Sally Beauty Holdings, Inc. (SBH)

**Baird Facts**

Please refer to Appendix - Important Disclosures and Analyst Certification.

<table>
<thead>
<tr>
<th>Headquartered</th>
<th>IPO/Founded</th>
<th>Management</th>
</tr>
</thead>
<tbody>
<tr>
<td>Denton, TX</td>
<td>2006/1964</td>
<td></td>
</tr>
<tr>
<td>President, Chief Executive Officer:</td>
<td>Christian Brickman</td>
<td></td>
</tr>
<tr>
<td>SVP, CFO; President, SBS:</td>
<td>Aaron Alt</td>
<td></td>
</tr>
<tr>
<td>President, BSG:</td>
<td>Mark Spinks</td>
<td></td>
</tr>
</tbody>
</table>

**Company Description**

Sally Beauty Holdings is a specialty retailer and distributor of professional beauty supplies. The company is the largest distributor in the U.S. (~81% of SBH revenue), with other operations across other North America markets, Europe, and South America. SBH operates two segments: Sally Beauty Supply (~59% of F2019 revenue), a specialty beauty retailer for consumers and professionals; and Beauty Systems Group (~41%), a professional beauty supply distributor.

**Revenue Profile**

<table>
<thead>
<tr>
<th>Consolidated Category Mix</th>
<th>Sally Beauty</th>
<th>BSG</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Skin and nail care</td>
<td>12%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Hair color</td>
<td>26%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other beauty items</td>
<td>19%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Haircare Products</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Segment ($mil)</th>
<th>F2019</th>
<th>F2020E</th>
<th>F2021E</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue</td>
<td>$</td>
<td>$</td>
<td>$</td>
</tr>
<tr>
<td>Sally Beauty</td>
<td>2,293</td>
<td>1,943</td>
<td>1,583</td>
</tr>
<tr>
<td>BSG</td>
<td>1,583</td>
<td>1,358</td>
<td>1,128</td>
</tr>
<tr>
<td>Total</td>
<td>3,876</td>
<td>3,301</td>
<td>2,711</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>EBIT</th>
<th>$</th>
<th>$</th>
<th>$</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sally Beauty</td>
<td>366</td>
<td>434</td>
<td>524</td>
</tr>
<tr>
<td>BSG</td>
<td>240</td>
<td>234</td>
<td>243</td>
</tr>
<tr>
<td>Total</td>
<td>606</td>
<td>668</td>
<td>767</td>
</tr>
</tbody>
</table>

**Competition**

**Direct**

Manufacturer direct to manufacturer-owned salons or “high-end” salons

**Mega-Salons**

Manufacturer direct to largeformat salons (ULTA classified here)

**Exclusive/Full-Service (BSG)**

Third party distribution to salons and beauty professionals via sales force and “professional only” stores

**Open-Line (Sally Beauty Supply)**

Distributes professional product to the public via retail stores

**Source:** Professional Consultants & Resources, 2014 Study (cited by SBH)
Investment Thesis

Headquartered in Denton, Texas, Sally Beauty Holdings is a specialty retailer and distributor of professional beauty supplies, with operations in the U.S. (largest distributor), other North America markets, Europe, and South America. SBH operates two segments: Sally Beauty Supply, a specialty beauty retailer for consumers and professionals; and Beauty Systems Group, a professional beauty supply distributor. Sally Beauty Holdings remains a major player in a steadily growing beauty sector. While we believe management is making appropriate investments (in the store experience, a loyalty program, CRM/marketing, systems/technology, ecommerce/mobile), taking aggressive actions to protect earnings/FCF, amid the COVID-19 crisis, at this stage of the transformational journey we view risk/reward as balanced--supporting our Neutral rating. Investment highlights include:

- **Valuation.** Our $11 price target reflects ~5x our NTM+1 EBITDA estimate, below current levels (~7x depressed earnings levels) and at the lower end of recent ranges (~6x one-year average; 5.5-6.5x range) given lower near-term earnings visibility. Sustained valuation expansion will require stabilization (post-COVID) and progress in comp growth and gross margin expansion -- which would support greater visibility toward longer term operating profit growth.

- **Key retailer/distributor in the beauty sector.** While SBH has experienced some recent challenges, the company plays an important role in the supply chain, with Sally Beauty Supply stores providing relatively value-oriented products to retail consumers and professional stylists and Beauty Systems Group servicing professional stylists and salons through stores and consultants.
  - **Sally Beauty Supply** stores feature an assortment of branded and exclusive-label beauty supplies. Professional clientele and product mix lend credibility, benefiting sales to retail consumers (~75% of U.S. sales). Sally is perceived to have a unique value proposition with salon-quality brands at lower prices and trained associates (many with cosmetology backgrounds) who can advise on products and hair-related inquiries.
  - **Beauty Systems Group.** BSG appeals to professionals through an extensive selection of salon brands attracted by its comprehensive market coverage. The trend toward stylist booth-renting has driven industry growth and increased the importance of BSG’s store base.

- **Improving retail fundamentals is expected to drive better retail comps.** Near term, management is focused on driving better retail comps through improved retail fundamentals. To drive traffic (increase the frequency of visits), the company is reallocating marketing spend (to radio, social, direct mail channels), re-focusing on defensible categories (hair color and hair care; launching box color at Sally), and launching an enhanced loyalty program (at Sally). To improve conversion, the company is adding increased training for associates, investing in technology (testing an endless-aisle concept at Sally, new POS systems, new supply chain platform), and rolling out a new impulse strategy.
**Risks & Caveats**

Sally Beauty is a leading specialty retailer and distributor of professional beauty supplies, with operations in the U.S. (largest distributor) and select international markets. While SBH's product mix includes a sizable replenishment business, demand for these discretionary categories is sensitive to macroeconomic forces affecting consumer income. Key risk factors include:

- **Competition.** Sally must differentiate its professional supplies from brands sold at specialty, mass, and drug, and online retailers as well as department stores. BSG must distinguish from other distributors through its store base, consultants, and exclusive assortment.

- **COVID-19.** The COVID-19 crisis has led to store closures and intense pressure on revenue/cash flow. If store closures persist and/or the economic backdrop continues to deteriorate, earnings would be significantly impaired.

- **Indebtedness.** SBH carries significant debt and the company maintains a 2.5-3.0x target leverage ratio (~$1.6 billion after F2019; currently near ~3x net debt/EBITDA). SBH must continue to service its debt and meet the covenants associated with its debt instruments.

- **Dependence on suppliers.** SBH is dependent on manufacturers to supply products and adhere to distribution agreements. Some suppliers have entered the distribution business as competitors to BSG.

- **International operations.** International operations expose SBH to additional currency, economic, legal, and regulatory risks.

- **Acquisitions.** SBH’s growth plan involves gaining market share through acquisitions by identifying attractive targets, financing acquisitions, and integrating acquired businesses.
Appendix - Important Disclosures and Analyst Certification

Approved on 28 May 2020 20:24EDT/ Published on 28 May 2020 20:29EDT.

Rating and Price Target History for: Sally Beauty Holdings, Inc. (SBH) as of 05-28-2020

1 Robert W. Baird & Co. Incorporated makes a market in the securities of SBH.

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