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Sally Beauty Holdings, Inc.
Form 10-K
November 14, 2018

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, 2018

-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

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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 every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit 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, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	Non-accelerated filer
Accelerated filer	Smaller reporting company
	Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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, 2018 was approximately \$2,017,069,000. At November 9, 2018, there were 120,144,658 shares of the registrant's common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's Proxy Statement relating to the registrant's 2019 Annual Meeting of Stockholders are incorporated by reference into Part III of this Annual Report on Form 10-K where indicated.

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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,” “might,” “anticipates” or similar expressions may constitute 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 and 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. The most important factors which could cause our actual results to differ from our forward-looking statements are set forth in our description of risk factors in Item 1A to this Annual Report on Form 10-K, which should be read in conjunction with the forward-looking statements in this report. Forward-looking statements speak only as of the date they are made, and we do not undertake any obligation to update any forward-looking statement.

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.

PART I

ITEM 1. BUSINESS

Introduction

Sally Beauty Holdings, Inc. is an international specialty retailer and distributor of professional beauty supplies with operations in North America, South America and Europe. We are one of the largest distributors of professional beauty supplies in the U.S. based on store count. At September 30, 2018, we operated two business segments, Sally Beauty Supply (“SBS”) and Beauty Systems Group (“BSG”), with 4,972 company-operated stores and 184 franchised stores. Within BSG, we also had one of the largest networks of distributor sales consultants (“DSCs”) for professional beauty products in North America, with 820 sales consultants who sell directly to salons and salon professionals. SBS targets retail consumers, salons and salon professionals, while BSG exclusively targets salons and salon professionals.

We provide our customers with a wide variety of leading third-party branded and owned-brand professional beauty supplies, including hair color and care products, styling tools, skin and nail care products and other beauty items. For each of the fiscal years ended September 30, 2018, 2017 and 2016, over 80% of our consolidated net sales were from customers located in the U.S.

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 reach broad, diversified geographies, and customer segments using varying product assortments.

Our stores are conveniently located and offer a wide selection of competitively priced beauty products, beauty solutions and expertise delivered by our knowledgeable salespeople. We also offer a comprehensive selection of ethnic products we believe further differentiates us from our competitors.

We believe that our DSCs distinguish us from other full-service/exclusive-channel distributors by providing us with a better understanding of our professional customers’ needs. In addition to placing orders through our DSCs, our customers have the ability to order and pick up the products they need between visits from our DSCs by visiting a nearby BSG store. We believe that our differentiated customer value proposition and strong brands drive customer loyalty.

Operating Strategy

Our mission is to empower our customers to express themselves through hair. Our strategy is to be the expert and leader in hair color and care for the consumer and the salon professional. We plan to focus on hair color and care through our strategic product assortment, leading experiences in color, and compelling customer experiences while also increasing our operating efficiency and profitability.

Our strategic product assortment includes being the partner of choice for brands and influencers. We believe that we offer our customers a strong and differentiated value proposition by providing salon-quality products, including an extensive collection of owned and exclusive-label brands and solutions at attractive prices.

Our focus and experiences with color include a strong emphasis on our sales force. We believe our approach to recruiting, training, and compensation results in a highly knowledgeable and effective sales force.

Our goal is to create an appealing shopping environment that embraces the retail consumer and salon professional and highlights our extensive product offering. We believe that our initiatives to create a compelling shopping environment, over time, will help drive increased customer traffic to our stores and increase their sales productivity.

Our digital strategy is evolving from a largely transactional-based to a more content-rich experience that enables customers to learn about the latest trends and techniques from influencers and engages them with our latest product launches and research products. We believe that these efforts will, over time, drive traffic and improve sales from these sites.

Professional Beauty Supply Industry Distribution Channels

The professional beauty supply industry serves end-users through four distribution channels:

Open-Line

This channel serves retail consumers and salon professionals through retail stores and e-commerce platforms. This channel is served by a large number of localized retailers and distributors, with only a few having a regional or national presence and significant channel share. We believe that SBS, with its nationwide network of retail stores, is the largest open-line distributor in the U.S. In addition, SBS'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.

Full-Service/Exclusive

This channel exclusively serves salons and salon professionals and distributes "professional-only" and other products for use in salons and for resale to consumers in salons. Many brands are distributed through exclusive arrangements with suppliers by geographic territory. BSG is one of the leading full-service distributors in the U.S. In addition, BSG offers its products for sale to salons and salon professionals through e-commerce platforms (including www.cosmoprofbeauty.com and www.cosmoprofequipment.com).

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 costs prohibitive for many manufacturers.

Mega-Salon Stores

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

Key Industry and Business Trends

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 257,000 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.

Rapidly evolving 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 millennials and 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 care products.

Increasing use of owned and exclusive-label brand products. We offer an extensive range of owned and exclusive-label brand professional beauty products. As our lines of owned and exclusive-label brand products have

matured and become better known in our retail stores and online, we have seen an increase in sales of these products.

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Growth in chair renting and frequent stocking needs. Salon professionals primarily rely on just-in-time inventory due to capital constraints and limited warehouse and shelf space. In addition, chair renters and suite renters, who now comprise a significant percentage of the total U.S. salon professionals, are often responsible for purchasing their own supplies. The number of chair renters and suite renters has significantly increased as a percentage of total salon professionals in recent years, and we expect this trend to continue. Chair renters and suite renters, given their smaller and more frequent purchase patterns, are dependent on frequent trips to professional beauty supply stores. We expect that these factors will continue to drive demand for conveniently located professional beauty supply stores, like BSG and SBS.

Business Segments

We operate in two business segments: (i) SBS, an open-line retailer of professional beauty supplies offering professional beauty supplies to both retail consumers and salon professionals, 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, in North America.

Our SBS stores and website carry an extensive selection of professional beauty supplies for retail customers, salons and salon professionals, featuring an average of 8,000 stock keeping units, or SKUs, of beauty products across a variety of product categories including hair color and care, skin and nail care, styling tools and other beauty products. SBS's stores and website carry leading third-party brands such as OPI®, China Glaze®, Wella®, Clairol®, Conair® and Hot Shot Tools®, as well as an extensive selection of owned and exclusive-label brand merchandise. We believe that SBS has differentiated by delivering an extensive selection of leading third-party branded and owned and exclusive-label brand professional beauty products at attractive prices through knowledgeable sales associates and convenient store locations.

BSG stores carry an extensive selection of third-party branded products, featuring an average of 10,500 SKUs of beauty products, including hair color and care, skin and nail care, styling tools and other beauty items at competitive prices. 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, websites and sales force, including Armstrong McCall, BSG is able to access a significant portion of the highly fragmented U.S. professional beauty salon products industry.

Neither the sales nor the product assortment for SBS or BSG are generally seasonal in nature.

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

	SBS			BSG		
	Fiscal Year Ended			Fiscal Year Ended		
	September 30,			September 30,		
	2018	2017	2016	2018	2017	2016
Company-operated stores	97.5 %	98.1 %	98.2 %	68.7 %	68.4 %	67.6 %
E-commerce	2.2 %	1.6 %	1.5 %	3.7 %	3.3 %	2.6 %
Franchise stores	0.3 %	0.3 %	0.3 %	7.7 %	7.7 %	8.0 %
Distributor sales consultants	—	—	—	—	—	—