523	\$2,308,743
BSG	1,588,087	1,504,820	1,444,755
Consolidated	<u>\$3,952,618</u>	<u>\$3,834,343</u>	<u>\$3,753,498</u>
Gross profit	\$1,963,940	\$1,897,851	\$1,860,172
Gross profit margin	49.7%	49.5%	49.6%
Selling, general and administrative expenses(b)(c)	\$1,365,986	\$1,313,134	\$1,273,513
Depreciation and amortization	\$ 99,657	\$ 89,391	\$ 79,663
Earnings before provision for income taxes:			
Segment operating earnings:			
Sally Beauty Supply(a)	\$ 409,787	\$ 412,393	\$ 431,655
BSG	254,479	231,151	216,971
Segment operating earnings	664,266	643,544	648,626
Unallocated expenses(b)	(153,389)	(131,440)	(119,523)
Share-based compensation expense(c)	(12,580)	(16,778)	(22,107)
Operating earnings	498,297	495,326	506,996
Interest expense(d)	(144,237)	(116,842)	(116,317)
Earnings before provision for income taxes	<u>\$ 354,060</u>	<u>\$ 378,484</u>	<u>\$ 390,679</u>
Segment operating profit margin:			
Sally Beauty Supply	17.3%	17.7%	18.7%
BSG	16.0%	15.4%	15.0%
Consolidated operating profit margin	12.6%	12.9%	13.5%
Number of stores at end-of-period (including franchises):			
Sally Beauty Supply	3,781	3,673	3,563
BSG	1,338	1,294	1,265
Consolidated	<u>5,119</u>	<u>4,967</u>	<u>4,828</u>
Same store sales growth(e)			
Sally Beauty Supply	1.7%	1.7%	1.3%
BSG	5.5%	5.7%	3.5%
Consolidated	2.9%	2.9%	2.0%

(a) For the fiscal year 2015, Sally Beauty Supply's operating earnings reflects \$5.3 million in expenses related to the restructuring of its operations in Germany. This amount includes \$1.4 million in expenses reported in cost of products sold and distribution expenses and \$3.9 million in expenses reported in selling, general and administrative expenses in our consolidated statements of earnings.

(b) Unallocated expenses consist of corporate and shared costs and are included in selling, general and administrative expenses in our consolidated statements of earnings. For the fiscal years 2016, 2015 and 2014, unallocated expenses reflect expenses of \$14.6 million, \$5.6 million (net of related

insurance recovery of \$0.6 million) and \$2.5 million, respectively, in connection with the data security incidents.

- (c) For the fiscal year 2014, share-based compensation expense reflects a charge of \$3.5 million in connection with the executive management transition plan. Share-based compensation expense is included in selling, general and administrative expenses in our consolidated statements of earnings.
- (d) For the fiscal year 2016, interest expense includes a loss on extinguishment of debt of \$33.3 million in connection with the Company's December 2015 redemption of its senior notes due 2019.
- (e) For the purpose of calculating our same store sales metrics, we compare the current period sales for stores open for 14 months or longer as of the last day of a month with the sales for these stores for the comparable period in the prior fiscal year. Our same store sales are calculated in constant dollars and include internet-based sales and the effect of store expansions, if applicable, but do not generally include the sales from stores relocated until 14 months after the relocation. The sales from stores acquired are excluded from our same store sales calculation until 14 months after the acquisition.

Description of Net Sales and Expenses

Net Sales. Our net sales consist primarily of the following:

Sally Beauty Supply. Sally Beauty Supply generates net sales primarily by selling products through its stores to both retail customers and salon professionals. Sally Beauty Supply sells products for hair color and care, skin and nail care, beauty sundries and styling tools. Because approximately 46% of our Sally Beauty Supply product sales come from exclusive-label brands, most of these same products are generally not available in most other retail stores or in our BSG business segment. Various factors influence Sally Beauty Supply's net sales including overall consumer traffic, local competition, inclement weather, product assortment and availability, price, hours of operation, and marketing and promotional activity. Sally Beauty Supply's product assortment and sales are generally not seasonal in nature.

Beauty Systems Group. BSG generates net sales primarily by selling products to salons and salon professionals through company-operated and franchised stores as well as through its network of professional distributor sales consultants. BSG sells products for hair color and care, skin and nail care, beauty sundries and styling tools. These products are not sold directly to the general public and are generally not the same products as those sold in our Sally Beauty stores. Various factors influence BSG's net sales, including product features and availability, competition, inclement weather, relationships with suppliers, new product introductions and price. BSG's product assortment and sales are generally not seasonal in nature.

Cost of Products Sold and Distribution Expenses. We do not manufacture the products we sell, and instead purchase these products from recognized brand manufacturers and private label fillers. Cost of products sold and distribution expenses consist of the cost to purchase merchandise from these suppliers, as well as certain overhead expenses including procurement costs, freight from distribution centers to stores and merchandise handling costs at the distribution centers. Cost of products sold and distribution expenses are reduced by vendor rebates and allowances earned and include inventory shrinkage expense, which represents product that is lost, stolen or damaged primarily while in the stores.

Selling, General and Administrative Expenses. Selling, general and administrative expenses consist primarily of employee compensation (including share-based compensation expense), commissions paid to professional distributor sales consultants, employee benefits, rent, utilities, property maintenance,

advertising costs, freight and distribution expenses for delivery to customers, credit card fees, insurance, corporate and shared costs, and other administrative costs and expenses.

Interest Expense. Interest expense includes the amortization of deferred debt issuance costs and is stated net of interest income.

The Fiscal Year Ended September 30, 2016 compared to the Fiscal Year Ended September 30, 2015

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

	Fiscal Year Ended September 30,			
	2016	2015	Increase	
Net sales:				
Sally Beauty Supply	\$2,364,531	\$2,329,523	\$ 35,008	1.5%
BSG	1,588,087	1,504,820	83,267	5.5%
Consolidated net sales	\$3,952,618	\$3,834,343	\$118,275	3.1%
Gross profit:				
Sally Beauty Supply	\$1,304,354	\$1,276,529	\$ 27,825	2.2%
BSG	659,586	621,322	38,264	6.2%
Consolidated gross profit	\$1,963,940	\$1,897,851	\$ 66,089	3.5%
Gross profit margin:				
Sally Beauty Supply	55.2%	54.8%	0.4%	
BSG	41.5%	41.3%	0.2%	
Consolidated gross profit margin	49.7%	49.5%	0.2%	

Net Sales

Consolidated net sales increased by \$118.3 million, or 3.1%, for the fiscal year ended September 30, 2016, compared to the fiscal year ended September 30, 2015. Company-operated Sally Beauty Supply and BSG stores that have been open for 14 months or longer contributed an increase in consolidated net sales of approximately \$113.4 million, or 3.0%, and sales through our BSG distributor sales consultants contributed an increase in consolidated net sales of approximately \$20.3 million, or 0.5% compared to the fiscal year ended September 30, 2015. Other sales channels (including sales from stores that have been open for less than 14 months, sales through our BSG franchise-based businesses, incremental sales from businesses acquired in the preceding 12 months and sales from our Sally Beauty Supply non-store sales channels) in the aggregate experienced a net decrease in sales of approximately \$15.4 million, or 0.4%, compared to the fiscal year ended September 30, 2015. Consolidated net sales reflect a 2.9% same store sales growth rate for both the fiscal year ended September 30, 2016 and the fiscal year ended September 30, 2015. Consolidated net sales for the fiscal year ended September 30, 2016, are inclusive of a net negative impact from changes in foreign currency exchange rates of \$56.4 million, or 1.5% of consolidated net sales, including the impact of the stronger U.S. dollar in the fiscal year ended September 30, 2016.

The \$118.3 million increase in consolidated net sales reflects, in our Sally Beauty Supply segment, increases in average unit prices resulting primarily from selective price increases in certain geographical areas of the U.S. and, in our BSG segment, increases in unit volume (including increases in sales at existing stores and the incremental sales from 37 BSG company-operated stores opened or acquired during the last twelve months) and increases in average unit prices (resulting from changes in product mix), as more fully discussed below.

Sally Beauty Supply. Net sales for Sally Beauty Supply increased by \$35.0 million, or 1.5%, for the fiscal year ended September 30, 2016, compared to the fiscal year ended September 30, 2015. In the Sally Beauty Supply segment, company-operated stores that have been open for 14 months or longer contributed an increase in segment net sales of approximately \$58.5 million, or 2.5%. Other sales channels (including sales from stores that have been open for less than 14 months and sales from our non-store sales channels, which include the catalog and internet sales of our Sinelco Group subsidiaries) in the aggregate experienced a net decrease in sales of approximately \$23.5 million, or 1.0%, compared to the fiscal year ended September 30, 2015. Net sales for Sally Beauty Supply reflect a 1.7% same store sales growth rate for both the fiscal year ended September 30, 2016 and the fiscal year ended September 30, 2015. Net sales for Sally Beauty Supply for the fiscal year ended September 30, 2016, are inclusive of a net negative impact from changes in foreign currency exchange rates of approximately \$45.7 million, or 2.0% of Sally Beauty Supply's net sales.

The \$35.0 million increase in the Sally Beauty Supply segment's net sales reflects increases in average unit prices resulting from selective price increases in certain geographical areas of the U.S. and a change in product mix primarily resulting from the introduction of certain products with higher average unit prices in the preceding 12 months.

Beauty Systems Group. Net sales for BSG increased by \$83.3 million, or 5.5%, for the fiscal year ended September 30, 2016, compared to the fiscal year ended September 30, 2015. In the BSG segment, company-operated stores that have been open for 14 months or longer contributed an increase in segment net sales of approximately \$54.9 million, or 3.6%, and sales through our distributor sales consultants contributed an increase in segment net sales of approximately \$20.3 million, or 1.3% compared to the fiscal year ended September 30, 2015. Other sales channels (including sales from stores that have been open for less than 14 months, sales through our franchise-based businesses and incremental sales from businesses acquired in the preceding 12 months) in the aggregate contributed a net increase in sales of approximately \$8.1 million, or 0.5%, compared to the fiscal year ended September 30, 2015. For the fiscal year ended September 30, 2016, the BSG segment's net sales reflect a 5.5% same store sales growth rate compared to 5.7% for the fiscal year ended September 30, 2015. Net sales for BSG for the fiscal year ended September 30, 2016, are inclusive of a net negative impact from changes in foreign currency exchange rates of approximately \$10.7 million, or less than 1.0% of BSG's net sales.

The \$83.3 million increase in the BSG segment's net sales is primarily the result of an increase in both unit volume (including increases in sales at existing stores and the incremental sales from 37 company-operated stores opened or acquired during the last twelve months) and increases in average unit prices (resulting from changes in product mix, including as a result of the introduction of certain third-party brands with higher average unit prices in the preceding 12 months).

Gross Profit

Consolidated gross profit increased by \$66.1 million, or 3.5%, for the fiscal year ended September 30, 2016, compared to the fiscal year ended September 30, 2015, principally due to higher sales volume and improved gross profit margins in both business segments, as more fully described below. Consolidated gross profit as a percentage of net sales, or consolidated gross profit margin, was 49.7% for the fiscal year ended September 30, 2016, compared to 49.5% for the fiscal year ended September 30, 2015.

Sally Beauty Supply. Sally Beauty Supply's gross profit increased by \$27.8 million, or 2.2%, for the fiscal year ended September 30, 2016, compared to the fiscal year ended September 30, 2015, principally as a result of higher sales volume and improved gross profit margin. Sally Beauty Supply's gross profit as a percentage of net sales increased to 55.2% for the fiscal year ended September 30, 2016, compared to 54.8% for the fiscal year ended September 30, 2015. This increase was primarily the result of selective price increases in certain geographical areas of the U.S., fewer promotions and a shift in product mix (to higher margin product) resulting from a shift in customer preferences.

Beauty Systems Group. BSG's gross profit increased by \$38.3 million, or 6.2%, for the fiscal year ended September 30, 2016, compared to the fiscal year ended September 30, 2015, principally as a result of higher sales volume and improved gross profit margin. BSG's gross profit as a percentage of net sales increased to 41.5% for the fiscal year ended September 30, 2016, compared to 41.3% for the fiscal year ended September 30, 2015 primarily as a result of a shift in product mix (to higher margin product) resulting from a shift in customer preferences and sales channel mix (to higher margin store-based product sales).

Selling, General and Administrative Expenses

Consolidated selling, general and administrative expenses increased by \$52.9 million, or 4.0%, for the fiscal year ended September 30, 2016, compared to the fiscal year ended September 30, 2015. This increase was attributable in part to incremental expenses (including employee compensation, rent and other occupancy-related expenses) resulting from stores opened or acquired in the preceding 12 months (approximately 145 net additional company-operated stores added since September 30, 2015, which represents a 3.0% increase in the number of company-operated stores). In addition, the increase reflects higher employee compensation and compensation-related expenses of \$28.0 million (including incremental compensation in connection with stores added since September 30, 2015 and expense of \$1.3 million incurred in connection with our ongoing management transition plan), higher expenses related to on-going upgrades to our information technology systems (approximately \$15.2 million), higher corporate expenses related to the data security incidents (\$9.1 million, including the accrued liability of \$12.8 million recorded in 2016, compared to the accrued liability of \$2.9 million recorded in 2015, as described above), higher legal and other professional fees mainly in connection with certain corporate initiatives (approximately \$6.1 million) and higher credit card fees (approximately \$3.7 million). The increase in selling, general and administrative expenses was partially offset by decreases in estimated future payments in connection with the Company's self-insurance programs of \$6.3 million and by the absence of expenses related to the 2015 Germany restructuring initiative (approximately \$3.9 million, net of approximately \$1.4 million reflected in cost of products sold and distribution expenses) during the fiscal year ended September 30, 2016. Selling, general and administrative expenses, as a percentage of net sales, were 34.6% for the fiscal year ended September 30, 2016, compared to 34.2% for the fiscal year ended September 30, 2015.

Depreciation and Amortization

Consolidated depreciation and amortization increased by \$10.3 million to \$99.7 million for the fiscal year ended September 30, 2016, compared to \$89.4 million for the fiscal year ended September 30, 2015. This increase reflects the incremental depreciation and amortization expenses associated with capital expenditures made in the preceding 12 months (mainly in connection with store openings in both operating segments, with store remodels in the Sally Beauty Supply segment (primarily in the U.S.) and with ongoing information technology upgrades), 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):

	Fiscal Year Ended September 30,			
	2016	2015	Increase (Decrease)	
Operating Earnings:				
Segment operating earnings:				
Sally Beauty Supply	\$ 409,787	\$ 412,393	\$ (2,606)	(0.6)%
BSG	254,479	231,151	23,328	10.1%
Segment operating earnings	664,266	643,544	20,722	3.2%
Unallocated expenses	(153,389)	(131,440)	21,949	16.7%
Share-based compensation expense	(12,580)	(16,778)	(4,198)	(25.0)%
Operating earnings	<u>\$ 498,297</u>	<u>\$ 495,326</u>	<u>\$ 2,971</u>	0.6%

Consolidated operating earnings increased by \$3.0 million, or 0.6%, for the fiscal year ended September 30, 2016, compared to the fiscal year ended September 30, 2015, primarily as a result of increased net sales and improved gross profit margin in both operating segments, and lower share-based compensation expense, partially offset by higher unallocated expenses, as more fully discussed below. Operating earnings, as a percentage of net sales, decreased by 30 basis points to 12.6% for the fiscal year ended September 30, 2016, compared to 12.9% for the fiscal year ended September 30, 2015. This decrease reflects higher consolidated operating expenses as a percentage of consolidated net sales, as more fully discussed below, partially offset by the improvement in consolidated gross profit margin described above.

Sally Beauty Supply. Sally Beauty Supply's segment operating earnings decreased by \$2.6 million, or 0.6%, for the fiscal year ended September 30, 2016, compared to the fiscal year ended September 30, 2015. This decrease was primarily a result of the incremental costs related to 108 net additional company-operated stores (stores opened during the past twelve months, which represents a 3.0% increase in the number of stores) operating during the fiscal year ended September 30, 2016, compared to the fiscal year ended September 30, 2015, higher depreciation expense principally associated with recent store openings and remodels (approximately \$10.0 million) and higher expenses related to recent upgrades to our information technology systems (approximately \$6.6 million). This decrease was partially offset by the increase in the segment's net sales and the improved gross profit margin described above and by the absence of expenses related to the 2015 Germany restructuring initiative (\$5.3 million) during the fiscal year 2016. Segment operating earnings, as a percentage of net sales, decreased by 40 basis points to 17.3% for the fiscal year ended September 30, 2016, compared to 17.7% for the fiscal year ended September 30, 2015. This decrease reflects higher segment operating expenses as a percentage of the segment's net sales, including the expense increases discussed in this paragraph, partially offset by the improvement in the segment's gross profit margin described above.

Beauty Systems Group. BSG's segment operating earnings increased by \$23.3 million, or 10.1%, for the fiscal year ended September 30, 2016, compared to the fiscal year ended September 30, 2015, primarily a result of the increase in the segment's net sales and the improved gross profit margin described above. This increase was partially offset by the incremental costs related to 37 net additional company-operated stores (stores opened or acquired during the past twelve months, which represents a 3.3% increase in the number of stores) operating during the fiscal year ended September 30, 2016, compared to the fiscal year ended September 30, 2015. Segment operating earnings, as a percentage of net sales, increased by 60 basis points to 16.0% for the fiscal year ended September 30, 2016, compared to 15.4% for the fiscal year ended

September 30, 2015. This increase reflects the increase in the segment's gross profit margin described above, as well as a decrease in segment operating expenses as a percentage of the segment's net sales.

Unallocated Expenses. Unallocated expenses, which represent certain corporate costs (such as payroll, employee benefits and travel expenses for corporate staff, certain professional fees, certain new business development expenses and corporate governance expenses) that have not been charged to our operating segments, increased by \$21.9 million, or 16.7%, for the fiscal year ended September 30, 2016, compared to the fiscal year ended September 30, 2015. This increase was due primarily to higher employee compensation and compensation-related expenses of \$5.3 million (including expenses incurred in connection with our ongoing management transition plan of \$1.3 million), higher corporate expenses related primarily to the data security incidents (approximately \$9.1 million including the accrued liability of \$12.8 million recorded in 2016, compared to the accrued liability of \$2.9 million recorded in 2015, as described above), net of certain insurance recovery related to the data security incidents in 2015, higher corporate expenses related to on-going upgrades to our information technology systems of \$7.5 million, and legal and other professional fees mainly in connection with certain corporate initiatives, in the aggregate, of \$4.7 million. This increase was partially offset by decreases in estimated future payments in connection with the Company's self-insurance programs of \$6.3 million.

Share-based Compensation Expense. Total compensation costs charged against income for share-based compensation arrangements decreased by \$4.2 million to \$12.6 million for the fiscal year ended September 30, 2016, compared to \$16.8 million for the fiscal year ended September 30, 2015. This decrease was mainly due to the timing of expense recognition in connection with retirement-eligible grantees during the fiscal year ended September 30, 2016 and the impact of awards that became fully vested after September 30, 2015.

Interest Expense

Interest expense increased by \$27.4 million to \$144.2 million for the fiscal year ended September 30, 2016, compared to \$116.8 million for the fiscal year ended September 30, 2015. Interest expense is net of interest income of approximately \$0.2 million for both the fiscal year ended September 30, 2016 and 2015. The increase in interest expense was principally due to the impact of our debt refinancing in December 2015, including a loss on extinguishment of debt of \$33.3 million recognized in connection with such debt refinancing, partially offset by lower interest expense on the senior notes due 2015 compared to the senior notes due 2019. Please see Note 13 of the Notes to Consolidated Financial Statements in Item 8—“Financial Statements and Supplementary Data” contained elsewhere in this Annual Report and “Liquidity and Capital Resources” below for additional information about the Company's debt.

Provision for Income Taxes

The provision for income taxes was \$131.1 million and \$143.4 million, and the annual effective income tax rate was 37.0% and 37.9%, for the fiscal years ended September 30, 2016 and 2015, respectively. The decrease in the effective income tax rate for the fiscal year ended September 30, 2016, compared to the fiscal year ended September 30, 2015, is primarily due to decreased losses subject to a valuation allowance in certain of the Company's foreign operations and a reduction in non-deductible executive compensation.

Net Earnings

As a result of the foregoing, consolidated net earnings decreased by \$12.1 million, or 5.2%, to \$222.9 million for the fiscal year ended September 30, 2016, compared to \$235.1 million for the fiscal year ended September 30, 2015. Net earnings, as a percentage of net sales, decreased by 50 basis points to 5.6% for the fiscal year ended September 30, 2016, compared to 6.1% for the fiscal year ended September 30, 2015.

The Fiscal Year Ended September 30, 2015 compared to the Fiscal Year Ended September 30, 2014

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

	Fiscal Year Ended September 30,			
	2015	2014	Increase (Decrease)	
Net sales:				
Sally Beauty Supply	\$2,329,523	\$2,308,743	\$20,780	0.9%
BSG	1,504,820	1,444,755	60,065	4.2%
Consolidated net sales	\$3,834,343	\$3,753,498	\$80,845	2.2%
Gross profit:				
Sally Beauty Supply	\$1,276,529	\$1,265,785	\$10,744	0.8%
BSG	621,322	594,387	26,935	4.5%
Consolidated gross profit	\$1,897,851	\$1,860,172	\$37,679	2.0%
Gross profit margin:				
Sally Beauty Supply	54.8%	54.8%	0.0%	
BSG	41.3%	41.1%	0.2%	
Consolidated gross profit margin	49.5%	49.6%	(0.1)%	

Net Sales

Consolidated Net Sales. Consolidated net sales increased by \$80.8 million, or 2.2%, for the fiscal year ended September 30, 2015, compared to the fiscal year ended September 30, 2014. Company-operated Sally Beauty Supply and BSG stores that have been open for 14 months or longer contributed an increase in consolidated net sales of approximately \$98.7 million, or 2.6% of consolidated net sales. Other sales channels (including sales from stores that have been open for less than 14 months, incremental sales from businesses acquired in the preceding 12 months, sales through our BSG franchise-based businesses and distributor sales consultants, and sales from our Sally Beauty Supply non-store sales channels) in the aggregate experienced a net decrease in sales of approximately \$17.9 million, or 0.5% of consolidated net sales, compared to the fiscal year ended September 30, 2014, primarily due to fewer acquisitions and store openings, and softer Sally Beauty Supply non-store sales. Consolidated net sales for the fiscal year ended September 30, 2015, are inclusive of a net negative impact from changes in foreign currency exchange rates of \$87.3 million, or 2.3% of consolidated net sales.

For the fiscal year ended September 30, 2015, consolidated net sales reflect a same store sales growth rate of 2.9% compared to 2.0% for the fiscal year ended September 30, 2014. For the fiscal year ended September 30, 2015, our consolidated same store sales growth rate was positively impacted by improved customer traffic in our BSG segment in the U.S. For the fiscal year ended September 30, 2014, the consolidated same store sales growth rate was negatively impacted by lower traffic in both operating segments driven primarily by inclement weather in the U.S.

The \$80.8 million increase in consolidated net sales is primarily the result of increases in unit volume (including increases in sales at existing stores and the incremental sales from 145 company-operated stores opened or acquired during the last twelve months) and average unit prices (resulting from changes in product mix, including the impact on average unit prices of third-party brands introduced this year at both segments).

Sally Beauty Supply. Net sales for Sally Beauty Supply increased by \$20.8 million, or 0.9% of segment net sales, for the fiscal year ended September 30, 2015, compared to the fiscal year ended September 30, 2014. In the Sally Beauty Supply segment, company-operated stores that have been open for 14 months or longer

contributed an increase in segment net sales of approximately \$30.0 million, or 1.3% of segment net sales. Other sales channels (including sales from stores that have been open for less than 14 months and sales from our non-store sales channels, which include the catalog and e-commerce sales of our Sinelco Group subsidiaries) in the aggregate experienced a net decrease in sales of approximately \$9.2 million, or 0.4% of segment net sales, compared to the fiscal year ended September 30, 2014, primarily due to fewer Sally Beauty Supply store openings and softer non-store sales. Net sales for Sally Beauty Supply for the fiscal year ended September 30, 2015, are inclusive of a net negative impact from changes in foreign currency exchange rates of approximately \$70.9 million, or 3.1% of Sally Beauty Supply's net sales.

For the fiscal year ended September 30, 2015, the Sally Beauty Supply segment's net sales reflect a same store sales growth rate of 1.7% compared to 1.3% for the fiscal year ended September 30, 2014. For the fiscal year ended September 30, 2015, the Sally Beauty Supply segment's same store sales growth rate was positively impacted by higher average sales transaction amounts at our U.S. stores compared to the fiscal year ended September 30, 2014. For the fiscal year ended September 30, 2014, the segment's same store sales growth rate was adversely impacted by lower traffic driven primarily by inclement weather in the U.S.

The \$20.8 million increase in the Sally Beauty Supply segment's net sales is the result of increases in unit volume (including increases in sales at existing stores and the incremental sales from 111 company-operated stores opened during the last twelve months) and average unit prices (resulting from changes in product mix, including the impact on average unit prices of third-party brands introduced this year at our Sally Beauty Supply segment).

Beauty Systems Group. Net sales for BSG increased by \$60.1 million, or 4.2% of segment net sales, for the fiscal year ended September 30, 2015, compared to the fiscal year ended September 30, 2014. In the BSG segment, company-operated stores that have been open for 14 months or longer contributed an increase in segment net sales of approximately \$68.7 million, or 4.8% of segment net sales, and sales through our distributor sales consultants contributed an increase in segment net sales of approximately \$9.1 million, or 0.6%, compared to the fiscal year ended September 30, 2014, while sales from stores that have been open for less than 14 months experienced a decrease of \$11.0 million, or 0.8% of segment net sales, compared to the fiscal year ended September 30, 2014, primarily due to a shift in the timing of store openings in the normal course of BSG's business. Other sales channels (including sales through our franchise-based businesses and incremental sales from businesses acquired in the preceding 12 months) in the aggregate experienced a net decrease in sales of approximately \$6.7 million, or 0.5% of segment net sales, compared to the fiscal year ended September 30, 2014, primarily due to fewer acquisitions. Net sales for BSG for the fiscal year ended September 30, 2015, are inclusive of a net negative impact from changes in foreign currency exchange rates of approximately \$16.5 million, or 1.1% of BSG's net sales.

For the fiscal year ended September 30, 2015, the BSG segment's net sales reflect a same store sales growth rate of 5.7% compared to 3.5% for the fiscal year ended September 30, 2014. For the fiscal year ended September 30, 2015, the BSG segment's same store sales growth rate was positively impacted by improved customer traffic in the U.S. compared to the fiscal year ended September 30, 2014.

The \$60.1 million increase in the BSG segment's net sales is primarily the result of increases in unit volume (including increases in sales at existing stores and the incremental sales from 34 company-operated stores opened or acquired during the last twelve months) and average unit prices (resulting from changes in product mix, including the impact of certain third-party brands with higher average unit prices introduced this year at our BSG segment).

Gross Profit

Consolidated Gross Profit. Consolidated gross profit increased by \$37.7 million, or 2.0%, for the fiscal year ended September 30, 2015, compared to the fiscal year ended September 30, 2014, primarily due to higher net sales. Consolidated gross profit as a percentage of net sales, or consolidated gross profit margin, was 49.5% for the fiscal year ended September 30, 2015, compared to 49.6% for the fiscal year ended

September 30, 2014. Consolidated gross profit for the fiscal year ended September 30, 2015 is inclusive of a negative impact from changes in foreign currency exchange rates of approximately \$40.6 million.

Sally Beauty Supply. Sally Beauty Supply's gross profit increased by \$10.7 million, or 0.8%, for the fiscal year ended September 30, 2015, compared to the fiscal year ended September 30, 2014, primarily due to higher sales. Sally Beauty Supply's gross profit as a percentage of net sales was 54.8% for both the fiscal year ended September 30, 2015 and the fiscal year ended September 30, 2014. Sally Beauty Supply's gross profit for the fiscal year ended September 30, 2015 is inclusive of a negative impact from changes in foreign currency exchange rates of approximately \$33.4 million.

Beauty Systems Group. BSG's gross profit increased by \$26.9 million, or 4.5%, for the fiscal year ended September 30, 2015, compared to the fiscal year ended September 30, 2014, due to higher sales and improved gross profit margin. BSG's gross profit as a percentage of net sales was 41.3% for the fiscal year ended September 30, 2015, compared to 41.1% for the fiscal year ended September 30, 2014. BSG's gross profit for the fiscal year ended September 30, 2015 is inclusive of a negative impact from changes in foreign currency exchange rates of approximately \$7.2 million.

Selling, General and Administrative Expenses

Consolidated selling, general and administrative expenses increased by \$39.6 million, or 3.1%, for the fiscal year ended September 30, 2015, compared to the fiscal year ended September 30, 2014. This increase was attributable in part to incremental expenses (including employee compensation, rent and other occupancy-related expenses) resulting from stores opened in the preceding 12 months (approximately 145 net additional company-operated stores added since September 30, 2014, which represents a 3.1% increase in the number of stores). In addition, the increase reflects higher recruitment and compensation-related expenses primarily in connection with our ongoing management transition plans (approximately \$5.0 million), higher expenses related to on-going upgrades to our information technology systems (approximately \$3.7 million), higher advertising costs in our Sally Beauty Supply segment (approximately \$5.4 million) and higher expenses principally associated with store remodels and relocations (approximately \$2.4 million) in the Sally Beauty Supply segment, higher corporate expenses related to the data security incidents and to ongoing data security upgrades (approximately \$4.0 million, net of related insurance recovery), and expenses incurred in connection with the restructuring of our Sally Beauty Supply segment's operations in Germany of approximately \$3.9 million (\$5.3 million, net of approximately \$1.4 million reflected in cost of products sold and distribution expenses) in the fiscal year ended September 30, 2015. Selling, general and administrative expenses, as a percentage of net sales, increased to 34.2% for the fiscal year ended September 30, 2015, compared to 33.9% for the fiscal year ended September 30, 2014, mainly as a result of the expense increases mentioned earlier in this paragraph. Consolidated selling, general and administrative expenses for the fiscal year ended September 30, 2015 are inclusive of a net positive impact from changes in foreign currency exchange rates, of approximately \$34.2 million, resulting from a stronger U.S. dollar during the fiscal year ended September 30, 2015.

Depreciation and Amortization

Consolidated depreciation and amortization increased by \$9.7 million, or 12.2%, to \$89.4 million for the fiscal year ended September 30, 2015, compared to \$79.7 million for the fiscal year ended September 30, 2014. This increase reflects the incremental depreciation and amortization expenses associated with capital expenditures made in the preceding 12 months (mainly in connection with store openings in both operating segments, store remodels in the Sally Beauty Supply segment in the U.S., and ongoing information technology upgrades), partially offset by the impact of assets (including intangible assets) that became fully depreciated (or fully amortized) 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):

	Fiscal Year Ended September 30,			
	2015	2014	Increase (Decrease)	
Operating Earnings:				
Segment operating earnings:				
Sally Beauty Supply	\$ 412,393	\$431,655	\$(19,262)	(4.5)%
BSG	231,151	216,971	14,180	6.5%
Segment operating earnings	643,544	648,626	(5,082)	(0.8)%
Unallocated expenses	(131,440)	(119,523)	11,917	10.0%
Share-based compensation expense	(16,778)	(22,107)	(5,329)	(24.1)%
Operating earnings	<u>\$ 495,326</u>	<u>\$506,996</u>	<u>\$(11,670)</u>	<u>(2.3)%</u>

Consolidated operating earnings decreased by \$11.7 million, or 2.3%, for the fiscal year ended September 30, 2015, compared to the fiscal year ended September 30, 2014. This decrease is primarily the result of higher unallocated expenses and a decrease in our Sally Beauty Supply segment's operating earnings, partially offset by an increase in our BSG segment's operating earnings and lower share-based compensation expense, as discussed below. Operating earnings, as a percentage of net sales, decreased to 12.9% for the fiscal year ended September 30, 2015, compared to 13.5% for the fiscal year ended September 30, 2014. This decrease reflects higher consolidated operating expenses as a percentage of consolidated net sales, including incremental corporate expenses related primarily to the data security incidents and ongoing data security upgrades of approximately \$4.0 million (net of certain insurance recovery related to the data security incidents) and expenses of \$5.3 million related to the Sally Beauty Supply segment's Germany restructuring mentioned earlier.

Sally Beauty Supply. Sally Beauty Supply's segment operating earnings decreased by \$19.3 million, or 4.5%, for the fiscal year ended September 30, 2015, compared to the fiscal year ended September 30, 2014. The decrease in the Sally Beauty Supply segment's operating earnings was primarily a result of the incremental costs related to 111 additional company-operated stores (stores opened during the past twelve months) operating during the fiscal year ended September 30, 2015. In addition, the decrease reflects higher advertising costs (\$5.4 million), the incremental depreciation expense (\$4.8 million) associated with capital expenditures made in the preceding 12 months (mainly in connection with store openings in several geographies and store remodels in the U.S., and with ongoing information technology upgrades), expenses related to the Germany restructuring initiative (\$5.3 million), higher expenses principally associated with store remodels and relocations (\$2.4 million) and higher recruitment and employee compensation-related expenses in connection with our management transition plans (\$1.4 million), partially offset by the increase in the Sally Beauty Supply segment's net sales described above. Segment operating earnings, as a percentage of net sales, decreased to 17.7% for the fiscal year ended September 30, 2015, compared to 18.7% for the fiscal year ended September 30, 2014. This decrease reflects higher segment operating expenses as a percentage of the segment's net sales, primarily as a result of the expense increases mentioned earlier in this paragraph.

Beauty Systems Group. BSG's segment operating earnings increased by \$14.2 million, or 6.5%, for the fiscal year ended September 30, 2015, compared to the fiscal year ended September 30, 2014, primarily as a result of increased sales, partially offset by the incremental costs related to 34 additional company-operated stores (stores opened during the past twelve months) operating during the fiscal year ended September 30, 2015, as well as by the incremental depreciation expense (\$1.9 million) associated with

capital expenditures made in the preceding 12 months (mainly in connection with ongoing information technology upgrades), higher allowance for doubtful accounts receivable (approximately \$0.8 million, predominantly related to one customer) and higher expenses related primarily to upgrades to our BSG information technology systems (approximately \$0.7 million). Segment operating earnings, as a percentage of net sales, increased to 15.4% for the fiscal year ended September 30, 2015, compared to 15.0% for the fiscal year ended September 30, 2014, primarily as a result of the increase in the segment's gross profit margin described above, as well as a reduction in the segment's operating expenses as a percentage of the segment's net sales.

Unallocated Expenses. Unallocated expenses, which represent certain corporate costs (such as payroll, employee benefits and travel expenses for corporate staff, certain professional fees, certain new business development expenses and corporate governance expenses) that have not been charged to our operating segments, increased by \$11.9 million, or 10.0%, for the fiscal year ended September 30, 2015, compared to the fiscal year ended September 30, 2014. This increase was due primarily to higher recruitment and employee compensation-related expenses primarily in connection with our ongoing management transition plans (approximately \$3.2 million), incremental depreciation expense (\$3.3 million) associated with capital expenditures made in the preceding 12 months (mainly in connection with ongoing information technology upgrades), higher corporate expenses related primarily to on-going upgrades to our information technology systems (approximately \$2.5 million), higher corporate expenses related primarily to the data security incidents and ongoing data security upgrades (approximately \$4.0 million, net of certain insurance recovery related to the data security incidents) and higher professional fees primarily related to new business development and other corporate initiatives (approximately \$1.0 million).

Share-based Compensation Expense. Total compensation costs charged against income for share-based compensation arrangements decreased by \$5.3 million, or 24.1%, to \$16.8 million for the fiscal year ended September 30, 2015, compared to \$22.1 million for the fiscal year ended September 30, 2014. This decrease was mainly due to lower aggregate fair value at the date of grant of the stock options awarded during the fiscal year ended September 30, 2015 and the impact of awards that became fully vested since September 30, 2014. In addition, this decrease reflects the impact of a \$3.5 million stock options award in connection with the executive management transition plan during the fiscal year ended September 30, 2014, without a comparable award in the fiscal year ended September 30, 2015.

Interest Expense

Interest expense was \$116.8 million for the fiscal year ended September 30, 2015, compared to \$116.3 million the fiscal year ended September 30, 2014. Interest expense is net of interest income of approximately \$0.2 million for each of the fiscal years ended September 30, 2015 and 2014. The increase in interest expense was primarily attributable to the effect of higher principal balances on our debt outstanding during the fiscal year ended September 30, 2015, including the senior notes due 2023 issued in October 2013. This increase was partially offset by lower borrowings under the ABL facility during the fiscal year ended September 30, 2015, compared to the fiscal year ended September 30, 2014. Please see Note 13 of the Notes to Consolidated Financial Statements in Item 8—"Financial Statements and Supplementary Data" contained elsewhere in this Annual Report and "Liquidity and Capital Resources" below for additional information about the Company's debt.

Provision for Income Taxes

The provision for income taxes was \$143.4 million and \$144.7 million and the annual effective tax rate was 37.9% and 37.0% for the fiscal years ended September 30, 2015 and 2014, respectively. The increase in the effective income tax rate for the fiscal year 2015, compared to the fiscal year 2014, is primarily due to increased foreign tax losses resulting in part from our ongoing expansion into international geographies and a beneficial tax settlement in the fiscal year 2014 without a comparable tax benefit in the fiscal year 2015.

Net Earnings

As a result of the foregoing, consolidated net earnings decreased by \$10.9 million, or 4.4%, to \$235.1 million for the fiscal year ended September 30, 2015, compared to \$246.0 million for the fiscal year ended September 30, 2014. Net earnings, as a percentage of net sales, were 6.1% for the fiscal year ended September 30, 2015, compared to 6.6% for the fiscal year ended September 30, 2014.

Financial Condition

September 30, 2016 Compared to September 30, 2015

Working capital (current assets less current liabilities) decreased by \$11.2 million to \$684.2 million at September 30, 2016, compared to \$695.4 million at September 30, 2015. The ratio of current assets to current liabilities was 2.40 to 1.00 at September 30, 2016, compared to 2.41 to 1.00 at September 30, 2015. The decrease in working capital reflects a decrease in current assets of \$14.3 million, partially offset by a decrease in current liabilities of \$3.0 million. The decrease in current assets is principally due to a decrease in cash and cash equivalents of \$53.4 million (please see “Liquidity and Capital Resources” below for a description of our sources and uses of cash) and a decrease of \$5.4 million in accounts receivable, other, partially offset by an increase of \$22.1 million in inventory, an increase in other current assets of \$17.8 million and an increase in deferred income tax assets of \$6.3 million. The decrease in current liabilities is principally due to a decrease of \$4.5 million in accounts payable and a decrease in income taxes payable of \$4.3 million, partially offset by an increase of \$5.9 million in accrued liabilities, as discussed below.

Accounts receivable, other decreased by \$5.4 million to \$37.0 million at September 30, 2016, compared to \$42.5 million at September 30, 2015 due primarily to the timing of collections from customers and vendors in the ordinary course of our business and the impact of foreign currency translation adjustments. Inventory increased by \$22.1 million to \$907.3 million at September 30, 2016, compared to \$885.2 million at September 30, 2015 primarily due to the effect of stores opened (145 net additional Sally Beauty Supply and BSG company-operated stores added during the fiscal year ended September 30, 2016) and the addition of new product lines in both operating segments, partially offset by the impact of foreign currency translation adjustments of approximately \$12.5 million. Other current assets increased by \$17.8 million to \$54.9 million at September 30, 2016, compared to \$37.0 million at September 30, 2015 due primarily to an increase in income tax receivable in the ordinary course of our business. Deferred income tax assets increased by \$6.3 million to \$40.0 million at September 30, 2016, compared to \$33.7 million at September 30, 2015 due primarily to the timing of recognition, for financial accounting purposes, of the loss contingency obligation discussed earlier compared to the timing of recognition of such loss for income tax purposes. Please see Note 16 of notes to consolidated financial statements included elsewhere in this Annual Report.

Accounts payable decreased by \$4.5 million to \$271.4 million at September 30, 2016, compared to \$275.9 million at September 30, 2015 due to the timing of payments to suppliers primarily in connection with recent purchases of merchandise inventory and capital expenditures. Accrued liabilities increased by \$5.9 million to \$214.6 million at September 30, 2016, compared to \$208.7 million at September 30, 2015, primarily due to an increase of \$12.8 million in the loss contingency obligation in connection with the data security incidents and an increase in other operational accruals, partially offset by a decrease in accrued compensation and benefits of \$5.6 million and a decrease in interest payable in connection with our debt, mainly as a result of our December 2015 debt refinancing. Income taxes payable decreased by \$4.3 million to \$2.0 million at September 30, 2016, compared to \$6.3 million at September 30, 2015 due primarily to the timing of federal estimated income tax payments in the ordinary course of our business.

Net property and equipment increased by \$48.7 million to \$319.6 million at September 30, 2016, compared to \$270.8 million at September 30, 2015, primarily due to capital expenditures of \$143.4 million, including

amounts incurred but not paid, partially offset by the fiscal year 2016 depreciation expense of \$86.3 million and foreign currency translation adjustments of approximately \$5.9 million.

Goodwill increased by \$8.3 million to \$532.7 million at September 30, 2016, compared to \$524.4 million at September 30, 2015, primarily due to \$12.8 million of goodwill recorded in connection with businesses acquired during the fiscal year 2016, partially offset by foreign currency translation adjustments of approximately \$4.5 million.

Intangible assets, excluding goodwill, decreased by \$5.9 million to \$93.0 million at September 30, 2016, compared to \$98.8 million at September 30, 2015, primarily due to amortization expense of \$13.3 million recognized in the fiscal year 2016 and foreign currency translation adjustments, partially offset by \$10.1 million of intangible assets recorded in connection with businesses acquired during the fiscal year 2016.

Long-term debt, including current portion, decreased by \$3.6 million to \$1,784.0 million at September 30, 2016, compared to \$1,787.6 million at September 30, 2015, primarily due to deferred financing costs of \$12.7 million paid in connection with our December 2015 issuance of our senior notes due 2025 and the amortization of premium on certain senior notes, partially offset by unamortized deferred financing costs of \$7.5 million expensed in connection with our December 2015 redemption of our senior notes due 2019 and amortization of deferred financing costs of \$3.3 million. Please see “Liquidity and Capital Resources” below.

Deferred income tax liabilities increased by \$28.8 million to \$114.7 million at September 30, 2016, compared to \$85.9 million at September 30, 2015 due primarily to the timing of recognition, for financial accounting purposes, of depreciation and amortization expenses compared to the timing of recognition of such expenses for income tax purposes. Please see Note 16 of notes to consolidated financial statements included elsewhere in this Annual Report.

Total stockholders’ deficit decreased by \$21.7 million to \$276.2 million at September 30, 2016, compared to \$297.8 million at September 30, 2015. This decrease was primarily a result of net earnings of \$222.9 million, and share-based compensation expense, the impact of exercises of stock options and other share-based compensation activity, in the aggregate, of approximately \$28.4 million. This decrease was partially offset by our repurchase and retirement of approximately 7.8 million shares of our common stock for approximately \$207.3 million and foreign currency translation adjustments, net of tax, of \$22.3 million. Please see “Liquidity and Capital Resources” below.

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.

We are highly leveraged and a substantial portion of our liquidity needs will arise from debt service on our outstanding indebtedness and from funding the costs of operations, working capital, capital expenditures and share repurchases. As a holding company, we depend on our subsidiaries, including Sally Holdings LLC (which we refer to as “Sally Holdings”), to distribute funds to us so that we may pay our obligations and expenses. The ability of our subsidiaries to make such distributions will be subject to their operating results, cash requirements and financial condition and their compliance with relevant laws, and covenants and financial ratios related to their existing or future indebtedness, including covenants restricting Sally Holdings’ ability to pay dividends to us. If, as a consequence of these limitations, we cannot receive sufficient distributions from our subsidiaries, we may not be able to meet our obligations to fund general corporate expenses. Please see “Risk Factors—Risks Relating to Our Business,” and “—Risks Relating to Our Substantial Indebtedness.”

We may from time to time repurchase or otherwise retire or refinance our debt (through our subsidiaries or otherwise) and take other steps to reduce or refinance our debt. These actions may include open market repurchases of our notes or other retirements of outstanding debt. The amount of debt that may be repurchased, or refinanced or otherwise retired, if any, will be determined in 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.

At September 30, 2016, cash and cash equivalents were \$86.6 million. Based upon the current level of operations and anticipated growth, we anticipate that existing cash balances (excluding certain amounts permanently invested in connection with foreign operations), funds expected to be generated by operations and funds available under the ABL facility will be sufficient to meet our working capital requirements, fund share repurchases and potential acquisitions, and finance anticipated capital expenditures, including information technology upgrades and store remodels, over the next twelve months.

However, there can be no assurance that our business will generate sufficient cash flows from operations, that anticipated net sales 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, general economic conditions and other risks discussed in this Annual Report. Please see "Risk Factors" in Item 1A of this Annual Report.

We utilize our ABL facility for the issuance of letters of credit, for certain working capital and liquidity needs and to manage normal fluctuations in our operational cash flow. In that regard, we may from time to time draw funds under the ABL facility for general corporate purposes including funding of capital expenditures, acquisitions, interest payments due on our indebtedness and share repurchases. The funds drawn on an individual occasion during the fiscal year ended September 30, 2016 have varied in amounts up to \$20.0 million, total amounts outstanding have ranged from zero up to \$90.0 million and the average daily balance outstanding was \$12.3 million. During the fiscal year ended September 30, 2016, the weighted average interest rate on our borrowings under the ABL facility was 3.0%. The amounts drawn are generally paid down with cash provided by our operating activities.

As of September 30, 2016, there were no borrowings outstanding under the ABL facility and Sally Holdings had \$478.4 million available for borrowings under the ABL facility, subject to borrowing base limitations, as reduced by outstanding letters of credit.

We are a holding company and do not have any material assets or operations other than ownership of equity interests in 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. Please see "*Long-Term Debt Covenants*" below.

During the fiscal years ended September 30, 2016, 2015 and 2014 we completed several individually immaterial acquisitions at an aggregate cost of \$26.1 million, \$7.1 million and \$4.9 million, respectively. We generally funded these acquisitions with cash from operations, borrowings under the ABL facility and a portion of the cash proceeds from our October 2013 debt issuance.

Share Repurchase Programs

In August 2014, we announced that the Board had approved the 2014 Share Repurchase Program authorizing us to repurchase up to \$1.0 billion of our common stock over an approximate three-year period expiring on September 30, 2017.

During the fiscal years ended September 30, 2016 and 2015, we repurchased and subsequently retired approximately 7.8 million and 8.1 million shares of our common stock, respectively, under the 2014 Share Repurchase Program at a cost of \$207.3 million and \$227.6 million, respectively. In addition, during the fiscal year ended September 30, 2014, we repurchased and retired approximately 12.6 million shares of our common stock under the 2013 Share Repurchase Program (a share repurchase program approved by our Board in March 2013 and terminated in connection with the authorization of the 2014 Share Repurchase Program) at a cost of \$333.3 million. We funded these share repurchases with cash from operations, borrowings under the ABL facility and a portion of the cash proceeds from our October 2013 debt issuance. Future repurchases of shares of our common stock are expected to be funded with existing cash balances, funds expected to be generated by operations and available borrowings under the ABL facility.

Historical Cash Flows

For the fiscal years 2016, 2015 and 2014, our primary sources of cash have been funds provided by operating activities, our October 2013 debt issuance and, when necessary, borrowings under our ABL facility. The primary uses of cash during the past three years were for share repurchases, debt service, capital expenditures and acquisitions.

The following table shows our sources and uses of funds for the fiscal years ended September 30, 2016, 2015 and 2014 (in thousands):

	Fiscal Year Ended September 30,					
	2016	2015	Change	2015	2014	Change
Net cash provided by operating activities	\$ 351,005	\$ 300,787	\$ 50,218	\$ 300,787	\$ 315,972	\$(15,185)
Net cash used by investing activities	(174,830)	(112,818)	(62,012)	(112,818)	(81,754)	(31,064)
Net cash used by financing activities	(229,030)	(151,955)	(77,075)	(151,955)	(173,734)	21,779
Effect of foreign currency exchange rate changes on cash and cash equivalents	(561)	(2,551)	1,990	(2,551)	(1,024)	(1,527)
Net increase (decrease) in cash and cash equivalents	<u>\$ (53,416)</u>	<u>\$ 33,463</u>	<u>\$(86,879)</u>	<u>\$ 33,463</u>	<u>\$ 59,460</u>	<u>\$(25,997)</u>

Net Cash Provided by Operating Activities

Net cash provided by operating activities during the fiscal year ended September 30, 2016 increased by \$50.2 million to \$351.0 million, compared to \$300.8 million during the fiscal year ended September 30, 2015 mainly due to an increase in net earnings before depreciation and amortization expenses, net loss on extinguishment of debt, share-based compensation, deferred income taxes, net loss on disposal of property and equipment and excess tax benefits resulting from share-based compensation activity (in the aggregate, \$60.2 million), partially offset by net changes in the components of working capital.

Net cash provided by operating activities during the fiscal year ended September 30, 2015 decreased by \$15.2 million to \$300.8 million compared to \$316.0 million during the fiscal year ended September 30, 2014, primarily due to a decrease in net earnings (\$10.9 million) and net changes in the components of working capital in the normal course of our business (\$11.4 million), partially offset by a change in

depreciation and amortization expense (\$9.7 million). The changes in the components of working capital include net changes in operating assets (\$49.3 million), partially offset by net changes in operating liabilities (\$37.8 million).

Net Cash Used by Investing Activities

Net cash used by investing activities during the fiscal year ended September 30, 2016 increased by \$62.0 million to \$174.8 million, compared to \$112.8 million during the fiscal year ended September 30, 2015. This increase reflects incremental capital expenditures of \$44.7 million, primarily related to store openings and ongoing information technology upgrades in both business segments, store remodels in the Sally Beauty Supply segment (primarily in the U.S.) and upgrades to certain distribution centers and an increase of \$19.7 million in cash used for acquisitions, net of cash acquired, in the fiscal year ended September 30, 2016, compared to the fiscal year ended September 30, 2015, partially offset by incremental proceeds from sale of property and equipment (\$2.3 million).

Net cash used by investing activities during the fiscal year ended September 30, 2015 increased by \$31.1 million to \$112.8 million compared to \$81.8 million during the fiscal year ended September 30, 2014. This increase reflects an increase in capital expenditures (\$29.7 million) primarily related to store openings and to ongoing information technology upgrades in both business segments, and to store remodels in the Sally Beauty Supply segment in the U.S. during the fiscal year ended September 30, 2015, as well as an increase in cash used for acquisitions (net of cash acquired) of \$1.3 million during the fiscal year ended September 30, 2015, compared to the fiscal year ended September 30, 2014.

Net Cash Used by Financing Activities

Net cash used by financing activities increased by \$77.1 million to cash used of \$229.0 million during the fiscal year ended September 30, 2016, compared to \$152.0 million during the fiscal year ended September 30, 2015, primarily due to the payment of a redemption premium (\$25.8 million) and debt issuance costs (\$12.7 million) in connection with our redemption of the senior notes due 2019 and issuance of the senior notes due 2025 in December 2015, and a decrease in proceeds from exercises of stock options and excess tax benefits resulting from share-based compensation activity, in the aggregate, of \$58.9 million, partially offset by a decrease in share repurchases under the 2014 Share Repurchase Program (\$20.2 million).

Net cash used by financing activities decreased by \$21.8 million to \$152.0 million during the fiscal year ended September 30, 2015, compared to \$173.7 million during the fiscal year ended September 30, 2014. This decrease was primarily due to a decrease in cash used to repurchase shares of our common stock of \$105.7 million, an increase in proceeds from exercises of stock options and excess tax benefits resulting from share-based compensation activity, in the aggregate, of \$35.1 million, and the impact of debt issuance costs of \$3.9 million paid in connection with issuance of the senior notes due 2023 in the fiscal year ended September 30, 2014 with no comparable amount in the fiscal year ended September 30, 2015, partially offset by a decrease in net borrowings under our long-term debt of \$123.0 million.

Long-Term Debt

Outstanding Long-Term Debt

In November 2006, the Company, through its subsidiaries (Sally Investment Holdings LLC and Sally Holdings) incurred \$1,850.0 million of indebtedness in connection with the Company's separation from its former parent, Alberto-Culver.

In the fiscal year 2011, Sally Holdings entered into a \$400 million, five-year asset-based senior secured loan facility (the "ABL facility"). The availability of funds under the ABL facility, as amended in June 2012, is subject to a customary borrowing base comprised of: (i) a specified percentage of our eligible credit card

and trade accounts receivable (as defined therein) and (ii) a specified percentage of our eligible inventory (as defined therein), and reduced by (iii) certain customary reserves and adjustments and by certain outstanding letters of credit. The ABL facility includes a \$25.0 million Canadian sub-facility for our Canadian operations. In the fiscal year 2013, the Company, Sally Holdings and other parties to the ABL facility entered into a second amendment to the ABL facility which, among other things, increased the maximum availability under the ABL Facility to \$500.0 million (subject to borrowing base limitations), reduced pricing, relaxed the restrictions regarding the making of Restricted Payments, extended the maturity to July 2018 and improved certain other covenant terms. At September 30, 2016, the Company had \$478.4 million available for borrowing under the ABL facility, including the Canadian sub-facility.

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

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

On December 3, 2015, the Issuers issued \$750.0 million aggregate principal amount of their senior notes due 2025 at par. The Company used the net proceeds from this debt issuance (approximately \$737.3 million), as well as existing cash balances, to redeem in full the senior notes due 2019, at a total redemption cost of \$775.8 million, excluding accrued interest. In connection with our redemption of the senior notes due 2019, we recorded a loss on extinguishment of debt in the amount of approximately \$33.3 million, including a redemption premium in the amount of approximately \$25.8 million and unamortized deferred financing costs of approximately \$7.5 million.

As of September 30, 2016, the principal amount of long-term debt (excluding capitalized leases) is as follows (dollars in thousands):

	Principal Amount(a)	Maturity Dates	Interest Rates(b)
ABL facility	\$ —	July 2018	(i) Prime plus (0.50% to 0.75%) or; (ii) LIBOR(c) plus (1.50% to 1.75%)
Senior notes due 2022	850,000	June 2022	5.750%
Senior notes due 2023	200,000	Nov. 2023	5.500%
Senior notes due 2025	750,000	Dec. 2025	5.625%
Total	<u>\$1,800,000</u>		

(a) Amounts reported above do not reflect unamortized premium of \$5.6 million related to notes with an aggregate principal amount of \$150.0 million or unamortized debt issuance costs in the aggregate amount of \$23.7 million, at September 30, 2016.

- (b) Interest rates shown represent the coupon or contractual rate related to each debt instrument listed.
- (c) When used in this Annual Report, LIBOR means the London Interbank Offered Rate.

Long-Term Debt Covenants

We are a holding company and do not have any material assets or operations other than ownership of equity interests in our subsidiaries.

The agreements and instruments governing our debt contain restrictions and limitations that could significantly impact our ability to operate our business. These restrictions and limitations relate to:

- Incurrence of additional indebtedness
- Repurchases and redemptions of capital stock and the payment of dividends
- Making of certain debt prepayments
- Mergers or consolidations
- Granting of liens on assets
- Making of investments, including joint ventures
- Making of acquisitions
- Disposition of assets

Borrowings under the ABL facility are secured by the accounts, inventory and credit card receivables (and related general intangibles and other property) of our domestic subsidiaries (and, in the case of borrowings under the Canadian sub-facility, such assets of our Canadian subsidiaries and, solely with respect to borrowings by SBH Finance B.V., intercompany notes owed to SBH Finance B.V. by our foreign subsidiaries). The senior notes due 2022, the senior notes due 2023 and the senior notes due 2025 (which we refer to collectively as “the Senior Notes” or the “senior notes due 2022, 2023 and 2025”) are unsecured obligations of the Issuers and are jointly and severally guaranteed by the Company and Sally Investment, and by each material domestic subsidiary of the Company. Interest on the senior notes due 2022, 2023 and 2025 is payable semi-annually, during the Company’s first and third fiscal quarters.

The ABL facility and the indentures governing the senior notes due 2022, 2023 and 2025 contain other covenants regarding restrictions on asset dispositions, granting of liens and security interests, prepayment of certain indebtedness and other matters and customary events of default, including customary cross-default and/or cross-acceleration provisions. As of September 30, 2016, all the net assets of our consolidated subsidiaries were unrestricted from transfer under our credit arrangements.

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

The senior notes due 2023 carry optional redemption features whereby the Company has the option to redeem the notes, in whole or in part, on or after November 1, 2021 at par, plus accrued and unpaid interest, if any, and on or after November 1, 2018 at par plus a premium declining ratably to par, plus accrued and unpaid interest, if any. Prior to November 1, 2018, the notes may be redeemed, in whole or in part, at a redemption price equal to par plus a make-whole premium as provided in the indenture, plus accrued and unpaid interest, if any.

The senior notes due 2025 carry optional redemption features whereby the Company has the option to redeem the notes, in whole or in part, on or after December 1, 2023 at par, plus accrued and unpaid interest, if any, and on or after December 1, 2020 at par plus a premium declining ratably to par, plus accrued and unpaid interest, if any. Prior to December 1, 2020, the notes may be redeemed, in whole or in part, at a redemption price equal to par plus a make-whole premium as provided in the indenture, plus

accrued and unpaid interest, if any. In addition, on or prior to December 1, 2018, the Company has the right to redeem at par plus a specified premium, plus accrued and unpaid interest, if any, up to 35% of the aggregate principal amount of notes originally issued, subject to certain limitations, with the proceeds from certain kinds of equity offerings, as defined in the indenture.

The ABL facility does not contain any restriction against the incurrence of unsecured indebtedness. However, the ABL facility restricts the incurrence of secured indebtedness if, after giving effect to the incurrence of such secured indebtedness, the Company's Secured Leverage Ratio exceeds 4.0 to 1.0. At September 30, 2016, the Company's Secured Leverage Ratio was less than 0.1 to 1.0. Secured Leverage Ratio is defined as the ratio of (i) Secured Funded Indebtedness (as defined in the ABL facility) to (ii) Consolidated EBITDA (as defined in the ABL facility) for the most recently completed twelve fiscal months.

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

The indentures governing the senior notes due 2022, 2023 and 2025 contain terms which restrict the ability of Sally Beauty's subsidiaries to incur additional indebtedness. However, in addition to certain other material exceptions, the Company may incur additional indebtedness under the indentures if its Consolidated Coverage Ratio, after giving pro forma effect to the incurrence of such indebtedness, exceeds 2.0 to 1.0 ("Incurrence Test"). At September 30, 2016, the Company's Consolidated Coverage Ratio was approximately 6.1 to 1.0. Consolidated Coverage Ratio is defined as the ratio of (i) Consolidated EBITDA (as defined in the indentures) for the period containing the most recent four consecutive fiscal quarters, to (ii) Consolidated Interest Expense (as defined in the indentures) for such period.

The indentures governing the Senior Notes restrict Sally Holdings and its subsidiaries from making certain dividends and distributions to equity holders and certain other restricted payments (hereafter, a "Restricted Payment" or "Restricted Payments") to us. However, the indentures permit the making of such Restricted Payments if, at the time of the making of such Restricted Payment, the Company satisfies the Incurrence Test as described above and the cumulative amount of all Restricted Payments made since the issue date of the applicable senior notes does not exceed the sum of: (i) 50% of Sally Holdings' and its subsidiaries' cumulative consolidated net earnings since July 1, 2006 (for the senior notes due 2022 and the senior notes due 2023) or since October 1, 2015 (for the senior notes due 2025), *plus* (ii) the proceeds from the issuance of certain equity securities or conversions of indebtedness to equity, in each case, since the issue date of the applicable senior notes *plus* (iii) the net reduction in investments in unrestricted subsidiaries since the issue date of the applicable senior notes *plus* (iv) the return of capital with respect to any sales or dispositions of certain minority investments since the issue date of the applicable senior notes *plus* (v) \$350 million (for the senior notes due 2025). Further, in addition to certain other baskets, the indentures permit the Company to make additional Restricted Payments in an unlimited amount if, after giving pro forma effect to the incurrence of any indebtedness to make such Restricted Payment, the Company's Consolidated Total Leverage Ratio (as defined in the indentures) is less than 3.25 to 1.00. At September 30, 2016, the Company's Consolidated Total Leverage Ratio was approximately 2.7 to 1.0. Consolidated Total Leverage Ratio is defined as the ratio of (i) Consolidated Total Indebtedness, as defined in the indentures, *minus* cash and cash equivalents on-hand up to \$100.0 million, in each case, as of the end of the most recently-ended fiscal quarter to (ii) Consolidated EBITDA (as defined in the indentures) for the period containing the most recent four consecutive fiscal quarters.

The ABL facility also restricts the making of Restricted Payments. More specifically, under the ABL facility, Sally Holdings may make Restricted Payments if availability under the ABL facility equals or exceeds certain thresholds, and no default then exists under the facility. For Restricted Payments up to \$30.0 million during each fiscal year, borrowing availability must equal or exceed the lesser of \$75.0 million or 15% of the borrowing base for 45 days prior to such Restricted Payment. For Restricted Payments in excess of that amount, borrowing availability must equal or exceed the lesser of \$100.0 million or 20% of

the borrowing base for 45 days prior to such Restricted Payment and the Consolidated Fixed Charge Coverage Ratio (as defined below) must equal or exceed 1.1 to 1.0. Further, if borrowing availability equals or exceeds the lesser of \$150.0 million or 30% of the borrowing base, Restricted Payments are not limited by the Consolidated Fixed Charge Coverage Ratio test. The Consolidated Fixed Charge Coverage Ratio is defined as the ratio of (i) Consolidated EBITDA (as defined in the ABL facility) during the trailing twelve-month period preceding such proposed Restricted Payment minus certain unfinanced capital expenditures made during such period and income tax payments paid in cash during such period to (ii) fixed charges (as defined in the ABL facility). In addition, during any period that borrowing availability under the ABL facility is less than the greater of \$40.0 million or 10% of the borrowing base, the level of the Consolidated Fixed Charge Coverage Ratio that the Company must satisfy is 1.0 to 1.0. As of September 30, 2016, the Consolidated Fixed Charge Coverage Ratio was approximately 3.1 to 1.0.

When used in this Annual Report, the phrase “Consolidated EBITDA” is intended to have the meaning ascribed to such phrase in the ABL facility or the indentures governing the senior notes due 2022, 2023 and 2025, as appropriate. EBITDA is not a recognized measurement under accounting principles generally accepted in the United States of America (“GAAP”) and should not be considered a substitute for financial performance and liquidity measures determined in accordance with GAAP, such as net earnings, operating earnings and operating cash flows.

We are currently in compliance with the agreements and instruments governing our debt, including our financial covenants. Our ability to comply with these covenants in future periods will depend on our ongoing financial and operating performance, which in turn will be subject to economic conditions and to financial, market and competitive factors, many of which are beyond our control. Further, our ability to comply with these covenants in future periods will also depend substantially on the pricing of our products, our success at implementing cost reduction initiatives and our ability to successfully implement our overall business strategy. Please see “Risk Factors—Risks Relating to Our Substantial Indebtedness.”

Capital Requirements

During the fiscal year ended September 30, 2016, we had total capital expenditures of approximately \$143.4 million, including amounts incurred but not paid at September 30, 2016 (approximately \$3.8 million), which were primarily in connection with the addition of new stores and store remodels, expansion or relocation of existing stores in the ordinary course of our business, upgrades to certain distribution centers in the U.S. and ongoing information technology upgrades. For the fiscal year 2017, we anticipate capital expenditures of approximately \$135.0 million, excluding acquisitions. Capital expenditures will be primarily to fund the addition of new stores, store remodels, upgrades to our distribution centers in the U.S., expansion or relocation of existing stores, as well as certain corporate projects in the ordinary course of our business, including ongoing technology upgrades.

Contractual Obligations

The following table is a summary of our contractual cash obligations and commitments outstanding by future payment dates at September 30, 2016 (in thousands):

	Payments Due by Period				Total
	Less than 1 year	1-3 years	3-5 years	More than 5 years	
Long-term debt obligations, including interest obligations(a)	\$102,867	\$204,775	\$205,012	\$2,031,266	\$2,543,920
Obligations under operating leases(b)	176,066	262,983	133,477	77,741	650,267
Purchase obligations(c)	18,754	19,333	19,000	8,708	65,795
Other long-term obligations(d)(e)	14,609	7,084	3,457	4,031	29,181
Total	<u>\$312,296</u>	<u>\$494,175</u>	<u>\$360,946</u>	<u>\$2,121,746</u>	<u>\$3,289,163</u>

- (a) Long-term debt obligations include obligations under capital leases and future interest payments on senior notes outstanding as of September 30, 2016. The amounts shown above do not include unamortized premium and deferred debt issuance costs reflected in the Company's consolidated balance sheets since those excluded amounts do not represent contractual obligations.
- (b) In accordance with GAAP, obligations under operating leases are not reflected in the Company's consolidated balance sheets. The amounts reported for operating leases do not include common area maintenance (CAM), property taxes or other executory costs. Please see Note 12 of the "Notes to Consolidated Financial Statements" in Item 8—"Financial Statements and Supplementary Data" contained elsewhere in this Annual Report for additional information about the Company's operating leases. The amounts shown above do not include obligations of the Company's franchisees under operating leases of approximately \$1.3 million for which the Company is contingently liable in the event of default by the franchisee.
- (c) Purchase obligations reflect legally binding agreements entered into by us to purchase goods or services, that specify minimum quantities to be purchased and with fixed or variable price provisions. In accordance with GAAP, these obligations are not reflected in the accompanying consolidated balance sheets. Amounts shown do not reflect open purchase orders, mainly for merchandise, to be fulfilled within one year, which are generally cancellable.
- (d) Other long-term obligations, including current portion, principally represent obligations under insurance and self-insurance programs. These obligations are included in accrued liabilities and other liabilities, as appropriate, in the Company's consolidated balance sheets.
- (e) The table above does not include \$1.3 million of unrecognized tax benefits due to uncertainty regarding the realization and timing of the related future cash flows, if any.

The information contained in the table above with regards to the Company's long-term debt obligations is based on the current terms of such debt obligations and does not reflect any assumptions about the Company's ability to refinance some or all of its senior notes on or before their maturity. In the event that the Company refinances some or all of its senior notes on or before their maturity, actual payments for some of the periods shown may differ materially from the amounts reported herein. In addition, other future events could cause actual payments to differ materially from these amounts.

The majority of our operating leases are for Sally Beauty Supply and BSG stores (which typically are located in strip shopping centers) and for Sally Beauty Supply and BSG distribution centers. The use of operating leases allows us to expand our business to new locations without making significant up-front cash outlays for the purchase of land and buildings.

Off-Balance Sheet Financing Arrangements

At September 30, 2016 and 2015, we had no off-balance sheet financing arrangements other than obligations under operating leases (see Contractual Obligations table above), and letters of credit (related to inventory purchases and self-insurance programs) in the aggregate amount of \$21.6 million and \$23.1 million, respectively.

Inflation

We believe inflation did not have a material effect on our results of operations during each of the three fiscal years in the period ended September 30, 2016. However, during the past few years, we have experienced an upswing in labor and real estate costs in the U.S. Employee compensation and rent expenses represent two of our most significant operating expenses. A material increase in labor and real estate costs in the future, particularly during an extended period of time, could have a material adverse effect on our results of operations.

Critical Accounting 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 different estimates that our management reasonably could have used have a material effect on the presentation of our financial condition, changes in financial condition or results of operations.

Our critical accounting estimates include but are not limited to the valuation of inventory, vendor rebates and concessions, retention of risk, income taxes, assessment of long-lived assets and intangible assets for impairment and share-based payments.

Valuation of Inventory

Inventory is stated at the lower of cost, determined using the first-in, first-out (“FIFO”) method, or net realizable value. When necessary, the Company adjusts the carrying value of inventory to the lower of cost or net realizable value, including disposal costs, and for estimated inventory shrinkage. In assessing the net realizable value of inventory, management considers several key factors including estimates of the future demand for the Company’s products, historical turn-over rates, the age and sales history of the inventory, and historic as well as anticipated changes in stock keeping units (“SKUs”). We estimate inventory shrinkage between physical counts based upon our historical experience. Actual results differing from these estimates could significantly affect our inventory and cost of products sold and distribution expenses. Inventory shrinkage expense averaged approximately 1.0% of consolidated net sales in fiscal years 2016, 2015 and 2014. A 10% increase or decrease in our estimate of inventory shrinkage at September 30, 2016, would impact net earnings by approximately \$1.5 million, net of income tax.

Vendor Rebates and Concessions

The Company deems a cash consideration received from a supplier to be a reduction of the cost of products sold unless it is in exchange for an asset or service or a reimbursement of a specific, incremental, identifiable cost incurred by the Company in selling the vendor’s products. The majority of cash consideration received by the Company is considered to be a reduction of the cost of the related products and is reflected in cost of products sold and distribution expenses in our consolidated statements of earnings as the related products are sold. Any portion of such cash consideration received that is attributable to inventory on hand is reflected as a reduction of inventory. We consider the facts and

circumstances of the various contractual agreements with vendors in order to determine the appropriate classification of amounts received in the consolidated statements of earnings. We record cash consideration expected to be received from vendors in other receivables at the amount we believe will be collected. These receivables could be significantly affected if the actual amounts subsequently collected differ from management's expectations. A 10% increase or decrease in these receivables at September 30, 2016, would impact net earnings by approximately \$2.2 million, net of income tax.

Retention of Risk

Employee Health Insurance Liability

We maintain a largely self-funded program, primarily in the U.S., for healthcare benefits for employees who meet certain eligibility requirements. We cover the majority of expenses associated with these benefits, other than certain fees and out-of-pocket expenses paid by the employees through payroll deductions. Payments for healthcare benefits below specified amounts (currently \$350,000 per individual per year) are self-insured by us. We base our estimate of ultimate liability on trends in claim payment history, historical trends in claims incurred but not yet reported, and other components such as expected increases in medical costs, projected premium costs and the number of plan participants. We review our liability on a regular basis and adjust our accruals accordingly. As of September 30, 2016 and 2015, we accrued an estimated liability relating to employee health insurance of \$7.7 million and \$6.5 million, respectively.

Changes in facts and circumstances may lead to a change in the estimated liability due to revisions of the estimated ultimate costs of our employee healthcare benefits. In assessing the adequacy of our employee health insurance liability, management considers several key factors including estimates of medical costs and trends in claims. This liability could be significantly affected if actual results differ from management's expectations. A 10% increase or decrease in our employee health insurance liability at September 30, 2016 would impact net earnings by approximately \$0.5 million, net of income tax.

Workers' Compensation Liability, General Liability, and Automobile and Property Liability

We maintain a large deductible insurance plan for workers' compensation liability, general liability and automobile and property liability loss exposures. We base our estimates of the ultimate liability on an actuarial analysis performed by an independent third-party actuary. We review our liability on a regular basis and adjust our accruals accordingly. As of September 30, 2016 and 2015, our balance sheets included an estimated liability related to these deductible and retention limits of approximately \$21.1 million and \$29.4 million, respectively.

Changes in facts and circumstances may lead to a change in the estimated liability due to revisions of the estimated ultimate costs that affect our workers' compensation, general liability, and automobile and property liability insurance coverage. Changes in estimates occur over time due to such factors as claims incidence and severity of injury or damages. Our liabilities could be significantly affected if actual results differ from management's expectations or actuarial analyses. A 10% increase or decrease in our workers' compensation liability, general liability, and automobile and property liability at September 30, 2016 would impact net earnings by approximately \$1.3 million, net of income tax.

The change in the insurance and self-insurance liability was as follows (in thousands):

	Fiscal Year Ended September 30,	
	2016	2015
Balance at beginning of period	\$ 36,477	\$ 39,103
Self-insurance expense	69,668	74,277
Payments, net of employee contributions	(76,966)	(76,903)
Balance at end of period	<u>\$ 29,179</u>	<u>\$ 36,477</u>

Income Taxes

We record income tax provisions in our consolidated financial statements based on an estimation of current income tax liabilities. The development of these provisions requires judgments about tax positions, potential outcomes and timing. If we prevail in tax matters for which provisions have been established or are required to settle matters in excess of established provisions, our effective tax rate for a particular period could be significantly affected.

For the fiscal years ended September 30, 2016, 2015 and 2014, the effective income tax rates were 37.0%, 37.9% and 37.0%, respectively. The decrease in the effective income tax rate for the fiscal year ended September 30, 2016, compared to the fiscal year ended September 30, 2015, is primarily due to decreased losses subject to a valuation allowance in certain of the Company's foreign operations and a reduction in non-deductible executive compensation. For the fiscal year ending September 30, 2017, the annual effective tax rate is expected to be in the range of 37.5% to 38.5%.

Deferred income taxes are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which temporary differences are estimated to be recovered or settled. We believe that it is more-likely-than-not that our results of operations in the future will generate sufficient taxable income to realize our deferred tax assets, net of the valuation allowance currently recorded. We have recorded a valuation allowance to account for uncertainties regarding the recoverability of certain deferred tax assets, primarily foreign loss carryforwards. In the future, if we determine that certain deferred tax assets will not be realizable, the related adjustments could significantly affect our effective tax rate at that time. The estimated tax benefit of an uncertain tax position is recorded in our financial statements only after determining a more-likely-than-not probability that the uncertain tax position will withstand challenge, if any, from applicable taxing authorities.

Assessment of Long-Lived Assets and Intangible Assets for Impairment

Long-lived assets, such as property and equipment, including store equipment, and purchased intangible assets subject to amortization are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be fully recoverable. The recoverability of long-lived assets and intangible assets subject to amortization is assessed by comparing the net carrying amount of each asset to its total estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds the sum of its undiscounted future cash flows, an impairment charge is recognized by the amount by which the carrying amount of the asset exceeds the estimated fair value of the asset.

Goodwill represents the excess of the purchase price over the fair value of the net assets acquired in a business combination. Goodwill and intangible assets with indefinite lives are not amortized; rather, they are reviewed for impairment at least annually, and whenever events or changes in circumstances indicate it

is more-likely-than-not that the value of the asset may be impaired. For the purpose of reviewing goodwill for impairment, the Company aggregates components of its operating segments with similar economic characteristics into a reportable unit.

When assessing goodwill and intangible assets with indefinite lives for potential impairment, management compares the carrying amount of the asset to its fair value. In addition, management considers whether the value of an asset has been impaired by evaluating if various factors (including current operating results, anticipated future results and cash flows, and relevant market and economic conditions) indicate a possible impairment.

When appropriate, the Company first assesses relevant qualitative factors in order to determine whether it is necessary to perform the quantitative impairment tests otherwise required under ASC Topic 350, *Intangibles-Goodwill and Other* (“ASC 350”). Based on the reviews performed by the Company and after taking into account recent potential triggering events, including the recent decline in the average daily trading prices for shares of our common stock, there were no material asset impairments recognized in the current or prior fiscal years presented, except for asset impairments in the aggregate amount of \$2.5 million recognized in connection with the Germany restructuring in the fiscal year ended September 30, 2015.

Share-Based Payments

We recognize share-based compensation expense on a straight-line basis over the vesting period or, in connection with service-based awards, to the date a participant becomes eligible for retirement, if earlier. For fiscal years 2016, 2015 and 2014, total compensation cost charged against income and included in selling, general and administrative expenses for share-based compensation arrangements was \$12.6 million, \$16.8 million and \$22.1 million, respectively.

The amount of share-based compensation expense related to stock option awards is determined based on the fair value of each stock option award on the date of grant. The fair value of each stock option is estimated using the Black-Scholes option pricing model using the following valuation inputs: expected life, volatility, risk-free interest rate and dividend yield. The expected life of stock options represents the period of time that the stock options granted are expected to be outstanding and is based on historical employee tenure and option exercise trends. The expected volatility reflects the average historical volatility for the Company’s common stock. The risk-free interest rate is based on the zero-coupon U.S. Treasury notes with a remaining term, at the grant date, equal to the expected life of the stock options. The dividend yield represents our anticipated cash dividend over the expected life of the stock options. The amount of expense recognized in connection with stock option awards is significantly affected by these estimates. In addition, we record periodic expense in connection with stock option awards based on an estimate of the number of stock options actually expected to vest, which requires us to estimate future forfeitures. We estimate future forfeitures based on our historical experience. Actual forfeitures could differ from these estimates and could significantly affect the amount and timing of recognition of our share-based compensation expense related to stock option awards.

The amount of share-based compensation expense related to performance-based restricted stock awards is determined based on the fair value of each award on the date of grant, which is based on the closing market price of the Company’s common stock on the date of grant. In addition, we record periodic expense (which is estimated quarterly) in connection with performance-based awards based on an estimate of the number of awards actually expected to vest. This requires that we estimate the Company’s future performance over the performance period (generally three years) associated with each award. Actual performance could differ from these estimates and could significantly affect the amount and timing of recognition of our share-based compensation expense related to performance-based awards.

We have based all share-based compensation estimates on management’s assumptions as of September 30, 2016. Our estimates for future periods may be based on different assumptions and, accordingly, may differ.

We believe that our share-based compensation expense is based on reasonable estimates and assumptions. However, if actual results are not consistent with our estimate or assumptions, we may be exposed to changes in share-based compensation expense that could be material. A 10% change in our share-based compensation expense for the year ended September 30, 2016 would affect earnings by approximately \$0.8 million, net of income tax.

Recent Accounting Pronouncements

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

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

In February 2016, the FASB issued ASU No. 2016-02, *Leases* (“ASU 2016-02”), which will require lessees to report on their balance sheets a right-of-use asset and a lease liability in connection with most lease agreements classified as operating leases under the current guidance. The lease liability will be measured based on the present value of future lease payments, subject to certain conditions. The right-of-use asset will be measured based on the initial amount of the liability, plus certain initial direct costs. The new guidance will further require that leases be classified at inception as either (a) operating leases or (b) finance leases. For operating leases, periodic expense will generally be flat (straight-line) throughout the life of the lease. For finance leases, periodic expense will decline (similar to capital leases under current rules) over the life of the lease. The new standard must be adopted using a modified retrospective transition method. For public companies, this amendment is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. Early adoption is permitted. The Company has completed a preliminary assessment of the potential impact of adopting ASU 2016-02 on its financial statements. At September 30, 2016, adoption of ASU 2016-02 would result in recognition of a right-of-use asset in the estimated amount of approximately \$600.0 million and a lease liability for a similar amount in the Company’s consolidated balance sheet. The Company does not believe adoption of ASU 2016-02 will have a material impact on the Company’s earnings or cash flows. At September 30, 2016, the Company has not made a decision to early adopt the new standard. The amount of the right-of-use asset and the lease liability ultimately recognized by the Company may materially defer from this preliminary estimate, including as a result of future organic growth in our business and potential acquisitions.

In March 2016, the FASB issued ASU No. 2016-09, *Improvements to Employee Share-Based Payment Accounting*, intended to simplify various aspects of how share-based payments are recorded and presented on the financial statements. For example, the new guidance will require that all the income tax effect related to share-based payments be recorded in income tax expense. The new guidance further removes the current requirement to delay recognition of a windfall tax benefit until it reduces current taxes payable. In addition, the new standard will require that excess tax benefits and shortfalls from share-based compensation awards be reported as operating activities in the statement of cash flows. For public companies, these amendments are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2016. Early adoption is permitted. The Company has not completed its assessment of the potential impact of adopting the provisions of ASU 2016-09 on its financial statements. The adoption of ASU 2016-09, however, could result in a material impact to the Company’s consolidated

results of operations and cash flows from operating activities in the period of adoption, and the application of the new standard in the future could result in greater fluctuation in the Company's effective income tax rate and income tax expense when compared to results under the current accounting guidance.

In addition, the Company has not yet adopted the following recent accounting pronouncements and does not believe their adoption will have a material effect on its consolidated financial statements:

In May 2014, the FASB issued ASU No. 2014-09, *Revenue from Contracts with Customers* which will supersede Accounting Standards Codification ("ASC") Topic 605, *Revenue Recognition*. In August 2015, the FASB deferred the effective date of this new standard by one year. A core principle of the new guidance is that an entity should measure revenue in connection with its sale of goods and services to a customer based on an amount that depicts the consideration to which the entity expects to be entitled in exchange for each of those goods and services. For a contract that involves more than one performance obligation, the entity must (a) determine or, if necessary, estimate the standalone selling price at inception of the contract for the distinct goods or services underlying each performance obligation and (b) allocate the transaction price to each performance obligation on the basis of the relative standalone selling prices. In addition, under the new guidance, an entity should recognize revenue when (or as) it satisfies each performance obligation under the contract by transferring the promised good or service to the customer. A good or service is deemed transferred when (or as) the customer obtains control of that good or service. The new standard permits the use of either the retrospective or cumulative effect transition method. For public companies, this amendment is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2017. Early application is permitted, but no earlier than December 16, 2016. The Company has not yet selected a transition method.

In April 2015, the FASB issued ASU No. 2015-05, *Customer's Accounting for Fees Paid in Cloud Computing Arrangement*. This pronouncement provides guidance to determine whether a cloud-based computing arrangement includes a software license. If a cloud-based computing arrangement includes a software license, the customer must account for the software element of the arrangement consistent with the acquisition of other software licenses. Otherwise, the customer must account for the arrangement as a service contract. The new standard permits the use of either the prospective or retrospective transition method. For public companies, this amendment is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015.

In September 2015, the FASB issued ASU No. 2015-16, *Business Combinations (Topic 805): Simplifying the Accounting for Measurement-Period Adjustments* ("ASU 2015-16") which will eliminate the current requirement to recognize measurement-period adjustments to provisional amounts retrospectively. Instead, ASU 2015-16 requires the acquirer to recognize measurement-period adjustments, as well as the impact on earnings of changes in depreciation, amortization and similar items (if any) resulting from the change to the provisional amounts, in the period when the amount of each measurement-period adjustment is determined. For public companies, this amendment is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015.

ITEM 7A. 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. Currently, we do not purchase or hold any derivative instruments for speculative or trading purposes.

Foreign currency exchange rate risk

We are exposed to potential gains or losses from foreign currency fluctuations affecting net investments and earnings denominated in foreign currencies. Our primary exposures are to changes in exchange rates for the U.S. dollar versus the Euro, the British pound sterling, the Canadian dollar, the Chilean peso, and

the Mexican peso. In addition, we currently have exposure to the currencies of several countries located in South America. Our various foreign currency exposures at times offset each other, sometimes providing a natural hedge against foreign currency risk. For each of the fiscal years 2016, 2015 and 2014, approximately 17% of our consolidated net sales were made in currencies other than the U.S. dollar. Consolidated net sales for the fiscal year ended September 30, 2016, are inclusive of an approximately \$56.4 million negative impact from changes in foreign currency exchange rates and other comprehensive income reflects \$22.3 million in foreign currency translation adjustments. For the fiscal years 2016, 2015 and 2014, 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.

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 our consolidated net sales by approximately 1.8% in the fiscal year 2016, and would have impacted our consolidated net assets by approximately 2.3% at September 30, 2016.

As more fully discussed elsewhere in this Annual Report, the Company uses from time to time foreign exchange contracts to mitigate its exposure to changes in foreign currency exchange rates. At September 30, 2016, the aggregate net fair value of all foreign exchange contracts held by the Company was approximately \$0.3 million, consisting of contracts in a liability position.

The Company's foreign currency derivatives are not designated as hedges and do not currently meet the requirements for hedge accounting. Accordingly, the changes in fair value of these derivative instruments, which are adjusted quarterly, are recorded in our consolidated statements of earnings. Selling, general and administrative expenses reflect a net loss of \$1.1 million for the fiscal year ended September 30, 2016, and net gains of \$2.7 million and \$1.9 million in the fiscal years ended September 30, 2015 and 2014, respectively in connection with all of the Company's foreign currency derivatives instruments, including marked-to-market adjustments.

Interest rate risk

We and certain of our subsidiaries are sensitive to interest rate fluctuations primarily as a result of borrowings under our ABL facility from time to time. 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 our 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. At September 30, 2016, we had no borrowings outstanding under our ABL facility and we held no interest rate swaps or similar derivative instruments.

Credit risk

We are exposed to credit risk in connection with 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 and that our allowance for doubtful accounts is sufficient to cover customer credit risks at September 30, 2016.

The derivative instruments held by the Company from time to time, including the foreign currency derivatives mentioned above, expose the Company to credit risk in the event of default by a counterparty. We believe that such exposure is mitigated by the substantial resources and strong creditworthiness of the counterparties to our derivative instruments at September 30, 2016. 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.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Please see “Index to Financial Statements” which is located on page 92 of this Annual Report.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

ITEM 9A. CONTROLS AND PROCEDURES

Background. Attached as exhibits to this Annual Report on Form 10-K are certifications of our Chief Executive Officer (“CEO”) and our acting Principal Financial Officer (“PFO”), which are required in accordance with Rule 13a-14 of the Exchange Act. This “Controls and Procedures” section includes information concerning the controls and controls evaluation referred to in the certifications. Part II, Item 8—Financial Statements and Supplementary Data of this Annual Report on Form 10-K sets forth the attestation report of KPMG LLP, our independent registered public accounting firm, regarding its audit of our internal control over financial reporting. This section should be read in conjunction with the certifications and the KPMG attestation report for a more complete understanding of the topics presented.

Controls Evaluation and Related CEO and PFO Certifications. Our management, with the participation of our CEO and PFO, 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 Annual 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 and PFO.

Certifications of our CEO and our PFO, which are required in accordance with Rule 13a-14 of the Exchange Act, are attached as exhibits to this Annual 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, within the Company 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 Annual 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 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, by 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 PFO have concluded that, as of September 30, 2016, 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 PFO, as appropriate to allow timely decisions regarding required disclosure.

Management's Annual Report on Internal Control over Financial Reporting.

Management of the Company, including the CEO and PFO, is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rule 13a-15(f) under the Exchange Act. Our internal control system was designed to provide reasonable assurance to management and our Board of Directors regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles.

All internal control systems, no matter how well designed, have inherent limitations. A system of internal controls may become inadequate over time because of changes in conditions or deterioration in the degree of compliance with the policies or procedures. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation.

Management assessed the effectiveness of our internal control over financial reporting as of September 30, 2016 using the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO") in *Internal Control—Integrated Framework (2013)*. Based on this assessment, management has concluded that, as of September 30, 2016 our internal control over financial reporting was effective to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles based on such criteria.

Report of Independent Registered Public Accounting Firm. Please refer to KPMG's Report of Independent Registered Public Accounting Firm on Internal Control over Financial Reporting on page F-1 of the financial statements, which begin on page 92 of this Annual Report.

Changes in Internal Control over Financial Reporting. During our last fiscal quarter, other than as described below, there have been no changes in our internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

During our last fiscal quarter, we implemented the Oracle enterprise resource planning software ("Oracle"), hosted by the International Business Machines Corporation (IBM), to replace our previous enterprise resource planning system, hosted internally. This new software affects aspects of our accounting and financial reporting systems, and our processes and internal control environment for U.S and Canada operations, including global consolidation for financial reporting purposes. These changes were not implemented in response to a significant control deficiency or material weakness, and we believe that these changes will improve our overall system of internal control over financial reporting.

ITEM 9B. OTHER INFORMATION

None.

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

The Board of Directors has adopted: (i) Corporate Governance Guidelines and a (ii) Code of Business Conduct and Ethics that apply to directors, officers and employees. Copies of these documents and the committee charters are available on our website at www.sallybeautyholdings.com and are available in print to any person, without charge, upon written request to our Vice President of Investor Relations. We intend to disclose on our website at www.sallybeautyholdings.com any substantive amendment to, or waiver from, a provision of the Code of Business Conduct and Ethics that applies to these individuals or persons performing similar functions.

The additional information required by Item 10 of this Annual Report on Form 10-K is incorporated herein by reference from our Proxy Statement related to the 2017 Annual Meeting of Stockholders under the headings “Proposal 1—Election of Directors,” “Executive Officers of the Registrant,” “Information Regarding Corporate Governance, the Board, and Its Committees,” “Section 16(a) Beneficial Ownership Reporting Compliance” and “Report of the Audit Committee.”

ITEM 11. EXECUTIVE COMPENSATION

The information required by Item 11 of this Annual Report on Form 10-K is incorporated herein by reference from our Proxy Statement related to the 2017 Annual Meeting of Stockholders under the headings “Information on the Compensation of Directors,” “Compensation Discussion and Analysis,” “Compensation Committee Report,” “Executive Compensation” and “Compensation Committee Interlocks and Insider Participation.”

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The information required by Item 12 of this Annual Report on Form 10-K is incorporated herein by reference from our Proxy Statement related to the 2017 Annual Meeting of Stockholders under the heading “Ownership of Securities.”

EQUITY COMPENSATION PLAN INFORMATION

The following table gives information as of September 30, 2016, about our common stock that may be issued under all of our existing equity compensation plans:

Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants and rights(1) (a)	Weighted-average exercise price of outstanding options, warrants and rights (b)	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))(2) (c)
Equity compensation plans approved by security holders	6,239,389	\$22.95	5,909,854
Equity compensation plans not approved by security holders	N/A	N/A	N/A
Total	<u>6,239,389</u>	\$22.95	<u>5,909,854</u>

- (1) Includes options issued and available for exercise and shares available for issuance in connection with past awards under the Sally Beauty Holdings, Inc. Amended and Restated 2010 Omnibus Incentive Plan (“the 2010 Plan”) and predecessor share-based compensation plans. We currently grant awards only under the 2010 Plan.
- (2) Represents shares that are available for issuance pursuant to restricted stock or other full value awards under the 2010 Plan, as amended.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

The information required by Item 13 of this Annual Report on Form 10-K is incorporated herein by reference from our Proxy Statement related to the 2017 Annual Meeting of Stockholders under the headings “Information Regarding Corporate Governance, the Board, and Its Committees,” “Compensation Committee Interlocks and Insider Participation” and “Certain Relationships and Related Party Transactions.”

ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES

The information required by Item 14 of this Annual Report on Form 10-K is incorporated herein by reference from our Proxy Statement related to the 2017 Annual Meeting of Stockholders under the heading “Proposal 4—Ratification of Selection of Auditors.”

PART IV

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES

Documents filed as part of this Annual Report:

(a) List of Financial Statements and Financial Statement Schedules

Please see “Index to Financial Statements” which is located on page 92 of this Annual Report.

(b) Exhibits

The following exhibits are filed as part of this Annual Report or are incorporated herein by reference:

Exhibit No.	Description
3.1	Third Restated Certificate of Incorporation of Sally Beauty Holdings, Inc., dated January 30, 2014, which is incorporated herein by reference from Exhibit 3.3 to the Company's Current Report on Form 8-K filed on January 30, 2014
3.2	Sixth Amended and Restated Bylaws of Sally Beauty Holdings, Inc., dated July 30, 2015, which is incorporated herein by reference from Exhibit 3.1 to the Company's Current Report on Form 8-K filed on August 6, 2015
4.1	Credit Agreement dated as of November 12, 2010 among Sally Holdings LLC, Beauty Systems Group LLC, Sally Beauty Supply LLC, as domestic borrowers, Beauty Systems Group (Canada), Inc., as Canadian borrower, SBH Finance B.V., as foreign borrower, the guarantors from time to time party hereto, Bank of America, N.A., as administrative agent and collateral agent, Bank of America, N.A. (acting through its Canada branch), as Canadian agent, the other lenders party hereto, JPMorgan Chase Bank, N.A., as documentation agent, Wells Fargo Capital Finance, LLC, as syndication agent, Banc of America Securities LLC, Wells Fargo Capital Finance, LLC, as joint lead arrangers and joint book managers, which is incorporated herein by reference from Exhibit 4.13 to the Company's Quarterly Report on Form 10-Q filed on February 3, 2011
4.2	Amendment No. 1 dated June 8, 2012, to that certain Credit Agreement dated as of November 12, 2010 among the Borrowers, the Guarantors, the Administrative Agent, the Collateral Agent, the Canadian Agent and the Lenders party thereto (as such terms are defined therein), which is incorporated herein by reference from Exhibit 4.1 to the Company's Current Report on Form 8-K filed on June 14, 2012
4.3	Second Amendment to Credit Agreement dated July 26, 2013, to that certain Credit Agreement dated as of November 12, 2010 among the Borrowers, the Guarantors, the Lenders party thereto, the Administrative Agent, the Collateral Agent, the Syndication Agent and the Documentation Agent (as such terms are defined therein), which is incorporated herein by reference from Exhibit 4.3 to the Company's Annual Report on Form 10-K filed on November 14, 2013†
4.4	Amended and Restated Security Agreement by Sally Holdings LLC, Beauty Systems Group LLC, Sally Beauty Supply LLC, as the domestic borrowers and the other domestic borrowers and domestic guarantors party hereto from time to time and Bank of America, N.A. as collateral agent dated as of July 26, 2013, which is incorporated herein by reference from Exhibit 4.4 to the Company's Annual Report on Form 10-K filed on November 14, 2013†

- 4.5 Amended and Restated General Security Agreement by Beauty Systems Group (Canada), Inc., as the Canadian borrower and Bank of America, N.A., (acting through its Canada branch), as Canadian agent dated as of July 26, 2013, which is incorporated herein by reference from Exhibit 4.5 to the Company's Annual Report on Form 10-K filed on November 14, 2013†
- 4.6 Joinder to Loan Documents, dated as of December 20, 2011, by and among Sally Holdings LLC, Beauty Systems Group LLC, Sally Beauty Supply LLC, Beauty Systems Group (Canada), Inc., SBH Finance B.V., the Guarantors named therein, Sally Beauty Holdings, Inc., Sally Investment Holdings LLC and Bank of America, N.A., as administrative agent and as collateral agent, which is incorporated herein by reference from Exhibit 4.10 to the Company's Quarterly Report on Form 10-Q filed on February 2, 2012†
- 4.7 Joinder to Loan Documents, dated as of May 28, 2015, by and among Sally Holdings LLC, Beauty Systems Group LLC, Sally Beauty Supply LLC, Beauty Systems Group (Canada), Inc., SBH Finance B.V., the Guarantors named therein, Sally Beauty Military Supply LLC, Loxa Beauty LLC and Bank of America, N.A., as administrative agent and as collateral agent, which is incorporated herein by reference from Exhibit 4.1 to the Company's Quarterly Report on Form 10-Q filed on August 6, 2015†
- 4.8 Indenture, dated as of May 18, 2012, by and among Sally Holdings LLC, Sally Capital Inc. and Wells Fargo Bank, National Association, which is incorporated herein by reference from Exhibit 4.1 to the Company's Current Report on Form 8-K filed on May 18, 2012
- 4.9 Supplemental Indenture, dated as of May 18, 2012, by and among Sally Holdings LLC, Sally Capital Inc., the guarantors listed therein and Wells Fargo Bank, National Association (including the form of Note attached as an exhibit hereto), which is incorporated herein by reference from Exhibit 4.2 to the Company's Current Report on Form 8-K filed on May 18, 2012
- 4.10 Second Supplemental Indenture, dated as of October 29, 2013, by and among Sally Holdings LLC, Sally Capital Inc., the guarantors listed therein and Wells Fargo Bank, National Association (including the form of Note attached as an exhibit thereto), which is incorporated herein by reference from Exhibit 4.2 to the Company's Current Report on Form 8-K filed on October 29, 2013
- 4.11 Third Supplemental Indenture, dated as of May 28, 2015, by and among Loxa Beauty LLC , Sally Beauty Military Supply LLC, Sally Holdings LLC, Sally Capital Inc., each existing Parent Guarantor and Subsidiary Guarantor listed therein and Wells Fargo Bank, National Association, which is incorporated herein by reference from Exhibit 4.2 to the Company's Quarterly Report on Form 10-Q filed on August 6, 2015
- 4.12 Third Supplemental Indenture, dated as of May 28, 2015, by and among Loxa Beauty LLC , Sally Beauty Military Supply LLC, Sally Holdings LLC, Sally Capital Inc., each existing Parent Guarantor and Subsidiary Guarantor listed therein and Wells Fargo Bank, National Association, which is incorporated herein by reference from Exhibit 4.3 to the Company's Quarterly Report on Form 10-Q filed on August 6, 2015
- 4.13 Third Supplemental Indenture, dated as of December 3, 2015, by and among Sally Holdings LLC, Sally Capital Inc., the guarantors listed therein and Wells Fargo Bank, National Association (including the form of Note attached as an exhibit thereto), which is incorporated herein by reference from Exhibit 4.2 to the Company's Current Report on Form 8-K filed on December 3, 2015

- 10.1 Tax Allocation Agreement, dated as of June 19, 2006, among Alberto-Culver Company, New Aristotle Holdings, Inc., New Sally Holdings, Inc. and Sally Holdings, Inc., which is incorporated herein by reference from Exhibit 10.1 to Amendment No. 3 to the Company's Registration Statement on Form S-4 (File No. 333-136259) filed on October 10, 2006
- 10.2 First Amendment to the Tax Allocation Agreement, dated as of October 3, 2006, among Alberto-Culver Company, New Aristotle Holdings, Inc., New Sally Holdings, Inc. and Sally Holdings, Inc., which is incorporated herein by reference from Exhibit 10.2 to Amendment No. 3 to the Company's Registration Statement on Form S-4 (File No. 333-136259) filed on October 10, 2006
- 10.3 Second Amendment to the Tax Allocation Agreement, dated as of October 26, 2006, among Alberto-Culver Company, New Aristotle Holdings, Inc., New Sally Holdings, Inc. and Sally Holdings, Inc., which is incorporated herein by reference from Exhibit 10.01 to the Company's Current Report on Form 8-K filed on October 30, 2006
- 10.4 Sally Beauty Holdings, Inc. 2007 Omnibus Incentive Plan, which is incorporated herein by reference from Exhibit 4.4 to the Company's Registration Statement on Form S-8 filed on May 3, 2007
- 10.5 2007 Form of Stock Option Agreement for Employees pursuant to the Sally Beauty Holdings, Inc. 2007 Omnibus Incentive Plan, which is incorporated herein by reference from Exhibit 10.2 to the Company's Current Report on Form 8-K filed on April 27, 2007
- 10.6 2007 Form of Restricted Stock Unit Agreement for Independent Directors pursuant to the Sally Beauty Holdings, Inc. 2007 Omnibus Incentive Plan, which is incorporated herein by reference from Exhibit 10.3 to the Company's Current Report on Form 8-K filed on April 27, 2007
- 10.7 2009 Form of Stock Option Agreement for Employees pursuant to the Sally Beauty Holdings, Inc. 2007 Omnibus Incentive Plan, which is incorporated herein by reference from Exhibit 10.23 to the Company's Annual Report on Form 10-K filed on November 20, 2008
- 10.8 2009 Form of Restricted Stock Unit Agreement for Independent Directors pursuant to the Sally Beauty Holdings, Inc. 2007 Omnibus Incentive Plan, which is incorporated herein by reference from Exhibit 10.24 to the Company's Annual Report on Form 10-K filed on November 20, 2008
- 10.9 Tax Sharing Agreement, dated as of November 16, 2006, made and entered into by and among Sally Beauty Holdings, Inc., Sally Investment Holdings LLC and Sally Holdings LLC, which is incorporated herein by reference from Exhibit 10.14 of the Quarterly Report on Form 10-Q of Sally Holdings LLC and Sally Capital Inc. filed on August 29, 2007
- 10.10 Form of Option Exercise Period Extension Agreement for Retired Executives, which is incorporated herein by reference from Exhibit 10.3 to the Company's Quarterly Report on Form 10-Q filed on May 6, 2009
- 10.11 Amended and Restated Alberto-Culver Company Employee Stock Option Plan of 2003, which is incorporated herein by reference from Exhibit 10.28 to the Company's Annual Report on Form 10-K filed on November 19, 2009
- 10.12 2010 Form of Restricted Stock Unit Agreement for Independent Directors pursuant to the Sally Beauty Holdings, Inc. 2007 Omnibus Incentive Plan, which is incorporated herein by reference from Exhibit 10.29 to the Company's Annual Report on Form 10-K filed on November 19, 2009

- 10.13 2010 Form of Restricted Stock Agreement for Employees pursuant to the Sally Beauty Holdings, Inc. 2007 Omnibus Incentive Plan, which is incorporated herein by reference from Exhibit 10.30 to the Company's Annual Report on Form 10-K filed on November 19, 2009
- 10.14 2010 Form of Stock Option Agreement for Employees pursuant to the Sally Beauty Holdings, Inc. 2007 Omnibus Incentive Plan, which is incorporated herein by reference from Exhibit 10.31 to the Company's Annual Report on Form 10-K filed on November 19, 2009
- 10.15 Form of Amended and Restated Indemnification Agreement with Directors, which is incorporated herein by reference from Exhibit 10.33 to the Company's Annual Report on Form 10-K filed on November 19, 2009
- 10.16 2011 Form of Restricted Stock Agreement for Employees pursuant to the Sally Beauty Holdings, Inc. 2010 Omnibus Incentive Plan, which is incorporated herein by reference from Exhibit 10.33 to the Company's Annual Report on Form 10-K filed on November 18, 2010
- 10.17 2011 Form of Stock Option Agreement for Employees pursuant to the Sally Beauty Holdings, Inc. 2010 Omnibus Incentive Plan, which is incorporated herein by reference from Exhibit 10.34 to the Company's Annual Report on Form 10-K filed on November 18, 2010
- 10.18 2011 Form of Restricted Stock Unit Agreement for Independent Directors pursuant to the Sally Beauty Holdings, Inc. 2010 Omnibus Incentive Plan, which is incorporated herein by reference from Exhibit 10.25 to the Company's Annual Report on Form 10-K filed November 15, 2012
- 10.19 Form of Option Exercise Period Extension and Restricted Stock Vesting Extension Agreement, which is incorporated herein by reference from Exhibit 10.3 to the Company's Quarterly Report on Form 10-Q filed on February 2, 2012
- 10.20 2016 Form of Performance Unit Award Agreement pursuant to the Sally Beauty Supply, Inc. Amended and Restated 2010 Omnibus Incentive Plan, which is incorporated herein by reference from Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q filed on February 4, 2016
- 10.21 Separation and Release Agreement by and between Gary Winterhalter and the Company, dated as of February 18, 2016, which is incorporated herein by reference from Exhibit 10.2 to the Company's Quarterly Report on Form 10-Q filed on May 5, 2016
- 10.22 Option Exercise Period Extension Agreement by and between the Company and Gary Winterhalter, dated as of February 18, 2016, which is incorporated herein by reference from Exhibit 10.3 to the Company's Quarterly Report on Form 10-Q filed on May 5, 2016
- 10.23 Separation and Release Agreement by and between Brian E. Walker and the Company, dated as of February 15, 2016, which is incorporated herein by reference from Exhibit 10.4 to the Company's Quarterly Report on Form 10-Q filed on May 5, 2016
- 10.24 Offer Letter to Christian A. Brickman, dated as of April 25, 2014, which is incorporated herein by reference from Exhibit 10.1 to the Company's Current Report on Form 8-K filed on May 1, 2014
- 10.25 Form of Severance Agreement between each of Matthew Haltom and the Company effective as of November 5, 2012, Christian A. Brickman and the Company effective as of June 2, 2014, Mark G. Spinks and the Company effective July 31, 2015 and Sharon Leite and the Company effective February 1, 2016, which is incorporated herein by reference from Exhibit 10.3 to the Company's Current Report on Form 8-K filed on November 5, 2012

- 10.26 2012 Form of Restricted Stock Unit Agreement for Independent Directors pursuant to the Sally Beauty Holdings, Inc. 2010 Omnibus Incentive Plan, which is incorporated herein by reference from Exhibit 10.37 to the Company's Annual Report on Form 10-K filed on November 15, 2012
- 10.27 Sally Beauty Holdings, Inc. Amended and Restated Annual Incentive Plan, which is incorporated herein by reference from Exhibit 10.38 to the Company's Annual Report on Form 10-K filed on November 15, 2012
- 10.28 Sally Beauty Holdings, Inc. Amended and Restated 2010 Omnibus Incentive Plan, which is incorporated herein by reference from Exhibit 10.39 to the Company's Annual Report on Form 10-K filed on November 15, 2012
- 10.29 Consulting Agreement by and between Sally Beauty Holdings, Inc. and John R. Golliher, which is incorporated herein by reference from Exhibit 10.1 to the Company's Current Report on Form 8-K filed on August 6, 2015
- 10.30 Sally Beauty Holdings, Inc. Third Amended and Restated Independent Director Compensation Policy*
- 10.31 Separation Agreement by and between Mark Flaherty and Sally Beauty Supply LLC, dated as of September 28, 2016*
- 21.1 List of Subsidiaries of Sally Beauty Holdings, Inc.*
- 23.1 Consent of KPMG*
- 31.1 Rule 13(a)-14(a)/15(d)-14(a) Certification of Christian A. Brickman*
- 31.2 Rule 13(a)-14(a)/15(d)-14(a) Certification of Janna S. Minton*
- 32.1 Section 1350 Certification of Christian A. Brickman*
- 32.2 Section 1350 Certification of Janna S. Minton*
- 101 The following financial information from our Annual Report on Form 10-K for the fiscal year ended September 30, 2016, formatted in XBRL (Extensible Business Reporting Language): (i) the Consolidated Balance Sheets; (ii) the Consolidated Statements of Earnings; (iii) the Consolidated Statements of Comprehensive Income; (iv) the Consolidated Statements of Cash Flows; (v) Consolidated Statements of Stockholders' Equity (Deficit) and (vi) the Notes to Consolidated Financial Statements*

* Included herewith

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

(c) Financial Statement Schedules

None

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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, on the 15th day of November, 2016.

SALLY BEAUTY HOLDINGS, INC.

By: /s/ CHRISTIAN A. BRICKMAN _____

Christian A. Brickman
President, Chief Executive Officer and
Director

By: /s/ JANNA S. MINTON _____

Janna S. Minton
Group Vice President, Chief Accounting
Officer and Controller

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Signature	Title	Date
/s/ CHRISTIAN A. BRICKMAN Christian A. Brickman	President, Chief Executive Officer and Director (Principal Executive Officer)	November 15, 2016
/s/ JANNA S. MINTON Janna S. Minton	Group Vice President, Chief Accounting Officer and Controller (Principal Financial Officer)	November 15, 2016
/s/ ROBERT R. MCMASTER Robert R. McMaster	Chairman of the Board of Directors	November 15, 2016
/s/ KATHERINE BUTTON BELL Katherine Button Bell	Director	November 15, 2016
/s/ MARSHALL E. EISENBERG Marshall E. Eisenberg	Director	November 15, 2016
/s/ DAVID W. GIBBS David W. Gibbs	Director	November 15, 2016
/s/ JOHN A. MILLER John A. Miller	Director	November 15, 2016
/s/ SUSAN R. MULDER Susan R. Mulder	Director	November 15, 2016
/s/ ERIN NEALY COX Erin Nealy Cox	Director	November 15, 2016
/s/ EDWARD W. RABIN Edward W. Rabin	Director	November 15, 2016

SALLY BEAUTY HOLDINGS, INC. AND SUBSIDIARIES

Financial Statements
Years ended September 30, 2016, 2015 and 2014

INDEX TO FINANCIAL STATEMENTS

	<u>Page</u>
Report of Independent Registered Public Accounting Firm	F-1
Consolidated Financial Statements:	
Consolidated Balance Sheets as of September 30, 2016 and 2015	F-3
Consolidated Statements of Earnings for the years ended September 30, 2016, 2015 and 2014	F-4
Consolidated Statements of Comprehensive Income for the years ended September 30, 2016, 2015 and 2014	F-5
Consolidated Statements of Cash Flows for the years ended September 30, 2016, 2015 and 2014	F-6
Consolidated Statements of Stockholders' Deficit for the years ended September 30, 2016, 2015 and 2014	F-7
Notes to Consolidated Financial Statements for the years ended September 30, 2016, 2015 and 2014	F-8

Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders
Sally Beauty Holdings, Inc.:

We have audited Sally Beauty Holdings, Inc. and subsidiaries' (the Company) internal control over financial reporting as of September 30, 2016, based on criteria established in *Internal Control—Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Annual Report on Internal Control over Financial Reporting included in Item 9A. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Sally Beauty Holdings, Inc. maintained, in all material respects, effective internal control over financial reporting as of September 30, 2016, based on criteria established in *Internal Control—Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Sally Beauty Holdings, Inc. and subsidiaries as of September 30, 2016 and 2015, and the related consolidated statements of earnings, comprehensive income, cash flows, and stockholders' deficit for each of the years in the three-year period ended September 30, 2016, and our report dated November 14, 2016 expressed an unqualified opinion on those consolidated financial statements.

/s/ KPMG LLP

KPMG LLP
Dallas, Texas
November 14, 2016

Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders
Sally Beauty Holdings, Inc.:

We have audited the accompanying consolidated balance sheets of Sally Beauty Holdings, Inc. and subsidiaries (the Company) as of September 30, 2016 and 2015, and the related consolidated statements of earnings, comprehensive income, cash flows, and stockholders' deficit for each of the years in the three-year period ended September 30, 2016. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Sally Beauty Holdings, Inc. and subsidiaries as of September 30, 2016 and 2015, and the results of their operations and their cash flows for each of the years in the three-year period ended September 30, 2016, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company's internal control over financial reporting as of September 30, 2016, based on criteria established in *Internal Control—Integrated Framework* (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated November 14, 2016 expressed an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

/s/ KPMG LLP

KPMG LLP
Dallas, Texas
November 14, 2016

SALLY BEAUTY HOLDINGS, INC. AND SUBSIDIARIES

Consolidated Balance Sheets
September 30, 2016 and 2015
(In thousands, except par value data)

	<u>2016</u>	<u>2015</u>
Assets		
Current assets:		
Cash and cash equivalents	\$ 86,622	\$ 140,038
Trade accounts receivable, net	46,942	48,602
Accounts receivable, other	37,041	42,490
Inventory	907,337	885,214
Other current assets	54,861	37,049
Deferred income tax assets	40,024	33,709
Total current assets	<u>1,172,827</u>	<u>1,187,102</u>
Property and equipment, net	319,558	270,847
Goodwill	532,714	524,369
Intangible assets, excluding goodwill, net	92,963	98,848
Other assets	14,001	13,185
Total assets	<u>\$2,132,063</u>	<u>\$2,094,351</u>
Liabilities and Stockholders' Deficit		
Current liabilities:		
Current maturities of long-term debt	\$ 716	\$ 755
Accounts payable	271,376	275,917
Accrued liabilities	214,584	208,717
Income taxes payable	1,989	6,310
Total current liabilities	<u>488,665</u>	<u>491,699</u>
Long-term debt	1,783,294	1,786,839
Other liabilities	21,614	27,734
Deferred income tax liabilities	114,656	85,900
Total liabilities	<u>2,408,229</u>	<u>2,392,172</u>
Stockholders' deficit:		
Common stock, \$0.01 par value. Authorized 500,000 shares; 144,842 and 151,898 shares issued and 144,571 and 151,452 shares outstanding at September 30, 2016 and 2015, respectively	1,446	1,515
Preferred stock, \$0.01 par value. Authorized 50,000 shares; none issued	—	—
Additional paid-in capital	—	—
Accumulated deficit	(177,561)	(218,670)
Treasury Stock, 121 shares, at cost	—	(2,961)
Accumulated other comprehensive loss, net of tax	(100,051)	(77,705)
Total stockholders' deficit	<u>(276,166)</u>	<u>(297,821)</u>
Total liabilities and stockholders' deficit	<u>\$2,132,063</u>	<u>\$2,094,351</u>

The accompanying notes to consolidated financial statements are an integral part of these financial statements.

SALLY BEAUTY HOLDINGS, INC. AND SUBSIDIARIES

Consolidated Statements of Earnings

Fiscal Years ended September 30, 2016, 2015 and 2014

(In thousands, except per share data)

	2016	2015	2014
Net sales	\$3,952,618	\$3,834,343	\$3,753,498
Cost of products sold and distribution expenses	1,988,678	1,936,492	1,893,326
Gross profit	1,963,940	1,897,851	1,860,172
Selling, general and administrative expenses	1,365,986	1,313,134	1,273,513
Depreciation and amortization	99,657	89,391	79,663
Operating earnings	498,297	495,326	506,996
Interest expense	144,237	116,842	116,317
Earnings before provision for income taxes	354,060	378,484	390,679
Provision for income taxes	131,118	143,397	144,686
Net earnings	<u>\$ 222,942</u>	<u>\$ 235,087</u>	<u>\$ 245,993</u>
Basic earnings per share	<u>\$ 1.51</u>	<u>\$ 1.50</u>	<u>\$ 1.54</u>
Diluted earnings per share	<u>\$ 1.50</u>	<u>\$ 1.49</u>	<u>\$ 1.51</u>
Weighted average shares:			
Basic	<u>147,179</u>	<u>156,353</u>	<u>159,933</u>
Diluted	<u>148,803</u>	<u>158,226</u>	<u>163,419</u>

The accompanying notes to consolidated financial statements are an integral part of these financial statements.

SALLY BEAUTY HOLDINGS, INC. AND SUBSIDIARIES
Consolidated Statements of Comprehensive Income
Fiscal Years ended September 30, 2016, 2015 and 2014
(In thousands)

	<u>2016</u>	<u>2015</u>	<u>2014</u>
Net earnings	\$222,942	\$235,087	\$245,993
Other comprehensive loss:			
Foreign currency translation adjustments	(22,346)	(49,157)	(19,308)
Income taxes related to other comprehensive income	<u>—</u>	<u>—</u>	<u>578</u>
Other comprehensive loss, net of tax	<u>(22,346)</u>	<u>(49,157)</u>	<u>(18,730)</u>
Total comprehensive income	<u>\$200,596</u>	<u>\$185,930</u>	<u>\$227,263</u>

The accompanying notes to consolidated financial statements are an integral part of these financial statements.

SALLY BEAUTY HOLDINGS, INC. AND SUBSIDIARIES
Consolidated Statements of Cash Flows
Fiscal Years ended September 30, 2016, 2015 and 2014
(In thousands)

	<u>2016</u>	<u>2015</u>	<u>2014</u>
Cash Flows from Operating Activities:			
Net earnings	\$ 222,942	\$ 235,087	\$ 245,993
Adjustments to reconcile net earnings to net cash provided by operating activities:			
Depreciation and amortization	99,657	89,391	79,663
Share-based compensation expense	12,580	16,778	22,107
Amortization of deferred financing costs	3,255	3,789	3,759
Excess tax benefit from share-based compensation	(1,347)	(22,084)	(14,646)
Net loss on disposal of property and equipment	495	2,570	354
Net loss on extinguishment of debt	33,296	—	—
Deferred income taxes	21,460	7,121	(815)
Changes in (exclusive of effects of acquisitions):			
Trade accounts receivable	936	774	4,020
Accounts receivable, other	4,697	3,255	(7,715)
Inventory	(31,397)	(80,321)	(27,533)
Other current assets	(17,194)	2,516	7,180
Other assets	(1,964)	(744)	(1,203)
Accounts payable and accrued liabilities	13,621	19,575	2,726
Income taxes payable	(4,331)	22,924	(1,529)
Other liabilities	(5,701)	156	3,611
Net cash provided by operating activities	<u>351,005</u>	<u>300,787</u>	<u>315,972</u>
Cash Flows from Investing Activities:			
Capital expenditures	(151,220)	(106,532)	(76,814)
Proceeds from sales of property and equipment	2,531	182	258
Acquisitions, net of cash acquired	(26,141)	(6,468)	(5,198)
Net cash used by investing activities	<u>(174,830)</u>	<u>(112,818)</u>	<u>(81,754)</u>
Cash Flows from Financing Activities:			
Proceeds from issuances of long-term debt	912,000	983	356,247
Repayments of long-term debt	(938,537)	(1,814)	(234,103)
Repurchases of common stock	(207,312)	(227,559)	(333,291)
Debt issuance costs	(12,748)	—	(3,896)
Proceeds from exercises of stock options	16,220	54,351	26,663
Excess tax benefit from share-based compensation	1,347	22,084	14,646
Net cash used by financing activities	<u>(229,030)</u>	<u>(151,955)</u>	<u>(173,734)</u>
Effect of foreign exchange rate changes on cash and cash equivalents	(561)	(2,551)	(1,024)
Net increase (decrease) in cash and cash equivalents	(53,416)	33,463	59,460
Cash and cash equivalents, beginning of year	140,038	106,575	47,115
Cash and cash equivalents, end of year	<u>\$ 86,622</u>	<u>\$ 140,038</u>	<u>\$ 106,575</u>
Supplemental Cash Flow Information:			
Interest paid(a)	\$ 138,956	\$ 113,041	\$ 107,882
Income taxes paid	\$ 123,738	\$ 107,589	\$ 138,852

(a) For the fiscal year ended September 30, 2016, interest paid includes \$25.8 million in call premiums paid in connection with the Company's December 2015 redemption in full of its senior notes due 2019.

The accompanying notes to consolidated financial statements are an integral part of these financial statements.

SALLY BEAUTY HOLDINGS, INC. AND SUBSIDIARIES
Consolidated Statements of Stockholders' Deficit
Fiscal Years ended September 30, 2016, 2015 and 2014
(In thousands)

	Common Stock		Additional	Accumulated	Treasury	Accumulated	Total
	Shares	Amount	Paid-in	Deficit	Stock	Other	Stockholders'
			Capital			Comprehensive	Deficit
						Loss	
Balance at September 30, 2013	164,425	\$1,644	\$ 91,022	\$(385,090)	\$(1,237)	\$ (9,818)	\$(303,479)
Net earnings	—	—	—	245,993	—	—	245,993
Other comprehensive loss	—	—	—	—	—	(18,730)	(18,730)
Repurchases and cancellations of							
common stock	(12,633)	(126)	(153,447)	(180,955)	1,237	—	(333,291)
Share-based compensation	149	2	22,105	—	—	—	22,107
Stock issued for stock options	2,727	27	40,320	—	—	—	40,347
Balance at September 30, 2014	154,668	1,547	—	(320,052)	—	(28,548)	(347,053)
Net earnings	—	—	—	235,087	—	—	235,087
Other comprehensive loss	—	—	—	—	—	(49,157)	(49,157)
Repurchases and cancellations of							
common stock	(7,977)	(80)	(90,813)	(133,705)	(2,961)	—	(227,559)
Share-based compensation	184	2	16,776	—	—	—	16,778
Stock issued for stock options	4,577	46	74,037	—	—	—	74,083
Balance at September 30, 2015	151,452	1,515	—	(218,670)	(2,961)	(77,705)	(297,821)
Net earnings	—	—	—	222,942	—	—	222,942
Other comprehensive loss	—	—	—	—	—	(22,346)	(22,346)
Repurchases and cancellations of							
common stock	(7,950)	(79)	(28,361)	(181,833)	2,961	—	(207,312)
Share-based compensation	131	1	12,579	—	—	—	12,580
Stock issued for stock options	938	9	15,782	—	—	—	15,791
Balance at September 30, 2016	144,571	\$1,446	\$ —	\$(177,561)	\$ —	\$(100,051)	\$(276,166)

The accompanying notes to consolidated financial statements are an integral part of these financial statements.

Sally Beauty Holdings, Inc. and Subsidiaries
Notes to Consolidated Financial Statements
Fiscal Years ended September 30, 2016, 2015 and 2014

1. Description of Business and Basis of Presentation

Description of Business

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

Sally Beauty Supply began operations with a single store in New Orleans in 1964 and was acquired in 1969 by our former parent company, The Alberto-Culver Company, which we refer to as Alberto-Culver. BSG became a subsidiary of Sally Beauty in 1995. In 2006, the Company separated from Alberto-Culver and became an independent company listed on the New York Stock Exchange.

Basis of Presentation

The consolidated financial statements included herein have been prepared in accordance with accounting principles generally accepted in the United States (“GAAP”) and include the accounts of the Company and its subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation.

Certain amounts for prior fiscal years have been reclassified to conform to the current fiscal year’s presentation.

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

2. Significant Accounting Policies

The preparation of financial statements in conformity with GAAP requires us to interpret and apply accounting standards and to develop and follow accounting policies consistent with such standards. The following is a summary of the significant accounting policies used in preparing the Company’s consolidated financial statements.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses, and disclosures of contingent liabilities in the financial statements. Our most significant estimates relate to: the valuation of inventory, vendor rebates and concessions, retention of risk, income taxes, the assessment of long-lived assets and intangible assets for impairment, loss contingencies and share-based payments. The level of uncertainty in estimates and assumptions generally increases with the length of time until the underlying transactions are completed. Actual results may differ from these estimates in amounts that may

Sally Beauty Holdings, Inc. and Subsidiaries
Notes to Consolidated Financial Statements (Continued)
Fiscal Years ended September 30, 2016, 2015 and 2014

be material to the financial statements. Management believes that the estimates and assumptions used in the preparation of the Company's consolidated financial statements are reasonable.

Cash and Cash Equivalents

Cash equivalents generally represent highly liquid investments purchased by the Company from time to time which have an original maturity of three months or less. These investments are stated at cost, which approximates fair value. In addition, cash equivalents include proceeds due from customer credit and debit cards and PayPal transactions, which generally settle within one to three days, and were \$15.1 million and \$13.3 million at September 30, 2016 and 2015, respectively.

Concentration of Credit Risk

Financial instruments that potentially expose the Company to concentration of credit risk consist primarily of investments in cash equivalents, accounts receivable and derivative instruments. The Company invests from time to time in securities of financial institutions it deems to be of high creditworthiness. Accounts receivable are deemed by the Company to be highly diversified due to the large number of individual customers comprising the Company's customer base and their dispersion across diverse geographical regions. The counterparties to our derivative instruments are deemed by the Company to be of substantial resources and strong creditworthiness. The Company believes that no significant concentration of credit risk exists with respect to its investments in cash equivalents, its accounts receivable and its derivative instruments at September 30, 2016 and 2015.

Trade Accounts Receivable and Accounts Receivable, Other

Trade accounts receivable are recorded at the values invoiced to customers and do not accrue interest. Trade accounts receivable are stated net of the allowance for doubtful accounts. The allowance for doubtful accounts requires management to estimate the future collectability of amounts receivable at the balance sheet date. The Company records allowances for doubtful accounts on the basis of its historical collection data and current customer information. Customer account balances are written off against the allowance after all means of collection have been exhausted and the potential for recovery is considered remote. In the Company's consolidated statements of earnings, bad debt expense is included in selling, general and administrative expenses. The Company's exposure to credit risk with respect to trade receivables is mitigated by the Company's broad customer base and their dispersion across diverse geographical regions.

Accounts receivable, other, consist primarily of amounts earned from vendors under various contractual agreements and are recorded at the amounts management estimates will be collected.

Inventory

Inventory consists primarily of beauty supplies and related accessories, and salon equipment for sale in the normal course of our business. Inventory is stated at the lower of cost, determined using the first-in, first-out ("FIFO") method, or net realizable value. Inventory cost reflects actual product costs, the cost of transportation to the Company's distribution centers and certain shipping and handling costs, such as freight from the distribution centers to the stores and handling costs incurred at the distribution centers. When necessary, the Company adjusts the carrying value of inventory to the lower of cost or net realizable value, including anticipated disposal costs and for estimated inventory shrinkage. When assessing the net realizable value of inventory, management considers several factors including estimates of future demand

Sally Beauty Holdings, Inc. and Subsidiaries
Notes to Consolidated Financial Statements (Continued)
Fiscal Years ended September 30, 2016, 2015 and 2014

for the Company's products, historical turn-over rates, the age and sales history of the inventory, and historic as well as anticipated changes in stock keeping units ("SKUs").

The Company estimates inventory shrinkage between physical counts based on its historical experience. Physical inventory counts are performed at substantially all stores and significant distribution centers at least annually, and sooner when management has reason to believe that the risk of inventory shrinkage at a particular location is heightened. Upon completion of physical inventory counts, the Company's consolidated financial statements are adjusted to reflect actual quantities on hand. The Company has policies and processes in place that are intended to minimize inventory shrinkage. Inventory shrinkage expense has averaged approximately 1.0% of our consolidated net sales during each of the past three fiscal years.

Lease Accounting

The majority of the Company's lease agreements for office space, company-operated stores and warehouse/distribution facilities are accounted for as operating leases, consistent with Accounting Standards Codification ("ASC") Topic 840, *Leases*. Please see Note 3, Recent Accounting Pronouncements, below for information about a new lease accounting standard released in February 2016 which is effective for fiscal years beginning after December 15, 2018. Rent expense (including any rent abatements or escalation charges) is recognized on a straight-line basis from the date the Company takes possession of the property to begin preparation of the site for occupancy to the end of the lease term, including renewal options determined to be reasonably assured. Certain lease agreements to which the Company is a party provide for contingent rents that are determined as a percentage of revenues in excess of specified levels. The Company records a contingent rent liability, along with the corresponding rent expense, when the specified levels of revenue have been achieved or when management determines that achieving the specified levels of revenue during the fiscal year is probable.

Certain lease agreements to which the Company is a party provide for tenant improvement allowances. Such allowances are recorded as deferred lease credits, included in accrued liabilities and other liabilities, as appropriate, on our consolidated balance sheets, and amortized on a straight-line basis over the lease term (including renewal options determined to be reasonably assured) as a reduction of rent expense. The amortization period used for deferred lease credits is generally consistent with the amortization period used for the constructed leasehold improvement asset for a given office, store or warehouse facility.

Valuation of Long-Lived Assets and Intangible Assets with Definite Lives

Long-lived assets, such as property and equipment, including store equipment, and purchased intangibles subject to amortization are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be fully recoverable. The recoverability of long-lived assets and intangible assets subject to amortization is assessed by comparing the net carrying amount of each asset to its total estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its undiscounted future cash flows, an impairment charge is recognized for the amount by which the carrying amount of the asset exceeds the estimated fair value of the asset. There were no significant impairment losses recognized in our consolidated financial statements in the current or prior fiscal years presented in connection with long-lived assets and intangible assets subject to amortization.

The Company's intangible assets subject to amortization include customer relationships, certain distribution rights and non-competition agreements, and are amortized, on a straight-line basis, over

Sally Beauty Holdings, Inc. and Subsidiaries
Notes to Consolidated Financial Statements (Continued)
Fiscal Years ended September 30, 2016, 2015 and 2014

periods of two to thirteen years. Such amortization periods are based on the estimated useful lives of the assets and take into account the terms of any underlying agreements, but do not generally reflect all renewal terms contractually available to the Company.

Goodwill and Intangible Assets with Indefinite Lives

Goodwill represents the excess of the purchase price over the fair value of the net assets acquired in a business combination. Our intangible assets with indefinite lives consist of trade names acquired in business combinations. Goodwill and intangible assets with indefinite lives are reviewed for impairment at least annually, during our second fiscal quarter, and whenever events or changes in circumstances indicate it is more-likely-than-not that the value of the asset may be impaired. When assessing goodwill and intangible assets with indefinite lives for potential impairment, management considers whether the value of the asset has been impaired by evaluating if various factors (including current operating results, anticipated future results and cash flows, and relevant market and economic conditions) indicate a possible impairment and, if appropriate, compares the carrying amount of the asset to its fair value.

Based on management's assessments, after taking into account potential triggering events, including the recent decline in the average daily trading prices for shares of our common stock, there was no material impairment of goodwill or intangible assets with indefinite lives recognized in our financial statements in the current or prior fiscal years presented.

Deferred Financing Costs

Certain costs incurred in connection with the issuance of debt are capitalized when incurred and are amortized over the estimated term of the related debt instruments or agreements generally using the effective interest method. Unamortized deferred financing costs are expensed proportionally when certain debt is prepaid or notes are redeemed. At September 30, 2016 and 2015, unamortized debt issuance costs of \$23.7 million and \$21.8 million, respectively, related to our senior notes are reported as a deduction from the related long-term debt obligations (in long-term debt) on the Company's consolidated balance sheets. In addition, unamortized debt issuance costs related to the Company's five-year asset-based senior secured loan facility (the "ABL facility") of \$1.6 million and \$2.4 million, at September 30, 2016 and 2015, respectively, are reported in other assets in our consolidated balance sheets.

Self-Insurance Programs

The Company retains a substantial portion of the risk related to certain of its workers' compensation, general and auto liability, and property damage insurable loss exposure. Predetermined loss limits have been arranged with insurance companies to limit the Company's exposure per occurrence and aggregate cash outlay. In addition, certain of our employees and their dependents are covered by a self-insurance program for healthcare benefit purposes (the "healthcare plan"). Currently these self-insurance costs (less amounts recovered through payroll deductions) and certain out-of-pocket amounts incurred in connection with the employee healthcare program are funded by the Company. The Company maintains an annual stop-loss insurance policy for the healthcare plan.

The Company records an estimated liability for the ultimate cost of claims incurred and unpaid as of the balance sheet date, which includes claims filed and estimated losses incurred but not yet reported. The Company estimates the ultimate cost based on an analysis of its historical data and actuarial estimates. Workers' compensation, general and auto liability and property damage insurable loss liabilities are recorded at the estimate of their net present value, while healthcare plan liabilities are not discounted.

Sally Beauty Holdings, Inc. and Subsidiaries
Notes to Consolidated Financial Statements (Continued)
Fiscal Years ended September 30, 2016, 2015 and 2014

These estimates are reviewed on a regular basis to ensure that the recorded liability is adequate. During the fiscal year ended September 30, 2016, the Company recorded a favorable expense adjustment of \$6.3 million resulting from a decrease in estimated future payments in connection with certain of its self-insurance programs. The Company believes the amounts accrued at September 30, 2016 and 2015, are adequate.

Revenue Recognition

The Company recognizes sales revenue when a customer consummates a point-of-sale transaction at a store. The cost of sales incentive programs, including customer and consumer coupons, is recognized as a reduction of revenue at the time of sale. Taxes collected from customers and remitted to governmental authorities are recorded on a net basis and are excluded from revenue. The Company also recognizes revenue on merchandise shipped to customers when title and risk of loss pass to the customer (generally upon shipment). Appropriate provisions for sales returns and cash discounts are made at the time the sales are recognized. Sales returns and allowances averaged approximately 2.0% of net sales during each of the past three fiscal years.

Please see Note 3, Recent Accounting Pronouncements, below for more information about a new revenue accounting standard released in May 2014, which is effective for fiscal years beginning after December 15, 2017.

Cost of Products Sold and Distribution Expenses

Cost of products sold and distribution expenses include actual product costs, the cost of transportation to the Company's distribution centers, vendor rebates and allowances, inventory shrinkage and certain shipping and handling costs, such as freight from the distribution centers to the stores and handling costs incurred at the distribution centers. All other shipping and handling costs are included in selling, general and administrative expenses when incurred.

Shipping and Handling

Shipping and handling costs (including freight and distribution expenses) related to delivery to customers are included in selling, general and administrative expenses in our consolidated statements of earnings when incurred and amounted to \$56.2 million, \$53.1 million and \$52.2 million for the fiscal years 2016, 2015 and 2014, respectively.

Advertising Costs

Advertising costs relate mainly to print advertisements, digital marketing, trade shows and product education for salon professionals. Advertising costs incurred in connection with print advertisements are expensed the first time the advertisement is run. Other advertising costs are expensed when incurred. Advertising costs were \$93.0 million, \$95.3 million and \$90.2 million for the fiscal years 2016, 2015 and 2014, respectively, and are included in selling, general and administrative expenses in our consolidated statements of earnings.

Vendor Rebates and Concessions

The Company deems a cash consideration received from a supplier to be a reduction of the cost of products sold unless it is in exchange for an asset or service or a reimbursement of a specific, incremental,

Sally Beauty Holdings, Inc. and Subsidiaries
Notes to Consolidated Financial Statements (Continued)
Fiscal Years ended September 30, 2016, 2015 and 2014

identifiable cost incurred by the Company in selling the vendor's products. The majority of cash consideration received by the Company is considered to be a reduction of the cost of the related products and is reflected in cost of products sold and distribution expenses in our consolidated statements of earnings as the related products are sold. Any portion of such cash consideration received that is attributable to inventory on hand is reflected as a reduction of inventory.

Income Taxes

The Company recognizes deferred income taxes for the estimated future tax consequences attributable to temporary differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which temporary differences are estimated to be recovered or settled. The effect on deferred taxes of a change in tax rates is recognized in the consolidated statements of earnings in the period of enactment. A valuation allowance is recorded to reduce the carrying amounts of deferred tax assets to the amount expected to be realized unless it is more-likely-than-not that such assets will be realized in full. The estimated tax benefit of an uncertain tax position is recorded in our financial statements only after determining a more-likely-than-not probability that the uncertain tax position will withstand challenge, if any, from applicable taxing authorities.

Foreign Currency

The functional currency of each of the Company's foreign operations is generally the respective local currency. Balance sheet accounts are translated into U.S. dollars (the Company's reporting currency) at the rates of exchange in effect at the balance sheet date, while the results of operations and cash flows are generally translated using average exchange rates for the periods presented. Individually material transactions, if any, are translated using the actual rate of exchange on the transaction date. The resulting translation adjustments are recorded as a component of accumulated other comprehensive loss in our consolidated balance sheets. Foreign currency transaction gains or losses, including changes in the fair value (i.e., marked-to-market adjustments) of certain foreign exchange contracts held by the Company, are included in selling, general and administrative expenses in our consolidated statements of earnings when incurred and were not significant in any of the periods presented in the accompanying financial statements. Please see Note 14 below for more information about the Company's foreign exchange contracts.

3. Recent Accounting Pronouncements

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

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

Sally Beauty Holdings, Inc. and Subsidiaries
Notes to Consolidated Financial Statements (Continued)
Fiscal Years ended September 30, 2016, 2015 and 2014

In February 2016, the FASB issued ASU No. 2016-02, *Leases*, which will require lessees to report on their balance sheets a right-of-use asset and a lease liability in connection with most lease agreements classified as operating leases under the current guidance. The lease liability will be measured based on the present value of future lease payments, subject to certain conditions. The right-of-use asset will be measured based on the initial amount of the liability, plus certain initial direct costs. The new guidance will further require that leases be classified at inception as either (a) operating leases or (b) finance leases. For operating leases, periodic expense will generally be flat (straight-line) throughout the life of the lease. For finance leases, periodic expense will decline (similar to capital leases under current rules) over the life of the lease. The new standard must be adopted using a modified retrospective transition method. For public companies, this amendment is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. Early adoption is permitted.

In March 2016, the FASB issued ASU No. 2016-09, *Improvements to Employee Share-Based Payment Accounting*, intended to simplify various aspects of how share-based payments are recorded and presented on the financial statements. For example, the new guidance will require that all the income tax effect related to share-based payments be recorded in income tax expense. The new guidance further removes the current requirement to delay recognition of a windfall tax benefit until it reduces current taxes payable. In addition, the new standard will require that excess tax benefits and shortfalls from share-based compensation awards be reported as operating activities in the statement of cash flows. For public companies, these amendments are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2016. Early adoption is permitted.

In addition, the Company has not yet adopted the following recent accounting pronouncements and does not believe their adoption will have a material effect on its consolidated financial statements:

In May 2014, the FASB issued ASU No. 2014-09, *Revenue from Contracts with Customers* which will supersede ASC Topic 605, *Revenue Recognition*. In August 2015, the FASB deferred the effective date of this new standard by one year. A core principle of the new guidance is that an entity should measure revenue in connection with its sale of goods and services to a customer based on an amount that depicts the consideration to which the entity expects to be entitled in exchange for each of those goods and services. For a contract that involves more than one performance obligation, the entity must (a) determine or, if necessary, estimate the standalone selling price at inception of the contract for the distinct goods or services underlying each performance obligation and (b) allocate the transaction price to each performance obligation on the basis of the relative standalone selling prices. In addition, under the new guidance, an entity should recognize revenue when (or as) it satisfies each performance obligation under the contract by transferring the promised good or service to the customer. A good or service is deemed transferred when (or as) the customer obtains control of that good or service. The new standard permits the use of either the retrospective or cumulative effect transition method. For public companies, this amendment is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2017. Early application is permitted, but no earlier than December 16, 2016. The Company has not yet selected a transition method.

In April 2015, the FASB issued ASU No. 2015-05, *Customer's Accounting for Fees Paid in Cloud Computing Arrangement*. This pronouncement provides guidance to determine whether a cloud-based computing arrangement includes a software license. If a cloud-based computing arrangement includes a software license, the customer must account for the software element of the arrangement consistent with the acquisition of other software licenses. Otherwise, the customer must account for the arrangement as a service contract. The new standard permits the use of either the prospective or retrospective transition

Sally Beauty Holdings, Inc. and Subsidiaries
Notes to Consolidated Financial Statements (Continued)
Fiscal Years ended September 30, 2016, 2015 and 2014

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

In September 2015, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2015-16, *Business Combinations (Topic 805): Simplifying the Accounting for Measurement-Period Adjustments* (“ASU 2015-16”) which will eliminate the current requirement to recognize measurement-period adjustments to provisional amounts retrospectively. Instead, ASU 2015-16 requires the acquirer to recognize measurement-period adjustments, as well as the impact on earnings of changes in depreciation, amortization and similar items (if any) resulting from the change to the provisional amounts, in the period when the amount of each measurement-period adjustment is determined. For public companies, this amendment is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015.

4. Fair Value Measurements

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

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

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

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

Level 3—Unobservable inputs for the asset or liability.

Sally Beauty Holdings, Inc. and Subsidiaries
Notes to Consolidated Financial Statements (Continued)
Fiscal Years ended September 30, 2016, 2015 and 2014

Consistent with this hierarchy, the Company categorized certain of its financial assets and liabilities as follows at September 30, 2016 and 2015 (in thousands):

As of September 30, 2016				
	Total	Level 1	Level 2	Level 3
Assets				
Cash equivalents(a)	\$ —	\$ —	\$ —	—
Total assets	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>	—
Liabilities				
Long-term debt(c)	\$1,899,749	\$1,897,625	\$2,124	—
Foreign exchange contracts(b)	272	—	272	—
Total liabilities	<u>\$1,900,021</u>	<u>\$1,897,625</u>	<u>\$2,396</u>	—
As of September 30, 2015				
	Total	Level 1	Level 2	Level 3
Assets				
Cash equivalents(a)	\$ 46,003	\$ 46,003	\$ —	—
Foreign exchange contracts(b)	322	—	322	—
Total assets	<u>\$ 46,325</u>	<u>\$ 46,003</u>	<u>\$ 322</u>	—
Liabilities				
Long-term debt(c)	\$1,873,620	\$1,870,750	\$2,870	—
Foreign exchange contracts(b)	58	—	58	—
Total liabilities	<u>\$1,873,678</u>	<u>\$1,870,750</u>	<u>\$2,928</u>	—

- (a) Cash equivalents at September 30, 2015 consist of highly liquid investments which have no maturity and are valued using unadjusted quoted market prices for such securities. The Company may from time to time invest in securities with maturities of three months or less (consisting primarily of investment-grade corporate and government bonds), with the primary investment objective of minimizing the potential risk of loss of principal.
- (b) Foreign exchange contracts (including foreign currency forwards and options) are valued for purposes of this disclosure using widely accepted valuation techniques, such as discounted cash flow analyses, and observable inputs, such as market foreign currency exchange rates. Please see Note 14 for more information about the Company's foreign exchange contracts.
- (c) At September 30, 2016 and 2015, long-term debt (including current maturities and borrowings under the ABL facility, if any) is reported in the Company's consolidated financial statements at amortized cost of \$1,807.7 million and \$1,809.4 million, respectively, less unamortized debt issuance costs of \$23.7 million and \$21.8 million, respectively. The Company's senior notes are valued for purposes of this disclosure using unadjusted quoted market prices for such debt securities. Other long-term debt (consisting primarily of borrowings under the ABL facility, if any, and capital lease obligations) is generally valued for purposes of this disclosure using widely accepted valuation techniques, such as discounted cash flow analyses, and observable inputs, such as market interest rates. Please see Note 13 for more information about the Company's debt.

Sally Beauty Holdings, Inc. and Subsidiaries
Notes to Consolidated Financial Statements (Continued)
Fiscal Years ended September 30, 2016, 2015 and 2014

5. Accumulated Stockholders' Deficit

The Company is authorized to issue up to 500.0 million shares of common stock with a par value of \$0.01 per share and up to 50.0 million shares of preferred stock with a par value of \$0.01 per share. As of September 30, 2016, the Company had approximately 144.8 million shares issued of its common stock and approximately 144.6 million shares outstanding. There have been no shares of the Company's preferred stock issued.

In August 2014, the Company announced that its Board of Directors (the "Board") approved a share repurchase program authorizing the Company to repurchase up to \$1.0 billion of its common stock over an approximate three-year period expiring on September 30, 2017 (the "2014 Share Repurchase Program"). During the fiscal years ended September 30, 2016 and 2015, the Company repurchased and subsequently retired approximately 7.8 million and 8.1 million shares of its common stock, respectively, under the 2014 Share Repurchase Program at a cost of \$207.3 million and \$227.6 million, respectively. In addition, during the fiscal year ended September 30, 2014, the Company repurchased and retired approximately 12.6 million shares of its common stock under the 2013 Share Repurchase Program (a share repurchase program approved by the Board in March 2013 and terminated in connection with the authorization of the 2014 Share Repurchase Program) at a cost of \$333.3 million. We reduced common stock and additional paid-in capital, in the aggregate, by these amounts. However, as required by GAAP, to the extent that share repurchase amounts exceeded the balance of additional paid-in capital prior to us recording such repurchases, we recorded the excess in accumulated deficit. The Company funded these share repurchases with cash from operations, borrowings under the ABL facility and a portion of the cash proceeds from our October 2013 debt issuance.

At September 30, 2016 and 2015, accumulated other comprehensive loss consists of cumulative foreign currency translation adjustments of \$100.1 million and \$77.7 million, respectively, and is net of income taxes of \$2.3 million at both dates. Comprehensive income reflects changes in accumulated stockholders' deficit from sources other than transactions with stockholders and, as such, includes net earnings and certain other specified components. Currently, the Company's only component of comprehensive income, other than net earnings, is foreign currency translation adjustments, net of income tax.

6. Earnings Per Share

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

Sally Beauty Holdings, Inc. and Subsidiaries
Notes to Consolidated Financial Statements (Continued)
Fiscal Years ended September 30, 2016, 2015 and 2014

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

	Year ended September 30,		
	2016	2015	2014
Net earnings	<u>\$222,942</u>	<u>\$235,087</u>	<u>\$245,993</u>
Total weighted average basic shares	<u>147,179</u>	<u>156,353</u>	<u>159,933</u>
Dilutive securities:			
Stock options and stock award programs	<u>1,624</u>	<u>1,873</u>	<u>3,486</u>
Total weighted average diluted shares	<u>148,803</u>	<u>158,226</u>	<u>163,419</u>
Earnings per share:			
Basic	<u>\$ 1.51</u>	<u>\$ 1.50</u>	<u>\$ 1.54</u>
Diluted	<u>\$ 1.50</u>	<u>\$ 1.49</u>	<u>\$ 1.51</u>

At September 30, 2016, 2015 and 2014, options to purchase 1,061,068, 1,090,459 and 130,952 shares, respectively, of the Company's common stock were outstanding but not included in the computation of diluted earnings per share, since these options were anti-dilutive. An anti-dilutive option is an option that is: (a) out-of-the-money (an option the exercise price of which is greater than the average price per share of the Company's common stock during the period), and (b) in-the-money (an option the exercise price of which is less than the average price per share of the Company's common stock during the period) for which the sum of assumed proceeds, including any unrecognized compensation expense related to such option, exceeds the average price per share for the period.

7. Share-Based Payments

The Company from time to time may grant performance-based awards and service-based awards to its employees under the Sally Beauty Holdings, Inc. Amended and Restated 2010 Omnibus Incentive Plan (the "2010 Plan"), a stockholder-approved share-based compensation plan which allows for the issuance of up to 29.8 million shares of the Company's common stock. As such, during the fiscal years ended September 30, 2016, 2015 and 2014, the Company granted approximately 1.5 million, 1.2 million and 1.6 million service-based stock options, respectively, and approximately 40,000, 222,000 and 247,000 service-based restricted stock awards, respectively, to its employees under the 2010 Plan. In addition, during the fiscal year ended September 30, 2016, the Company granted approximately 152,000 performance-based restricted stock units ("Performance Units") to its employees under the 2010 Plan. Furthermore, during the fiscal years ended September 30, 2016, 2015 and 2014, the Company granted approximately 28,000, 20,000 and 27,000 service-based restricted stock units, respectively, to its non-employee directors under the 2010 Plan.

The Company measures the cost of services received from employees and directors in exchange for an award of equity instruments based on the fair value of the award on the date of grant, and recognizes compensation expense on a straight-line basis over the vesting period or, in connection with service-based awards, over the period ending on the date a participant becomes eligible for retirement, if earlier. For the fiscal years 2016, 2015 and 2014, total compensation cost charged against income and included in selling, general and administrative expenses in the Company's consolidated statements of earnings for all share-based compensation arrangements was \$12.6 million, \$16.8 million and \$22.1 million, respectively, and

Sally Beauty Holdings, Inc. and Subsidiaries
Notes to Consolidated Financial Statements (Continued)
Fiscal Years ended September 30, 2016, 2015 and 2014

resulted in an increase in additional paid-in capital by the same amounts. These amounts include, for the fiscal years 2016, 2015 and 2014, \$1.3 million, \$4.8 million and \$8.8 million, respectively, of accelerated expense related to certain retirement eligible employees who continue vesting in service-based awards upon retirement, pursuant to provisions contained in the 2010 Plan, including, for the fiscal year 2014, expense of \$3.5 million in connection with the executive management transition plan announced in May 2014. For fiscal years 2016, 2015 and 2014, the total income tax benefit recognized in our consolidated statements of earnings in connection with all share-based compensation awards was \$4.8 million, \$6.3 million and \$8.2 million, respectively.

Performance-Based Awards

The Company from time to time may grant Performance Units under the 2010 Plan. Performance Units represent unsecured obligations of the Company to issue shares of its common stock. The number of shares, if any, which will be issued in connection with these awards, is contingent upon both (a) employee service conditions and (b) the Company's level of achievement with respect to specified performance targets. The Company measures the cost of services received from employees in exchange for an award of Performance Units based on the fair value of the award on the date of grant and it recognizes expense over the requisite service period (generally three years). The fair value of a Performance Unit is determined based on the closing market price of the Company's common stock on the date of grant.

During the fiscal year ended September 30, 2016, the Company granted approximately 152,000 Performance Units ("target units") to its employees. Under the terms of these awards, a grantee may earn from 0% to 200% of his or her target units, with the ultimate number of units earned upon settlement (and expense recognized) dependent on the Company's level of achievement with respect to certain specified cumulative performance targets during the three-year period ending on September 30, 2018 (the "Performance Period") and satisfaction of the employee service condition. Periodic expense for Performance Unit awards, which is estimated quarterly, is based on the Company's projected performance during the Performance Period compared to the performance targets contained in the award. As such, for the fiscal year ended September 30, 2016, the Company has estimated and recognized compensation expense at 100% of the performance targets since it believes achievement of that percentage of the performance targets is probable. To date, the Company has only granted Performance Units subject to the Company's level of achievement with respect to specified performance targets related to: consolidated sales growth and return on invested capital, in addition to service conditions. The awards issued during the fiscal year ended September 30, 2016 contain a performance matrix for each of the two performance metrics (consolidated sales growth and return on invested capital), which matrices provide for achievement of 0% to 100% of the applicable performance targets. The performance multiplier to be applied to the number of target units awarded will be calculated by adding together the percentage of the target award earned under each of the two performance matrices.

Sally Beauty Holdings, Inc. and Subsidiaries
Notes to Consolidated Financial Statements (Continued)
Fiscal Years ended September 30, 2016, 2015 and 2014

The following table presents a summary of the activity for the Company's Performance Unit awards for the fiscal year ended September 30, 2016:

Performance Unit Awards	Number of Shares (in Thousands)	Weighted Average Fair Value Per Share	Weighted Average Remaining Vesting Term (in Years)
Unvested at September 30, 2015	—	\$ —	—
Granted	152	23.45	
Vested	—	—	
Forfeited	(20)	23.45	
Unvested at September 30, 2016	<u>132</u>	\$23.45	2.0

At September 30, 2016, unrecognized compensation costs related to unvested performance unit awards are approximately \$2.0 million and are expected to be recognized over the weighted average period of 2.0 years.

Service-Based Awards

Stock Option Awards

The Company from time to time may grant service-based stock option awards to employees under the 2010 Plan. Each option has an exercise price equal to the closing market price of the Company's common stock on the date of grant and generally has a maximum term of 10 years. Options generally vest ratably over a three or four-year period and are generally subject to forfeiture until the vesting period is complete, subject to certain retirement provisions contained in the 2010 Plan.

The following table presents a summary of the activity for the Company's service-based stock option awards for the fiscal year ended September 30, 2016:

	Number of Outstanding Options (in Thousands)	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (in Years)	Aggregate Intrinsic Value (in Thousands)
Outstanding at September 30, 2015	5,316	\$21.89	6.8	\$19,255
Granted	1,486	23.65		
Exercised	(938)	17.27		
Forfeited or expired	(280)	25.64		
Outstanding at September 30, 2016	<u>5,584</u>	\$22.95	6.1	\$19,615
Exercisable at September 30, 2016	<u>3,550</u>	\$21.54	5.4	\$17,071

Sally Beauty Holdings, Inc. and Subsidiaries
Notes to Consolidated Financial Statements (Continued)
Fiscal Years ended September 30, 2016, 2015 and 2014

The following table summarizes additional information about service-based stock options outstanding at September 30, 2016 under the Company's share-based compensation plans:

Range of Exercise Prices	Options Outstanding			Options Exercisable	
	Number of Options Outstanding (in Thousands)	Weighted Average Remaining Contractual Term (in Years)	Weighted Average Exercise Price	Number of Options Exercisable (in Thousands)	Weighted Average Exercise Price
\$5.24 - 19.99	1,169	3.6	\$12.84	1,169	\$12.84
\$20.00 - 31.58	4,415	6.7	25.63	2,381	25.81
Total	<u>5,584</u>	6.1	\$22.95	<u>3,550</u>	\$21.54

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

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

	Year Ended September 30,		
	2016	2015	2014
Expected life (in years)	5.0	5.0	5.0
Expected volatility for the Company's stock	27.2%	30.9%	47.3%
Risk-free interest rate	1.5%	1.6%	1.3%
Dividend yield	0.0%	0.0%	0.0%

The expected life of options awarded represents the period of time that such options are expected to be outstanding and is based on the Company's historical experience. The risk-free interest rate is based on the zero-coupon U.S. Treasury notes with a term comparable to the expected life of an award at the date of the grant. Since the Company does not currently expect to pay dividends, the dividend yield used for this purpose is 0%.

The weighted average fair value per share at the date of grant of the stock options awarded by the Company during the fiscal years 2016, 2015 and 2014 was \$6.32, \$8.78 and \$11.08, respectively. The aggregate fair value of stock options that vested during the fiscal years 2016, 2015 and 2014 was \$16.5 million, \$10.0 million and \$19.5 million, respectively.

The aggregate intrinsic value of options exercised by the Company's grantees during the fiscal years 2016, 2015 and 2014 was \$11.0 million, \$86.7 million and \$50.3 million, respectively. The total cash received by the Company during the fiscal years 2016, 2015 and 2014 from these option exercises was \$16.2 million, \$54.4 million and \$26.7 million, respectively, and the tax benefit realized for the tax deductions from these option exercises was \$3.7 million, \$31.7 million and \$18.3 million, respectively.

Sally Beauty Holdings, Inc. and Subsidiaries
Notes to Consolidated Financial Statements (Continued)
Fiscal Years ended September 30, 2016, 2015 and 2014

At September 30, 2016, approximately \$8.5 million of total unrecognized compensation costs related to unvested stock option awards are expected to be recognized over the weighted average period of 1.8 years.

Restricted Stock Awards

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

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

During the fiscal year 2014, the Company granted 210,820 service-based restricted stock awards with restrictions that lapse ratably over terms ranging from three to four years, in connection with the executive management transition plan announced in May 2014.

The following table presents a summary of the activity for the Company's service-based restricted stock awards for the fiscal year ended September 30, 2016:

Restricted Stock Awards	Number of Shares (in Thousands)	Weighted Average Fair Value Per Share	Weighted Average Remaining Vesting Term (in Years)
Unvested at September 30, 2015 . . .	446	\$25.82	2.8
Granted	40	25.35	
Vested	(192)	24.16	
Forfeited	(23)	27.18	
Unvested at September 30, 2016 . . .	<u>271</u>	\$26.80	1.9

At September 30, 2016, approximately \$3.0 million of total unrecognized compensation costs related to unvested restricted stock awards are expected to be recognized over the weighted average period of 1.9 years.

Restricted Stock Units

The Company currently grants service-based restricted stock unit ("RSU" or "RSUs") awards, which generally vest within one year from the date of grant, pursuant to the 2010 Plan. As of September 30, 2016, the Company has only granted service-based RSU awards to its non-employee directors. RSUs represent an unsecured promise of the Company to issue shares of its common stock. Unless forfeited prior to the vesting date, RSUs are converted into shares of the Company's common stock generally on the vesting date. An independent director who receives an RSU award may elect, upon receipt of such award, to defer until a later date delivery of the shares of the Company's common stock that would otherwise be issued on

Sally Beauty Holdings, Inc. and Subsidiaries
Notes to Consolidated Financial Statements (Continued)
Fiscal Years ended September 30, 2016, 2015 and 2014

the vesting date. RSUs granted prior to the fiscal year 2012, are generally retained by the Company as deferred stock units that are not distributed until six months after the independent director's service as a director terminates. RSUs are independent of stock option grants and are generally subject to forfeiture if service terminates prior to the vesting of the units. Participants have no voting rights with respect to unvested RSUs. Under the 2010 Plan, the Company may settle the vested deferred stock units with shares of the Company's common stock or in cash.

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

The following table presents a summary of the activity for the Company's service-based RSUs for the fiscal year ended September 30, 2016:

Restricted Stock Units	Number of Shares (in Thousands)	Weighted Average Fair Value Per Share	Weighted Average Remaining Vesting Term (In Years)
Unvested at September 30, 2015	—	\$ —	—
Granted	28	24.10	
Vested	(28)	24.10	
Forfeited	—	—	
Unvested at September 30, 2016	<u>—</u>	\$ —	—

At September 30, 2016, all RSUs previously awarded have vested and there are no unrecognized compensation costs in connection therewith.

8. Allowance for Doubtful Accounts

The change in the allowance for doubtful accounts was as follows (in thousands):

	Year Ended September 30,		
	2016	2015	2014
Balance at beginning of period	\$ 1,162	\$ 1,752	\$ 2,556
Bad debt expense	1,939	2,282	1,175
Uncollected accounts written off, net of recoveries	<u>(1,694)</u>	<u>(2,872)</u>	<u>(1,979)</u>
Balance at end of period	<u>\$ 1,407</u>	<u>\$ 1,162</u>	<u>\$ 1,752</u>

Sally Beauty Holdings, Inc. and Subsidiaries
Notes to Consolidated Financial Statements (Continued)
Fiscal Years ended September 30, 2016, 2015 and 2014

9. Property and Equipment

Property and equipment, net consists of the following (in thousands):

	September 30,	
	2016	2015
Land	\$ 11,113	\$ 11,074
Buildings and building improvements	62,087	59,407
Leasehold improvements	238,173	245,309
Furniture, fixtures and equipment	476,050	383,558
Total property and equipment, gross	787,423	699,348
Less accumulated depreciation and amortization	(467,865)	(428,501)
Total property and equipment, net	<u>\$ 319,558</u>	<u>\$ 270,847</u>

Depreciation expense for the fiscal years 2016, 2015 and 2014 was \$86.3 million, \$75.1 million and \$65.1 million, respectively. Depreciation of property and equipment is calculated using the straight-line method based on the estimated useful lives of the respective classes of assets and is reflected in depreciation and amortization expense in our consolidated statements of earnings. Buildings and building improvements are depreciated over periods ranging from five to 40 years. Leasehold improvements are amortized over the lesser of the estimated useful lives of the assets or the term of the related lease, including renewals determined to be reasonably assured. Furniture, fixtures and equipment are depreciated over periods ranging from two to ten years. Expenditures for maintenance and repairs are expensed when incurred, while expenditures for major renewals and improvements are capitalized.

10. Goodwill and Intangible Assets

The changes in the carrying amounts of goodwill by operating segment during the fiscal years 2015 and 2016 are as follows (in thousands):

	Sally Beauty Supply	Beauty Systems Group	Total
Balance at September 30, 2014	\$91,332	\$445,009	\$536,341
Acquisitions	—	2,814	2,814
Foreign currency translation	(8,116)	(6,670)	(14,786)
Balance at September 30, 2015	\$83,216	\$441,153	\$524,369
Acquisitions	—	12,797	12,797
Foreign currency translation	(3,674)	(778)	(4,452)
Balance at September 30, 2016	<u>\$79,542</u>	<u>\$453,172</u>	<u>\$532,714</u>

The Company completed its annual assessment of goodwill for impairment during the fiscal quarter ended March 31, 2016. No impairment losses were recognized in the current or prior periods presented in connection with the Company's goodwill and each of the Company's reporting units passed by a significant margin in each period presented.

The Company also completed its annual assessment of intangible assets, other than goodwill and including indefinite-lived intangible assets, for impairment during the fiscal quarter ended March 31, 2016. No

Sally Beauty Holdings, Inc. and Subsidiaries
Notes to Consolidated Financial Statements (Continued)
Fiscal Years ended September 30, 2016, 2015 and 2014

material impairment losses were recognized in the current or prior periods presented in connection with the Company's intangible assets.

The following table provides the carrying value for intangible assets with indefinite lives, excluding goodwill, and the gross carrying value and accumulated amortization for intangible assets subject to amortization by operating segment at September 30, 2016 and 2015 (in thousands):

	September 30, 2016			September 30, 2015		
	Sally Beauty Supply	Beauty Systems Group	Total	Sally Beauty Supply	Beauty Systems Group	Total
Intangible assets with indefinite lives:						
Trade names	\$ 17,732	\$ 26,194	\$ 43,926	\$ 19,289	\$ 27,210	\$ 46,499
Intangible assets subject to amortization:						
Gross carrying amount	27,271	132,479	159,750	27,352	122,894	150,246
Accumulated amortization	(17,127)	(93,586)	(110,713)	(14,991)	(82,906)	(97,897)
Net book value	10,144	38,893	49,037	12,361	39,988	52,349
Total intangible assets, excluding goodwill, net	\$ 27,876	\$ 65,087	\$ 92,963	\$ 31,650	\$ 67,198	\$ 98,848

As described in Note 17, during the fiscal year ended September 30, 2016, intangible assets subject to amortization in the amount of \$10.1 million were recorded by BSG in connection with several individually immaterial acquisitions. Amortization expense totaled \$13.3 million, \$14.3 million and \$14.5 million for the fiscal years ended September 30, 2016, 2015 and 2014, respectively. As of September 30, 2016, future amortization expense related to intangible assets subject to amortization is estimated to be as follows (in thousands):

Fiscal Year:	
2017	\$13,039
2018	11,513
2019	10,137
2020	7,346
2021	3,819
Thereafter	3,183
	<u>\$49,037</u>

The weighted average remaining amortization period for intangible assets subject to amortization is approximately 4.6 years.

Sally Beauty Holdings, Inc. and Subsidiaries
Notes to Consolidated Financial Statements (Continued)
Fiscal Years ended September 30, 2016, 2015 and 2014

11. Accrued Liabilities

Accrued liabilities consist of the following (in thousands):

	September 30,	
	2016	2015
Compensation and benefits	\$ 75,675	\$ 81,319
Interest payable	35,624	40,837
Deferred revenue	23,220	22,674
Loss contingency obligation	15,644	2,859
Rental obligations	12,942	12,641
Property and other taxes	4,870	4,730
Insurance reserves	6,472	7,783
Operating accruals and other	40,137	35,874
Total accrued liabilities	<u>\$214,584</u>	<u>\$208,717</u>

12. Commitments and Contingencies

Lease Commitments

The Company's principal leases relate to retail stores and warehousing properties. At September 30, 2016, future minimum payments under non-cancelable operating leases, net of sublease income, are as follows (in thousands):

Fiscal Year:	
2017	\$176,066
2018	148,397
2019	114,586
2020	81,074
2021	52,403
Thereafter	77,741
	<u>\$650,267</u>

Certain of the Company's leases require the Company to pay a portion of real estate taxes, insurance, maintenance and special assessments assessed by the lessor. Also, certain of the Company's leases include renewal options and escalation clauses. Aggregate rental expense for all operating leases amounted to \$231.0 million, \$223.2 million and \$218.0 million for the fiscal years 2016, 2015 and 2014, respectively, and is included in selling, general and administrative expenses in our consolidated statements of earnings.

Contingencies

Legal Proceedings

The Company is, from time to time, involved in various claims and lawsuits incidental to the conduct of its business in the ordinary course. The Company does not believe that the ultimate resolution of these matters will have a material adverse impact on its consolidated financial position, results of operations or cash flows.

Sally Beauty Holdings, Inc. and Subsidiaries
Notes to Consolidated Financial Statements (Continued)
Fiscal Years ended September 30, 2016, 2015 and 2014

Other Contingencies

During the fiscal year 2014, the Company disclosed that it had experienced a data security incident (the “2014 data security incident”). During the fiscal year 2015, the Company disclosed that it had experienced a second data security incident (the “2015 data security incident” and, together with the 2014 data security incident, the “data security incidents”). The data security incidents involved the unauthorized installation of malicious software (malware) on our information technology systems, including our point-of-sale systems that, we believe may have placed at risk certain payment card data for some transactions. The costs that the Company has incurred to date in connection with the data security incidents include assessments by payment card networks, professional advisory fees and legal costs and expenses relating to investigating and remediating the data security incidents.

For the fiscal years ended September 30, 2016, 2015 and 2014, selling, general and administrative expenses reflect expenses of \$14.6 million, \$5.6 million (net of related insurance recovery of \$0.6 million) and \$2.5 million, respectively, consisting of costs related to the data security incidents, inclusive of an accrued liability of approximately \$2.9 million related to loss contingencies associated with the 2014 data security incident recorded during the fiscal year ended September 30, 2015 and an accrued liability of approximately \$12.8 million related to loss contingencies associated with the 2015 data security incident recorded during the fiscal year ended September 30, 2016. As of September 30, 2016 and 2015, the Company had an aggregate accrued liability relating to the data security incidents of \$15.6 million and \$2.9 million, respectively. The Company’s estimated probable losses related to the claims made by the payment card networks in connection with the data security incidents are based on currently available information. The Company disputes the validity of these claims and intends to contest them. Estimates related to these claims may change as new information becomes available or circumstances change.

The Company expects to incur additional costs and expenses related to the data security incidents in the future. These costs may result from potential additional liabilities to payment card networks, governmental or third party investigations, proceedings or litigation and legal and other fees necessary to defend against any potential liabilities or claims, and further investigatory and remediation costs. As of September 30, 2016, the scope of these additional costs, or a range thereof, cannot be reasonably estimated and, while we do not anticipate these additional costs or liabilities would have a material adverse impact on our business, financial condition and operating results, these additional costs could be significant.

The Company provides healthcare benefits to most of its full-time employees. The Company is largely self-funded for the cost of the healthcare plan (including healthcare claims) primarily in the U.S., other than certain fees and out-of-pocket expenses paid by the employees. In addition, the Company retains a substantial portion of the risk related to certain workers’ compensation, general liability, and automobile and property insurance. The Company records an estimated liability for the ultimate cost of claims incurred and unpaid as of the balance sheet date. The estimated liability is included in accrued liabilities (current portion) and other liabilities (long-term portion) in our consolidated balance sheets. The Company carries insurance coverage in such amounts in excess of its self-insured retention which management believes to be reasonable.

Liabilities for loss contingencies, arising from claims, assessments, litigation, fines, penalties, the data security incidents and other sources are recorded when it is probable that a liability has been incurred and the amount of the assessment can be reasonably estimated. The Company has no significant liabilities for loss contingencies at September 30, 2016 and 2015, except as disclosed above.

Sally Beauty Holdings, Inc. and Subsidiaries
Notes to Consolidated Financial Statements (Continued)
Fiscal Years ended September 30, 2016, 2015 and 2014

13. Short-term Borrowings and Long-Term Debt

Details of long-term debt (which is reported at amortized cost) are as follows at September 30, 2016 and 2015 (dollars in thousands):

	As of September 30,		Interest Rates(a)
	2016	2015	
ABL facility(b)	\$ —	\$ —	(i) Prime plus (0.50% to 0.75%) or; (ii) LIBOR(b) plus (1.50% to 1.75%)
Senior notes due Nov. 2019	—	750,000	6.875%
Senior notes due Jun. 2022	850,000	850,000	5.750%
Senior notes due Nov. 2023	200,000	200,000	5.500%
Senior notes due Dec. 2025	750,000	—	5.625%
Total	<u>\$1,800,000</u>	<u>\$1,800,000</u>	
Plus: capital lease obligations	2,123	2,870	
Less: unamortized debt issuance costs and premium, net(c)	<u>18,113</u>	<u>15,276</u>	
Total debt	<u>\$1,784,010</u>	<u>\$1,787,594</u>	
Less: current maturities	<u>716</u>	<u>755</u>	
Total long-term debt	<u><u>\$1,783,294</u></u>	<u><u>\$1,786,839</u></u>	

(a) Interest rates shown represent the coupon or contractual rate or rates related to each debt instrument listed.

(b) When used in this Annual Report, LIBOR means the London Interbank Offered Rate. At September 30, 2016 and 2015, unamortized debt issuance costs of \$1.6 million and \$2.4 million, respectively, related to the ABL facility are reported in other assets in the Company's consolidated balance sheets.

(c) Amounts are net of unamortized premium of \$5.6 million and \$6.5 million as of September 30, 2016 and 2015, respectively, related to certain notes with an aggregate principal amount of \$150.0 million.

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

In the fiscal year 2011, Sally Holdings entered into a \$400 million, five-year asset-based senior secured loan facility (the "ABL facility"). The availability of funds under the ABL facility, as amended in June 2012, is subject to a customary borrowing base comprised of: (i) a specified percentage of our eligible credit card and trade accounts receivable (as defined therein) and (ii) a specified percentage of our eligible inventory (as defined therein), and reduced by (iii) certain customary reserves and adjustments and by certain outstanding letters of credit. The ABL facility includes a \$25.0 million Canadian sub-facility for our Canadian operations. In the fiscal year 2013, the Company, Sally Holdings and other parties to the ABL facility entered into a second amendment to the ABL facility which, among other things, increased the maximum availability under the ABL Facility to \$500.0 million (subject to borrowing base limitations), reduced pricing, relaxed the restrictions regarding the making of Restricted Payments, extended the maturity to July 2018 and improved certain other covenant terms.

Sally Beauty Holdings, Inc. and Subsidiaries
Notes to Consolidated Financial Statements (Continued)
Fiscal Years ended September 30, 2016, 2015 and 2014

At September 30, 2016, there were no borrowings outstanding under the ABL facility and the Company had \$478.4 million available for borrowing under the ABL facility, including the Canadian sub-facility. Borrowings under the ABL facility are secured by the accounts, inventory and credit card receivables (and related general intangibles and other property) of our domestic subsidiaries (and, in the case of borrowings under the Canadian sub-facility, such assets of our Canadian subsidiaries and, solely with respect to borrowings by SBH Finance B.V., intercompany notes owed to SBH Finance B.V. by our foreign subsidiaries). In addition, the terms of the ABL facility contain a commitment fee of 0.25% on the unused portion of the facility.

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

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

On December 3, 2015, the Issuers issued \$750.0 million aggregate principal amount of their senior notes due 2025 at par. The Company used the net proceeds from this debt issuance (approximately \$737.3 million) as well as cash from operations and borrowings under the ABL facility, to redeem in full the senior notes due 2019 at a total redemption cost of \$775.8 million, including the redemption premium but excluding accrued interest paid upon redemption of such notes. In connection with our redemption of the senior notes due 2019, we recorded a loss on extinguishment of debt in the amount of approximately \$33.3 million, including a redemption premium in the amount of approximately \$25.8 million and unamortized deferred financing costs of approximately \$7.5 million. In connection with the issuance of the senior notes due 2025, the Company incurred and capitalized financing costs of approximately \$12.7 million. This amount is reported as a deduction from the senior notes due 2025 on the Company’s consolidated balance sheets and is being amortized over the term of the senior notes due 2025 using the effective interest method.

The senior notes due 2022, the senior notes due 2023 and the senior notes due 2025, which we refer to collectively as “the Notes” or “the senior notes due 2022, 2023 and 2025,” are unsecured obligations of the Issuers and are jointly and severally guaranteed by the Company and Sally Investment, and by each material domestic subsidiary of the Company. Interest on the senior notes due 2022, 2023 and 2025 is payable semi-annually, during the Company’s first and third fiscal quarters. Please see Note 19 for certain condensed financial statement data pertaining to Sally Beauty, the Issuers, the guarantor subsidiaries and the non-guarantor subsidiaries.

Sally Beauty Holdings, Inc. and Subsidiaries
Notes to Consolidated Financial Statements (Continued)
Fiscal Years ended September 30, 2016, 2015 and 2014

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

The senior notes due 2023 carry optional redemption features whereby the Company has the option to redeem the notes, in whole or in part, on or after November 1, 2021 at par, plus accrued and unpaid interest, if any, and on or after November 1, 2018 at par plus a premium declining ratably to par, plus accrued and unpaid interest, if any. Prior to November 1, 2018, the notes may be redeemed, in whole or in part, at a redemption price equal to par plus a make-whole premium as provided in the indenture, plus accrued and unpaid interest, if any.

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

Maturities of the Company's long-term debt are as follows at September 30, 2016 (in thousands):

Twelve months ending September 30:

2017-2021	\$ —
Thereafter	1,800,000
	<u>\$1,800,000</u>
Plus: capital lease obligations	2,123
Less: unamortized debt issuance costs and premium, net	18,113
Less: current portion	716
Total long-term debt	<u>\$1,783,294</u>

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

The ABL facility does not contain any restriction against the incurrence of unsecured indebtedness. However, the ABL facility restricts the incurrence of secured indebtedness if, after giving effect to the incurrence of such secured indebtedness, the Company's Secured Leverage Ratio exceeds 4.0 to 1.0. At September 30, 2016, the Company's Secured Leverage Ratio was less than 0.1 to 1.0. Secured Leverage Ratio is defined as the ratio of (i) Secured Funded Indebtedness (as defined in the ABL facility) to (ii) Consolidated EBITDA (as defined in the ABL facility) for the most recently completed twelve fiscal months.

Sally Beauty Holdings, Inc. and Subsidiaries
Notes to Consolidated Financial Statements (Continued)
Fiscal Years ended September 30, 2016, 2015 and 2014

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

The indentures governing the senior notes due 2022, 2023 and 2025 contain terms which restrict the ability of Sally Beauty's subsidiaries to incur additional indebtedness. However, in addition to certain other material exceptions, the Company may incur additional indebtedness under the indentures if its Consolidated Coverage Ratio, after giving pro forma effect to the incurrence of such indebtedness, exceeds 2.0 to 1.0 ("Incurrence Test"). At September 30, 2016, the Company's Consolidated Coverage Ratio was approximately 6.1 to 1.0. Consolidated Coverage Ratio is defined as the ratio of (i) Consolidated EBITDA (as defined in the indentures) for the period containing the most recent four consecutive fiscal quarters, to (ii) Consolidated Interest Expense (as defined in the indentures) for such period.

The indentures governing the senior notes due 2022, 2023 and 2025 restrict Sally Holdings and its subsidiaries from making certain dividends and distributions to equity holders and certain other restricted payments (hereafter, a "Restricted Payment" or "Restricted Payments") to us. However, the indentures permit the making of such Restricted Payments if, at the time of the making of such Restricted Payment, the Company satisfies the Incurrence Test as described above and the cumulative amount of all Restricted Payments made since the issue date of the applicable senior notes does not exceed the sum of: (i) 50% of Sally Holdings' and its subsidiaries' cumulative consolidated net earnings since July 1, 2006 (for the senior notes due 2022 and the senior notes due 2023) or since October 1, 2015 (for the senior notes due 2025), *plus* (ii) the proceeds from the issuance of certain equity securities or conversions of indebtedness to equity, in each case, since the issue date of the applicable senior notes *plus* (iii) the net reduction in investments in unrestricted subsidiaries since the issue date of the applicable senior notes *plus* (iv) the return of capital with respect to any sales or dispositions of certain minority investments since the issue date of the applicable senior notes *plus* (v) \$350 million (for the senior notes due 2025). Further, in addition to certain other baskets, the indentures permit the Company to make additional Restricted Payments in an unlimited amount if, after giving pro forma effect to the incurrence of any indebtedness to make such Restricted Payment, the Company's Consolidated Total Leverage Ratio (as defined in the indentures) is less than 3.25 to 1.00. At September 30, 2016, the Company's Consolidated Total Leverage Ratio was approximately 2.7 to 1.0. Consolidated Total Leverage Ratio is defined as the ratio of (i) Consolidated Total Indebtedness (as defined in the indentures) *minus* cash and cash equivalents on-hand up to \$100.0 million, in each case, as of the end of the most recently-ended fiscal quarter to (ii) Consolidated EBITDA (as defined in the indentures) for the period containing the most recent four consecutive fiscal quarters.

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

Sally Beauty Holdings, Inc. and Subsidiaries
Notes to Consolidated Financial Statements (Continued)
Fiscal Years ended September 30, 2016, 2015 and 2014

defined in the ABL facility). In addition, during any period that borrowing availability under the ABL facility is less than the greater of \$40.0 million or 10% of the borrowing base, the level of the Consolidated Fixed Charge Coverage Ratio that the Company must satisfy is 1.0 to 1.0. As of September 30, 2016, the Consolidated Fixed Charge Coverage Ratio was approximately 3.1 to 1.0.

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

The ABL facility and the indentures governing the senior notes due 2022, 2023 and 2025 contain other covenants regarding restrictions on the disposition of assets, the granting of liens and security interests, the prepayment of certain indebtedness, and other matters and customary events of default, including customary cross-default and/or cross-acceleration provisions. As of September 30, 2016, all the net assets of our consolidated subsidiaries were unrestricted from transfer under our credit arrangements.

At September 30, 2016 and 2015, the Company had no off-balance sheet financing arrangements other than obligations under operating leases, as disclosed in Note 12, and letters of credit (related to inventory purchases and self-insurance programs) in the aggregate amount of \$21.6 million and \$23.1 million, respectively.

14. Derivative Instruments and Hedging Activities

Risk Management Objectives of Using Derivative Instruments

The Company is exposed to a wide variety of risks, including risks arising from changing economic conditions. The Company manages its exposure to certain economic risks (including liquidity, credit risk, and changes in foreign currency exchange rates and in interest rates) primarily: (a) by closely managing its cash flows from operating and investing activities and the amounts and sources of its debt obligations; (b) by assessing periodically the creditworthiness of its business partners; and (c) through the use of derivative instruments from time to time (including, foreign exchange contracts and interest rate swaps) by Sally Holdings and its subsidiaries.

The Company from time to time uses foreign exchange contracts (including foreign currency forwards and options), as part of its overall economic risk management strategy, to fix the amount of certain foreign assets and obligations relative to its functional and reporting currency (the U.S. dollar) or relative to the functional currency of certain of its consolidated subsidiaries, or to add stability to cash flows resulting from its net investments (including intercompany notes not permanently invested) and earnings denominated in foreign currencies. The Company’s foreign currency exposures at times offset each other, sometimes providing a natural hedge against its foreign currency risk. In connection with the remaining foreign currency risk, the Company uses foreign exchange contracts to effectively fix the foreign currency exchange rate applicable to specific anticipated foreign currency-denominated cash flows thus limiting the potential fluctuations in such cash flows as a result of foreign currency market movements.

The Company from time to time has used interest rate swaps, as part of its overall economic risk management strategy, to add stability to the interest payments due in connection with its debt obligations. At September 30, 2016, our exposure to interest rate fluctuations relates to interest payments under the ABL facility, if any, and the Company held no derivatives instruments in connection therewith.

Sally Beauty Holdings, Inc. and Subsidiaries
Notes to Consolidated Financial Statements (Continued)
Fiscal Years ended September 30, 2016, 2015 and 2014

As of September 30, 2016, the Company did not purchase or hold any derivative instruments for trading or speculative purposes.

Designated Cash Flow Hedges

The Company may use from time to time derivative instruments designated as hedges to manage its exposure to interest rate or foreign currency exchange rate movements, as appropriate. However, at September 30, 2016, the Company did not purchase or hold any such derivatives.

Non-designated Cash Flow Hedges

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

The Company uses foreign exchange contracts to manage the exposure to the U.S. dollar resulting from certain of its Sinelco Group subsidiaries' purchases of merchandise from third-party suppliers. Sinelco's functional currency is the Euro. As such, at September 30, 2016, we hold foreign currency forwards which enable us to sell approximately €16.0 million (\$18.0 million, at the September 30, 2016 exchange rate) at the weighted average contractual exchange rate of 1.1219. The foreign currency forwards discussed in this paragraph are with a single counterparty and expire ratably through September 15, 2017.

The Company also uses foreign exchange contracts to mitigate its exposure to changes in foreign currency exchange rates in connection with certain intercompany balances not permanently invested. As such, at September 30, 2016, we hold: (a) a foreign currency forward which enables us to sell approximately €22.4 million (\$25.1 million, at the September 30, 2016 exchange rate) at the contractual exchange rate of 1.1267, (b) a foreign currency forward which enables us to sell approximately \$4.1 million Canadian dollars (\$3.1 million, at the September 30, 2016 exchange rate) at the contractual exchange rate of 1.3121, (c) foreign currency forwards which enable us to buy approximately \$15.5 million Canadian dollars (\$11.8 million, at the September 30, 2016 exchange rate) at the weighted average contractual exchange rate of 1.3078, (d) a foreign currency forward which enables us to sell approximately 17.9 million Mexican pesos (\$0.9 million, at the September 30, 2016 exchange rate) at the contractual exchange rate of 19.4605 and (e) a foreign currency forward which enables us to buy approximately £7.2 million (\$9.3 million, at the September 30, 2016 exchange rate) at the contractual exchange rate of 1.3030. All the foreign currency forwards discussed in this paragraph are with a single counterparty (not the same counterparty as that on the forwards discussed in the preceding paragraph) and expire on or before December 30, 2016.

The Company's foreign exchange contracts are not designated as hedges and do not currently meet the requirements for hedge accounting. Accordingly, the changes in the fair value (i.e., marked-to-market adjustments) of these derivative instruments, which are adjusted quarterly, are recorded in selling, general and administrative expenses in our consolidated statements of earnings. Selling, general and administrative expenses reflect a net loss of \$1.1 million in the fiscal year ended September 30, 2016, and net gains of \$2.7 million and \$1.9 million in the fiscal years ended September 30, 2015 and 2014, respectively, in connection with all of the Company's foreign currency derivative instruments, including marked-to-market adjustments.

The table below presents the fair value of the Company's derivative financial instruments as well as their classification on the Company's consolidated balance sheets as of September 30, 2016 and 2015 (in thousands):

The table below presents the effect of the Company's derivative financial instruments on the Company's consolidated statements of earnings for the fiscal years ended September 30, 2016, 2015 and 2014 (in thousands):

		Amount of Gain or (Loss) Recognized in Income on Derivatives		
		Fiscal Year Ended September 30,		
Derivatives Not Designated as Hedging Instruments	Classification of Gain or (Loss) Recognized in Income	2016	2015	2014
Foreign Exchange Contracts	Selling, general and administrative expenses	\$(1,051)	\$2,731	\$1,935
Total derivatives not designated as hedging instruments		\$(1,051)	\$2,731	\$1,935

At September 30, 2016, the aggregate fair value of all foreign exchange contracts held which consisted of derivative instruments in a liability position was approximately 0.3 million. The Company was under no obligation to post and had not posted any collateral related to the derivative instruments in a liability position.

Sally Beauty Holdings, Inc. and Subsidiaries
Notes to Consolidated Financial Statements (Continued)
Fiscal Years ended September 30, 2016, 2015 and 2014

The counterparties to our derivative instruments are deemed by the Company to be of substantial resources and strong creditworthiness. However, these transactions result in exposure to credit risk in the event of default by a counterparty. For example, the financial crisis that has affected the global banking systems and certain financial markets in recent years 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 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.

15. 401(k) and Profit Sharing Plan

The Company sponsors the Sally Beauty 401(k) and Profit Sharing Plan (the “401k Plan”), which is a qualified defined contribution plan. The 401k Plan covers employees of the Company who meet certain eligibility requirements and who are not members of a collective bargaining unit. Under the terms of the 401k Plan, employees may contribute a percentage of their annual compensation to the 401k Plan up to certain maximums, as defined by the 401k Plan and by the U.S. Internal Revenue Code. The Company currently matches a portion of employee contributions to the plan. The Company recognized expense of \$7.1 million, \$6.8 million and \$6.4 million in the fiscal years ended September 30, 2016, 2015 and 2014, respectively, related to such employer matching contributions and these amounts are included in selling, general and administrative expenses in our consolidated statements of earnings.

In addition, pursuant to the 401k Plan, the Company may make profit sharing contributions to the accounts of employees who meet certain eligibility requirements and who are not members of a collective bargaining unit. The Company’s profit sharing contributions to the 401k Plan are determined by the Compensation Committee of the Board. The Company recognized expense of \$2.6 million, \$3.3 million and \$3.2 million in the fiscal years ended September 30, 2016, 2015 and 2014, respectively, related to such profit sharing contributions and these amounts are included in selling, general and administrative expenses in our consolidated statements of earnings.

Sally Beauty Holdings, Inc. and Subsidiaries
Notes to Consolidated Financial Statements (Continued)
Fiscal Years ended September 30, 2016, 2015 and 2014

16. Income Taxes

The provision for income taxes for the fiscal years 2016, 2015 and 2014 consists of the following (in thousands):

	Fiscal Year Ended September 30,		
	2016	2015	2014
Current:			
Federal	\$ 87,088	\$113,023	\$121,418
Foreign	8,795	9,531	9,414
State	13,816	13,686	14,637
Total current portion	<u>109,699</u>	<u>136,240</u>	<u>145,469</u>
Deferred:			
Federal	20,915	7,963	(335)
Foreign	(932)	(1,461)	(895)
State	1,436	655	447
Total deferred portion	<u>21,419</u>	<u>7,157</u>	<u>(783)</u>
Total provision for income taxes	<u>\$131,118</u>	<u>\$143,397</u>	<u>\$144,686</u>

The difference between the U.S. statutory federal income tax rate and the effective income tax rate is summarized below:

	Fiscal Year Ended September 30,		
	2016	2015	2014
Statutory tax rate	35.0%	35.0%	35.0%
State income taxes, net of federal tax benefit	2.9	2.7	2.7
Effect of foreign operations	(0.4)	(0.1)	(0.5)
Other, net	(0.5)	0.3	(0.2)
Effective tax rate	<u>37.0%</u>	<u>37.9%</u>	<u>37.0%</u>

Sally Beauty Holdings, Inc. and Subsidiaries
Notes to Consolidated Financial Statements (Continued)
Fiscal Years ended September 30, 2016, 2015 and 2014

The tax effects of temporary differences that give rise to the Company's deferred tax assets and liabilities are as follows (in thousands):

	<u>At September 30,</u>	
	<u>2016</u>	<u>2015</u>
Deferred tax assets attributable to:		
Share-based compensation expense	\$ 18,425	\$ 17,082
Accrued liabilities	32,145	27,949
Inventory adjustments	4,492	3,055
Foreign loss carryforwards	36,419	35,315
Unrecognized tax benefits	532	471
Other	3,225	4,065
Total deferred tax assets	95,238	87,937
Valuation allowance	(36,571)	(34,965)
Total deferred tax assets, net	58,667	52,972
Deferred tax liabilities attributable to:		
Depreciation and amortization	131,201	103,697
Total deferred tax liabilities	131,201	103,697
Net deferred tax liability	\$ 72,534	\$ 50,725

Management believes that it is more-likely-than-not that the results of future operations will generate sufficient taxable income to realize the deferred tax assets, net of the valuation allowance. The Company has recorded a valuation allowance to account for uncertainties regarding recoverability of certain deferred tax assets, primarily foreign loss carryforwards.

Domestic earnings before provision for income taxes were \$327.1 million, \$362.1 million and \$361.8 million in the fiscal years 2016, 2015 and 2014, respectively. Foreign operations had earnings before provision for income taxes of \$27.0 million, \$16.4 million and \$28.9 million in the fiscal years 2016, 2015 and 2014, respectively.

Tax reserves are evaluated and adjusted as appropriate, while taking into account the progress of audits by various taxing jurisdictions and other changes in relevant facts and circumstances evident at each balance sheet date. Management does not expect the outcome of current or future tax audits to have a material adverse effect on the Company's financial condition, results of operations or cash flow.

At September 30, 2016, undistributed earnings of the Company's foreign operations are intended to remain permanently invested to finance anticipated future growth and expansion. Accordingly, federal and state income taxes have not been provided on accumulated but undistributed earnings of \$263.0 million and \$233.2 million as of September 30, 2016 and 2015, respectively, as such earnings have been permanently reinvested in the business. The determination of the amount of the unrecognized deferred tax liability related to the undistributed earnings is not practicable.

At September 30, 2016 and 2015, the Company had total operating loss carry-forwards of \$117.9 million and \$114.2 million, respectively, of which \$104.0 million and \$98.4 million, respectively, are subject to a valuation allowance. At September 30, 2016, operating loss carry-forwards of \$13.9 million expire between 2017 and 2025 and operating loss carry-forwards of \$104.0 million have no expiration date. At

Sally Beauty Holdings, Inc. and Subsidiaries
Notes to Consolidated Financial Statements (Continued)
Fiscal Years ended September 30, 2016, 2015 and 2014

September 30, 2016 and 2015, the Company had tax credit carry-forwards of \$3.1 million and \$3.4 million, respectively, including, at September 30, 2016, tax credit carry-forwards of \$1.9 million which expire between 2024 and 2026, and tax credit carry-forwards of \$1.2 million have no expiration date.

The changes in the amount of unrecognized tax benefits are as follows (in thousands):

	Fiscal Year Ended September 30,	
	2016	2015
Balance at beginning of the fiscal year	\$ 2,982	\$2,867
Increases related to prior year tax positions	447	43
Decreases related to prior year tax positions	(18)	(134)
Increases related to current year tax positions	275	308
Settlements	(2,261)	—
Lapse of statute	(130)	(102)
Balance at end of fiscal year	<u>\$ 1,295</u>	<u>\$2,982</u>

If recognized, these positions would affect the Company's effective tax rate.

The Company recognizes interest and penalties, accrued in connection with unrecognized tax benefits, in income tax expense. The total amount of accrued interest and penalties as of September 30, 2016 and 2015 was \$0.2 million and \$1.2 million, respectively.

Because existing tax positions will continue to generate increased liabilities for unrecognized tax benefits over the next 12 months, and the fact that from time to time we are routinely under audit by various taxing authorities, it is reasonably possible that the amount of unrecognized tax benefits will change during the next 12 months. An estimate of the amount of such change, or a range thereof, cannot be made at this time. However, we do not expect the change, if any, to have a material effect on our consolidated financial condition or results of operations within the next 12 months.

The IRS has concluded the field work associated with their examination of the Company's consolidated federal income tax returns for the fiscal years ended September 30, 2007 through September 30, 2013, and issued their examination reports. The Company is currently seeking relief from double taxation through competent authority on certain cross-border adjustments related to the fiscal years ended September 30, 2007 through September 30, 2012, and it does not anticipate the ultimate resolution of these items to have a material impact on the Company's financial statements.

The Company's consolidated federal income tax returns for the fiscal years ended September 30, 2015 and 2016 are currently under IRS examination. Pending the resolution of the adjustments discussed in the preceding paragraph, our statute remains open from the year ended September 30, 2007 forward. Our foreign subsidiaries are impacted by various statutes of limitations, which are generally open from 2011 forward. Generally, states' statutes in the United States are open for tax reviews from 2007 forward.

17. Acquisitions

In the fiscal year ended September 30, 2016, the Company acquired certain assets and business operations of Peerless, a distributor of beauty products with 15 stores operating in the Midwestern region of the U.S. for approximately \$23.9 million. The results of operations of Peerless are included in the Company's

Sally Beauty Holdings, Inc. and Subsidiaries
Notes to Consolidated Financial Statements (Continued)
Fiscal Years ended September 30, 2016, 2015 and 2014

consolidated financial statements subsequent to the acquisition date. The Company recorded intangible assets subject to amortization of \$7.8 million and goodwill of \$13.1 million (which is expected to be deductible for tax purposes) in connection with this acquisition.

In addition, we completed several other individually immaterial acquisitions during the fiscal years 2016, 2015 and 2014 at the aggregate cost of approximately \$2.3 million, \$7.1 million and \$4.9 million, respectively, and recorded intangible assets subject to amortization of \$2.3 million, \$2.2 million and \$1.4 million in connection with these acquisitions. Further, we recorded goodwill in the amount of \$2.8 million and \$2.6 million, the majority of which is expected to be deductible for tax purposes, in connection with these individually immaterial acquisitions completed in the fiscal year 2015 and 2014, respectively.

We funded the acquisitions completed in the fiscal years 2016, 2015 and 2014 primarily with cash from operations and borrowings under the ABL facility.

18. Business Segments and Geographic Area Information

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 primarily in North America, Puerto Rico, and parts of Europe and South America 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 and salon professionals through its own sales force and professional-only stores (including franchise stores) in partially exclusive geographical territories in North America and parts of Europe.

The accounting policies of both of our business segments are the same as described in the summary of significant accounting policies contained in Note 2. Sales between segments, which were eliminated in consolidation, were not material for the fiscal years ended September 30, 2016, 2015 and 2014.

Sally Beauty Holdings, Inc. and Subsidiaries
Notes to Consolidated Financial Statements (Continued)
Fiscal Years ended September 30, 2016, 2015 and 2014

Business Segments Information

Segment data for the fiscal years ended September 30, 2016, 2015 and 2014 are as follows (in thousands):

	Year Ended September 30,		
	2016	2015	2014
Net sales:			
Sally Beauty Supply	\$2,364,531	\$2,329,523	\$2,308,743
BSG	1,588,087	1,504,820	1,444,755
Total	<u>\$3,952,618</u>	<u>\$3,834,343</u>	<u>\$3,753,498</u>
Earnings before provision for income taxes:			
Segment operating earnings:			
Sally Beauty Supply(a)	\$ 409,787	\$ 412,393	\$ 431,655
BSG	254,479	231,151	216,971
Segment operating earnings	664,266	643,544	648,626
Unallocated expenses(b)	(153,389)	(131,440)	(119,523)
Share-based compensation expense(c)	(12,580)	(16,778)	(22,107)
Interest expense(d)	(144,237)	(116,842)	(116,317)
Earnings before provision for income taxes . . .	<u>\$ 354,060</u>	<u>\$ 378,484</u>	<u>\$ 390,679</u>
Identifiable assets:			
Sally Beauty Supply	\$ 972,441	\$ 976,152	\$ 959,210
BSG	1,020,987	976,169	969,674
Sub-total	1,993,428	1,952,321	1,928,884
Corporate	138,635	142,030	75,435
Total	<u>\$2,132,063</u>	<u>\$2,094,351</u>	<u>\$2,004,319</u>
Depreciation and amortization:			
Sally Beauty Supply	\$ 55,460	\$ 45,572	\$ 41,019
BSG	29,971	28,678	26,782
Corporate	14,226	15,141	11,862
Total	<u>\$ 99,657</u>	<u>\$ 89,391</u>	<u>\$ 79,663</u>
Capital expenditures:(e)			
Sally Beauty Supply	\$ 95,587	\$ 65,983	\$ 43,114
BSG	24,026	16,755	19,179
Corporate	31,607	23,794	14,521
Total	<u>\$ 151,220</u>	<u>\$ 106,532</u>	<u>\$ 76,814</u>

- (a) For the fiscal year 2015, Sally Beauty Supply's operating earnings reflects \$5.3 million in expenses related to a restructuring of its operations in Germany.
- (b) Unallocated expenses consist of corporate and shared costs and are included in selling, general and administrative expenses in our consolidated statements of earnings. For the fiscal year 2016, 2015 and 2014, unallocated expenses reflect \$14.6 million, \$5.6 million (net of related insurance recovery of \$0.6 million) and \$2.5 million, respectively, related to the data security incidents.
- (c) For the fiscal year 2014, share-based compensation expenses reflect \$3.5 million in expense in connection with the executive management transition plan disclosed in May 2014. Share-based compensation expenses are included in selling, general and administrative expenses in our consolidated statements of earnings.

Sally Beauty Holdings, Inc. and Subsidiaries
Notes to Consolidated Financial Statements (Continued)
Fiscal Years ended September 30, 2016, 2015 and 2014

- (d) For the fiscal year ended September 30, 2016, interest expense includes a loss on extinguishment of debt of \$33.3 million in connection with the Company's December 2015 redemption of its senior notes due 2019.
- (e) Capital expenditures exclude amounts incurred but not paid at September 30, 2016 and 2015 of \$3.8 million and \$11.6 million, respectively. At September 30, 2014, such amounts were not material.

Geographic Area Information

Geographic data for the fiscal years ended September 30, 2016, 2015 and 2014 are as follows (in thousands):

	Year Ended September 30,		
	2016	2015	2014
Net sales:(a)			
United States	\$3,261,648	\$3,145,894	\$3,031,000
Other Countries	690,970	688,449	722,498
Total	<u>\$3,952,618</u>	<u>\$3,834,343</u>	<u>\$3,753,498</u>
Identifiable assets:			
United States	\$1,505,237	\$1,460,413	\$1,405,671
Other Countries	488,191	491,908	523,213
Corporate	138,635	142,030	75,435
Total	<u>\$2,132,063</u>	<u>\$2,094,351</u>	<u>\$2,004,319</u>

- (a) Net sales are attributable to individual countries based on the location of the customer. For the fiscal year 2016 and 2015, net sales outside the U.S. include a net negative impact from changes in foreign currency exchange rates of \$56.4 million and \$87.3 million, respectively. For the fiscal year 2014, changes in foreign currency exchange rates did not have a material impact on sales.

19. Parent, Issuers, Guarantor and Non-Guarantor Condensed Consolidated Financial Statements

The following consolidating financial information presents the condensed consolidating balance sheets as of September 30, 2016 and 2015, the related condensed consolidating statements of earnings and comprehensive income, and the condensed consolidating statements of cash flows for each of the three fiscal years in the period ended September 30, 2016 of: (i) Sally Beauty Holdings, Inc., or the "Parent;" (ii) Sally Holdings LLC and Sally Capital Inc., or the "Issuers;" (iii) the guarantor subsidiaries; (iv) the non-guarantor subsidiaries; (v) elimination entries necessary for consolidation purposes; and (vi) Sally Beauty on a consolidated basis.

Investments in subsidiaries are accounted for using the equity method for purposes of the consolidating presentation. The principal elimination entries relate to investments in subsidiaries and intercompany balances and transactions. Separate financial statements and other disclosures with respect to the subsidiary guarantors have not been provided as management believes the following information is sufficient, as guarantor subsidiaries are 100% indirectly owned by the Parent and all guarantees are full and unconditional. Additionally, the accounts, inventory, credit card receivables, deposit accounts, certain intercompany notes and certain other personal property of the guarantor subsidiaries relating to the inventory and accounts are pledged under the ABL facility and consequently may not be available to satisfy the claims of general creditors.

Sally Beauty Holdings, Inc. and Subsidiaries
Notes to Consolidated Financial Statements (Continued)
Fiscal Years ended September 30, 2016, 2015 and 2014

Condensed Consolidating Balance Sheet
September 30, 2016
(In thousands)

	Parent	Sally Holdings LLC and Sally Capital Inc.	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Consolidating Eliminations	Sally Beauty Holdings, Inc. and Subsidiaries
Assets						
Cash and cash equivalents	\$ —	\$ 28,372	\$ 22,368	\$ 35,882	\$ —	\$ 86,622
Trade and other accounts receivable, less allowance for doubtful accounts	16	—	55,989	27,978	—	83,983
Due from affiliates	—	—	1,966,505	—	(1,966,505)	—
Inventory	—	—	709,523	197,814	—	907,337
Other current assets	14,816	30	23,864	16,151	—	54,861
Deferred income tax assets	50	—	35,740	4,234	—	40,024
Property and equipment, net . . .	15	—	239,791	79,752	—	319,558
Investment in subsidiaries	870,907	3,395,436	359,193	—	(4,625,536)	—
Goodwill and other intangible assets, net	—	—	479,682	145,995	—	625,677
Other assets	1,515	2,158	(8,090)	18,418	—	14,001
Total assets	<u>\$ 887,319</u>	<u>\$3,425,996</u>	<u>\$3,884,565</u>	<u>\$526,224</u>	<u>\$(6,592,041)</u>	<u>\$2,132,063</u>
Liabilities and Stockholders' (Deficit) Equity						
Accounts payable	\$ 116	\$ 1	\$ 215,552	\$ 55,707	\$ —	\$ 271,376
Due to affiliates	1,162,045	736,373	—	68,087	(1,966,505)	—
Accrued liabilities	1,324	35,320	145,661	32,279	—	214,584
Income taxes payable	—	1,508	—	481	—	1,989
Long-term debt	—	1,781,887	17	2,106	—	1,784,010
Other liabilities	—	—	17,852	3,762	—	21,614
Deferred income tax liabilities . .	—	—	110,047	4,609	—	114,656
Total liabilities	1,163,485	2,555,089	489,129	167,031	(1,966,505)	2,408,229
Total stockholders' (deficit) equity	(276,166)	870,907	3,395,436	359,193	(4,625,536)	(276,166)
Total liabilities and stockholders' (deficit) equity	<u>\$ 887,319</u>	<u>\$3,425,996</u>	<u>\$3,884,565</u>	<u>\$526,224</u>	<u>\$(6,592,041)</u>	<u>\$2,132,063</u>

Sally Beauty Holdings, Inc. and Subsidiaries
Notes to Consolidated Financial Statements (Continued)
Fiscal Years ended September 30, 2016, 2015 and 2014

Condensed Consolidating Balance Sheet
September 30, 2015
(In thousands)

	Parent	Sally Holdings LLC and Sally Capital Inc.	Guarantor Subsidiaries	Non- Guarantor Subsidiaries	Consolidating Eliminations	Sally Beauty Holdings, Inc. and Subsidiaries
Assets						
Cash and cash equivalents	\$ —	\$ 46,003	\$ 58,851	\$ 35,184	\$ —	\$ 140,038
Trade and other accounts receivable, less allowance for doubtful accounts	—	—	60,744	30,348	—	91,092
Due from affiliates	—	—	1,687,325	35	(1,687,360)	—
Inventory	—	—	687,884	197,330	—	885,214
Other current assets	2,308	27	17,803	16,911	—	37,049
Deferred income tax assets	—	11	30,565	3,133	—	33,709
Property and equipment, net . . .	2	—	195,271	75,574	—	270,847
Investment in subsidiaries	663,045	3,099,141	360,416	—	(4,122,602)	—
Goodwill and other intangible assets, net	—	—	468,342	154,875	—	623,217
Other assets	1,384	2,894	(6,949)	15,856	—	13,185
Total assets	<u>\$ 666,739</u>	<u>\$3,148,076</u>	<u>\$3,560,252</u>	<u>\$529,246</u>	<u>\$(5,809,962)</u>	<u>\$2,094,351</u>
Liabilities and Stockholders' (Deficit) Equity						
Accounts payable	\$ —	\$ —	\$ 217,964	\$ 57,953	\$ —	\$ 275,917
Due to affiliates	962,264	658,106	35	66,955	(1,687,360)	—
Accrued liabilities	771	40,768	136,688	30,490	—	208,717
Income taxes payable	1,525	1,337	—	3,448	—	6,310
Long-term debt	—	1,784,724	109	2,761	—	1,787,594
Other liabilities	—	—	24,686	3,048	—	27,734
Deferred income tax liabilities . .	—	96	81,629	4,175	—	85,900
Total liabilities	964,560	2,485,031	461,111	168,830	(1,687,360)	2,392,172
Total stockholders' (deficit) equity	(297,821)	663,045	3,099,141	360,416	(4,122,602)	(297,821)
Total liabilities and stockholders' (deficit) equity	<u>\$ 666,739</u>	<u>\$3,148,076</u>	<u>\$3,560,252</u>	<u>\$529,246</u>	<u>\$(5,809,962)</u>	<u>\$2,094,351</u>

Sally Beauty Holdings, Inc. and Subsidiaries
Notes to Consolidated Financial Statements (Continued)
Fiscal Years ended September 30, 2016, 2015 and 2014

Condensed Consolidating Statement of Earnings and Comprehensive Income
Fiscal Year Ended September 30, 2016
(In thousands)

	Parent	Sally Holdings LLC and Sally Capital Inc.	Guarantor Subsidiaries	Non- Guarantor Subsidiaries	Consolidating Eliminations	Sally Beauty Holdings, Inc. and Subsidiaries
Net sales	\$ —	\$ —	\$3,219,812	\$732,806	\$ —	\$3,952,618
Related party sales	—	—	2,666	—	(2,666)	—
Cost of products sold and distribution expenses . . .	—	—	1,595,187	396,157	(2,666)	1,988,678
Gross profit	—	—	1,627,291	336,649	—	1,963,940
Selling, general and administrative expenses . .	11,902	364	1,074,821	278,899	—	1,365,986
Depreciation and amortization	3	—	76,250	23,404	—	99,657
Operating earnings (loss)	(11,905)	(364)	476,220	34,346	—	498,297
Interest expense (income) .	—	144,229	(6)	14	—	144,237
Earnings (loss) before provision for income taxes	(11,905)	(144,593)	476,226	34,332	—	354,060
Provision (benefit) for income taxes	(4,638)	(56,161)	181,932	9,985	—	131,118
Equity in earnings of subsidiaries, net of tax . .	230,209	318,641	24,347	—	(573,197)	—
Net earnings	<u>222,942</u>	<u>230,209</u>	<u>318,641</u>	<u>24,347</u>	<u>(573,197)</u>	<u>222,942</u>
Other comprehensive income (loss), net of tax .	—	—	—	(22,346)	—	(22,346)
Total comprehensive income	<u>\$222,942</u>	<u>\$ 230,209</u>	<u>\$ 318,641</u>	<u>\$ 2,001</u>	<u>\$(573,197)</u>	<u>\$ 200,596</u>

Sally Beauty Holdings, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Continued)

Fiscal Years ended September 30, 2016, 2015 and 2014

Condensed Consolidating Statement of Earnings and Comprehensive Income
Fiscal Year Ended September 30, 2015
(In thousands)

	Parent	Sally Holdings LLC and Sally Capital Inc.	Guarantor Subsidiaries	Non- Guarantor Subsidiaries	Consolidating Eliminations	Sally Beauty Holdings, Inc. and Subsidiaries
Net sales	\$ —	\$ —	\$3,102,406	\$731,937	\$ —	\$3,834,343
Related party sales	—	—	2,733	—	(2,733)	—
Cost of products sold and distribution expenses . . .	—	—	1,545,873	393,352	(2,733)	1,936,492
Gross profit	—	—	1,559,266	338,585	—	1,897,851
Selling, general and administrative expenses . .	9,473	475	1,012,810	290,376	—	1,313,134
Depreciation and amortization	1	—	66,093	23,297	—	89,391
Operating earnings (loss)	(9,474)	(475)	480,363	24,912	—	495,326
Interest expense	—	116,753	2	87	—	116,842
Earnings (loss) before provision for income taxes	(9,474)	(117,228)	480,361	24,825	—	378,484
Provision (benefit) for income taxes	(3,679)	(45,532)	185,388	7,220	—	143,397
Equity in earnings of subsidiaries, net of tax . .	240,882	312,578	17,605	—	(571,065)	—
Net earnings	<u>235,087</u>	<u>240,882</u>	<u>312,578</u>	<u>17,605</u>	<u>(571,065)</u>	<u>235,087</u>
Other comprehensive income (loss), net of tax .	—	—	—	(49,157)	—	(49,157)
Total comprehensive income (loss)	<u>\$235,087</u>	<u>\$ 240,882</u>	<u>\$ 312,578</u>	<u>\$ (31,552)</u>	<u>\$ (571,065)</u>	<u>\$ 185,930</u>

Sally Beauty Holdings, Inc. and Subsidiaries
Notes to Consolidated Financial Statements (Continued)
Fiscal Years ended September 30, 2016, 2015 and 2014

Condensed Consolidating Statement of Earnings and Comprehensive Income
Fiscal Year Ended September 30, 2014
(In thousands)

	Parent	Sally Holdings LLC and Sally Capital Inc.	Guarantor Subsidiaries	Non- Guarantor Subsidiaries	Consolidating Eliminations	Sally Beauty Holdings, Inc. and Subsidiaries
Net sales	\$ —	\$ —	\$2,986,026	\$767,472	\$ —	\$3,753,498
Related party sales	—	—	2,854	—	(2,854)	—
Cost of products sold and distribution expenses . . .	—	—	1,486,048	410,132	(2,854)	1,893,326
Gross profit	—	—	1,502,832	357,340	—	1,860,172
Selling, general and administrative expenses . .	10,396	474	969,026	293,617	—	1,273,513
Depreciation and amortization	1	—	56,682	22,980	—	79,663
Operating earnings (loss)	(10,397)	(474)	477,124	40,743	—	506,996
Interest expense	—	116,063	13	241	—	116,317
Earnings (loss) before provision for income taxes	(10,397)	(116,537)	477,111	40,502	—	390,679
Provision (benefit) for income taxes	(4,037)	(45,264)	181,741	12,246	—	144,686
Equity in earnings of subsidiaries, net of tax . .	252,353	323,626	28,256	—	(604,235)	—
Net earnings	245,993	252,353	323,626	28,256	(604,235)	245,993
Other comprehensive income (loss), net of tax .	—	—	—	(18,730)	—	(18,730)
Total comprehensive income (loss)	\$245,993	\$ 252,353	\$ 323,626	\$ 9,526	\$(604,235)	\$ 227,263

Sally Beauty Holdings, Inc. and Subsidiaries
Notes to Consolidated Financial Statements (Continued)
Fiscal Years ended September 30, 2016, 2015 and 2014

Condensed Consolidating Statement of Cash Flows
Fiscal Year Ended September 30, 2016
(In thousands)

	Parent	Sally Holdings LLC and Sally Capital Inc.	Guarantor Subsidiaries	Non- Guarantor Subsidiaries	Consolidating Eliminations	Sally Beauty Holdings, Inc. and Subsidiaries
Net cash provided by operating activities	\$ 189,761	\$ 20,902	\$ 107,289	\$ 33,053	\$—	\$ 351,005
Cash Flows from Investing Activities:						
Capital expenditures, net of proceeds from sale of property and equipment	(16)	—	(117,539)	(31,134)	—	(148,689)
Acquisitions, net of cash acquired . . .	—	—	(26,141)	—	—	(26,141)
Net cash used by investing activities . . .	(16)	—	(143,680)	(31,134)	—	(174,830)
Cash Flows from Financing Activities:						
Proceeds from issuance of long-term debt	—	912,000	—	—	—	912,000
Repayments of long-term debt	—	(937,785)	(92)	(660)	—	(938,537)
Debt issuance costs	—	(12,748)	—	—	—	(12,748)
Repurchases of common stock	(207,312)	—	—	—	—	(207,312)
Proceeds from exercises of stock options	16,220	—	—	—	—	16,220
Excess tax benefit from share-based compensation	1,347	—	—	—	—	1,347
Net cash used by financing activities . . .	(189,745)	(38,533)	(92)	(660)	—	(229,030)
Effect of foreign exchange rate changes on cash and cash equivalents	—	—	—	(561)	—	(561)
Net increase (decrease) in cash and cash equivalents	—	(17,631)	(36,483)	698	—	(53,416)
Cash and cash equivalents, beginning of period	—	46,003	58,851	35,184	—	140,038
Cash and cash equivalents, end of period	\$ —	\$ 28,372	\$ 22,368	\$ 35,882	\$—	\$ 86,622

Sally Beauty Holdings, Inc. and Subsidiaries
Notes to Consolidated Financial Statements (Continued)
Fiscal Years ended September 30, 2016, 2015 and 2014

Condensed Consolidating Statement of Cash Flows
Fiscal Year Ended September 30, 2015
(In thousands)

	Parent	Sally Holdings LLC and Sally Capital Inc.	Guarantor Subsidiaries	Non- Guarantor Subsidiaries	Consolidating Eliminations	Sally Beauty Holdings, Inc. and Subsidiaries
Net cash provided by operating activities	\$ 151,126	\$19,003	\$104,239	\$ 26,419	\$—	\$ 300,787
Cash Flows from Investing Activities:						
Capital expenditures, net of proceeds from sale of property and equipment	(2)	—	(79,541)	(26,807)	—	(106,350)
Acquisitions, net of cash acquired . . .	—	—	(5,731)	(737)	—	(6,468)
Net cash used by investing activities . . .	(2)	—	(85,272)	(27,544)	—	(112,818)
Cash Flows from Financing Activities:						
Proceeds from issuance of long-term debt	—	—	14	969	—	983
Repayments of long-term debt	—	—	(172)	(1,642)	—	(1,814)
Repurchases of common stock	(227,559)	—	—	—	—	(227,559)
Proceeds from exercises of stock options	54,351	—	—	—	—	54,351
Excess tax benefit from share-based compensation	22,084	—	—	—	—	22,084
Net cash used by financing activities . . .	(151,124)	—	(158)	(673)	—	(151,955)
Effect of foreign exchange rate changes on cash and cash equivalents	—	—	—	(2,551)	—	(2,551)
Net increase (decrease) in cash and cash equivalents	—	19,003	18,809	(4,349)	—	33,463
Cash and cash equivalents, beginning of period	—	27,000	40,042	39,533	—	106,575
Cash and cash equivalents, end of period	\$ —	\$46,003	\$ 58,851	\$ 35,184	\$—	\$ 140,038

Sally Beauty Holdings, Inc. and Subsidiaries
Notes to Consolidated Financial Statements (Continued)
Fiscal Years ended September 30, 2016, 2015 and 2014

Condensed Consolidating Statement of Cash Flows
Fiscal Year Ended September 30, 2014
(In thousands)

	Parent	Sally Holdings LLC and Sally Capital Inc.	Guarantor Subsidiaries	Non- Guarantor Subsidiaries	Consolidating Eliminations	Sally Beauty Holdings, Inc. and Subsidiaries
Net cash provided (used) by operating activities	\$ 291,982	\$ (93,104)	\$ 78,699	\$ 38,395	\$—	\$ 315,972
Cash Flows from Investing Activities:						
Capital expenditures, net of proceeds from sale of property and equipment	—	—	(50,315)	(26,241)	—	(76,556)
Acquisitions, net of cash acquired . . .	—	—	(4,765)	(433)	—	(5,198)
Net cash used by investing activities . . .	—	—	(55,080)	(26,674)	—	(81,754)
Cash Flows from Financing Activities:						
Proceeds from issuance of long-term debt	—	356,000	247	—	—	356,247
Repayments of long-term debt	—	(232,000)	(161)	(1,942)	—	(234,103)
Debt issuance costs	—	(3,896)	—	—	—	(3,896)
Repurchases of common stock	(333,291)	—	—	—	—	(333,291)
Proceeds from exercises of stock options	26,663	—	—	—	—	26,663
Excess tax benefit from share-based compensation	14,646	—	—	—	—	14,646
Net cash (used) provided by financing activities	(291,982)	120,104	86	(1,942)	—	(173,734)
Effect of foreign exchange rate changes on cash and cash equivalents	—	—	—	(1,024)	—	(1,024)
Net increase in cash and cash equivalents	—	27,000	23,705	8,755	—	59,460
Cash and cash equivalents, beginning of period	—	—	16,337	30,778	—	47,115
Cash and cash equivalents, end of period	\$ —	\$ 27,000	\$ 40,042	\$ 39,533	\$—	\$ 106,575

Sally Beauty Holdings, Inc. and Subsidiaries
Notes to Consolidated Financial Statements (Continued)
Fiscal Years ended September 30, 2016, 2015 and 2014

20. Quarterly Financial Data (Unaudited)

Certain unaudited quarterly consolidated statement of earnings information for the fiscal years ended September 30, 2016 and 2015 is summarized below (in thousands, except per share data):

<u>Fiscal Year</u>	<u>1st Quarter</u>	<u>2nd Quarter</u>	<u>3rd Quarter</u>	<u>4th Quarter</u>
2016:				
Net sales	\$998,032	\$980,067	\$998,161	\$976,358
Gross profit	\$494,049	\$487,474	\$498,976	\$483,441
Net earnings	\$ 42,243	\$ 60,159	\$ 67,919	\$ 52,621
Earnings per common share(a)				
Basic	\$ 0.28	\$ 0.41	\$ 0.47	\$ 0.36
Diluted	\$ 0.28	\$ 0.41	\$ 0.46	\$ 0.36
2015:				
Net sales	\$964,468	\$937,755	\$967,890	\$964,230
Gross profit	\$473,769	\$467,452	\$481,319	\$475,311
Net earnings	\$ 54,909	\$ 61,535	\$ 62,463	\$ 56,180
Earnings per common share(a)				
Basic	\$ 0.35	\$ 0.39	\$ 0.40	\$ 0.36
Diluted	\$ 0.35	\$ 0.39	\$ 0.39	\$ 0.36

- (a) The sum of the quarterly earnings per share may not equal the full year amount due to rounding of the calculated amounts.

CERTIFICATION
PURSUANT TO EXCHANGE ACT RULES 13a-14(a) AND 15d-14(a),
AS ADOPTED PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Christian A. Brickman, certify that:

- (1) I have reviewed this Annual Report on Form 10-K of Sally Beauty Holdings, Inc.;
- (2) Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
- (3) Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
- (4) The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
- (5) The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 15, 2016

By: /s/ CHRISTIAN A. BRICKMAN

Christian A. Brickman
Chief Executive Officer

CERTIFICATION
PURSUANT TO EXCHANGE ACT RULES 13a-14(a) AND 15d-14(a),
AS ADOPTED PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Janna S. Minton, certify that:

- (1) I have reviewed this Annual Report on Form 10-K of Sally Beauty Holdings, Inc.;
- (2) Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
- (3) Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
- (4) The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
- (5) The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 15, 2016

By: /s/ JANNA S. MINTON

Janna S. Minton
*Group Vice President, Chief Accounting Officer
and Controller (Principal Financial Officer)*

**CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Annual Report of Sally Beauty Holdings, Inc. (the “Company”) on Form 10-K for the fiscal year ended September 30, 2016 as filed with the Securities and Exchange Commission on the date hereof (the “Report”), I, Christian A. Brickman, Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. §1350, as adopted pursuant to §906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

By: /s/ CHRISTIAN A. BRICKMAN

Christian A. Brickman
Chief Executive Officer

Date: November 15, 2016

**CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Annual Report of Sally Beauty Holdings, Inc. (the “Company”) on Form 10-K for the fiscal year ended September 30, 2016 as filed with the Securities and Exchange Commission on the date hereof (the “Report”), I, Janna S. Minton, Group Vice President, Chief Accounting Officer and Controller of the Company, certify, pursuant to 18 U.S.C. §1350, as adopted pursuant to §906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

By: /s/ JANNA S. MINTON

Janna S. Minton
*Group Vice President, Chief Accounting Officer
and Controller (Principal Financial Officer)*

Date: November 15, 2016

Shareholder Information

Board of Directors

Robert R. McMaster

Retired Partner of KPMG LLP
Chairman of the Board

Christian A. Brickman

President and Chief Executive Officer
Sally Beauty Holdings, Inc.

Katherine Button Bell

Vice President and Chief Marketing Officer
Emerson Electric Company

Erin Nealy Cox

Retired Executive Managing Director
Stroz Friedberg LLP

Marshall E. Eisenberg

Founding Partner
Neal, Gerber & Eisenberg LLP

David W. Gibbs

President and Chief Financial Officer
Yum! Brands, Inc.

John A. Miller

President and Chief Executive Officer
North American Corporation

Susan R. Mulder

Chief Executive Officer
Nic & Zoe Co.

Edward W. Rabin

Retired President
Hyatt Hotels Corporation

Executive Officers

Christian A. Brickman

President and Chief Executive Officer

Sharon M. Leite

President, Sally Beauty Supply

Mark G. Spinks

President, Beauty Systems Group

Matthew O. Haltom

Senior Vice President, General Counsel and Secretary

Janna S. Minton

Interim Chief Financial Officer, Group Vice President,
Chief Accounting Officer and Controller

Executive Offices

3001 Colorado Boulevard
Denton, Texas 76210

1-940-898-7500
1-800-777-5706

www.sallybeautyholdings.com

Common Stock

Approximately 900 shareholders of record.

Traded on the New York Stock Exchange (the "NYSE")
Symbol: SBH

Independent Registered Public Accounting Firm

KPMG LLP

Dallas, Texas

Transfer Agent

Computershare Trust Company, N.A.

P.O. Box 30170
College Station, TX 77842-3170

Tel: 1-800-733-5001

www.computershare.com/investor

Annual Meeting

The annual meeting of stockholders is to be held on January 26, 2017, at 9:00 a.m. (Central) at the Sally Beauty Holdings, Inc. headquarters location at 3001 Colorado Boulevard, Denton, Texas. The Board of Directors has also set December 1, 2016, as the record date for determination of stockholders entitled to vote at the annual meeting.

Form 10-K Reports And Investor Relations

The Company has included as an Exhibit to its Annual Report on Form 10-K filed with the Securities and Exchange Commission certificates of the Company's Chief Executive Officer and Interim Chief Financial Officer certifying the quality of the Company's public disclosure.

The certification of our Chief Executive Officer regarding compliance with the New York Stock Exchange (NYSE) corporate governance listing standards required by NYSE Rule 303A.12 will be filed with the NYSE in January of 2017, following the 2017 Annual Meeting of Stockholders. Last year, we filed this certification with the NYSE after the 2016 Annual Meeting of Stockholders.

A copy of the Sally Beauty Holdings, Inc. 2016 Form 10-K, as filed with the Securities and Exchange Commission, is available on the investing section of the Company's website at investor.sallybeautyholdings.com. Investor inquiries or a copy of the Company Annual Report or Form 10-K or any exhibit thereto can be obtained by writing, submitting a request via the investor section of the website, or calling the Investor Relations department at:

Sally Beauty Holdings, Inc.

3001 Colorado Boulevard
Denton, Texas 76210

1-940-297-3877

<http://investor.sallybeautyholdings.com>

Cautionary Statement

Cautionary Notice Regarding Forward-Looking Statements

Statements in this report which are not purely historical facts or which depend upon future events may be 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. Words such as "anticipate," "believe," "estimate," "expect," "intend," "plan," "project," "target," "can," "could," "may," "should," "will," "would," or similar expressions may also 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: anticipating and effectively responding to changes in consumer and professional stylist preferences and buying trends in a timely manner; the success of our strategic initiatives, including our store refresh program and increased marketing efforts, to enhance the customer experience, attract new customers, drive brand awareness and improve customer loyalty; our ability to efficiently manage and

control our costs and the success of our cost control plans; the highly competitive nature of, and the increasing consolidation of, the beauty products distribution industry; the timing and acceptance of new product introductions; shifts in product mix sold during any period; potential fluctuation in our same store sales and quarterly financial performance; our dependence upon manufacturers who may be unwilling or unable to continue to supply products to us; our dependence upon manufacturers who have developed or could develop their own distribution businesses which compete directly with ours; the possibility of material interruptions in the supply of products by our third-party manufacturers or distributors, or increases in the prices of products we purchase from our third-party manufacturers or distributors; products sold by us being found to be defective in labeling or content; compliance with current laws and regulations or becoming subject to additional or more stringent laws and regulations; the success of our e-commerce businesses; the diversion of professional products sold by Beauty Systems Group to mass retailers or other unauthorized resellers; the operational and financial performance of our franchise-based business; successfully identifying acquisition candidates and successfully completing desirable acquisitions; integrating acquired businesses; the success of our initiatives to expand into new geographies; the success of our existing stores, and our ability to increase sales at existing stores; opening and operating new stores profitably; the volume of traffic to our stores; the impact of the health of the economy upon our business; conducting business outside the United States; the impact of Britain's vote to leave the European Union and related or other disruptive events in the European Union or other geographies in which we conduct business; rising labor and rental costs; protecting our intellectual property rights, particularly our trademarks; the risk that our products may infringe on the intellectual property rights of others; successfully updating and integrating our information technology systems; disruption in our information technology systems; a significant data security breach, including misappropriation of our customers' or employees' or suppliers' confidential information, and the potential costs related thereto; the negative impact on our reputation and loss of confidence of our customers, suppliers and others arising from a significant data security breach; the costs and diversion of management's attention required to investigate and remediate a data security breach and to continuously upgrade our information technology security systems to address evolving cyber-security threats; the ultimate determination of the extent or scope of the potential liabilities relating to our past or any future data security incidents; our ability to attract or retain highly skilled management and other personnel; severe weather, natural disasters, or acts of violence or terrorism; the preparedness of our accounting and other management systems to meet financial reporting and other requirements, and the upgrade of our existing financial reporting system; being a holding company, with no operations of our own, and depending on our subsidiaries for our liquidity needs; our ability to execute and implement our common stock repurchase program; our substantial indebtedness; the possibility that we may incur substantial additional debt, including secured debt, in the future; restrictions and limitations in the agreements and instruments governing our debt; generating the significant amount of cash needed to service all of our debt, and refinancing all or a portion of our indebtedness or obtaining additional financing; changes in interest rates increasing the cost of servicing our debt; and the costs and effects of litigation.

Additional factors that could cause actual events or results to differ materially from the events or results described in the forward-looking statements can be found in our filings with the Securities and Exchange Commission, including our most recent Annual Report on Form 10-K for the year ended September 30, 2016, as filed with the Securities and Exchange Commission. Consequently, all forward-looking statements in this Annual Report are qualified by the factors, risks and uncertainties contained therein. We assume no obligation to publicly update or revise any forward-looking statements.



