Sally Beauty Holdings, Inc.
Form 10-Q
February 05, 2015
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

---

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

FOR THE QUARTERLY PERIOD ENDED: DECEMBER 31, 2014

-OR-

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

Commission File No. 1-33145

SALLY BEAUTY HOLDINGS, INC.

(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	**36-2257936** (I.R.S. Employer Identification No.)
3001 Colorado Boulevard **Denton, Texas** (Address of principal executive offices)	**76210** (Zip Code)

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

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

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

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

Large accelerated filer x	Accelerated filer ¨
Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company ¨

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

As of January 30, 2015, there were 158,343,373 shares of the issuer s common stock outstanding.

Table of Contents

TABLE OF CONTENTS

		Page
	PART I FINANCIAL INFORMATION	
ITEM 1.	FINANCIAL STATEMENTS	6
ITEM 2.	MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS	30
ITEM 3.	QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK	47
ITEM 4.	CONTROLS AND PROCEDURES	48
	PART II OTHER INFORMATION	
ITEM 1.	LEGAL PROCEEDINGS	49
ITEM 1A.	RISK FACTORS	49
ITEM 2.	UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS	49
ITEM 3.	DEFAULTS UPON SENIOR SECURITIES	49
ITEM 4.	MINE SAFETY DISCLOSURES	49
ITEM 5.	OTHER INFORMATION	49
ITEM 6.	EXHIBITS	50

Table of Contents

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

Cautionary Notice Regarding Forward-Looking Statements

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

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

- the highly competitive nature of, and the increasing consolidation of, the beauty products distribution industry;
- anticipating and effectively responding to changes in consumer preferences and buying trends in a timely manner;
- potential fluctuation in our same store sales and quarterly financial performance;
- our dependence upon manufacturers who may be unwilling or unable to continue to supply products to us;
- the possibility of material interruptions in the supply of products by our 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;
- product diversion to mass retailers or other unauthorized resellers;
- the operational and financial performance of our Armstrong McCall, L.P., which we refer to as Armstrong McCall, franchise-based business;
- successfully identifying acquisition candidates and successfully completing desirable acquisitions;
- integrating acquired businesses;
- opening and operating new stores profitably;

- the impact of the health of the economy upon our business;
- the success of our cost control plans;
- protecting our intellectual property rights, particularly our trademarks;
- the risk that our products may infringe on the intellectual property rights of others or that we may be required to defend our intellectual property rights;
- conducting business outside the United States;
- disruption in our information technology systems;
- a significant data security breach, including misappropriation of our customers or employees 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;
- the ultimate determination of the extent or scope of the potential liabilities relating to our recent data security incident;
- 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 cash;
- 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;

Table of Contents

- generating the significant amount of cash needed to service all of our debt and refinancing all or a portion of our indebtedness or obtaining additional financing;
- changes in interest rates increasing the cost of servicing our debt;
- the potential impact on us if the financial institutions we deal with become impaired; 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 Item 1A. Risk Factors contained in Part I of our Annual Report on Form 10-K for the fiscal year ended September 30, 2014, as filed with the Securities and Exchange Commission, or SEC, and the other periodic reports that we file with the SEC. 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.

Table of Contents

WHERE YOU CAN FIND MORE INFORMATION

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

Sally Beauty maintains a website at *www.sallybeautyholdings.com* where investors and other interested parties may obtain, free of charge, press releases and other information as well as gain access to our periodic filings with the SEC. The information contained on this website should not be considered to be a part of this or any other report filed with or furnished to the SEC.

Table of Contents

PART I FINANCIAL INFORMATION

Item 1. Financial Statements.

The following consolidated balance sheets as of December 31, 2014 and September 30, 2014, the consolidated statements of earnings, consolidated statements of comprehensive income and consolidated statements of cash flows for the three months ended December 31, 2014 and 2013 are those of Sally Beauty Holdings, Inc. and its consolidated subsidiaries.

Table of Contents

SALLY BEAUTY HOLDINGS, INC. AND SUBSIDIARIES
Consolidated Statements of Earnings
(In thousands, except per share data)

(Unaudited)

	Three Months Ended December 31,			
	2014		2013	
Net sales	$	964,468	$	940,464
Cost of products sold and distribution expenses		490,699		479,938
Gross profit		473,769		460,526
Selling, general and administrative expenses		336,954		319,478
Depreciation and amortization		20,579		19,255
Operating earnings		116,236		121,793
Interest expense		29,241		28,489
Earnings before provision for income taxes		86,995		93,304
Provision for income taxes		32,086		35,309
Net earnings	$	54,909	$	57,995
Earnings per share:				
Basic	$	0.35	$	0.35
Diluted	$	0.35	$	0.35
Weighted average shares:				
Basic		156,104		163,603
Diluted		158,545		167,755

The accompanying condensed notes, together with the Notes to Consolidated Financial Statements contained in the Company s Annual Report on Form 10-K for the fiscal year ended September 30, 2014, are an integral part of these financial statements.

Table of Contents

SALLY BEAUTY HOLDINGS, INC. AND SUBSIDIARIES
Consolidated Statements of Comprehensive Income
(In thousands)

(Unaudited)

	Three Months Ended December 31,	
	2014	**2013**
Net earnings	$ 54,909	$ 57,995
Other comprehensive (loss) income:		
Foreign currency translation adjustments	(17,301)	2,567
Total other comprehensive (loss) income, before tax	(17,301)	2,567
Income taxes related to other comprehensive income		
Other comprehensive (loss) income, net of tax	(17,301)	2,567
Total comprehensive income	$ 37,608	$ 60,562

The accompanying condensed notes, together with the Notes to Consolidated Financial Statements contained in the Company s Annual Report on Form 10-K for the fiscal year ended September 30, 2014, are an integral part of these financial statements.

Table of Contents

SALLY BEAUTY HOLDINGS, INC. AND SUBSIDIARIES
Consolidated Balance Sheets
(In thousands, except par value data)

	December 31, 2014 (Unaudited)	September 30, 2014
Assets		
Current assets:		
Cash and cash equivalents	$ 190,681	$ 106,575
Trade accounts receivable, less allowance for doubtful accounts of $1,983 at December 31, 2014 and $1,752 at September 30, 2014	46,916	51,797
Accounts receivable, other	40,735	46,703
Inventory	837,822	828,429
Other current assets	35,868	38,995
Deferred income tax assets, net	31,746	31,650
Total current assets	1,183,768	1,104,149
Property and equipment, net of accumulated depreciation of $419,466 at December 31, 2014 and $413,208 at September 30, 2014	236,678	238,111
Goodwill	531,412	536,341
Intangible assets, excluding goodwill, net of accumulated amortization of $89,887 at December 31, 2014 and $86,320 at September 30, 2014	109,589	114,744
Other assets	35,587	36,628
Total assets	$ 2,097,034	$ 2,029,973
Liabilities and Stockholders Deficit		
Current liabilities:		
Current maturities of long-term debt	$ 888	$ 974
Accounts payable	264,773	259,463
Accrued liabilities	160,630	198,769
Income taxes payable	3,724	4,331
Total current liabilities	430,015	463,537
Long-term debt	1,810,104	1,810,667
Other liabilities	28,903	27,848
Deferred income tax liabilities, net	83,568	74,974
Total liabilities	2,352,590	2,377,026
Stockholders deficit:		
Common stock, $0.01 par value. Authorized 500,000 shares; 158,324 and 155,104 shares issued and 157,757 and 154,668 shares outstanding at December 31, 2014 and September 30, 2014, respectively	1,578	1,547
Preferred stock, $0.01 par value. Authorized 50,000 shares; none issued		
Additional paid-in capital		
Accumulated deficit	(211,285)	(320,052)
Accumulated other comprehensive loss, net of tax	(45,849)	(28,548)
Total stockholders deficit	(255,556)	(347,053)
Total liabilities and stockholders deficit	$ 2,097,034	$ 2,029,973

The accompanying condensed notes, together with the Notes to Consolidated Financial Statements contained in the Company s Annual Report on Form 10-K for the fiscal year ended September 30, 2014, are an integral part of these financial statements.

Table of Contents

SALLY BEAUTY HOLDINGS, INC. AND SUBSIDIARIES
Consolidated Statements of Cash Flows
(In thousands)

(Unaudited)

	Three Months Ended December 31,	
	2014	**2013**
Cash Flows from Operating Activities:		
Net earnings	$ 54,909	$ 57,995
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation and amortization	20,579	19,255
Share-based compensation expense	7,760	8,522
Amortization of deferred financing costs	950	921
Excess tax benefit from share-based compensation	(17,043)	(2,985)
Deferred income taxes	8,341	(563)
Changes in (exclusive of effects of acquisitions):		
Trade accounts receivable	3,944	4,537
Accounts receivable, other	5,532	(754)
Inventory	(17,616)	(4,984)
Other current assets	19,943	2,948
Other assets	(572)	(160)
Accounts payable and accrued liabilities	(30,363)	(57,259)
Income taxes payable	(497)	29,057
Other liabilities	1,169	3,574
Net cash provided by operating activities	57,036	60,104
Cash Flows from Investing Activities:		
Capital expenditures	(18,800)	(13,375)
Net cash used by investing activities	(18,800)	(13,375)
Cash Flows from Financing Activities:		
Proceeds from issuance of long-term debt		232,719
Repayments of long-term debt	(258)	(109,025)
Repurchases of common stock	(7,253)	(66,183)
Debt issuance costs		(3,888)
Proceeds from exercises of stock options	37,156	7,319
Excess tax benefit from share-based compensation	17,043	2,985
Net cash provided by financing activities	46,688	63,927
Effect of foreign exchange rate changes on cash and cash equivalents	(818)	153
Net increase in cash and cash equivalents	84,106	110,809
Cash and cash equivalents, beginning of period	106,575	47,115
Cash and cash equivalents, end of period	$ 190,681	$ 157,924
Supplemental Cash Flow Information:		
Interest paid	$ 56,138	$ 50,807
Income taxes paid	$ 4,835	$ 4,119

The accompanying condensed notes, together with the Notes to Consolidated Financial Statements contained in the Company s Annual Report on Form 10-K for the fiscal year ended September 30, 2014, are an integral part of these financial statements.

Table of Contents

Sally Beauty Holdings, Inc. and Subsidiaries

Condensed Notes to Consolidated Financial Statements

(Unaudited)

1. Description of Business and Basis of Presentation

Description of Business

Sally Beauty Holdings, Inc. and its consolidated subsidiaries (Sally Beauty or the Company) sell professional beauty supplies through its Sally Beauty Supply retail stores primarily in the U.S., Puerto Rico, Canada, Mexico, Chile, 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., Puerto Rico, Canada, the United Kingdom and certain other countries in Europe, and to franchises in the southern and southwestern regions of the U.S., and in Mexico through the operations of its subsidiary Armstrong McCall, L.P. (Armstrong McCall). Certain beauty products sold by BSG and Armstrong McCall are sold under exclusive territory agreements with the manufacturers of the products.

Basis of Presentation

The accompanying consolidated interim financial statements include the accounts of the Company and its subsidiaries. All significant inter-company accounts and transactions have been eliminated in consolidation. In the opinion of management, these consolidated financial statements reflect all adjustments which are of a normal recurring nature and which are necessary to present fairly the Company s consolidated financial position as of December 31, 2014 and September 30, 2014, and its consolidated results of operations and consolidated cash flows for the three months ended December 31, 2014 and 2013.

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

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

2. Significant Accounting Policies

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

statements prepared in accordance with accounting principles generally accepted in the United States (GAAP) have been condensed or omitted pursuant to those rules and regulations, although the Company believes that the disclosures made are adequate to make the information not misleading. These consolidated interim financial statements should be read in conjunction with the financial statements and notes thereto included in the Company s Annual Report on Form 10-K for the fiscal year ended September 30, 2014. The Company adheres to the same accounting policies in the preparation of its interim financial statements. As permitted under GAAP, interim accounting for certain expenses, including income taxes, is based on full year assumptions. Such amounts are expensed in full in the year incurred. For interim financial reporting purposes, income taxes are recorded based upon estimated annual effective income tax rates.

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

3. Recent Accounting Pronouncements

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

In May 2014, the Financial Accounting Standards Board issued Accounting Standards Update (ASU) No. 2014-09, *Revenue from Contracts with Customers* (ASU 2014-09) which will supersede Accounting Standards Codification (ASC) Topic 605, *Revenue Recognition*. 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, 2016. Early application is not permitted for public companies. The Company has not yet selected a transition method nor determined the effect of the new standard on its financial statements.

Table of Contents

Sally Beauty Holdings, Inc. and Subsidiaries

Condensed Notes to Consolidated Financial Statements

(Unaudited)

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.

Consistent with this hierarchy, the Company categorized certain of its financial assets and liabilities as follows at December 31, 2014 and September 30, 2014 (in thousands):

	As of December 31, 2014			
	Total	**Level 1**	**Level 2**	**Level 3**
Assets				
Cash equivalents (a)	$ 107,501	$ 107,501	$	
Foreign exchange contracts (b)	1,284		1,284	
Total assets	$ 108,785	$ 107,501	$ 1,284	

	Total	Level 1	Level 2	Level 3
Liabilities				
Long-term debt (c)	$ 1,893,779	$ 1,890,000	$ 3,779	
Foreign exchange contracts (b)	3		3	
Total liabilities	$ 1,893,782	$ 1,890,000	$ 3,782	

	As of September 30, 2014			
	Total	Level 1	Level 2	Level 3
Assets				
Cash equivalents (a)	$ 27,000	$ 27,000	$	
Foreign exchange contracts (b)	511		511	
Total assets	$ 27,511	$ 27,000	$ 511	
Liabilities				
Long-term debt (c)	$ 1,874,444	$ 1,870,250	$ 4,194	
Foreign exchange contracts (b)	47		47	
Total liabilities	$ 1,874,491	$ 1,870,250	$ 4,241	

(a) Cash equivalents 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 reasonable estimates, such as market foreign currency exchange rates. Please see Note 10 for more information about the Company s foreign exchange contracts.

(c) Long-term debt (including current maturities and borrowings under the ABL facility, if any) is carried in the Company s consolidated financial statements at amortized cost of $1,811.0 million at December 31, 2014 and $1,811.6 million at September 30, 2014. 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 9 for more information about the Company s debt.

Table of Contents

Sally Beauty Holdings, Inc. and Subsidiaries

Condensed Notes to Consolidated Financial Statements

(Unaudited)

5. Accumulated Stockholders Equity (Deficit)

In August 2014, we announced that our Board of Directors approved a share repurchase program authorizing us to repurchase up to $1.0 billion of our common stock over a period of approximately three years (the 2014 Share Repurchase Program). The 2014 Share Repurchase Program expires on September 30, 2017.

During the three months ended December 31, 2014, the Company repurchased and subsequently retired approximately 0.2 million shares of its common stock under the 2014 Share Repurchase Program at an aggregate cost of $7.3 million. In addition, during the three months ended December 31, 2013, the Company repurchased and subsequently retired approximately 2.4 million shares of its 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 an aggregate cost of $66.2 million. The Company reduced common stock and additional paid-in capital, in the aggregate, by these amounts. As required by GAAP, the Company recorded any amounts paid to repurchase shares in excess of the balance of additional paid-in capital in accumulated deficit.

At December 31, 2014 and September 30, 2014, accumulated other comprehensive loss consists of cumulative foreign currency translation adjustments of $45.8 million and $28.5 million, respectively, net of income taxes of $2.3 million at both dates. Comprehensive income (loss) reflects changes in accumulated stockholders equity (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.

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

	Three Months Ended December 31,

	2014	2013
Net earnings	$ 54,909	$ 57,995
Weighted average basic shares	156,104	163,603
Dilutive securities:		
Stock option and stock award programs	2,441	4,152
Weighted average diluted shares	158,545	167,755
Earnings per share:		
Basic	$ 0.35	$ 0.35
Diluted	$ 0.35	$ 0.35

At December 31, 2014 and 2013, options to purchase 1,259,204 shares and 1,462,543 shares, respectively, of the Company s common stock were outstanding but not included in the computations of diluted earnings per share since these options were anti-dilutive. Anti-dilutive options are: (a) out-of-the-money options (options the exercise price of which is greater than the average price per share of the Company s common stock during the period), and (b) in-the-money options (options 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 options, exceeds the average price per share for the period.

Table of Contents

Sally Beauty Holdings, Inc. and Subsidiaries

Condensed Notes to Consolidated Financial Statements

(Unaudited)

7. Share-Based Payments

The Company measures the cost of services received from employees, directors and consultants 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 over the period ending on the date a participant becomes eligible for retirement, if earlier.

The Company granted approximately 1.1 million and 1.5 million stock options and approximately 214,000 and 25,000 restricted share awards to its employees and consultants during the three months ended December 31, 2014 and 2013, respectively. Upon issuance of such grants, the Company recognized accelerated share-based compensation expense of $4.8 million and $5.3 million in the three months ended December 31, 2014 and 2013, respectively, in connection with certain retirement eligible employees who are eligible to continue vesting awards upon retirement under the provisions of the Sally Beauty Holdings, Inc. Amended and Restated 2010 Omnibus Incentive Plan (the 2010 Plan). In addition, the Company granted approximately 20,000 and 27,000 restricted stock units to its non-employee directors during the three months ended December 31, 2014 and 2013, respectively.

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

	Three Months Ended December 31,	
	2014	**2013**
Share-based compensation expense	$ 7,760	$ 8,522
Income tax benefit related to share-based compensation expense	$ 2,918	$ 3,181

Stock Option Awards

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 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 and certain predecessor share-based compensation plans such as the Sally Beauty Holdings, Inc. 2007 Omnibus Incentive Plan.

The following table presents a summary of the activity for the Company s stock option awards for the three months ended December 31, 2014:

	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, 2014	8,983	$	15.93	6.2	$	102,751
Granted	1,132		29.20			
Exercised	(3,265)		11.38			
Forfeited or expired	(33)		22.64			
Outstanding at December 31, 2014	6,817	$	20.28	7.1	$	71,282
Exercisable at December 31, 2014	3,405	$	14.78	5.5	$	54,366

Table of Contents

Sally Beauty Holdings, Inc. and Subsidiaries

Condensed Notes to Consolidated Financial Statements

(Unaudited)

The following table summarizes additional information about stock options outstanding under the Company s share-based compensation plans:

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	**Number Outstanding at December 31, 2014 (in Thousands)**	**Weighted Average Remaining Contractual Term (in Years)**	**Weighted Average Exercise Price**	**Number Exercisable at December 31, 2014 (in Thousands)**	**Weighted Average Exercise Price**
$2.00 19.99	3,026	5.0	$ 12.79	2,617	$ 11.78
$20.00 29.20	3,791	8.7	26.27	788	24.70
Total	6,817	7.1	$ 20.28	3,405	$ 14.78

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 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:

	Three months ended December 31,	
	2014	**2013**
Expected life (in years)	5.0	5.0
Expected volatility for the Company s stock	31.0%	48.4%
Risk-free interest rate	1.6%	1.3%
Dividend yield	0.0%	0.0%

The expected life of options represents the period of time that the options granted are expected to be outstanding and is based on historical experience of employees of the Company who have been granted stock options. The risk-free interest rate is based on the zero-coupon U.S. Treasury notes with a comparable term as of the date of the grant. Since the Company does not currently expect to pay dividends, the dividend yield used is 0%.

The weighted average fair value at the date of grant of the stock options issued by the Company in the three months ended December 31, 2014 and 2013 was $8.77 and $11.32 per option, respectively. The total intrinsic value of options exercised during the three months ended December 31, 2014 was $61.5 million. The cash proceeds from these option exercises were $37.2 million and the tax benefit realized from these

option exercises was $23.4 million.

At December 31, 2014, unrecognized compensation costs related to unvested stock option awards are approximately $18.0 million and are expected to be recognized over the weighted average period of 2.6 years.

Stock Awards

Restricted Stock Awards

The Company from time to time grants restricted stock awards to employees and consultants 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) the restrictions over which lapse ratably over a specified period of time (generally four 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 of the 2010 Plan.

The fair value of the Company s restricted stock awards is expensed on a straight-line basis over the period (generally four to five years) in 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.

Table of Contents

Sally Beauty Holdings, Inc. and Subsidiaries

Condensed Notes to Consolidated Financial Statements

(Unaudited)

The following table presents a summary of the activity for the Company s restricted stock awards for the three months ended December 31, 2014:

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, 2014	436	$	22.42	3.4
Granted	214		29.20	
Vested	(83)		14.30	
Forfeited				
Unvested at December 31, 2014	567	$	26.16	3.2

At December 31, 2014, unrecognized compensation costs related to unvested restricted stock awards are approximately $6.8 million and are expected to be recognized over the weighted average period of 3.2 years.

Restricted Stock Units

The Company currently grants Restricted Stock Unit (RSU or RSUs) awards, which generally vest within one year from the date of grant, pursuant to the 2010 Plan. To date, the Company has only granted RSU awards to its non-employee directors. RSUs represent an unsecured promise of the Company to issue shares of the Company s 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 common stock of the Company that would otherwise be issued to such director on 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 the RSUs, which is determined to be the fair value of the RSUs at the date of grant, on a straight-line basis over the vesting period (generally one year). For these purposes, the fair value of the 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 RSUs for the three months ended December 31, 2014:

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, 2014		$		
Granted	20		29.20	
Vested				
Forfeited				
Unvested at December 31, 2014	20	$	29.20	0.8

At December 31, 2014, unrecognized compensation costs related to unvested RSUs are approximately $0.5 million and are expected to be recognized over the weighted average period of 0.8 years.

8. Commitments and Contingencies

In the fiscal year ended September 30, 2014, the Company disclosed that it had experienced a data security incident. The costs that the Company has incurred to date in connection with the data security incident primarily include professional advisory and legal costs. For the three months ended December 31, 2014, selling, general and administrative expenses reflect a charge of $0.2 million, consisting primarily of these costs relating to the data security incident.

The Company may incur additional costs and expenses related to the data security incident in the future. These costs may also result from potential 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. As of December 31, 2014, while the scope of these additional costs, or a range thereof, cannot be reasonably estimated we do not anticipate these additional costs or liabilities would have a material adverse impact on our business, financial condition and operating results.

Table of Contents

Sally Beauty Holdings, Inc. and Subsidiaries

Condensed Notes to Consolidated Financial Statements

(Unaudited)

9. Short-term Borrowings and Long-term Debt

Details of long-term debt as of December 31, 2014 are as follows (dollars in thousands):

ABL facility	$	(i) Prime plus (0.50% to 0.75%) or; (ii) LIBOR(a) plus (1.50% to 1.75%)
Senior notes due Jun. 2022(b)	857,213	5.750%(b)
Other, due Jun. 2015(c)	51	5.790%
Less: current portion	888	

(a) London Interbank Offered Rate (LIBOR).

(b) Amounts include unamortized premium of $7.2 million related to notes with an aggregate principal amount of $150.0 million. The 5.75% interest rate relates to notes in the aggregate principal amount of $850.0 million.

(c) Represents pre-acquisition debt of Sinelco Group BVBA (Sinelco).

In November 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, The Alberto-Culver Company, which we refer to as Alberto-Culver. Please see our Annual Report on Form 10-K for the fiscal year ended September 30, 2014 for additional information about the Company s separation from Alberto-Culver.

In the fiscal year ended September 30, 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 July 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 December 31, 2014, the Company had $478.1 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 of our domestic subsidiaries and Canadian subsidiaries (in the case of borrowings under the Canadian sub-facility), together with general intangibles and certain other personal property of our domestic subsidiaries and Canadian subsidiaries (in the case of borrowings under the Canadian sub-facility) relating to the accounts and inventory, as well as deposit accounts of our domestic subsidiaries and Canadian subsidiaries (in the case of borrowings under the Canadian sub-facility) 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 ended September 30, 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 notes in the aggregate principal amount of $150.0 million which were 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.

Table of Contents

Sally Beauty Holdings, Inc. and Subsidiaries

Condensed Notes to Consolidated Financial Statements

(Unaudited)

On October 29, 2013, the Issuers issued $200.0 million aggregate principal amount of their 5.5% Senior Notes due 2023 (the senior notes due 2023). The senior notes due 2023 bear interest at an annual rate of 5.5% and were issued 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.

The senior notes due 2019, the senior notes due 2022 and the senior notes due 2023, which we refer to collectively as the Notes or the senior notes due 2019, 2022 and 2023, 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 2019, 2022 and 2023 is payable semi-annually, during the Company s first and third fiscal quarters. Please see Note 12 for certain condensed financial statement data pertaining to Sally Beauty, the Issuers, the guarantor subsidiaries and the non-guarantor subsidiaries.

The senior notes due 2019 carry optional redemption features whereby the Company has the option to redeem the notes, in whole or in part, on or after November 15, 2017 at par, plus accrued and unpaid interest, if any, and on or after November 15, 2015 at par plus a premium declining ratably to par, plus accrued and unpaid interest, if any. Prior to November 15, 2015, 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 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. In addition, on or prior to June 1, 2015, 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 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. In addition, on or prior to November 1, 2016, 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 as of December 31, 2014 (in thousands):

Twelve months ending December 31:		
2015	$	51
2016-2018		
2019		750,000
Thereafter		1,057,213
	$	1,807,264
Capital lease obligations		3,728
Less: current portion		888
Total	$	1,810,104

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 December 31, 2014, 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

Condensed Notes to Consolidated Financial Statements

(Unaudited)

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 2019, 2022 and 2023 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 December 31, 2014, the Company s Consolidated Coverage Ratio was approximately 5.5 *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 2019, 2022 and 2023 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, *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. 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 December 31, 2014, the Company s Consolidated Total Leverage Ratio was approximately 2.8 *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 December 31, 2014, the Consolidated Fixed Charge Coverage Ratio was approximately 3.4 *to* 1.0.

When used in this Quarterly 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 2019, 2022 and 2023, 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 2019, 2022 and 2023 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 December 31, 2014, all the net assets of our consolidated subsidiaries were unrestricted from transfer under our credit arrangements.

Table of Contents

Sally Beauty Holdings, Inc. and Subsidiaries

Condensed Notes to Consolidated Financial Statements

(Unaudited)

10. 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.

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 December 31, 2014, our exposure to interest rate fluctuations relates to interest payments under the ABL facility, if any, and the Company held no derivative instruments in connection therewith.

As of December 31, 2014, 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. The Company did not purchase or hold any such derivatives at December 31, 2014.

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 interest rate or foreign currency exchange rate movements, as appropriate.

The Company uses foreign exchange contracts to manage the exposure to the U.S. dollar resulting from certain of its international subsidiaries purchases of merchandise from third-party suppliers. These subsidiaries currently have a functional currency other than the U.S. dollar - their functional currency is either the British pound sterling or the Euro. As such, at December 31, 2014, we hold: (a) foreign currency forwards which enable us to sell approximately £4.9 million ($7.6 million, at the December 31, 2014 exchange rate) at the weighted average contractual exchange rate of 1.6268 and (b) foreign currency forwards which enable us to sell approximately   8.8 million ($10.6 million, at the December 31, 2014 exchange rate) at the weighted average contractual exchange rate of 1.2908. These foreign currency forwards expire ratably through September 21, 2015.

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 December 31, 2014, we hold: (a) a foreign currency forward which enables us to sell approximately   18.1 million ($21.9 million, at the December 31, 2014 exchange rate) at the contractual exchange rate of 1.2183, (b) a foreign currency forward which enables us to sell approximately $5.2 million Canadian dollars ($4.5 million, at the December 31, 2014 exchange rate) at the contractual exchange rate of 1.1621, (c) a foreign currency forward which enables us to buy approximately $15.6 million Canadian dollars ($13.4 million, at the December 31, 2014 exchange rate) at the contractual exchange rate of 1.1664, (d) a foreign currency forward which enables us to sell approximately 30.7 million Mexican pesos ($2.1 million, at the December 31, 2014 exchange rate) at the contractual exchange rate of 14.7790 and (e) a foreign currency forward which enables us to buy approximately £1.1 million ($1.8 million, at the December 31, 2014 exchange rate) at the contractual exchange rate of 1.5511. All the foreign currency forwards discussed in this paragraph expire on or before March 31, 2015.

Table of Contents

Sally Beauty Holdings, Inc. and Subsidiaries

Condensed Notes to Consolidated Financial Statements

(Unaudited)

In addition, the Company uses foreign exchange contracts including, at December 31, 2014, foreign currency forwards with an aggregate notional amount of £2.3 million ($3.5 million, at the December 31, 2014 exchange rate) to mitigate the exposure to the British pound sterling resulting from the sale of products and services among certain European subsidiaries of the Company. The foreign currency forwards discussed in this paragraph enable the Company to buy British pound sterling in exchange for Euro currency at the weighted average contractual exchange rate of 0.7984 and expire ratably through September 30, 2015.

At December 31, 2014, all of the Company s foreign exchange contracts are with a single counterparty. 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 three months ended December 31, 2014 and 2013, selling, general and administrative expenses include net gains of $1.5 million and net losses of $0.9 million, respectively, in connection with all of the Company s foreign currency derivative instruments, including marked-to-market adjustments.

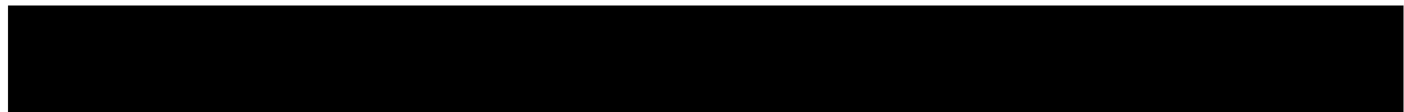
The table below presents the fair value of the Company s derivative financial instruments as well as their classification on the Company s consolidated balance sheet as of December 31, 2014 and September 30, 2014 (in thousands):

	Classification	Asset Derivatives December 31, 2014	September 30, 2014	Classification	Liability Derivatives December 31, 2014	September 30, 2014
Derivatives designated as hedging instruments:						
None						
Derivatives not designated as hedging instruments:						
Foreign exchange contracts	Other current assets	$ 1,284	$ 511	Accrued liabilities	$ 3	$ 47
		$ 1,284	$ 511		$ 3	$ 47

The table below presents the effect of the Company s derivative financial instruments on the Company s consolidated statements of earnings for the three months ended December 31, 2014 and 2013 (in thousands):

Derivatives Designated as Hedging Instruments	Amount of Gain or (Loss) Recognized in OCI on Derivative (Effective Portion), net of tax	Amount of Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)

None



Foreign exchange contracts	Selling, general and administrative expenses	$	1,504	$	(858)

Credit-risk-related Contingent Features

At December 31, 2014, the aggregate fair value of all foreign exchange contracts held which consisted of derivative instruments in a liability position was less than $0.1 million. The Company was under no obligation to post and had not posted any collateral related to the agreements in a liability position.

Table of Contents

Sally Beauty Holdings, Inc. and Subsidiaries

Condensed Notes to Consolidated Financial Statements

(Unaudited)

The counterparty to our derivative instruments is 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 the counterparty. The financial crisis that has affected the banking systems and financial markets in recent years 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 the 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.

11. Business Segments

The Company s business is organized into two separate segments: (i) Sally Beauty Supply, a domestic and international chain of cash and carry retail stores which offers professional beauty supplies to both salon professionals and retail customers 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, Puerto Rico 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 of the Notes to Consolidated Financial Statements in Item 8 - Financial Statements and Supplementary Data contained in our Annual Report on Form 10-K for the fiscal year ended September 30, 2014. Sales between segments, which were eliminated in consolidation, were not material during the three months ended December 31, 2014 and 2013.

Segment data for the three months ended December 31, 2014 and 2013 is as follows (in thousands):

	Three Months Ended December 31,			
		2014		**2013**
Net sales:				
Sally Beauty Supply	$	586,519	$	573,355
BSG		377,949		367,109
Total	$	964,468	$	940,464
Earnings before provision for income taxes:				
Segment operating profit:				
Sally Beauty Supply	$	101,179	$	103,543
BSG		56,589		54,834
Segment operating profit		157,768		158,377

Unallocated expenses (a)		(33,772)		(28,062)
Share-based compensation expense		(7,760)		(8,522)
Interest expense		(29,241)		(28,489)
Earnings before provision for income taxes	$	86,995	$	93,304

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

Sally Beauty Holdings, Inc. and Subsidiaries

Condensed Notes to Consolidated Financial Statements

(Unaudited)

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

The following consolidating financial information presents the condensed consolidating balance sheets as of December 31, 2014 and September 30, 2014, and the related condensed consolidating statements of earnings, condensed consolidating statements of comprehensive income and condensed consolidating statements of cash flows for the three months ended December 31, 2014 and 2013: (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 guarantor subsidiaries 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.

Table of Contents

Sally Beauty Holdings, Inc. and Subsidiaries

Condensed Notes to Consolidated Financial Statements

(Unaudited)

Condensed Consolidating Balance Sheet

December 31, 2014

(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	$	$ 107,501	$ 40,440	$ 42,740	$	$ 190,681
Trade and other accounts receivable, less allowance for doubtful accounts			58,231	29,420		87,651
Due from affiliates			1,540,318	447	(1,540,765)	
Inventory			641,006	196,816		837,822
Other current assets	5,448	1,251	13,115	16,054		35,868
Deferred income tax assets, net	(213)	1	30,527	1,431		31,746
Property and equipment, net	1		158,962	77,715		236,678
Investment in subsidiaries	510,580	2,892,899	380,787		(3,784,266)	
Goodwill and other intangible assets, net			472,901	168,100		641,001
Other assets		27,751	1,610	6,226		35,587
Total assets	$ 515,816	$ 3,029,403	$ 3,337,897	$ 538,949	$ (5,325,031)	$ 2,097,034
Liabilities and Stockholders (Deficit) Equity						
Accounts payable	$ 6	$	$ 207,454	$ 57,313	$	$ 264,773
Due to affiliates	772,232	697,914	447	70,172	(1,540,765)	
Accrued liabilities	559	12,876	122,182	25,013		160,630
Income taxes payable		1,120	1	2,603		3,724
Long-term debt		1,807,213	223	3,556		1,810,992
Other liabilities			26,069	2,834		28,903
Deferred income tax liabilities, net	(1,425)	(300)	88,622	(3,329)		83,568
Total liabilities	771,372	2,518,823	444,998	158,162	(1,540,765)	2,352,590
Total stockholders (deficit) equity	(255,556)	510,580	2,892,899	380,787	(3,784,266)	(255,556)
Total liabilities and stockholders (deficit) equity	$ 515,816	$ 3,029,403	$ 3,337,897	$ 538,949	$ (5,325,031)	$ 2,097,034

Table of Contents

Sally Beauty Holdings, Inc. and Subsidiaries

Condensed Notes to Consolidated Financial Statements

(Unaudited)

Condensed Consolidating Balance Sheet

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
Assets						
Cash and cash equivalents	$	$ 27,000	$ 40,042	$ 39,533	$	$ 106,575
Trade and other accounts receivable, less allowance for doubtful accounts	2		63,009	35,489		98,500
Due from affiliates			1,464,752	27	(1,464,779)	
Inventory			631,786	196,643		828,429
Other current assets	7,935	452	15,016	15,592		38,995
Deferred income tax assets, net	(213)	1	30,527	1,335		31,650
Property and equipment, net	1		158,402	79,708		238,111
Investment in subsidiaries	471,320	2,835,722	392,270		(3,699,312)	
Goodwill and other intangible assets, net			476,113	174,972		651,085
Other assets		28,931	1,625	6,072		36,628
Total assets	$ 479,045	$ 2,892,106	$ 3,273,542	$ 549,371	$ (5,164,091)	$ 2,029,973
Liabilities and Stockholders (Deficit) Equity						
Accounts payable	$	$	$ 202,743	$ 56,720	$	$ 259,463
Due to affiliates	826,819	571,847	27	66,086	(1,464,779)	
Accrued liabilities	691	40,751	129,791	27,536		198,769
Income taxes payable		1,051	1	3,279		4,331
Long-term debt		1,807,447	267	3,927		1,811,641
Other liabilities			25,020	2,828		27,848
Deferred income tax liabilities, net	(1,412)	(310)	79,971	(3,275)		74,974
Total liabilities	826,098	2,420,786	437,820	157,101	(1,464,779)	2,377,026
Total stockholders (deficit) equity	(347,053)	471,320	2,835,722	392,270	(3,699,312)	(347,053)
Total liabilities and stockholders (deficit) equity	$ 479,045	$ 2,892,106	$ 3,273,542	$ 549,371	$ (5,164,091)	$ 2,029,973

Table of Contents

Sally Beauty Holdings, Inc. and Subsidiaries

Condensed Notes to Consolidated Financial Statements

(Unaudited)

Condensed Consolidating Statement of Earnings and Comprehensive Income
Three Months Ended December 31, 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	$	$	$ 767,923	$ 196,545	$	$ 964,468
Related party sales			767		(767)	
Cost of products sold and distribution expenses			386,816	104,650	(767)	490,699
Gross profit			381,874	91,895		473,769
Selling, general and administrative expenses	2,376	104	257,786	76,688		336,954
Depreciation and amortization			14,854	5,725		20,579
Operating earnings (loss)	(2,376)	(104)	109,234	9,482		116,236
Interest expense		29,193	2	46		29,241
Earnings (loss) before provision for income taxes	(2,376)	(29,297)	109,232	9,436		86,995
Provision (benefit) for income taxes	(724)	(11,379)	40,872	3,317		32,086
Equity in earnings of subsidiaries, net of tax	56,561	74,479	6,119		(137,159)	
Net earnings	54,909	56,561	74,479	6,119	(137,159)	54,909
Other comprehensive income (loss), net of tax				(17,301)		(17,301)
Total comprehensive income (loss)	$ 54,909	$ 56,561	$ 74,479	$ (11,182)	$ (137,159)	$ 37,608

Table of Contents

Sally Beauty Holdings, Inc. and Subsidiaries

Condensed Notes to Consolidated Financial Statements

(Unaudited)

Condensed Consolidating Statement of Earnings and Comprehensive Income
Three Months Ended December 31, 2013

(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	$	$	$ 743,276	$ 197,188	$	$ 940,464
Related party sales			803		(803)	
Cost of products sold and distribution expenses			374,681	106,060	(803)	479,938
Gross profit			369,398	91,128		460,526
Selling, general and administrative expenses	2,463	112	241,881	75,022		319,478
Depreciation and amortization			13,870	5,385		19,255
Operating earnings (loss)	(2,463)	(112)	113,647	10,721		121,793
Interest expense		28,425	1	63		28,489
Earnings (loss) before provision for income taxes	(2,463)	(28,537)	113,646	10,658		93,304
Provision (benefit) for income taxes	(932)	(11,080)	43,980	3,341		35,309
Equity in earnings of subsidiaries, net of tax	59,526	76,983	7,317		(143,826)	
Net earnings	57,995	59,526	76,983	7,317	(143,826)	57,995
Other comprehensive income, net of tax				2,567		2,567
Total comprehensive income	$ 57,995	$ 59,526	$ 76,983	$ 9,884	$ (143,826)	$ 60,562

Table of Contents

Sally Beauty Holdings, Inc. and Subsidiaries

Condensed Notes to Consolidated Financial Statements

(Unaudited)

Condensed Consolidating Statement of Cash Flows
Three months ended December 31, 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 (used) provided by operating activities	$ (46,946)	$ 80,501	$ 12,356	$ 11,125	$	$ 57,036
Cash Flows from Investing Activities:						
Capital expenditures, net of proceeds from sale of property and equipment			(11,915)	(6,885)		(18,800)
Net cash used by investing activities			(11,915)	(6,885)		(18,800)
Cash Flows from Financing Activities:						
Repayments of long-term debt			(43)	(215)		(258)
Repurchases of common stock	(7,253)					(7,253)
Proceeds from exercises of stock options	37,156					37,156
Excess tax benefit from share-based compensation	17,043					17,043
Net cash provided (used) by financing activities	46,946		(43)	(215)		46,688
Effect of foreign exchange rate changes on cash and cash equivalents				(818)		(818)
Net increase in cash and cash equivalents		80,501	398	3,207		84,106
Cash and cash equivalents, beginning of period		27,000	40,042	39,533		106,575
Cash and cash equivalents, end of period	$	$ 107,501	$ 40,440	$ 42,740	$	$ 190,681

Table of Contents

Sally Beauty Holdings, Inc. and Subsidiaries

Condensed Notes to Consolidated Financial Statements

(Unaudited)

Condensed Consolidating Statement of Cash Flows
Three Months Ended December 31, 2013

(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	$ 55,879	$ (41,111)	$ 34,374	$ 10,962	$	$ 60,104
Cash Flows from Investing Activities:						
Capital expenditures, net of proceeds from sale of property and equipment			(7,766)	(5,609)		(13,375)
Net cash used by investing activities			(7,766)	(5,609)		(13,375)
Cash Flows from Financing Activities:						
Proceeds from issuance of long-term debt		232,500	219			232,719
Repayments of long-term debt		(108,500)	(39)	(486)		(109,025)
Debt issuance costs		(3,888)				(3,888)
Repurchases of common stock	(66,183)					(66,183)
Proceeds from exercises of stock options	7,319					7,319
Excess tax benefit from share-based compensation	2,985					2,985
Net cash (used) provided by financing activities	(55,879)	120,112	180	(486)		63,927
Effect of foreign exchange rate changes on cash and cash equivalents				153		153
Net increase in cash and cash equivalents		79,001	26,788	5,020		110,809
Cash and cash equivalents, beginning of period			16,337	30,778		47,115
Cash and cash equivalents, end of period	$	$ 79,001	$ 43,125	$ 35,798	$	$ 157,924

Table of Contents

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

This section discusses management s view of the financial condition, results of operations and cash flows of Sally Beauty and its consolidated subsidiaries. This section should be read in conjunction with the audited consolidated financial statements and the related notes included in our Annual Report on Form 10-K for the fiscal year ended September 30, 2014, as well as the Risk Factors section contained in that Annual Report and information contained elsewhere in this Quarterly Report, including the consolidated interim financial statements and condensed notes to those financial statements. 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, included at the beginning of this Quarterly Report for a discussion of the uncertainties, risks and assumptions associated with these forward-looking statements that could cause results to differ materially from those reflected in such forward-looking statements.

Highlights of the Three months ended December 31, 2014:

- 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 2.3% for the three months ended December 31, 2014, compared to the three months ended December 31, 2013;

- Our consolidated net sales for the three months ended December 31, 2014, increased by $24.0 million, or 2.6%, to $964.5 million compared to $940.5 million for the three months ended December 31, 2013;

- Our consolidated gross profit for the three months ended December 31, 2014, increased by $13.2 million, or 2.9%, to $473.8 million compared to $460.5 million for the three months ended December 31, 2013. As a percentage of net sales, gross profit was 49.1% for the three months ended December 31, 2014, compared to 49.0% for the three months ended December 31, 2013;

- Our consolidated operating earnings for the three months ended December 31, 2014, decreased by $5.6 million, or 4.6%, to $116.2 million compared to $121.8 million for the three months ended December 31, 2013. As a percentage of net sales, operating earnings decreased by 90 basis points to 12.1% for the three months ended December 31, 2014, compared to 13.0% for the three months ended December 31, 2013;

- Our consolidated net earnings decreased by $3.1 million, or 5.3%, to $54.9 million for the three months ended December 31, 2014, compared to $58.0 million for the three months ended December 31, 2013. As a percentage of net sales, net earnings decreased by 50 basis points to 5.7% for the three months ended December 31, 2014, compared to 6.2% for the three months ended December 31, 2013;

- Cash provided by operations was $57.0 million for the three months ended December 31, 2014, compared to $60.1 million for the three months ended December 31, 2013; and

- During the three months ended December 31, 2014, we repurchased and subsequently retired approximately 0.2 million shares of our common stock under the share repurchase program approved by our Board of Directors in August 2014, at an aggregate cost of approximately $7.3 million.

Overview

Description of Business

As of December 31, 2014, we operated primarily through two business units, Sally Beauty Supply and Beauty Systems Group, or BSG. As of December 31, 2014, through Sally Beauty Supply and BSG, we operated a multi-channel platform of 4,695 company-operated stores and supplied 185 franchised stores primarily in North America and selected South American and European countries. We believe the Company is the largest distributor of professional beauty supplies in the U.S. based on store count. Within BSG, we also have one of the largest networks of professional distributor sales consultants in North America. 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. Sally Beauty Supply stores target retail consumers and salon professionals, while BSG exclusively targets salons and salon professionals. For the three months ended December 31, 2014, our consolidated net sales and operating earnings were $964.5 million and $116.2 million, respectively.

We believe Sally Beauty Supply is the largest open-line distributor of professional beauty supplies in the U.S. based on store count. As of December 31, 2014, Sally Beauty Supply operated 3,586 company-operated retail stores, 2,820 of which are located in the U.S., with the remaining 766 company-operated stores located in Canada, Mexico, Chile, Peru, the United Kingdom, Ireland, Belgium, France, Germany, the Netherlands and Spain. Sally Beauty Supply also supplied 19 franchised stores located in the United Kingdom and certain other European countries. In the U.S. and Canada, our Sally Beauty Supply stores average approximately 1,700 square feet in size and are located primarily in strip shopping centers. Our Sally Beauty Supply 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 electrical appliances. Sally Beauty Supply 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. In addition, the Company s website (*www.sallybeauty.com*) and other e-commerce platforms provide access to product offerings and information beyond our retail stores. For the three months ended December 31, 2014, Sally Beauty Supply s net sales and segment operating profit were $586.5 million and $101.2 million, representing 61% and 64%, respectively, of our consolidated net sales and consolidated operating profit before unallocated corporate expenses and share-based compensation expenses.

Table of Contents

We believe BSG is the largest full-service distributor of professional beauty supplies in North America, exclusively targeting salons and salon professionals. As of December 31, 2014, BSG had 1,109 company-operated stores, supplied 166 franchised stores and had a sales force of approximately 967 professional distributor sales consultants selling exclusively to salons and salon professionals in all states in the U.S., and in Canada, Puerto Rico, 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 9,000 SKUs that include hair color and care, skin and nail care, beauty sundries and electrical appliances. 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. In addition, we offer our BSG products for sale to salons and salon professionals through the Company s websites (*www.cosmoprofbeauty.com*, *www.cosmoprofequipment.com*, *www.loxabeauty.com* and *www.ebobdirect.com*). For the three months ended December 31, 2014, BSG s net sales and segment operating profit were $377.9 million and $56.6 million, representing 39% and 36%, respectively, of our consolidated net sales and consolidated operating profit before unallocated corporate expenses and share-based compensation expenses.

Key Industry and Business Trends

We operate primarily within the large and growing U.S. professional beauty supply industry. 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 300,000 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 booth renting and frequent stocking needs.* Salon professionals primarily rely on just-in-time inventory due to capital constraints and a lack of warehouse and shelf space at salons. In addition, booth renters, who comprise a significant percentage of total U.S. salon professionals, are often responsible for purchasing their own supplies. Historically, the number of booth 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, booth renters are likely to be dependent on frequent trips to professional beauty supply stores, like BSG and Sally Beauty Supply. We expect that these factors will continue to drive demand for conveniently located professional beauty supply stores.

- *Increasing use of exclusive-label products.* We offer 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. 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* in Item 1A of our Annual Report on Form 10-K for the fiscal year ended September 30, 2014.

- *Favorable demographic and consumer trends.* We expect the aging baby-boomer population to drive future growth in professional beauty supply sales, including through an increase in the usage of hair color and hair loss products. Additionally, continuously changing fashion-related trends that drive new hair styles are expected to result in continued demand for hair styling products. Changes in consumer tastes and fashion trends can have an impact on our financial performance. Our continued success depends 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* in Item 1A of our Annual Report on Form 10-K for the fiscal year ended September 30, 2014.

Table of Contents

• *International growth strategies.* A key element of our growth strategy depends on our ability to capitalize on international growth opportunities and to grow our current level of non-U.S. operations. For example, during the fiscal year ended September 30, 2014, our number of international company-operated stores increased from 789 stores to 850 stores. In addition, we have completed a number of international acquisitions over the past five 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* in Item 1A of our Annual Report on Form 10-K for the fiscal year ended September 30, 2014.

• *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* in Item 1A of our Annual Report on Form 10-K for the fiscal year ended September 30, 2014.

• *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 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, we do not have contractual assurances of continued supply, pricing or access to new products and vendors may change the terms upon which they sell. Infrequently, a supplier will seek to terminate a distribution relationship through legal action. Changes in our relationships with suppliers occur often and could positively or negatively impact our net sales and operating profits. 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 unfavorable changes in our supplier relationships, there can be no assurance that our efforts will continue to completely offset the loss of these or other distribution rights. Please see Risk Factors *We depend upon manufacturers who may be unable to provide products of adequate quality or who may be unwilling to continue to supply products to us* in Item 1A of our Annual Report on Form 10-K for the fiscal year ended September 30, 2014.

Table of Contents

- *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. BSG competes with other domestic and international beauty product wholesale and retail suppliers and manufacturers selling professional beauty products directly to salons and individual salon professionals. We also face competition from authorized and unauthorized retailers and internet sites offering professional salon-only products. The increasing availability of unauthorized professional salon products in large-format retail stores such as drug stores, grocery stores and others could also have a negative impact on our business. Please see Risk Factors *The beauty products distribution industry is highly competitive and is consolidating* in Item 1A of our Annual Report on Form 10-K for the fiscal year ended September 30, 2014.

- *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 electrical products category and our full-service sales business. In addition, higher freight costs resulting from increases in the cost of fuel, especially for an extended period of time, may impact our expenses at levels that we cannot pass through to our customers. These factors could have a material adverse effect on our business, financial condition and results of operations. Please see Risk Factors *The health of the economy in the channels 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* in Item 1A of our Annual Report on Form 10-K for the fiscal year ended September 30, 2014.

- *Controlling expenses*. An important aspect of our business is our ability to control costs by right-sizing and maximizing the efficiency of our business. Please see Risk Factors *We are not certain that our ongoing cost control plans will continue to be successful* in Item 1A of our Annual Report on Form 10-K for the fiscal year ended September 30, 2014.

- *Opening new stores*. Our future growth strategy depends in part on our ability to open and profitably operate new stores in existing and additional geographic areas 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. 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* in Item 1A of our Annual Report on Form 10-K for the fiscal year ended September 30, 2014.

- *Changes to our information technology systems*. As our operations grow in both size and scope and as cyber-attacks and security intrusions involving retailers have become more frequent, we will continuously need to improve and upgrade our information systems and infrastructure while maintaining the reliability and integrity of those systems and infrastructure. 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* in Item 1A of our Annual Report on Form 10-K for the fiscal year ended September 30, 2014.

Share Repurchase Programs

In August 2014, we announced that our Board of Directors approved a share repurchase program authorizing us to repurchase up to $1.0 billion of our common stock over a period of approximately three years (the 2014 Share Repurchase Program). The 2014 Share Repurchase Program expires on September 30, 2017.

During the three months ended December 31, 2014, the Company repurchased and subsequently retired approximately 0.2 million shares of its common stock under the 2014 Share Repurchase Program at an aggregate cost of $7.3 million, which we funded with existing cash balances and cash from operations. In addition, during the three months ended December 31, 2013, the Company repurchased and subsequently retired approximately 2.4 million shares of its 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 an aggregate cost of $66.2 million. We funded these share repurchases with existing cash balances, cash from operations, borrowings under the ABL facility and a portion of the cash proceeds from our October 2013 debt issuance. The Company reduced common stock and additional paid-in capital, in the aggregate, by these amounts. As required by GAAP, we recorded any amounts paid to repurchase shares in excess of the balance of additional paid-in capital in accumulated deficit. As of December 31, 2014, we had approximately $992.7 million of additional share repurchase authorization remaining under such program. Please see Item 2. Unregistered Sales of Equity Securities and Use of Proceeds (c) Purchases of Equity Securities by the Issuer and Affiliated Purchasers in Part II Other Information, of this Quarterly Report for additional information about the Company s share repurchases.

Data Security Incident

In the fiscal year ended September 30, 2014, the Company disclosed that it had experienced a data security incident. The costs that we have incurred to date in connection with the data security incident primarily include professional advisory and legal costs relating to our investigation of the data security incident. We may incur additional costs and expenses related to the data security incident in the future. These costs may result from potential 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. At this time, while we are unable to determine the probability of or to reasonably estimate the exact extent of these potential liabilities or a range thereof, we do not anticipate that any of these additional costs or liabilities would have a material adverse impact on our business, financial condition and operating results. 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 experienced a data security incident and are not yet able to determine the full extent or scope of the potential liabilities relating to this data security incident* in Item 1A of our Annual Report on Form 10-K for the fiscal year ended September 30, 2014.

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 business to manage these market risks, including, when deemed appropriate, the use of derivative instruments such as interest rate swaps, and foreign currency options, collars and forwards, hereafter, foreign exchange contracts. 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. 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 international subsidiaries purchases of merchandise from third-party suppliers. These subsidiaries currently have a functional currency other than the U.S. dollar - their

functional currency is either the British pound sterling or the Euro. As such, at December 31, 2014, we hold: (a) foreign currency forwards which enable us to sell approximately £4.9 million ($7.6 million, at the December 31, 2014 exchange rate) at the weighted average contractual exchange rate of 1.6268 and (b) foreign currency forwards which enable us to sell approximately 8.8 million ($10.6 million, at the December 31, 2014 exchange rate) at the weighted average contractual exchange rate of 1.2908. These foreign currency forwards expire ratably through September 21, 2015.

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 December 31, 2014, we hold: (a) a foreign currency forward which enables us to sell approximately 18.1 million ($21.9 million, at the December 31, 2014 exchange rate) at the contractual exchange rate of 1.2183, (b) a foreign currency forward which enables us to sell approximately $5.2 million Canadian dollars ($4.5 million, at the December 31, 2014 exchange rate) at the contractual exchange rate of 1.1621, (c) a foreign currency forward which enables us to buy approximately $15.6 million Canadian dollars ($13.4 million, at the December 31, 2014 exchange rate) at the contractual exchange rate of 1.1664, (d) a foreign currency forward which enables us to sell approximately 30.7 million Mexican pesos ($2.1 million, at the December 31, 2014 exchange rate) at the contractual exchange rate of 14.7790 and (e) a foreign currency forward which enables us to buy approximately £1.1 million ($1.8 million, at the December 31, 2014 exchange rate) at the contractual exchange rate of 1.5511. All the foreign currency forwards discussed in this paragraph expire on or before March 31, 2015.

Table of Contents

In addition, the Company uses foreign exchange contracts including, at December 31, 2014, foreign currency forwards with an aggregate notional amount of £2.3 million ($3.5 million, at the December 31, 2014 exchange rate) to mitigate the exposure to the British pound sterling resulting from the sale of products and services among certain European subsidiaries of the Company. The foreign currency forwards discussed in this paragraph enable the Company to buy British pound sterling in exchange for Euro currency at the weighted average contractual exchange rate of 0.7984 and expire ratably through September 30, 2015.

At December 31, 2014, all of the Company s foreign exchange contracts are with a single counterparty. 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 three months ended December 31, 2014 and 2013, selling, general and administrative expenses include net gains of $1.5 million and net losses of $0.9 million, respectively, in connection with all of the Company s foreign currency derivative instruments, including marked-to-market adjustmentsPlease see Item 3 Quantitative and Qualitative Disclosures about Market Risk Foreign currency exchange rate risk contained in this Quarterly Report on Form 10-Q and Note 14 of the Notes to Consolidated Financial Statements in Item 8 - Financial Statements and Supplementary Data contained in our Annual Report on Form 10-K for the fiscal year ended September 30, 2014 for additional information about the Company s foreign currency derivative instruments.

Share-Based Compensation Awards

The Company granted approximately 1.1 million and 1.5 million stock options and approximately 214,000 and 25,000 restricted share awards to its employees and consultants during the three months ended December 31, 2014 and 2013, respectively. Upon issuance of such grants, the Company recognized accelerated share-based compensation expense of $4.8 million and $5.3 million in the three months ended December 31, 2014 and 2013, respectively, in connection with certain retirement eligible employees who are eligible to continue vesting awards upon retirement under the provisions of the Sally Beauty Holdings, Inc. Amended and Restated 2010 Omnibus Incentive Plan. In addition, the Company granted approximately 20,000 and 27,000 restricted stock units to its non-employee directors during the three months ended December 31, 2014 and 2013, respectively. For the three months ended December 31, 2014 and 2013, total share-based compensation costs charged against earnings were $7.8 million and $8.5 million, respectively.

Results of Operations

The following table shows the condensed results of operations of our business for the three months ended December 31, 2014 and 2013 (dollars in thousands):

Net sales	$	964,468	100.0%	$	940,464	100.0%
Cost of products sold and distribution expenses		490,699	50.9%		479,938	51.0%
Gross profit		473,769	49.1%		460,526	49.0%
Total other operating costs and expenses		357,533	37.0%		338,733	36.0%
Operating earnings		116,236	12.1%		121,793	13.0%
Interest expense		29,241	3.1%		28,489	3.1%

Earnings before provision for income taxes		86,995	9.0%		93,304	9.9%
Provision for income taxes		32,086	3.3%		35,309	3.7%
Net earnings	$	54,909	5.7%	$	57,995	6.2%

Table of Contents

Key Operating Metrics

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

	Three Months Ended December 31,	
	2014	**2013**
Net sales:		
Sally Beauty Supply	$ 586,519	$ 573,355
BSG	377,949	367,109
Consolidated	$ 964,468	$ 940,464
Gross profit	$ 473,769	$ 460,526
Gross profit margin	49.1%	49.0%
Selling, general and administrative expenses	$ 336,954	$ 319,478
Depreciation and amortization	$ 20,579	$ 19,255
Earnings before provision for income taxes:		
Segment operating profit:		
Sally Beauty Supply	$ 101,179	$ 103,543
BSG	56,589	54,834
Segment operating profit	157,768	158,377
Unallocated expenses (a)	(33,772)	(28,062)
Share-based compensation expense	(7,760)	(8,522)
Operating earnings	116,236	121,793
Interest expense	(29,241)	(28,489)
Earnings before provision for income taxes	$ 86,995	$ 93,304
Segment operating profit margin:		
Sally Beauty Supply	17.3%	18.1%
BSG	15.0%	14.9%
Consolidated operating profit margin	12.1%	13.0%
Number of stores at end-of-period (including franchises):		
Sally Beauty Supply	3,605	3,444
BSG	1,275	1,249
Consolidated	4,880	4,693
Same store sales growth (b)		
Sally Beauty Supply	1.6%	0.9%
BSG	3.9%	5.2%
Consolidated	2.3%	2.2%

(a) Unallocated expenses consist of corporate and shared costs. Unallocated expenses are included in selling, general and administrative expenses in our consolidated statements of earnings.

(b) 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 separately material for each of the periods presented herein) 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.

36

Table of Contents

The Three Months Ended December 31, 2014 compared to the Three Months Ended December 31, 2013

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

	Three Months Ended December 31,			
	2014	2013	Increase	
Net sales:				
Sally Beauty Supply	$ 586,519	$ 573,355	$ 13,164	2.3%
BSG	377,949	367,109	10,840	3.0%
Consolidated net sales	$ 964,468	$ 940,464	$ 24,004	2.6%
Gross profit:				
Sally Beauty Supply	$ 319,009	$ 311,288	$ 7,721	2.5%
BSG	154,760	149,238	5,522	3.7%
Consolidated gross profit	$ 473,769	$ 460,526	$ 13,243	2.9%
Gross profit margin:				
Sally Beauty Supply	54.4%	54.3%	0.1%	
BSG	40.9%	40.7%	0.2%	
Consolidated gross profit margin	49.1%	49.0%	0.1%	

Net Sales

Consolidated net sales increased by $24.0 million, or 2.6%, for the three months ended December 31, 2014, compared to the three months ended December 31, 2013. 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 $27.8 million, or 3.0%, compared to the three months ended December 31, 2013. Other sales channels (including sales from stores that have been open for less than 14 months, sales through our BSG franchise-based businesses and distributor sales consultants, 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 $3.8 million, or 0.4%, compared to the three months ended December 31, 2013. Consolidated net sales for the three months ended December 31, 2014, are inclusive of a net negative impact from changes in foreign currency exchange rates of $12.0 million, including the impact of a stronger U.S. dollar in three months ended December 31, 2014.

For the three months ended December 31, 2014, consolidated net sales reflect a 2.3% same store sales growth rate compared to a 2.2% growth rate for the same stores for the three months ended December 31, 2013. For the three months ended December 31, 2014, our consolidated same store sales growth rate was positively impacted by improved customer traffic in our Sally Beauty Supply segment in the U.S.

The $24.0 million increase in consolidated net sales reflects increases in both unit volume (including increases in sales at existing stores and the incremental sales from 180 company-operated stores opened or acquired during the last twelve months) and average unit prices (resulting from changes in product mix).

Sally Beauty Supply. Net sales for Sally Beauty Supply increased by $13.2 million, or 2.3%, for the three months ended December 31, 2014, compared to the three months ended December 31, 2013. 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 $13.6 million, or 2.4%. 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 $0.4 million, or 0.1%, compared to the three months ended December 31, 2013. Net sales for Sally Beauty Supply for the three months ended December 31, 2014, are inclusive of a net negative impact from changes in foreign currency exchange rates of approximately $9.3 million.

Table of Contents

For the three months ended December 31, 2014, the Sally Beauty Supply segment s net sales reflect a 1.6% same store sales growth rate compared to a 0.9% growth rate for the three months ended December 31, 2013. For the three months ended December 31, 2014, the Sally Beauty Supply segment s same store sales growth rate was positively impacted by improved customer traffic in the U.S. On the other hand, the segment s same store sales growth rate for the three months ended December 31, 2013 was adversely affected by lower non-Beauty Club Card traffic in the U.S. and a difficult comparison against strong growth in the prior year in certain of the Sally Beauty Supply segment s product categories (such as hair care, and skin and nail care).

The $13.2 million increase in the Sally Beauty Supply segment s net sales reflects increases in both unit volume (including increases in sales at existing stores and the incremental sales from 163 company-operated stores opened during the last twelve months) and 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.

Beauty Systems Group. Net sales for BSG increased by $10.8 million, or 3.0%, for the three months ended December 31, 2014, compared to the three months ended December 31, 2013. 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 $14.2 million, or 3.9%, compared to the three months ended December 31, 2013. Other sales channels (including sales from stores that have been open for less than 14 months, sales through our franchise-based businesses, incremental sales from businesses acquired in the preceding 12 months, and sales through our distributor sales consultants) in the aggregate experienced a net decrease in sales of approximately $3.4 million, or 0.9%, compared to the three months ended December 31, 2013. Net sales for BSG for the three months ended December 31, 2014, are inclusive of a net negative impact from changes in foreign currency exchange rates of approximately $2.8 million.

For the three months ended December 31, 2014, the BSG segment s net sales reflect a 3.9% same store sales growth rate compared to a 5.2% growth rate for the three months ended December 31, 2013. BSG s same store sales growth rate for the three months ended December 31, 2013 reflected the favorable impact of products lines introduced in the later part of the fiscal year ended September 30, 2013.

The $10.8 million increase in the BSG segment s net sales is primarily the result of an increase 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 $13.2 million, or 2.9%, for the three months ended December 31, 2014, compared to the three months ended December 31, 2013, 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 49.1% for the three months ended December 31, 2014, compared to 49.0% for the three months ended December 31, 2013. Consolidated gross profit is inclusive of a net negative impact from changes in foreign currency exchange rates of approximately $5.9 million.

Sally Beauty Supply. Sally Beauty Supply s gross profit increased by $7.7 million, or 2.5%, for the three months ended December 31, 2014, compared to the three months ended December 31, 2013, principally as a result of higher sales volume and improved gross profit margins. Sally Beauty Supply s gross profit as a percentage of net sales increased to 54.4% for the three months ended December 31, 2014, compared to 54.3%

for the three months ended December 31, 2013. This increase was primarily the result of 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 $5.5 million, or 3.7%, for the three months ended December 31, 2014, compared to the three months ended December 31, 2013, principally as a result of higher sales volume and improved gross profit margins. BSG s gross profit as a percentage of net sales increased to 40.9% for the three months ended December 31, 2014, compared to 40.7% for the three months ended December 31, 2013 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).

Table of Contents

Selling, General and Administrative Expenses

Consolidated selling, general and administrative expenses increased by $17.5 million, or 5.5%, for the three months ended December 31, 2014, compared to the three months ended December 31, 2013. This increase was attributable in part to incremental expenses (including employee compensation, rent and other occupancy-related expenses) resulting from stores opened and businesses acquired in the preceding 12 months (approximately 180 net additional company-operated stores added since December 31, 2013, which represents a 4.0% increase in the number of stores). In addition, the increase reflects higher expenses associated with our self-funded employee healthcare benefits program in the U.S. (approximately $3.5 million), higher recruitment and compensation-related expenses primarily in connection with our ongoing management transition plans (approximately $1.5 million), higher advertising expenses ($1.4 million), higher expenses related to on-going upgrades to our information technology systems (approximately $1.3 million), higher expenses principally associated with store remodels and relocations (approximately $0.9 million) in the Sally Beauty Supply segment, higher allowance for doubtful accounts receivable (approximately $0.6 million, predominately related to one BSG customer) and higher corporate expenses related to the data security incident and to ongoing data security upgrades (approximately $0.6 million). Selling, general and administrative expenses, as a percentage of net sales, increased to 34.9% for the three months ended December 31, 2014, compared to 34.0% for the three months ended December 31, 2013, mainly as a result of the expense increases mentioned earlier in this paragraph.

Depreciation and Amortization

Consolidated depreciation and amortization was $20.6 million for the three months ended December 31, 2014, compared to $19.3 million for the three months ended December 31, 2013. This increase reflects the incremental depreciation and amortization expenses associated with businesses acquired in the preceding 12 months and with capital expenditures made in that period (mainly in connection with store openings in both operating segments 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):

Operating Earnings:				
Segment operating profit:				
Sally Beauty Supply	$ 101,179	$ 103,543	$ (2,364)	(2.3)%
BSG	56,589	54,834	1,755	3.2%
Segment operating profit	157,768	158,377	(609)	(0.4)%
Unallocated expenses	(33,772)	(28,062)	5,710	20.3%
Share-based compensation expense	(7,760)	(8,522)	(762)	(8.9)%
Operating earnings	$ 116,236	$ 121,793	$ (5,557)	(4.6)%

Consolidated operating earnings decreased by $5.6 million, or 4.6%, for the three months ended December 31, 2014, compared to the three months ended December 31, 2013. The decrease in consolidated operating earnings reflects higher unallocated expenses and a decrease in the Sally Beauty Supply segment s operating profit, partially offset by lower share-based compensation expense and an increase in the BSG segment s operating profit, as more fully discussed below. Operating earnings, as a percentage of net sales, decreased to 12.1% for the three months ended December 31, 2014, compared to 13.0% for the three months ended December 31, 2013. This decrease reflects higher consolidated operating expenses as a percentage of consolidated net sales, as further described below.

Sally Beauty Supply. Sally Beauty Supply s segment operating earnings decreased by $2.4 million, or 2.3%, for the three months ended December 31, 2014, compared to the three months ended December 31, 2013. The decrease in the Sally Beauty Supply segment s operating earnings was primarily a result of the incremental costs related to 163 net additional company-operated stores (stores opened during the past twelve months, which represents a 4.8% increase in the number of stores) operating during the three months ended December 31, 2014, compared to the three months ended December 31, 2013, higher advertising expenses of $1.3 million, higher expenses principally associated with store remodels and relocations (approximately $0.9 million), higher expenses associated with our self-funded employee healthcare benefits program in the U.S. (approximately $0.7 million) and higher recruitment and compensation-related expenses primarily in connection with our ongoing management transition plans (approximately $0.4 million). These increases were partially offset by the increase in the Sally Beauty Supply segment s sales volume and gross profit margin improvement described above. Segment operating earnings, as a percentage of net sales, decreased to 17.3% for the three months ended December 31, 2014, compared to 18.1% for the three months ended December 31, 2013. This decrease reflects higher operating expenses as a percentage of the segment s net sales, mainly as a result of the expense increases mentioned earlier in this paragraph, partially offset by the improvement in the segment s gross profit margin described above.

Table of Contents

Beauty Systems Group. BSG s segment operating earnings increased by $1.8 million, or 3.2%, for the three months ended December 31, 2014, compared to the three months ended December 31, 2013, primarily as a result of increased sales and improved gross profit margin. This increase was partially offset by the incremental costs related to 17 net additional company-operated stores (stores opened or acquired during the past twelve months) operating during the three months ended December 31, 2014, higher allowance for doubtful accounts receivable (approximately $0.6 million, predominately related to one customer), higher expenses associated with our self-funded employee healthcare benefits program in the U.S. (approximately $0.3 million), higher expenses related primarily to upgrades to our BSG information technology systems (approximately $0.3 million) and investments in new business development (approximately $0.5 million) primarily related to our Loxa Beauty website. Segment operating earnings, as a percentage of net sales, increased to 15.0% for the three months ended December 31, 2014, compared to 14.9% for the three months ended December 31, 2013. This increase reflects the increase in the segment s gross profit margin described above, partially offset by higher segment operating expenses as a percentage of the segment s net sales, mainly as a result of the expense increases mentioned earlier in this paragraph.

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 $5.7 million, or 20.3%, for the three months ended December 31, 2014, compared to the three months ended December 31, 2013. This increase was due primarily to higher expenses associated with our self-funded employee healthcare benefits program in the U.S. (approximately $2.4 million), higher employee compensation-related expenses primarily in connection with our ongoing management transition plans (approximately $1.1 million), higher corporate expenses related primarily to on-going upgrades to our information technology systems (approximately $0.9 million) and to the data security incident and ongoing data security upgrades (approximately $0.6 million).

Share-based Compensation Expense. Total compensation costs charged against income for share-based compensation arrangements decreased by $0.8 million to $7.8 million for the three months ended December 31, 2014, compared to $8.5 million for the three months ended December 31, 2013. This decrease was mainly due to lower aggregate fair value at the date of grant of the stock options issued during the three months ended December 31, 2014 and the impact of awards that became fully vested since December 31, 2013.

Interest Expense

Interest expense increased by $0.8 million to $29.2 million for the three months ended December 31, 2014, compared to $28.5 million for the three months ended December 31, 2013. The increase in interest expense was primarily due to the effect of higher principal balances on our debt outstanding during the three months ended December 31, 2014, including the senior notes due 2023 issued on October 29, 2013, partially offset by lower borrowings under our ABL facility compared to the three months ended December 31, 2013.

Provision for Income Taxes

The provision for income taxes was $32.1 million and $35.3 million, and the effective income tax rate was 36.9% and 37.8%, for the three months ended December 31, 2014 and 2013, respectively.

The annual effective tax rate for the full fiscal year 2015 is currently expected to be in the range of 37.5% to 38.5%, versus a comparable actual tax rate for the full fiscal year 2014 of 37.0%.

Net Earnings

As a result of the foregoing, consolidated net earnings decreased by $3.1 million, or 5.3%, to $54.9 million for the three months ended December 31, 2014, compared to $58.0 million for the three months ended December 31, 2013. Net earnings, as a percentage of net sales, were 5.7% for the three months ended December 31, 2014, compared to 6.2% for the three months ended December 31, 2013.

Financial Condition

December 31, 2014 Compared to September 30, 2014

Working capital (current assets less current liabilities) increased by $113.1 million to $753.8 million at December 31, 2014, compared to $640.6 million at September 30, 2014. The ratio of current assets to current liabilities was 2.75 to 1.00 at December 31, 2014, compared to 2.38 to 1.00 at September 30, 2014. The increase in working capital reflects an increase of $79.6 million in current assets and a decrease of $33.5 million in current liabilities. The increase in current assets as of December 31, 2014, is principally due to an increase in cash and cash equivalents of $84.1 million (please see Liquidity and Capital Resources below for a description of our sources and uses of cash) and an increase of $9.4 million in inventory, partially offset by a decrease in trade accounts receivable and accounts receivable, other, in the aggregate, of $10.8 million. The decrease in current liabilities is principally due to a decrease of $38.1 million in accrued liabilities, partially offset by an increase of $5.3 million in accounts payable, as discussed below.

Table of Contents

Trade accounts receivable and accounts receivable, other, in the aggregate, decreased by $10.8 million to $87.7 million at December 31, 2014, compared to $98.5 million at September 30, 2014 due primarily to the timing of collections from customers and vendors of balances outstanding and the impact of foreign currency translation adjustments. Inventory increased by $9.4 million to $837.8 million at December 31, 2014, compared to $828.4 million at September 30, 2014 due primarily to an increase in company-operated stores (approximately 48 net additional company-operated stores added since September 30, 2014), partially offset by the impact of foreign currency translation adjustments. Accounts payable increased by $5.3 million to $264.8 million at December 31, 2014, compared to $259.5 million at September 30, 2014 due primarily to the timing of payments to suppliers mainly in connection with purchases of merchandise inventory and capital expenditures. Accrued liabilities decreased by $38.1 million to $160.6 million at December 31, 2014, compared to $198.8 million at September 30, 2014, due primarily to the timing of payments of interest on our senior notes. Interest on the senior notes due 2019, 2022 and 2023 is payable semi-annually, during the Company s first and third fiscal quarters.

Total stockholders deficit, for the three months ended December 31, 2014, decreased by $91.5 million primarily as a result of net earnings of $54.9 million, and share-based compensation expense, the impact of exercises of stock options and other share-based compensation activity, in the aggregate, of approximately $61.1 million, partially offset by our repurchase and subsequent retirement of approximately 0.2 million shares of our common stock for approximately $7.3 million and foreign currency translation adjustments, net of tax, of $17.3 million.

Liquidity and Capital Resources

We broadly define liquidity as our ability to generate sufficient cash flow from operating activities to meet our obligations and commitments. In addition, liquidity includes the ability to obtain appropriate debt and equity financing and to convert into cash those assets that are no longer required to meet existing strategic and financial objectives. Therefore, liquidity cannot be considered separately from capital resources that consist of current or potentially available funds for use in achieving long-range business objectives and meeting debt service commitments. Please see Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources in our Annual Report on Form 10-K for the fiscal year ended September 30, 2014 for additional information on our liquidity and capital resources.

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* in Item 1A of our Annual Report on Form 10-K for the fiscal year ended September 30, 2014.

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 December 31, 2014, cash and cash equivalents were $190.7 million. Based upon the current level of operations and anticipated growth, we anticipate that existing cash balances (excluding 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, 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 and general economic conditions. Please see Risk Factors in Part I of our Annual Report on Form 10-K for the fiscal year ended September 30, 2014.

Table of Contents

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. During the three months ended December 31, 2014, we did not borrow under the ABL facility and, as of December 31, 2014, there were no borrowings outstanding and Sally Holdings had $478.1 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 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. Please see *Long-Term Debt Covenants* below.

Share Repurchase Programs

In March 2013, we announced that our Board of Directors approved a share repurchase program authorizing us to repurchase up to $700.0 million of our common stock (the 2013 Share Repurchase Program). In addition, in August 2014, we announced that our Board of Directors approved a new share repurchase program authorizing us to repurchase up to $1.0 billion of our common stock over a period of approximately three years (the 2014 Share Repurchase Program). In connection with the authorization of the 2014 Share Repurchase Program, the 2013 Share Repurchase Program was terminated. The 2014 Share Repurchase Program expires on September 30, 2017.

During the three months ended December 31, 2014, the Company repurchased and subsequently retired approximately 0.2 million shares of its common stock under the 2014 Share Repurchase Program at an aggregate cost of $7.3 million, which we funded with existing cash balances and cash from operations. In addition, during the three months ended December 31, 2013, the Company repurchased and subsequently retired approximately 2.4 million shares of its common stock under the 2013 Share Repurchase Program at an aggregate cost of $66.2 million. We funded these share repurchases with existing cash balances, cash from operations, borrowings under the ABL facility and a portion of the cash proceeds from our October 2013 debt issuance. As of December 31, 2014, we had approximately $992.7 million of additional share repurchase authority remaining under such program. 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 funds available under the ABL facility.

Historical Cash Flows

Historically, our primary source of cash has been funds provided by operating activities and, when necessary, borrowings under our ABL facility. The primary uses of cash have been for acquisitions, capital expenditures, repayments of long-term debt and share repurchases. The following table shows our sources and uses of funds for the three months ended December 31, 2014 and 2013 (in thousands):

	Three months ended December 31,	
	2014	**2013**
Net cash provided by operating activities	$ 57,036	$ 60,104
Net cash used by investing activities	(18,800)	(13,375)

Net cash provided by financing activities		46,688		63,927
Effect of foreign currency exchange rate changes on cash and cash equivalents		(818)		153
Net increase in cash and cash equivalents	$	84,106	$	110,809

Net Cash Provided by Operating Activities

Net cash provided by operating activities during the three months ended December 31, 2014 decreased by $3.1 million to $57.0 million, compared to $60.1 million during the three months ended December 31, 2013 mainly due to lower net earnings ($3.1 million).

Net Cash Used by Investing Activities

Net cash used by investing activities during the three months ended December 31, 2014 increased by $5.4 million to $18.8 million, compared to $13.4 million during the three months ended December 31, 2013. This increase reflects, in the Sally Beauty Supply segment, capital expenditures related to incremental store openings, and store remodels primarily U.S. in the three months ended December 31, 2014 without a comparable capital project in the three months ended December 31, 2013.

Table of Contents

Net Cash Provided by Financing Activities

Net cash provided by financing activities decreased by $17.2 million to $46.7 million during the three months ended December 31, 2014, compared to $63.9 million during the three months ended December 31, 2013. This change was primarily due to a decrease in net borrowings under our long-term debt of $124.0 million, partially offset by a decrease in cash used to repurchase shares of our common stock of $58.9 million, an increase in proceeds from exercises of stock options and in excess tax benefits resulting from share-based compensation activity, in the aggregate, of $43.9 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 three months ended December 31, 2013 with no comparable amount in the three months ended December 31, 2014.

Long-Term Debt

Outstanding Long-Term Debt

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

72,386 2/20/2018 30,730 61,460 30,731 61,462 61,461 122,922

97,654 195,308

Daniel J. Cregg

2/21/2017	5,568	11,136	-	-	5,568	11,136	2/20/2018	5,280	10,559	5,280	10,560	10,559	21,119
	16,127	32,255											

Ralph A. LaRossa

2/21/2017	7,239	14,478	-	-	7,239	14,478	2/20/2018	6,159	12,318	6,160	12,320	12,319	24,638
	47,841	95,682											

Tamara L. Linde

2/21/2017 5,568 11,136 - - 5,568 11,136 2/20/2018 5,280 10,559 5,280 10,559 10,559 21,118

16,127 32,254

David M. Daly

2/21/2017 1,293 2,586 - - 1,293 2,586 2/20/2018 3,739 7,478 3,740 7,480 7,479 14,958

8,772 17,544

(6) Value of PSUs is shown at target, multiplied by the closing price on the NYSE on December 31, 2018 of $52.05.

Table of Contents

Executive Compensation

OPTION EXERCISES AND STOCK VESTED DURING 2018 TABLE

The following table provides information, as noted, regarding the exercise of stock options by the NEOs in 2018 and the vesting during 2018 of RSUs and PSUs previously granted to the NEOs, under our LTIP.

	Option Awards		Stock Awards		
Name	Number of Shares Acquired on Exercise (#)	Value Realized on Exercise ($)[1]	Award	Number of Shares Acquired on Vesting (#)	Value Realized on Vesting ($)
Ralph Izzo	115,967	2,306,483	PSU[2][3] RSU[4][5]	126,088 44,008	7,444,866 2,290,615
Daniel J. Cregg	-	-	PSU[2][3] RSU[4][5]	15,743 7,561	929,545 393,533
Ralph A. LaRossa	-	-	PSU[2][3] RSU[4][5]	23,150 8,820	1,366,892 459,104
	-	-	PSU[2][3]	15,743	929,545

Tamara L. Linde					
			RSU(4)(5)	7,561	393,533
David M. Daly	-	-	PSU(2)(3)	4,631	273,437
			RSU(4)(5)	5,356	278,770

(1) Reflects the difference between the exercise price and the market price on the date of exercise, multiplied by the number of shares acquired.

(2) The table above shows the total payout value distributed for each of the NEOs for the 2016 grants based on the results of the three-year performance period and our Common Stock price, as described further in the CD&A. Each NEO became retirement eligible prior to 2018. Under the LTIP, PSUs vest one-thirty sixth per month of service for retirement eligible participants. We show below for each NEO the number of PSUs, including accrued dividend equivalents, at both target and maximum values, that vested in 2018 with respect to their 2017 and 2018 grants. No dollar values are shown for these as payouts, if any, are dependent on the actual results of the performance metrics and applicable stock prices for the respective performance periods. The number of PSUs, including dividend equivalents, earned, if any, will be determined at the conclusion of the applicable performance periods and reported in the relevant proxy statements. PSUs under Mr. LaRossa s retention award are not included, as they are not subject to retirement eligible vesting.

	PSU Grant Date	Granted	Target Vested (#)	Maximum Vested (#)
Ralph Izzo	2/21/2017	101,067	36,193	72,386
	2/20/2018	89,062	30,731	61,462
Daniel J. Cregg	2/21/2017	15,549	5,568	11,136
	2/20/2018	15,301	5,280	10,560
Ralph A. LaRossa	2/21/2017	20,214	7,239	14,478
	2/20/2018	17,851	6,159	12,318
Tamara L. Linde	2/21/2017	15,549	5,568	11,136
	2/20/2018	15,301	5,280	10,560
David M. Daly	2/21/2017	3,610	1,293	2,586
	2/20/2018	10,838	3,740	7,480

(3) Each of the NEOs had PSUs which vested on December 31, 2018, including accrued dividend equivalents, for the three-year performance period ended that day. The final awards shown in the table were made at 127% of target, as explained in the CD&A. PSUs earned and value realized reflects rounding. Shares are issued in 2019. Value realized reflects the value of the PSUs on March 1, 2019, the PSU value determination date, using the average of the high and low NYSE stock price of $59.05. Mr. Izzo deferred payment as reported in the Non-Qualified Deferred Compensation Table.

(4) Represents RSUs that vested for NEOs, each of whom is retirement eligible, at the NYSE closing price of $52.05 on December 31, 2018. RSUs awarded under Mr. LaRossa s retention award are not included, as they are not subject to retirement eligible vesting.

(5) RSUs that vested in 2016 and 2017 due to retirement eligibility were previously reported in our prior years proxy statements and were distributed on January 1, 2018, in the following amounts, including DEUs: Mr. Izzo: 64,611 shares, with a value of $3,324.905; Mr. Cregg: 2,461 shares, with a value of $126,663; Mr. LaRossa: 14,097 shares, with a value of $725,434; Ms. Linde: 7,888 shares, with a value of $405,897. Mr. Daly received a distribution of 2,797 shares, with a value of $143,935. The average of the high and low NYSE stock price of $51.46 on December 29, 2017 was used to calculate the value of the shares. Amounts include rounding.

Table of Contents

2018 PENSION BENEFITS TABLE

The following table provides information on the actuarial present value of the NEOs accumulated benefit under each of our pension and retirement plans.

Name	Plan Name	Number of Years Credited Service (#)	Present Value of Accumulated Benefit ($)[4]
Ralph Izzo	Qualified Pension Plan[1]	26.69	2,561,000
	Retirement Income Reinstatement Plan[2]	26.69	6,043,000
	Supplemental Executive Retirement Plan[3]	31.69	4,491,000
			13,095,000
Daniel J. Cregg	Qualified Pension Plan[1]	27.17	1,532,000
	Retirement Income Reinstatement Plan[2]	27.17	1,129,000
			2,661,000
Ralph A. LaRossa	Qualified Pension Plan[1]	33.50	1,894,000
	Retirement Income Reinstatement Plan[2]	33.50	3,913,000
	Supplemental Executive Retirement Plan	33.50	1,038,000

			6,845,000
Tamara L. Linde	Qualified Pension Plan[1]	28.46	1,656,000
	Retirement Income Reinstatement Plan[2]	28.46	1,347,000
			3,003,000
David M. Daly	Qualified Pension Plan[1]	31.86	1,589,000
	Retirement Income Reinstatement Plan[2]	31.86	574,000
			2,163,000

(1) All NEOs participate in the Final Average Pay Component of the Pension Plan, described below. Years shown reflect actual years of service. Each is retirement eligible.

(2) Years shown reflect actual years of service.

(3) Mr. Izzo receives five additional years of credited service, for the purpose of retirement benefit calculations under the Supplemental Plan in recognition of prior work experience. Years shown reflect the sum of actual years of service and years credited under the Supplemental Plan. The actuarial present value of accumulated benefits based on actual years of service for Mr. Izzo is $11,755,000 and the actuarial present value of accumulated benefits based on additional years of service for him is $1,340,000.

(4) Amounts shown represent the actuarial present value of accumulated benefit computed as of the same Pension Plan measurement date used for our financial statements for the year ended December 31, 2018, with these exceptions: (i) NEOs were assumed to retire at the earliest date as of which they would be eligible to receive unreduced benefits; and (ii) no pre-retirement termination, disability or death was assumed to occur. For a discussion of the valuation method and material assumptions applied in quantifying the present value, see Note 13 to the Consolidated Financial Statements included in our Form 10-K.

.

Table of Contents

Executive Compensation

Qualified and Non-Qualified Pension Plans

All of our employees are eligible to participate in the Pension Plan in either the Final Average Pay Component or the Cash Balance Component, depending upon date of hire.

Final Average Pay Component

The Final Average Pay Component covers non-represented employees hired prior to January 1, 1996 and represented employees hired prior to January 1, 1997 and provides participants with a life annuity benefit at normal retirement (age 65) pursuant to a formula based upon (a) the participant s number of years of service and (b) the average of the participant s five or seven highest years of compensation up to the limit imposed by the IRC. We amended the Final Average Pay Component effective January 1, 2012, to change the benefit formula for non-represented participants. The effect of the change is to reduce projected pension payments. Under the new formula, the average of the participant s seven highest years of compensation up to the limit imposed by the IRC will be used rather than the average of the participant s five highest years of compensation.

A participant s benefit under the Final Average Pay Component is equal to A plus B:

A. The accrued benefit calculated under the five-year final average pay formula as of December 31, 2011, as follows:

(i) 1.3% of the lesser of 5-year final average earnings (determined as of December 31, 2011) or $24,600 times years of credited service (determined as of December 31, 2011) not exceeding 35 years;

(ii) 1.5% of the amount by which 5-year final average earnings (determined as of December 31, 2011) exceeds $24,600 times years of credited service not exceeding 35 years; and

(iii) 1.5% of 5-year final average earnings times years of credited service (determined as of December 31, 2011) in excess of 35 years.

B. The accrued benefit calculated under the seven-year final average pay formula, as follows:

(i) 1.3% of the lesser of 7-year final average earnings beginning on January 1, 2012 or $24,600 times years of credited service not exceeding 35 years less the number of years as of December 31, 2011;

(ii) 1.5% of the amount by which 7-year final average earnings beginning on January 1, 2012 exceeds $24,600 times years of credited service not exceeding 35 years less the number of years as of December 31, 2011; and

(iii) 1.5% of 7-year final average earnings times years of credited service in excess of 35 years less the number of years in excess of 35 years as of December 31, 2011.

An additional benefit equal to $4.00 per month (effective January 1, 2018, $5.00 per month for represented employees) for each year of credited service is payable until the retiree reaches age 65.

All active participants are fully vested in their Final Average Pay Component benefit. Benefits are payable on an unreduced basis (i) at age 65, (ii) at age 60, if the participant s age, plus years of service, equals or exceeds 80 or (iii) at age 55, if the participant has 25 or more years of service. Participants whose age, plus years of service, equals or exceeds 80, but who have not yet met the criteria in (ii) or (iii) may commence their Final Average Pay Component benefits on a reduced basis.

Cash Balance Component

The Cash Balance Component covers non-represented employees hired or rehired after December 31, 1995 and represented employees hired after December 31,1996 and provides each participant with a life annuity benefit at normal retirement (age 65) equal to the actuarial equivalent of a notional amount maintained for him/her. Participants are eligible for retirement under the Cash Balance Component upon the attainment of age 55 with five or more years of service. Participants accounts are credited each year with a percentage of compensation, which is determined based on the participant s age plus years of service measured at year-end.

Sum of Age and Service	Percentage of Compensation Credited (%)
<30	2.00
30-39	2.50
40-49	3.25
50-59	4.25

60-69	5.50
70-79	7.00
80-89	9.00
90+	12.00

Each participant s notional amount grows each year with interest credits based on a 6.0% annual rate of interest. Participants become immediately fully vested in their Cash Balance Component benefit.

Reinstatement Plan

Certain management and highly compensated employees participate in a nonqualified excess benefit retirement plan, the Reinstatement Plan, designed to replace earned pension benefits as determined under the Pension Plan formula, but which cannot be paid from the Pension Plan as a result of the IRC mandated limits for qualified plans or the terms of the Pension Plan. The benefits payable under this plan mirror those of the Pension Plan described above except that the compensation considered in computing the benefit (i) will not be limited by qualified plan limits, (ii) will include any amounts that the participant deferred under deferred compensation plan, (iii) will include amounts earned under the SMICP and, as applicable, the Management Incentive Compensation Plan (which are not considered under the Pension Plan), (iv) will be limited to 150% of average base salary for the applicable five or seven years for Final Average Pay Component participants and will be limited to 150% of base salary each year for Cash Balance Component participants and (v) will be offset by any benefits received by the participant under the Pension Plan (Final Average Pay Component or Cash Balance Component).

Supplemental Plan

Certain employees receive supplemental limited retirement and death benefits in a nonqualified plan, the Supplemental Plan. In addition, certain employees receive additional years of service for the purpose of retirement benefit calculations in recognition of prior allied work experience. However, we have determined, effective January 1, 2011, to no longer offer additional credited service to those who do not already have this benefit. Such benefits are paid from the Supplemental Plan. Benefits payable under the additional service provisions of the Supplemental Plan mirror those payable under the Reinstatement Plan, except that the additional years of service are considered in calculating the Supplemental Plan benefit amount. Any benefit payable under the Supplemental Plan is offset by benefits payable under the Pension Plan and the Reinstatement Plan.

Certain participants in the Supplemental Plan receive additional limited benefits. This portion of the Supplemental Plan provides a total target replacement income percentage equal to credited service for qualified pension plan calculation purposes, plus any applicable additional credited service, plus 30, to a maximum of 75%, of an average of covered compensation. Covered compensation used for determining limited benefits under the Supplemental Plan is the same as the covered compensation used under the Reinstatement Plan. The target replacement amount under the

limited benefit portion of the Supplemental Plan is reduced by any pension benefits from any previous employers accrued and vested at the time of hire, by the participant s Social Security benefit at normal retirement age and by the pension benefits provided by each other PSEG retirement benefit plan (qualified plans and non-qualified plans). The additional limited benefits provision of the Supplemental Plan also provides a death benefit equal to 150% of base compensation if death occurs while the participant is actively employed. Participants designated for the additional limited benefit become entitled to this benefit only upon (a) retirement under the terms of the component of the Pension Plan in which they participate (Final Average Pay Component or Cash Balance Component), or (b) death.

Table of Contents

Executive Compensation

The change in the benefit formula under the qualified Final Average Pay Component from a five-year final average pay formula to a seven-year final average pay formula impacts the limited benefits under the Supplemental Plan. Accordingly, we amended the Supplemental Plan as of January 1, 2012 to reflect this change.

2018 NON-QUALIFIED DEFERRED COMPENSATION TABLE

The following table provides information regarding compensation deferred by the NEOs under our Deferred Compensation Plans.

Name		Executive Contributions in Last Fiscal Year (2018) ($)[1]	Registrant Contributions in Last Fiscal Year (2018) ($)	Aggregate Earnings in Last Fiscal Year (2018) ($)[2]	Aggregate Withdrawals/ Distributions (2018) ($)	Aggregate Balance at Last Fiscal Year End (2018) ($)[1][3]
Ralph Izzo	Deferred Compensation Plan	-	-	360,687	-	10,443,430
	Equity Deferral Plan	10,770,378	-	3,117,236	-	68,659,711
Daniel J. Cregg	Deferred Compensation Plan	248,764	-	(39,948)	-	960,009
	Equity Deferral Plan	-	-	60,441	-	1,381,864
Ralph A. LaRossa	Deferred Compensation Plan	-	-	-	-	-
	Equity Deferral Plan	-	-	317,118	-	7,250,252
Tamara L. Linde	Deferred Compensation Plan	-	-	-	-	-
	Equity Deferral Plan	-	-	-	-	-
David M. Daly	Deferred Compensation Plan	-	-	-	-	-
	Equity Deferral Plan	-	-	-	-	-

(1) Amounts shown include, pursuant to the Deferred Compensation Plan, 2018 deferred salary and SMICP earned in 2018 and paid in 2019 and, pursuant to the Equity Deferral Plan, PSUs vested at December 31, 2018 and paid in

2019 and RSUs vested on January 1, 2018, as shown in the Option Exercises and Stock Vested During 2018 Table.

(2) Reflects earnings and change in value on amount in each individual s deferred compensation account.

(3) Includes amounts reported in the Summary Compensation Table in prior-year proxy statements for the Deferred Compensation Plan and/or the Equity Deferral Plan, respectively, as follows: Mr. Izzo $7,473,894 and $37,817,963; Mr. Cregg $946,394 and no equity deferral as the equity grant was made prior to becoming CFO; Mr. LaRossa equity deferral of $3,814,439.

Deferred Compensation

Deferred Compensation Plan

Under the Deferred Compensation Plan, participants, including the NEOs, may elect to defer any portion of their cash compensation by making appropriate elections in the calendar year prior to the year in which the services giving rise to the compensation being deferred are rendered. A participant may change an election to defer compensation not later than the date that is the last date that an election to defer may be made.

At the same time he/she elects to defer compensation, the participant must make an election as to the timing and the form of distribution of that year s deferrals from his/her Deferred Compensation Plan account. For compensation deferred in 2011 and earlier years distribution may commence (a) on the thirtieth day after the date he/she terminates employment or, in the alternative, (b) on January 15th of any calendar year following termination of employment elected by him/her, but in any event no later than the later of (i) the January of the year following the year of his/her 70th birthday or (ii) the January following termination of employment. Notwithstanding the forgoing, however, for NEOs and other specified employees, distribution of his/her account may not occur earlier than six months following the date of his/her termination of service. Participants may elect to receive the distribution of their Deferred Compensation account in the form of one lump-sum payment, annual distributions over a five-year period or annual distributions over a 10-year period.

With respect to compensation deferred in 2012 and future years, participants may elect to commence distribution of a particular year s deferrals (a) six months following his/her termination of employment, or (b) a specified number of years following his/her termination from employment. Participants may elect to receive distribution of such deferrals under the Deferred Compensation Plan in the form of a lump-sum payment or annual distributions over a period of three to fifteen years.

Under the scheduled future date distribution feature, participants may elect to receive a specific plan year s deferral balance on a specified date as early as three years after the beginning of the year in which the deferrals are made. Distributions are paid in a lump sum within 90 days from the date elected regardless of whether the participant is employed by us on the payment date.

Participants may change their distribution elections as to future year s deferrals. Participants may also make changes of their distribution elections with respect to prior years deferrals provided that (a) any such new distribution election is made at least one year prior to the previously selected commencement date or (b) the new commencement date is at least five years later than the previously selected commencement date.

Amounts deferred under the Deferred Compensation Plan are credited with earnings based on (a) the performance of one or more of the investment portfolio funds available to employees under our 401(k) plans (except the Company Stock Fund and the Fidelity Brokerage Link Account) or (b) at the rate of Prime plus 1/2%, capped at 120% of the applicable federal long-term rate, in such percentages as selected by the participant. A participant who fails to provide a designation of investment funds will accrue earnings on his/her account at the rate of Prime plus 1/2%, capped at 120% of the applicable federal long-term rate. A participant may change his/her investment election on a daily basis.

For 2018, the one-year rates of return as of December 31, 2018 for the funds offered as computed by the recordkeeper of the Deferred Compensation Plan were as follows:

Rates of Return			
Funds		**Target Retirement Funds**	
Stable Value	2.45%	Target Retirement Income	(2.06)%
Diversified Bond	(0.40)%	Target Retirement 2015	(2.99)%
Fidelity Intermediate Bond	0.43%	Target Retirement 2020	(4.20)%
Large Company Stock Index	(4.43)%	Target Retirement 2025	(5.06)%
Mid-Cap Index	(9.23)%	Target Retirement 2030	(5.83)%
Institutional Developed Markets Index	(14.48)%	Target Retirement 2035	(6.58)%
Small-Cap Index	(9.33)%	Target Retirement 2040	(7.33)%
Primary Money Market	1.76%	Target Retirement 2045	(7.91)%
Other		Target Retirement 2050	(7.87)%
Prime Plus 1/2%	3.58%	Target Retirement 2055	(7.90)%
		Target Retirement 2060	(7.87)%
		Target Retirement 2065	(7.73)%

Equity Deferral Plan

Participants in our Equity Deferral Plan may defer receipt of all or a portion of the shares of our Common Stock underlying future equity awards under the LTIP. Deferral elections must be made during an annual enrollment period

prior to the date that services giving rise to the awards are performed. Deferral elections under the Equity Deferral Plan are irrevocable.

Generally, at the time a participant elects to defer he/she must make an election as to the timing of payment of the deferred shares. Distributions will be made in a lump sum. Distributions may commence (a) on a specified date occurring between the third anniversary and the fifteenth anniversary of the date that the shares otherwise would have been distributed to the participant (b) upon termination of employment, or (c) the earlier of (a) and (b). Notwithstanding the forgoing, however, for NEOs and other specified employees, distribution may not occur earlier than six months following the date of his/her termination of employment. Participants will receive shares on the applicable distribution date. We hold the deferred shares in a Rabbi Trust. The dividends attributable to the deferred shares are reinvested in Common Stock and distributed at the same time that the deferred shares are distributed to the participants. Participants are not permitted to direct the trustee of the Rabbi Trust to vote the deferred shares.

Executive Compensation

POTENTIAL PAYMENTS UPON TERMINATION OF EMPLOYMENT OR CHANGE-IN-CONTROL

Termination without Cause

Mr. Izzo s severance agreement provides for certain benefits if he is terminated without cause (a willful failure to perform his duties) or resigns for good reason (a reduction in pay, position or authority) during the term of such agreement. He would be paid a benefit of two times base salary and target bonus, as well as a prorated payment of SMICP target incentive award for the year of termination. His welfare benefits would be continued for two years, unless he is sooner employed. Any unvested equity awards would be forfeited. The agreement provides that Mr. Izzo will be prohibited from competing with and from recruiting employees from us or our subsidiaries or affiliates, for certain periods after termination of employment. Violations of these provisions require a forfeiture of certain benefits.

Our Key Executive Severance Plan provides severance benefits to Messrs. Izzo, Cregg, LaRossa and Daly and Ms. Linde, and to certain of our other key executive-level employees whose employment is terminated without cause. Participants must agree to restrictive covenants including confidentiality, non-competition and non-solicitation. Termination for cause includes certain violations of our performance, behavioral and value expectations for executives.

Also under the Key Executive Severance Plan, Messrs. Cregg, LaRossa and Daly and Ms. Linde would be entitled to certain severance benefits in the event that their employment was terminated without cause other than in a change-in-control situation. In such event they would be entitled to 1.0 times their annual base salary plus their target bonus, as well as a prorated payment of their SMICP target incentive award for the year of termination and certain outplacement services, educational assistance, health care and life insurance coverage. The Key Executive Severance Plan further provides that any unvested equity awards would be accelerated or forfeited in accordance with the terms of the individual s grants under the LTIP and/or employment agreement.

In accordance with Mr. LaRossa s retention award, upon termination, voluntary or involuntary, following a change in leadership, Mr. LaRossa would become fully vested in his retention award as described in the CD&A on page 54.

Assuming a termination without cause or for a reduction in force or reorganization had occurred on December 31, 2018, each of the NEOs would have received the following benefits as a lump sum payment:

	Izzo	Cregg	LaRossa	Linde	Daly
Termination without Cause	($)	($)	($)	($)	($)
Severance	6,030,000	1,100,225	1,259,475	1,042,300	913,850

Pro Rata Bonus (SMICP)	1,675,000	471,525	539,775	446,700	391,650
Unvested Restricted Stock Units[(1)]	-	-	1,639,731	-	-
Performance Share Unit Payout[(1)]	-	-	1,472,182	-	-
Health/Welfare Benefits	54,407	10,430	23,363	29,321	22,980
Outplacement	25,000	25,000	25,000	25,000	25,000
Education Assistance	3,000	3,000	3,000	3,000	3,000
Aggregate Payments	**7,787,407**	**1,610,180**	**4,962,526**	**1,546,321**	**1,356,480**

(1) Includes Mr. LaRossa s retention award.

Assuming a termination due to death or disability had occurred on December 31, 2018, each of the NEOs would have received the following benefits as a lump sum payment:

Termination Upon Death or Disability	Izzo ($)	Cregg ($)	LaRossa ($)	Linde ($)	Daly ($)
Unvested and Vested Restricted Stock Units[(1)]	224,562	37,154	1,684,717	37,154	21,223
Performance Share Unit Payout[(1)]	-	-	1,472,182	-	-
Death Benefit Under Supplemental Plan[(2)]	2,010,000	-	1,079,550	-	-
Aggregate Payments	**2,234,562**	**37,154**	**4,236,449**	**37,154**	**21,223**

(1) For Mr. LaRossa, includes his retention award.

(2) Includes an additional death benefit under the Supplemental Plan equal to 1.5 times base salary.

Table of Contents

Change-In-Control

Under our Key Executive Severance Plan, if any of Messrs. Izzo, Cregg, LaRossa and Daly and Ms. Linde is terminated without cause or resigns his/her employment for good reason within two years after a change-in-control, the individual will receive (1) three times (two times for Messrs. Cregg and Daly and Ms. Linde) the sum of his/her salary and target incentive bonus, (2) a pro rata bonus based on his/her target annual incentive compensation, (3) accelerated vesting of equity-based awards, except for PSUs, which vest pro rata, based on target, (4) a lump sum payment equal to the actuarial equivalent of his/her benefits under all of our retirement plans in which the individual participates calculated as though he/she remained employed for three years (two years for Messrs. Cregg and Daly and Ms. Linde) beyond the date employment is terminated less the actuarial equivalent of such benefits on the date employment terminates (reported in the table below as Enhanced Retirement Benefit for pension-related amount and as Retiree Medical Increase for amount due for retiree medical benefits), (5) three years (two years for Messrs. Cregg and Daly and Ms. Linde) continued welfare benefits, (6) one year of PSEG-paid outplacement services and (7) vesting of any compensation previously deferred. Payments are limited to an amount that would not give rise to an excise tax liability under applicable IRS provisions, currently 2.99 times the individual s average W-2 compensation for the period. Amounts above that limit are forfeited. Potential payments are shown in the Change-in-Control Termination Table.

Assuming a termination without cause or resignation with good reason had occurred on December 31, 2018 following a change-in-control, each of the NEOs would have received the following benefits:

Change-in-Control Termination	Izzo ($)	Cregg ($)	LaRossa ($)	Linde ($)	Daly ($)
Severance	9,045,000	2,200,450	3,778,425	2,084,600	1,827,700
Pro Rata Bonus (SMICP)	1,675,000	471,525	539,775	446,700	391,650
Unvested and Vested Restricted Stock Units[(1)(2)]	224,562	37,154	1,684,717	37,154	21,223
Performance Share Unit Payout[(1)]	5,367,222	854,470	2,546,373	854,470	329,251
Enhanced Retirement Benefit	-	419,000	25,000	1,605,000	301,000
Retiree Medical Increase	115,000	-	-	166,000	-
Health/Welfare Benefits	91,420	22,767	79,900	73,893	52,231
Outplacement	25,000	25,000	25,000	25,000	25,000
Parachute Payments Forfeited	(779,117)	(2,394,623)	(1,161,000)	(2,048,867)	(670,326)
Aggregate Payments	**15,764,087**	**1,635,743**	**7,518,190**	**3,243,950**	**2,277,729**

(1) For Mr. LaRossa, includes his retention award.

(2) All annually granted RSUs for all NEOs, each of whom are retirement eligible, were vested at December 31, 2018. Amounts shown for them represent the present value of the accelerated payout at December 31, 2018

No NEO would be eligible for any payments under the Key Executive Severance Plan, either prior to or following a change-in-control, if he/she voluntarily terminated his/her employment (other than for good reason as described above under Termination Without Cause) or if his/her employment were terminated by us for cause.

If a NEO were to retire or his/her employment were terminated on account of death or disability, the Key Executive Severance Plan provides that such participant would be entitled to accrued pay through the date of termination and prorated payment of his/her target incentive award for the year of termination.

Change-in-control provisions under the Key Executive Severance Plan generally mean the occurrence of any of the following events:

- Any person is or becomes the beneficial owner of our securities representing 25% or more of the combined voting power of our then outstanding securities; or

- A majority of the Board is replaced without approval of the current Board; or

- There is consummated a merger or consolidation of us, other than a merger or consolidation which would result in our voting securities outstanding immediately prior to such merger continuing to represent at least 75% of the combined voting power of the securities of us or such surviving entity immediately after such merger or consolidation; or

- Our stockholders approve a plan of complete liquidation or dissolution of us or there is consummated an agreement for the sale or disposition by us of all or substantially all of our assets.

For additional information regarding the provisions of LTIP awards, see Material Factors Concerning Awards Shown in Summary Compensation Table, Grants of Plan-Based Awards Table and Employment Agreements.

Table of Contents

PAY RATIO

We have calculated the ratio of our CEO s compensation to that of our median employee. In doing so, we reviewed a comparison of our CEO s annual total compensation for 2018 to that of all other employees in 2018, using the same methodology and elements of compensation as we used in determining the total compensation shown for our CEO in the Summary Compensation Table that appears on page 60. Our calculation is based on the same median employee previously identified for our 2018 proxy statement disclosure and includes all employees as of December 31, 2017. There have been no changes to our employee population or employee compensation arrangements that we reasonably believe would result in a significant change to our pay ratio disclosure. The median employee was determined using internal payroll records of income reported on IRS Form W-2, which is a consistently applied compensation measure, as provided by the applicable SEC provisions. We believe that the pay ratio shown below is a reasonable estimate calculated in a manner consistent with those provisions. We note that our calculation does not include all elements of our employee compensation package, such as health insurances and other benefits generally applicable to all employees.

For 2018, for purposes of this pay ratio disclosure, the compensation of our median employee was $133,067 and the compensation of our CEO was $10,419,291. The ratio of CEO to median employee pay was approximately 78:1.

Table of Contents

Ratification of Auditor

The Audit Committee of the Board, each member of which is independent, has appointed Deloitte & Touche LLP of Parsippany, NJ, as independent auditor to make the annual audit of our books of account and supporting records for 2019, subject to the ratification of the stockholders at the Annual Meeting. The responsibilities of the independent auditor include performing an audit of, and expressing an opinion on, our financial statements and internal control over financial reporting as well as discussing with the Audit Committee any matters deemed appropriate. Deloitte & Touche LLP (or its predecessors) has performed the annual audit of the books of account of PSEG (and its predecessors) since 1934. The members of the Audit Committee and the Board believe that the continued retention of Deloitte & Touche LLP is in the best interests of the Company. We believe our company derives many benefits from the long-term relationship, including:

- Enhanced audit quality due to a deep understanding of our business, accounting policy and practices and internal controls,
- Efficient fee structures due to experience and a familiarity with our company and industry expertise; and
- Avoidance of significant costs, disruptions and distractions that would be associated with engaging a new independent auditor.

As recommended by the Board, we ask you to ratify this appointment.

Representatives of Deloitte & Touche LLP will be present at the Annual Meeting and will be afforded an opportunity to make a statement if they so desire and to respond to appropriate questions.

Vote required: An affirmative vote requires a majority of the votes cast in person or by proxy, excluding abstentions and shares withheld of for which no instructions are given and not voted.

THE BOARD OF DIRECTORS RECOMMENDS A VOTE FOR THIS PROPOSAL.

OVERSIGHT OF THE INDEPENDENT AUDITOR

The appointment, termination, compensation and oversight of the quality of the work of the Independent Registered Public Accountants, Deloitte & Touche LLP, our independent auditor, is the direct responsibility of the Audit Committee of our Board, which reviews its independence, the services provided and its fees, the selection of the lead engagement partner, as well as Public Company Accounting Oversight Board and peer review reports of its performance. The Audit Committee meets with the independent auditors and discusses the audit and as necessary any

issues that may be encountered in connection with the audit. Additional information about the Audit Committee appears above in Proposal 1 Election of Directors-Board Committee Responsibilities on page 14.

The Audit Committee annually reviews the independence and performance of Deloitte & Touche LLP in connection with the Committee s determination as to whether to retain that firm or engage another as our independent auditor. Among other things, it considers various safeguards for auditor independence, including regulatory requirements and limits on non-audit services. Under applicable accounting requirements, there is a mandatory rotation of the lead engagement partner every five years. The current lead engagement partner was appointed in 2018. In evaluating Deloitte & Touche, LLP, the Committee considers, among other things:

Quality of work and performance, both recent and historical;

Professional qualifications, capabilities and expertise;

Level and appropriateness of fees;

Independence;

Experience with and knowledge of the Company and industry; and

The impact that changing the independent auditor might have.

Table of Contents

Ratification of Auditor

Pre-Approval of Services

Annually, in accordance with the Audit Committee Charter, the Audit Committee pre-approves all audit and non-audit services provided by the independent auditor. The Audit Committee reviews, in detail, the particular services in each of the Audit, Audit-Related, Tax and All Other categories that the independent auditor will perform subject to predetermined limits set by the Audit Committee for each category of service. The annual pre-approval of services and predetermined limits is documented in a Committee resolution.

During the year, circumstances may arise when it becomes necessary to engage the independent registered public accountants for additional services not contemplated in the annual Committee resolution. For those instances, the Chairman of the Committee has been authorized by the Audit Committee to approve Audit, Audit-Related, Tax and All Other in excess of the amounts and different from the types of service authorized in the Committee resolution, as well as the scope and amount of services with regard to the annual audit that may be necessary or advisable provided that any such authorizations are reported to the Audit Committee at the next meeting following such authorization.

Fees Billed by Deloitte & Touche LLP for 2018 and 2017

The fees billed by Deloitte & Touche LLP are negotiated by management under the direction of the CFO, with the oversight and ultimate approval of the Audit Committee. The table below shows the fees paid to Deloitte and Touche LLP for Audit, Audit-Related, Tax and All Other services during or in connection with 2018 and 2017, all of which were approved, as described above.

	Years ended December 31,	
	2018	2017
Description of Professional Service	**($)**	**($)**
Audit Fees - The audit fees were incurred for audits of our annual consolidated financial statements and those of our subsidiaries, including our Annual Reports on Form 10-K, reviews of financial statements included in our quarterly reports on Form 10-Q and for services rendered in connection with certain financing transactions, statutory and regulatory filings and fees for accounting consultations related to the application of new accounting standards and rules.	$ 6,781,000	$ 6,758,700
Audit Related Fees - The audit related fees primarily related to performing certain attest services.	223,092	-
Tax Fees - The tax fees relate to tax compliance and tax advice for preparation of various state and foreign corporate returns and assistance with filing tax refund claims.	72,015	94,188

All Other Fees	-	-

AUDIT COMMITTEE REPORT

The Audit Committee of the PSEG Board of Directors is comprised solely of independent directors. It operates under a written charter adopted by the PSEG Board of Directors which is posted on PSEG s website, https://corporate.pseg.com/aboutpseg/leadershipandgovernance/boardofdirectors/committeedescriptions. The Audit Committee Charter is annually reviewed and assessed for adequacy by the PSEG Audit Committee.

Management is responsible for PSEG s financial statements and internal controls. The independent auditor of PSEG, Deloitte & Touche LLP, reports directly to the PSEG Audit Committee and is responsible for performing an independent audit of PSEG s annual consolidated financial statements in accordance with the standards of the Public Company Accounting Oversight Board (PCAOB) (U.S.) and on PSEG s internal controls and for issuing reports thereon. The Audit Committee s overall responsibility is to assist the PSEG Board of Directors in overseeing the quality and integrity of the accounting, auditing and financial reporting practices.

Management has represented to the Audit Committee that PSEG s Consolidated Financial Statements were prepared in accordance with generally accepted accounting principles (GAAP) in the United States. In performance of its responsibilities, the Audit Committee has reviewed PSEG s Consolidated Financial Statements for the year ended December 31, 2018 and discussed these financial statements with management, the internal auditors and the independent auditor.

The Committee periodically meets in executive session with the independent auditor, the Vice President - Internal Auditing Services, the Chief Financial Officer, the General Counsel and the Chief Compliance Officer. At all of its meetings (except those held telephonically) the Audit Committee meets in executive session with only Audit Committee members present. The Audit Committee discussed with the independent auditor:

PSEG s critical accounting policies;

New accounting standards and policies affecting PSEG;

That there were no disagreements with management over the application of GAAP;

Significant accounting estimates made by management and the disclosures in the financial statements;

Accounting and reporting for significant transactions; and

The other matters required to be discussed as described in PCAOB Auditing Standards No.16 Communications with Audit Committees, which relate to the audit, financial statements, significant risks and critical accounting estimates, among others.

The independent auditor also provided to the Audit Committee the written disclosures required by the PCAOB s standards in PCAOB Rule 3526, Communication with Audit Committee Concerning Independence, and current Securities and Exchange Commission (SEC) requirements for auditor independence. The Audit Committee discussed with the independent auditor the firm s independence with respect to PSEG, internal quality control procedures, and any material issues raised and any steps taken to deal with such issues by the most recent internal quality control review or by any review, inquiry or investigation by governmental or professional authorities within the preceding five years, with respect to one or more independent audits carried out by the firm. The Audit Committee has also reviewed the requirements of the Sarbanes-Oxley Act of 2002 with respect to auditor independence and has defined the amount and scope of services that may be performed by Deloitte & Touche LLP consistent with maintaining that firm s independence. The Audit Committee requires that all services of Deloitte & Touche LLP be pre-approved by the Audit Committee or the Audit Committee Chair. The Audit Committee has considered whether the independent auditor s provision of non-audit services to PSEG and the total fees paid for non-audit services relative to fees paid for audit services are compatible with maintaining the independent auditor s independence. On the basis of its review, the Audit Committee determined that the independent auditor has the requisite independence.

Based on the Audit Committee s discussions with management, the internal auditors and the independent auditor, the Audit Committee s review of the audited financial statements, the representations of management to the independent auditor regarding the audited financial statements and the independent auditor s report to the Audit Committee, the Audit Committee recommended to the Board of Directors that the audited financial statements be included in PSEG s Annual Report on Form 10-K for the fiscal year ended December 31, 2018, for filing with the SEC.

Members of the Audit Committee:

Susan Tomasky, Chair	David Lilley
Willie A. Deese	Thomas A. Renyi
William V. Hickey	Alfred W. Zollar

February 18, 2019

Annual Meeting, Voting and Procedures

Proxy Statement

This Proxy Statement is provided by us on behalf of the Board. A proxy is a person you have legally designated to vote the stock you own. We are asking you to designate as proxies the individuals named by us on the proxy card, voting instruction form or electronic instruction associated with this Proxy Statement to vote at the 2019 Annual Meeting of Stockholders scheduled to be held on April 16, 2019 and at all adjournments or postponements of that meeting. For instructions on how to vote, please see Proxy Card and Voting of Shares section below.

The mailing address of our principal executive offices is 80 Park Plaza, Newark, NJ 07102, telephone (973) 430-7000. Our Internet website is www.pseg.com.

Annual Report on Form 10-K

We have provided without charge to each person solicited by means of this Proxy Statement a copy of our Form 10-K for 2018, which has been filed with the SEC, including a list briefly describing the related exhibits. You may request copies of the exhibits by writing to: Senior Director - Investor Relations, Public Service Enterprise Group Incorporated, 80 Park Plaza, T4B, Newark, NJ 07102. The Form 10-K is also available on our website https://investor.pseg.com/sec-filings.

Delivery of Documents and Internet Availability

We use several different methods to deliver the proxy statement and voting materials to you, including the U.S. Mail and the Internet. Each stockholder receives his/her own proxy card, voting instruction form or electronic instructions for voting. For detailed information on how to vote, see Proxy Card and Voting of Shares below.

One Copy per Household

We have sent only a single copy of our Annual Report to Stockholders, including our Form 10-K, and Proxy Statement, to any household with two or more stockholders having the same last name and address unless one of the stockholders has requested individual copies. This householding saves our company printing and delivery costs. If you share an address with another stockholder and receive only a single copy of one of those documents, you may request an additional copy or delivery of a separate copy in the future by writing to the above address or contacting us at (973) 430-6566.

Electronic Delivery

Stockholders may choose to no longer receive printed copies of our Annual Report, Form 10-K and Proxy Statement and instead receive and view them electronically over the internet. If you would like to receive these documents, as well as other stockholder communications and materials, electronically in the future and save us the cost of printing and mailing them to you, you may do so by following the instructions at the websites shown on page i, under Electronic Delivery. If your shares are held in the name of a bank or broker, please follow that organization s

instructions for electronic delivery. You may also follow the instructions provided for future electronic delivery if you vote via the Internet.

If you receive our future Proxy Statements, Annual Reports and Forms 10-K electronically over the Internet, you will receive each year an e-mail message containing the Internet address to access these documents. The e-mail will also include instructions for voting via the Internet as you will not receive a separate proxy card.

Table of Contents

Annual Meeting

This year we will be holding our Annual Meeting at the Newark Museum, in Newark, NJ. Please note the address, 49 Washington Street, Newark, NJ 07102.

Attendance

Our Annual Meeting will be held on Tuesday, April 16, 2019 at 1:00 PM, at the Newark Museum, 49 Washington Street in Newark, NJ.

You have the right to attend the Annual Meeting if you are a stockholder of record, beneficial owner whose shares are held of record by a bank or broker, or a participant in one of the plans noted below.

We request that if you plan to attend the Annual Meeting, you should so indicate on the proxy card or voting instruction form or when voting your shares telephonically or electronically.

Please bring with you evidence that you are a stockholder.

We have included transportation information and a map in this Proxy Statement.

Holders of record of the 504,999,536 shares of Common Stock outstanding on February 15, 2019 will have one vote per share. A quorum will consist of the holders of Common Stock entitled to cast a majority of the votes at the Annual Meeting, present in person or represented by proxy. All votes cast by proxy or in person will be counted. Abstentions and broker non-votes will not be counted, except for the purpose of establishing a quorum. All votes will be tabulated by an independent inspector of elections.

Election of directors under Proposal 1 is subject to our majority vote requirement described above. The say-on-pay vote presented in Proposal 2 is advisory and non-binding, whether or not approved by a majority of the votes cast. A majority of the votes cast is needed for ratification of the appointment of the auditor under Proposal 3. In tallying the vote on each proposal, we exclude abstentions and shares withheld or except as provided by applicable provisions, as discussed below, for which no instructions are given.

Proxy Card and Voting of Shares: How to Vote

Stockholders of Record

Every vote is important. We urge you to vote whether or not you plan to attend the Annual Meeting. You may specify your choices by marking the appropriate boxes on the enclosed proxy card. Once done, kindly sign, date and return the accompanying proxy card, or you may vote your proxy using the toll-free telephone number listed on the proxy card or via the Internet at the electronic address provided on page iii and also listed on the proxy card. When a proxy

card is returned properly dated and signed, or properly voted telephonically or electronically, the shares represented by the proxy will be voted by the persons named as proxies in accordance with the voting stockholder s directions. If you are a stockholder of record, your shares will not be voted unless you provide a proxy by return mail, telephonically or electronically or vote in person at the Annual Meeting.

Shares Held in Plans

Enterprise Direct: The proxy card includes any shares registered in the names shown on the proxy in Enterprise Direct (our dividend reinvestment and stock purchase plan). If a proxy card is dated, signed and returned without specifying choices, the shares will be voted as recommended by the Board. If you vote telephonically or electronically, you should follow the directions given during the call or on the computer screen. If no instructions are received from you with respect to any shares held in Enterprise Direct, the administrator of the plan will vote those shares in accordance with the recommendations of the Board.

PSEG Employee Stock Purchase Plan (ESPP): If you are a participant in the ESPP, you will receive a separate voting instruction form from the administrator of the plan. If no instructions are received from you with respect to any shares held in the ESPP, the administrator of the plan may vote those shares in accordance with the recommendations of the Board.

PSEG Employee Benefit Plans: If you are a participant in the Thrift and Tax-Deferred Savings Plan or the Employee Savings Plan of PSEG (PSEG Savings Plans) or either of the two Incentive Thrift Plans (Incentive Thrift Plans) of Long Island Electric Utility Servco LLC, a subsidiary of PSEG LI, you will receive a separate proxy card from the respective plan s trustee for shares that have been allocated to your accounts. The trustee will vote the shares of Common Stock beneficially owned by you under the respective plan in accordance with your instructions. If no instructions are received with respect to the PSEG Savings Plans, the shares will not be voted. If no instructions are received with respect to the Incentive Thrift Plans, the respective trustee will vote your shares in the same proportion as those shares as to which it receives instructions from other participants in the plan in which you participate.

Annual Meeting, Voting and Procedures

Shares Held by Banks or Brokers

If your shares are held in the name of a bank or broker, you should follow the voting directions on the instruction form received from your bank or broker. For such shares, while the availability of telephone or Internet voting will depend on the processes of your bank or broker, we believe that most will make such voting methods available. In accordance with the rules of the NYSE, if no instructions are received from you by a bank or broker with respect to such shares, the bank or broker may use its discretion to vote your shares that are held by it only in regard to Proposal 3, Ratification of the Appointment of Independent Auditor and the shares will not be voted on the other proposals presented in this Proxy Statement.

Revoking a Proxy

You may revoke a proxy given in the form of the card which accompanies this Proxy Statement or a vote made telephonically or electronically. However, by law, your presence at the Annual Meeting will not revoke a proxy you have given unless you file a written notice of such revocation with the Secretary of PSEG prior to the voting of the proxies at the Annual Meeting or you vote the shares subject to the proxy by written ballot. The Secretary s mailing address is: Corporate Secretary, Public Service Enterprise Group Incorporated, 80 Park Plaza, T4B, Newark, NJ 07102.

Solicitation

The cost of soliciting proxies in the form accompanying this Proxy Statement will be borne by us. In addition to solicitation by mail, proxies may be solicited by our directors, officers and employees, none of whom will be directly compensated for such services, in person or by telephone, electronically or by facsimile. We have also retained Alliance Advisors to assist in the distribution and solicitation of proxies from brokers, bank nominees, other institutional holders and certain large individual holders. The anticipated cost of such services to us is approximately $20,000 plus reimbursement of expenses.

Date for Submission of Stockholder Proposals

In accordance with SEC rules, stockholders may submit proposals intended for inclusion in the Proxy Statement in connection with our 2020 Annual Meeting of Stockholders. Such proposals should be sent to: Corporate Secretary, Public Service Enterprise Group Incorporated, 80 Park Plaza, T4B, Newark, NJ 07102 and must be received by November 13, 2019.

Proxy Voting Authority

If any matters not described in this Proxy Statement are properly presented at the Annual Meeting, the persons named in the enclosed proxy card or their substitutes will vote proxies so given in respect of any such matters in accordance

with their best judgment. As of the date of this Proxy Statement, the Board and management did not know of any other matters which might be presented for stockholder action at the Annual Meeting.

If we are not notified by January 27, 2020 of any proposal intended to be presented for consideration at the 2020 Annual Meeting of Stockholders, then the persons named by us shall have discretionary voting authority with respect to such proposal if presented at that Annual Meeting.

The named proxies will have discretionary authority to vote for any replacement nominee in the event that any nominee named in this Proxy Statement withdraws, resigns or otherwise does not stand for election.

Voting Tabulation Results

Proxies and ballots will be received and tabulated by an independent inspector of elections. We will announce preliminary voting results at the Annual Meeting. We will disclose the final voting results in a Current Report on Form 8-K to be filed with the SEC on or before April 22, 2019. The Form 8-K will be available on our website at https://investor.pseg.com/sec-filings and on the SEC s website at www.sec.gov

Table of Contents

Appendix A: Reconciliations

APPENDIX A

Operating Earnings (Non-GAAP) and Adjusted EBITDA (Non-GAAP) Reconciliations

Public Service Enterprise Group Incorporated

Reconciling Items	2018	2017	2016	2015	2014
	Year Ended December 31, ($ millions, Unaudited)				
Net Income	**$ 1,438**	**$ 1,574**	**$ 887**	**$ 1,679**	**$ 1,518**
(Gain) Loss on Nuclear Decommissioning Trust (NDT) Fund Related Activity, pre-tax[(a)] (PSEG Power)	144	(133)	(5)	(24)	(138)
(Gain) Loss on Mark-to-Market (MTM), pre-tax[(b)] (PSEG Power)	117	167	168	(157)	(111)
Storm O&M, net of insurance recoveries, pre-tax (PSEG Power)	-	-	-	(172)	27
Hudson/Mercer (Gain on Sale) / Early Retirement, pre-tax (PSEG Power)	(51)	975	669	-	-
Lease Related Activity, pre-tax (PSEG Enterprise/Other)	8	77	147	-	-
Income Taxes related to Operating Earnings (non-GAAP) reconciling items, excluding Tax Reform[(c)]	(74)	(427)	(391)	150	104
Tax Reform	-	(745)	-	-	-
Operating Earnings (non-GAAP)	**$ 1,582**	**$ 1,488**	**$ 1,475**	**$ 1,476**	**$ 1,400**
Fully Diluted Average Shares Outstanding (in millions)	**507**	**507**	**508**	**508**	**508**
	($ Per Share Impact Diluted, Unaudited)				
Net Income	**$ 2.83**	**$ 3.10**	**$ 1.75**	**$ 3.30**	**$ 2.99**
(Gain) Loss on NDT Fund Related Activity, pre-tax[(a)] (PSEG Power)	0.28	(0.26)	(0.01)	(0.05)	(0.27)
(Gain) Loss on MTM, pre-tax[(b)] (PSEG Power)	0.23	0.33	0.33	(0.31)	(0.22)

Storm O&M, net of insurance recoveries, pre-tax (PSEG Power)	-	-	-	(0.34)	0.05
Hudson/Mercer (Gain on Sale) / Early Retirement, pre-tax (PSEG Power)	(0.10)	1.92	1.32	-	-
Lease Related Activity, pre-tax (PSEG Enterprise/Other)	0.02	0.15	0.29	-	-
Income Taxes related to Operating Earnings (non-GAAP) reconciling items, excluding Tax Reform[(c)]	(0.14)	(0.84)	(0.78)	0.31	0.21
Tax Reform	-	(1.47)	-	-	-
Operating Earnings (non-GAAP)	**$ 3.12**	**$ 2.93**	**$ 2.90**	**$ 2.91**	**$ 2.76**

(a) Effective January 1, 2018, unrealized gains (losses) on equity securities are recorded in Net Income instead of Other Comprehensive Income (Loss).

(b) Includes the financial impact from positions with forward delivery months.

(c) Income tax effect calculated at 28.11% statutory rate for 2018 and 40.85% statutory rate for prior years, except for lease related activity which is calculated at a combined leveraged lease effective tax rate and NDT related activity which is calculated at the statutory rate plus a 20% tax on income (losses) from qualified NDT funds.

PSE&G

Reconciling Items	2018	2017	2016	2015	2014
	Year Ended December 31, ($ millions, Unaudited)				
Net Income	**$ 1,067**	**$ 973**	**$ 889**	**$ 787**	**$ 725**
Tax Reform	-	(10)	-	-	-
Operating Earnings (non-GAAP)	**$ 1,067**	**$ 963**	**$ 889**	**$ 787**	**$ 725**

Table of Contents

Appendix A: Reconciliations

PSEG Power LLC					
	Year Ended December 31,				
	2018	2017	2016	2015	2014
Reconciling Items	($ millions, Unaudited)				
Net Income	**$ 365**	**$ 479**	**$ 18**	**$ 856**	**$ 760**
(Gain) Loss on Nuclear Decommissioning Trust (NDT) Fund Related Activity, pre-tax[(a)] (PSEG Power)	144	(133)	(5)	(24)	(138)
(Gain) Loss on Mark-to-Market (MTM), pre-tax[(b)] (PSEG Power)	117	167	168	(157)	(111)
Storm O&M, net of insurance recoveries, pre-tax (PSEG Power)	-	-	-	(172)	27
Hudson/Mercer (Gain on Sale) / Early Retirement, pre-tax (PSEG Power)	(51)	975	669	-	-
Income Taxes related to Operating Earnings (non-GAAP) reconciling items, excluding Tax Reform[(c)]	(73)	(395)	(336)	150	104
Tax Reform	-	(588)	-	-	-
Operating Earnings (non-GAAP)	**$ 502**	**$ 505**	**$ 514**	**$ 653**	**$ 642**
Depreciation and Amortization, pre-tax[(d)]	346	333	329	301	291
Interest Expense, pre-tax[(d) (e)]	72	48	83	120	120
Income Taxes[(d)]	139	286	275	361	387
Adjusted EBITDA (non-GAAP)	**$ 1,059**	**$ 1,172**	**$ 1,201**	**$ 1,435**	**$ 1,440**

(a) Effective January 1, 2018, unrealized gains (losses) on equity securities are recorded in Net Income instead of Other Comprehensive Income (Loss).

(b) Includes the financial impact from positions with forward delivery months.

(c) Income tax effect calculated at 28.11% statutory rate for 2018 and 40.85% statutory rate for prior years, except for NDT related activity which is calculated at the statutory rate plus a 20% tax on income (losses) from qualified NDT funds.

(d) Excludes amounts related to Operating Earnings (non-GAAP) reconciling items.

(e) Net of capitalized interest.

PSEG Enterprise/Other

Reconciling Items	2018	2017	2016	2015	2014
	Year Ended December 31, ($ millions, Unaudited)				
Net Income (Loss)	**$ 6**	**$ 122**	**$ (20)**	**$ 36**	**$ 33**
Lease Related Activity, pre-tax (PSEG Enterprise/Other)	8	77	147	-	-
Income Taxes related to Operating Earnings (non-GAAP) reconciling items, excluding Tax Reform[(a)]	(1)	(32)	(55)	-	-
Tax Reform	-	(147)	-	-	-
Operating Earnings (non-GAAP)	**$ 13**	**$ 20**	**$ 72**	**$ 36**	**$ 33**

(a) Income tax effect calculated at a combined leveraged lease effective tax rate.

Management uses Operating Earnings and Adjusted Earnings Before Interest, Taxes, Depreciation and Amortization (EBITDA) in addition to its Net Income reported in accordance with accounting principles generally accepted in the United States (GAAP). Operating Earnings and Adjusted EBITDA are non-GAAP financial measures that differ from Net Income. Non-GAAP Operating Earnings exclude the impact of returns (losses) associated with the Nuclear Decommissioning Trust (NDT), Mark-to-Market (MTM) accounting and material one-time items. Non-GAAP Adjusted EBITDA excludes the same items as our non-GAAP Operating Earnings measure as well as income tax expense, interest expense and depreciation and amortization.

Management uses non-GAAP Operating Earnings in its internal analysis, and in communications with investors and analysts, as a consistent measure for comparing PSEG s financial performance to previous financial results. Management believes non-GAAP Adjusted EBITDA is useful to investors and other users of our financial statements in evaluating operating performance because it provides them with an additional tool to compare business performance across companies and across periods. Management also believes that non-GAAP Adjusted EBITDA is widely used by investors to measure operating performance without regard to items such as income tax expense, interest expense and depreciation and amortization, which can vary substantially from company to company depending upon, among other things, the book value of assets, capital structure and whether assets were constructed or acquired. Non-GAAP Adjusted EBITDA also allows investors and other users to assess the underlying financial performance of our fleet before management s decision to deploy capital. The presentation of non-GAAP Operating Earnings and non-GAAP Adjusted EBITDA is intended to complement, and should not be considered an alternative to, the presentation of Net Income, which is an indicator of financial performance determined in accordance with GAAP. In addition, non-GAAP Operating Earnings and non-GAAP Adjusted EBITDA as presented in the tables

above may not be comparable to similarly titled measures used by other companies.

Table of Contents

Map, Directions and Transportation

Please note the **location** for this year s annual

meeting of stockholders. The meeting will take place at:

Newark Museum

49 Washington Street,

Newark, NJ

and begins at 1:00 PM

on Tuesday, April 16, 2019

Arrangements have been made to provide **free parking**

at the **Newark Museum.**

The **Newark Museum** in Newark, NJ is in close proximity to all major highways. You may obtain driving directions and public transportation information by calling **973-596-6550** or on the www.newarkmuseum.org Web site.

Please note: Large bags and backpacks must be left at the museum coat check.

You must present evidence that you are a stockholder in order to gain admittance to the meeting. If shares are held in the name of a broker, trustee, bank or other nominee, you must bring with you a proxy or letter from the broker, trustee, bank or nominee confirming your beneficial ownership of the shares. Each stockholder may be asked to present valid picture identification, such as a driver s license. Use of cameras, recording devices and other electronic devices will not be permitted at the meeting. For wheelchair and hearing-impaired seating, please see host/hostess for assistance.

Table of Contents

EQ Shareowner Services
P.O. Box 64945
St. Paul, MN 55164-0945

Address Change? Mark box, sign, and indicate changes below:

TO VOTE BY INTERNET OR

TELEPHONE, SEE REVERSE SIDE

OF THIS PROXY CARD.

TO VOTE BY MAIL AS THE BOARD OF DIRECTORS RECOMMENDS ON ALL ITEMS BELOW, SIMPLY SIGN, DATE, AND RETURN THIS PROXY CARD.

The Board of Directors Recommends a Vote FOR Items 1, 2 and 3.

1. ELECTION OF DIRECTORS:

		FOR	AGAINST	ABSTAIN			FOR	AGAINST	ABSTAIN
1.1	Willie A. Deese				**1.6**	Barry H. Ostrowsky			
1.2	William V. Hickey				**1.7**	Laura A. Sugg			

Please fold here Do not separate

1.3	Ralph Izzo				**1.8**	Richard J. Swift			
1.4	Shirley Ann				**1.9**	Susan Tomasky			

	Jackson					
1.5	David Lilley	**1.10**	Alfred W. Zollar			
2.	Advisory vote on the approval of executive compensation			For	Against	Abstain
3.	Ratification of the appointment of Deloitte & Touche LLP as Independent Auditor for the year 2019			For	Against	Abstain

THIS PROXY WHEN PROPERLY EXECUTED WILL BE VOTED AS DIRECTED OR, IF NO DIRECTION IS GIVEN, WILL BE VOTED AS THE BOARD RECOMMENDS.

Please indicate if you plan to attend the Annual Meeting by marking this box.

Date

Signature(s) in Box

Please sign exactly as your name(s) appears on Proxy. If held in joint tenancy, all persons should sign. Trustees, administrators, etc., should include title and authority. Corporations should provide full name of corporation and title of authorized officer signing the Proxy.

Table of Contents

Public Service Enterprise Group Incorporated

2019 Annual Meeting of Stockholders

Newark Museum

49 Washington Street, Newark, New Jersey

April 16, 2019 at 1:00 P.M.

(Registration begins at 12:00 P.M. Light refreshments will be available.)

For wheelchair and hearing-impaired seating, please see host/hostess for assistance.

You must present evidence that you are a stockholder in order to gain admittance to the meeting. If shares are held in the name of a broker, trustee, bank or other nominee, you must bring with you a proxy or letter from the broker, trustee, bank or nominee confirming your beneficial ownership of the shares. Each stockholder may be asked to present valid picture identification, such as a driver s license. Use of cameras, recording devices and other electronic devices will not be permitted at the meeting.

For electronic delivery of future proxy materials, please visit www.proxyconsent.com/peg.

Important notice regarding the Internet availability of proxy materials for the

Annual Meeting of Stockholders

The 2019 Proxy Statement and the 2018 Annual Report to Stockholders are available

at: **www.ezodproxy.com/pseg/2019/ar**

PUBLIC SERVICE ENTERPRISE GROUP INCORPORATED

PROXY FOR ANNUAL MEETING OF STOCKHOLDERS

April 16, 2019

THIS PROXY IS SOLICITED ON BEHALF OF THE BOARD OF DIRECTORS OF PSEG

The undersigned hereby appoints **Shirley Ann Jackson, Ralph Izzo and Richard J. Swift,** and each or any of them, proxies of the undersigned, each with full power of substitution, to vote in their discretion (subject to any directions indicated on the reverse side of this proxy) at the Annual Meeting of Stockholders of Public Service Enterprise Group Incorporated (PSEG) to be held on April 16, 2019 and at all adjournments or postponements thereof, upon all matters which may properly come before the meeting or any adjournment or postponement thereof, including the proposals set

forth in the Notice of Meeting and Proxy Statement, receipt of which is hereby acknowledged. Said proxies are instructed to vote as set forth on the reverse side hereof with respect to said proposals.

Shares represented by this proxy will be voted in accordance with recommendations of the Board of Directors of PSEG as stated on the reverse side, unless otherwise indicated on the reverse, in which case they will be voted as marked. Information pertaining to each proposal is included in the Proxy Statement under proposals corresponding to the item numbers set forth on the reverse side.

Please mark your proxy on the reverse side,

sign and date it, and return it promptly in the envelope provided.

Vote by Internet, Telephone or Mail

24 Hours a Day, 7 Days a Week

Your phone or Internet vote authorizes the named proxies to vote your shares

in the same manner as if you marked, signed, dated and returned your proxy card.

INTERNET/MOBILE	**PHONE**	**MAIL**
www.proxypush.com/peg	**1-866-883-3382**	
Use the Internet to vote your proxy	Use a touch-tone telephone to	Mark, sign and date your proxy card and return it in the
until 11:59 p.m. (ET) on	vote your proxy until 11:59 p.m. (ET)	postage-paid envelope provided.
April 15, 2019.	on April 15, 2019.	

If you vote your proxy by Internet or by Telephone, you do NOT need to mail back your Proxy Card.