BADGER METER INC
Form SC 13G/A
February 11, 2005

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

SCHEDULE 13G

Under the Securities Exchange Act of 1934

(Amendment No. 8)

BADGER METER, INC.

(Name of Issuer)

Common Stock, $1.00 par value

(Title of Class of Securities)

056525108

(CUSIP Number)

December 31, 2004

(Date of Event Which Requires Filing of this Statement)

Check the appropriate box to designate the rule pursuant to which this Schedule is filed:

[X] Rule 13d-1(b)
[ ] Rule 13d-1(c)
[ ] Rule 13d-1(d)

* The remainder of this cover page shall be filled out for a reporting person s initial filing on this form with respect to the subject class of securities, and for any subsequent amendment containing information which would alter the disclosures provided in a prior cover page.

The information required in the remainder of this cover page shall not be deemed to be filed for the purpose of Section 18 of the Securities Exchange Act of 1934 (Act) or otherwise subject to the liabilities of that section of the Act but shall be subject to all other provisions of the Act.

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1. NAME OF REPORTING PERSON

MARSHALL & ILSLEY CORPORATION

I.R.S. IDENTIFICATION NO. OF ABOVE PERSON

39-0968604

2. CHECK THE APPROPRIATE BOX IF A MEMBER OF A GROUP

(a) [ ]
(b) [ ]

3. SEC USE ONLY

4. CITIZENSHIP OR PLACE OF ORGANIZATION

WISCONSIN

NUMBER OF SHARES BENEFICIALLY OWNED BY EACH REPORTING PERSON WITH:

5. SOLE VOTING POWER

629,620

6. SHARED VOTING POWER

117,978*

7. SOLE DISPOSITIVE POWER

628,820

8. SHARED DISPOSITIVE POWER

118,778*

9 AGGREGATE AMOUNT BENEFICIALLY OWNED BY EACH REPORTING PERSON

747,598*

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*Beneficial ownership of 103,578 shares is specifically disclaimed. See Item 4.

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10. CHECK IF THE AGGREGATE AMOUNT IN ROW (9) EXCLUDES CERTAIN SHARES [ ]

Not applicable

11. PERCENT OF CLASS REPRESENTED BY AMOUNT IN ROW (9)

11.2%

12. TYPE OF REPORTING PERSON

HC

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ITEM 1 (a) NAME OF ISSUER

BADGER METER, INC.

(b) ADDRESS OF ISSUER S PRINCIPAL EXECUTIVE OFFICES

4545 W. BROWN DEER ROAD, MILWAUKEE, WI 53223

ITEM 2 (a) NAME OF PERSON FILING

MARSHALL & ILSLEY CORPORATION

(b) ADDRESS OF PRINCIPAL BUSINESS OFFICE OR, IF NONE, RESIDENCE

770 NORTH WATER STREET, MILWAUKEE, WISCONSIN 53202

(c) CITIZENSHIP

WISCONSIN CORPORATION

(d) TITLE OF CLASS OF SECURITIES

COMMON STOCK

(e) CUSIP NUMBER

056525108

ITEM 3. IF THIS STATEMENT IS FILED PURSUANT TO SECTIONS 13d-1(b) OR 13d-2(b) or (c), CHECK WHETHER THE PERSON FILING IS A:

(a)	[ ]	Broker or dealer registered under Section 15 of the Act (15 U.S.C. 78o);
(b)	[ ]	Bank as defined in Section 3(a)(6) of the Act (15 U.S.C. 78c);
(c)	[ ]	Insurance company as defined in Section 3(a)(19) of the Act (15 U.S.C. 78c);
(d)	[ ]	Investment company registered under Section 8 of the Investment Company Act of 1940 (15 U.S.C. 80a-8);
(e)	[ ]	An investment adviser in accordance with Section 13d-1(b)(1)(ii)(E);
(f)	[ ]	An employee benefit plan or endowment fund in accordance with Section 13d-1(b)(1)(ii)(F);

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ITEM 3. Continued	(g)	[X]	A parent holding company or control person in accordance with Section 13d-1(b)(1)(ii)(G);
	(h)	[ ]	A savings association defined in Section 3(b) of the Federal Deposit Insurance Act (12 U.S.C. 1813);
	(i)	[ ]	A church plan that is excluded from the definition of an investment company under Section 3(c)(14) of the Investment Company Act of 1940 (15 U.S.C. 80a-3);
	(j)	[ ]	Group, in accordance with Section 13d-1(b)(1)(ii)(J).

ITEM 4. OWNERSHIP

(a)	Amount Beneficially Owned		747,598*
(b)	Percent of Class		11.2%
(c)	Number of Shares as to which the person has:		
	(i)	Sole power to vote or to direct the vote	629,620
	(ii)	Shared power to vote or to direct the vote	117,978*
	(iii)	Sole power to dispose or to direct the disposition of	628,820*
	(iv)	Shared power to dispose or to direct the disposition of	118,778*

*Includes 103,578 shares held in one or more employee benefit plans where Marshall & Ilsley Trust Company N.A., as custodian, may be viewed as having voting or dispositive authority in certain situations pursuant to Department of Labor regulations or interpretations or federal case law. Pursuant to Rule 13d-4 under the Act, inclusion of such shares in this statement shall not be construed as an admission that the Reporting Person or its subsidiaries are, for purposes of Sections 13(d) or 13(g) of the Act, the beneficial owners of such securities.

ITEM 5 OWNERSHIP OF FIVE PERCENT OR LESS OF A CLASS

If this statement is being filed to report the fact that as of the date hereof the reporting person has ceased to be the beneficial owner of more than five percent of the class of securities, check the following [ ]

ITEM 6 OWNERSHIP OF MORE THAN FIVE PERCENT ON BEHALF OF ANOTHER PERSON

Trust beneficiaries and customers are known to have the right to receive or the power to direct the receipt of dividends from, or the proceeds from the sale of, the subject securities. The following person is believed to possess such an interest relating to more than 5% of the class of subject securities:

Badger Meter Company Stock Fund

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ITEM 7. IDENTIFICATION AND CLASSIFICATION OF THE SUBSIDIARY WHICH ACQUIRED THE SECURITY BEING REPORTED ON BY THE PARENT HOLDING COMPANY

See Exhibit 1

ITEM 8. IDENTIFICATION AND CLASSIFICATION OF MEMBERS OF THE GROUP

Not Applicable

ITEM 9. NOTICE OF DISSOLUTION OF GROUP

Not Applicable

ITEM 10. CERTIFICATION

By signing below I certify that, to the best of my knowledge and belief, the securities referred to above were acquired and are held in the ordinary course of business and were not acquired and are not held for the purpose of or with the effect of changing or influencing the control of the issuer of the securities and were not acquired and are not held in connection with or as a participant in any transaction having that purpose or effect.

SIGNATURE

After reasonable inquiry and to the best of my knowledge and belief, I certify that the information set forth in this statement is true, complete and correct.

Dated as of the 11th day of February, 2005.

/s/ Randall J. Erickson

Randall J. Erickson

Senior Vice President, General Counsel and Secretary

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Exhibit 1

ITEM 7 INFORMATION

Marshall & Ilsley Corporation is the parent holding company of Marshall & Ilsley Trust Company N.A., a bank as defined in Section 3(a)(6) of the Act.

3.5 5.0Expected volatility 41.2% - 41.9% 20.0% 20.0%Risk-free interest rate 4.4% - 4.6% 4.2% - 5.0% 3.4%Dividend yield 0.0% 1.0% 0.9%

(a) Assumptions are based on the Company's future expectations.

(b) Assumptions were calculated based on the Company being a wholly-owned subsidiary of Alberto-Culver and using historical assumptions of Alberto-Culver, such as expected volatility and dividend yield of Alberto-Culver's common stock at the time.

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 that have been granted stock options under stock option plans of Alberto-Culver. Expected volatility is derived by using the average volatility of similar companies since it is not practicable to estimate the Company's expected volatility due to a lack of trading history. The risk-free interest rate is based on the zero-coupon U.S. Treasury issue as of the date of the grant. Since the Company does

not expect to pay dividends, the dividend yield is 0%.

The weighted average fair value of the Company's stock options issued to Company employees at the date of grant in fiscal years 2007, 2006 and 2005 was $4.11, $9.48 and $9.41 per option, respectively.

The total intrinsic value of options exercised during fiscal years 2007, 2006 and 2005 was $5.9 million, $7.5 million and $11.8 million, respectively, and the tax benefit realized for the tax deductions from these option exercises was $2.3 million, $2.5 million and $4.3 million, respectively. The total cash received from these option exercises was $1.7 million during fiscal year 2007. Prior to the Separation Transactions the

total cash received by the Company from these option exercises was zero as the cash went to Alberto-Culver. The total fair value of stock options issued to Company employees that vested during fiscal years 2007, 2006 and 2005 was $7.3 million, $4.4 million and $4.3 million, respectively.

At September 30, 2007, approximately $10.6 million of total unrecognized compensation cost related to non-vested stock option awards is expected to be recognized over the weighted average period of 3.1 years.

Stock Awards

Restricted Stock Awards

The Company grants restricted stock awards to employees under the 2003 Restricted Stock Plan (the "RSP"). A restricted stock award is an award of shares of the Company's common stock that is subject to time-based vesting during a specified period. Restricted stock awards are independent of option grants and are generally subject to forfeiture if employment terminates prior to the vesting of the awards. Participants have full voting and dividend rights with respect to shares of stock awards.

The RSP provides for the grant of restricted stock awards for up to 900,000 shares of the Company's common stock to key employees (including officers and directors who are also employees) of the Company. Restricted stock awards issued under the RSP generally vest ratably over a five year period and are subject to forfeiture until the five year vesting period is complete.

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

The following table presents a summary of the activity for the Company's restricted stock awards:

Restricted Stock Awards	Number of Shares (In Thousands)	Weighted Average Fair Value Per Share	Weighted Average Remaining Vesting Term (In Years)
Non-vested at September 30, 2006	31	$ 38.95	
Accelerated vesting (a)	(31)	38.95	
Granted	350	8.10	
Vested			
Forfeited			
Non-vested at September 30, 2007	350	$ 8.10	4.3

(a) Per the Employee Matters Agreement, in connection with the Separation Transactions, all Alberto-Culver restricted stock awards, which were held by the Company's employees, became vested immediately.

For fiscal year 2007, approximately 31,000 restricted stock awards vested, all in connection with the Separation Transactions. The remaining unrecognized compensation cost related to unvested restricted stock awards at September 30, 2007 was $2.4 million and the weighted average period of time over which this cost will be recognized is 4.3 years.

Restricted Stock Units

The Company grants RSUs, which generally vest less than one year from date of grant, to its non-employee directors pursuant to its 2007 Plan. RSUs are independent of option grants and are generally subject to forfeiture if service terminates prior to the vesting of the units. Participants have no voting and dividend rights with respect to shares of RSUs.

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

Under the 2007 Plan, the Company will issue to non-employee directors the shares of common stock underlying the vested RSUs on the date, which is six months after the effective date of director's termination of service as a member of the board of directors of the Company. The 2007 Plan requires the Company to settle the vested RSUs with common stock and not with a cash equivalent.

The following table presents a summary of the activity for the Company's RSUs for the year ended September 30, 2007 (shares in thousands):

Restricted Stock Units	Number of Shares	Weighted Average Fair Value Per Share	Weighted Average Remaining Vesting Term (In Years)
Non-vested at September 30, 2006		$	
Granted	79	8.81	
Vested	(79)	8.81	
Forfeited			
Non-vested at September 30, 2007		$	

During fiscal year 2007, all RSUs vested. Therefore, there is no remaining unrecognized compensation cost to be expensed as of September 30, 2007.

7. Allowance for Doubtful Accounts

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

	Year Ended September 30,		
	2007	2006	2005
Balance at beginning of period	$ 2,246	$ 2,073	$ 2,500
Bad debt expense	2,632	2,403	1,754
Uncollected accounts written off, net of recoveries	(2,568)	(2,252)	(2,292)
Allowance for doubtful accounts of acquired companies	254	22	111
Balance at end of period	$ 2,564	$ 2,246	$ 2,073

8. Property and Equipment, Net

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

	September 30,	
	2007	2006
Land	$ 9,773	$ 9,632
Buildings and building improvements	48,885	48,510
Leasehold improvements	118,816	96,479
Furniture, fixtures and equipment	192,420	175,203
Total property and equipment, gross	369,894	329,824
Less accumulated depreciation and amortization	(215,826)	(187,089)
Total property and equipment, net	$ 154,068	$ 142,735

Depreciation expense totaled $38.9 million, $35.0 million and $30.6 million in fiscal years 2007, 2006 and 2005, respectively.

9. Goodwill and Other Intangibles

The change in the carrying amounts of goodwill by operating segment for the fiscal years 2007 and 2006 is as follows (in thousands):

	Sally Beauty Supply	Beauty Systems Group	Total
Balance at September 30, 2005	$ 10,089	$ 343,436	$ 353,525
Additions, net of purchase price adjustments		9,087	9,087
Foreign currency translation	71	2,010	2,081
Balance at September 30, 2006	10,160	354,533	364,693
Additions, net of purchase price adjustments	30,832	4,418	35,250
Foreign currency translation	1,531	5,149	6,680
Balance at September 30, 2007	$ 42,523	$ 364,100	$ 406,623

As described in Note 16, the $30.8 million increase in Sally Beauty Supply's goodwill in fiscal year 2007 was principally attributable to the acquisition of Salon Services in February 2007, net of purchase price adjustments. The $4.4 million increase in BSG's goodwill in fiscal year 2007 was principally attributable to several smaller acquisitions and purchase price adjustments for prior years' acquisitions. The $9.1 million increase in BSG's goodwill in fiscal year 2006 was principally attributable to the acquisition of Salon Success in June 2006, net of purchase price adjustments for prior years' acquisitions.

The following table provides the gross carrying value and accumulated amortization for intangible assets with indefinite lives and intangible assets subject to amortization by operating segment at September 30, 2007 and 2006 (in thousands):

	Sally Beauty Supply	Beauty Systems Group	Total
Balance at September 30, 2007:			
Intangible assets with indefinite lives:			
Trade names	$ 15,802	$ 34,886	$ 50,688
Other intangibles		6,053	6,053
Total	15,802	40,939	56,741
Intangible assets subject to amortization:			
Gross carrying amount	540	25,128	25,668
Accumulated amortization	(18)	(11,886)	(11,904)
Net value	522	13,242	13,764
Total intangible assets, net	$ 16,324	$ 54,181	$ 70,505
Balance at September 30, 2006:			
Intangible assets with indefinite lives:			
Trade names	$ 713	$ 34,480	$ 35,193
Other intangibles		6,053	6,053
Total	713	40,533	41,246
Intangible assets subject to amortization:			
Gross carrying amount		20,187	20,187
Accumulated amortization		(8,195)	(8,195)
Net value		11,992	11,992
Total intangible assets, net	$ 713	$ 52,525	$ 53,238

The increase in Sally Beauty Supply's trade names and intangible assets subject to amortization in fiscal year 2007 was primarily due to the acquisition of Salon Services. The increase in BSG's trade names and intangible assets subject to amortization in fiscal year 2006 was primarily due to the acquisition of Salon Success. Amortization expense totaled $3.7 million, $3.0 million and $3.3 million in fiscal years 2007, 2006 and 2005, respectively. As of September 30, 2007, future amortization expense related to intangible assets subject to amortization is estimated to be as follows (in millions):

Fiscal Year:	
2008	$ 4.2
2009	3.2
2010	2.5
2011	1.9
2012	1.0
Thereafter	1.0
	$ 13.8

The weighted average amortization period is approximately four years.

10. Accounts Payable and Accrued Expenses

Accounts payable at September 30, 2006 include book cash overdrafts of $6.5 million. There were no book cash overdrafts at September 30, 2007.

Accrued expenses consist of the following (in thousands):

	September 30,	
	2007	2006
Compensation and benefits	$ 53,440	$ 55,886
Interest payable	34,540	
Deferred revenue	11,209	9,823
Rental obligations	9,575	9,114
Property and other taxes	6,495	7,620
Insurance reserves	3,615	
Acquisition related payables	3,202	8,714
Operating accruals and other	31,750	22,899
Total accrued expenses	$ 153,826	$ 114,056

11. Lease Commitments and Contingencies

Commitments

The Company's principal leases relate to retail stores and warehousing properties. At September 30, 2007, future minimum payments under non-cancelable operating leases, net of sublease income, are as follows (in thousands):

Fiscal Year:	
2008	$ 110,561
2009	94,439
2010	74,884
2011	57,179
2012	35,684
Thereafter	56,881
	$ 429,628

Certain leases require the Company to pay its respective portion of real estate taxes, insurance, maintenance and special assessments. Also, certain of the Company's leases include renewal options and escalation clauses.

During the third quarter of fiscal year 2007, the Company exercised an option to purchase a warehouse building for approximately $7.6 million that was subsequently sold for approximately $8.0 million. In connection with the sale of the building, the Company entered into a lease agreement under which it will pay monthly rent for continued use of the building. The lease has an initial term of 24 months and the monthly rent is subject to certain escalation clauses over the life of the lease.

Total rental expense for operating leases amounted to approximately $147.3 million, $133.5 million and $123.1 million in fiscal years 2007, 2006 and 2005, respectively, and is included in selling, general and administrative expenses in the consolidated statements of earnings. Included in this amount is $0.8 million,

$0.7 million and $1.3 million for contingent rents for the years ended September 30, 2007, 2006 and 2005, respectively.

Contingencies

Legal Proceedings and Other

There were no material legal proceedings pending against the Company or its subsidiaries, as of September 30, 2007. The Company is involved in various claims and lawsuits incidental to the conduct of its business in the ordinary course. The Company does not believe that the ultimate resolution of these matters will have a material adverse impact on the Company's consolidated financial position, statements of earnings or cash flows.

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

Liabilities for loss contingencies, arising from claims, assessments, litigation, fines, penalties and other sources are recorded when it is probable that a liability has been incurred and the amount of the assessment can be reasonably estimated. The Company has no significant liabilities for loss contingencies at September 30, 2007 and 2006.

12. Long-Term Debt

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

		September 30, 2007	Maturity dates (Fiscal Year)	Interest Rates
ABL facility	$	11,400	2012	(i) PRIME and up to 0.50% or; (ii) LIBOR (a) plus (1.00% to 1.50%)
Term Loan A		142,500	2013	(i) PRIME plus (1.00% to 1.50%) or; (ii) LIBOR plus (2.00% to 2.50%)
Term Loan B		910,800	2014	(i) PRIME plus (1.25% to 1.50%) or; (ii) LIBOR plus (2.25% to 2.50%)
Total	$	1,064,700		
Senior notes	$	430,000	2015	9.25%
Senior subordinated notes		280,000	2017	10.50%
Total	$	710,000		
Capitalized leases and other	$	1,041		
Less: current portion		(17,147)		
Total long-term debt	$	1,758,594		

(a) London Interbank Offered Rate ("LIBOR")

In connection with the Separation Transactions on November 16, 2006, the Company, through its subsidiaries, Sally Investment Holdings LLC and Sally Holdings LLC, incurred $1,850.0 million of indebtedness by: (i) drawing on a $400.0 million revolving (asset-based lending ("ABL")) facility in an amount equal to $70.0 million; (ii) entering into two term loan facilities (term loans A and B) in an aggregate amount of $1,070.0 million; (iii) and issuing senior notes in an aggregate amount of $430.0 million and senior subordinated notes in an aggregate amount of $280.0 million. The Company incurred approximately $58.5 million in costs related to the issuance of the debt, which was capitalized and is being amortized to interest expense over the life of the related debt instruments. Proceeds from the initial debt were used primarily to pay the $25.00 per share special cash dividend to holders of record of Alberto-Culver stockholders and for certain expenses associated with the Separation Transactions.

The ABL facility provides for senior secured revolving loans up to a maximum aggregate principal amount of $400.0 million, subject to borrowing base limitations. The availability under the ABL facility is subject to a borrowing base calculation, which is based on specified percentages of the value of eligible inventory and eligible accounts receivables, subject to certain reserves and other adjustments and reduced by certain outstanding letters of credit. At September 30, 2007, the Company had $334.6 available for additional borrowings under the ABL facility. Additionally, the Company is required to pay a commitment fee ranging from 0.20% to 0.35% on the unused portion of the ABL facility. At September 30, 2007, the commitment fee rate was 0.20%.

The ABL facility contains a covenant requiring Sally Holdings and its subsidiaries to maintain a fixed-charge coverage ratio of at least 1.0 to 1.0 when availability under the ABL facility falls below $40.0 million. The fixed-charge coverage ratio is defined as the ratio of EBITDA (as defined in the agreement underlying the ABL facility, or Credit Agreement EBITDA), less unfinanced capital expenditures to fixed charges (as included in the definition of the fixed-charge coverage ratio in the agreement governing the ABL facility). The ABL facility uses fixed amounts for Credit Agreement EBITDA for periods preceding the Separation Transactions.

The term loan facilities consist of (i) a $150.0 million senior term loan A facility and (ii) a $920.0 million senior term loan B facility. Interest is payable on a quarterly basis.

The term loan facilities contain a covenant requiring Sally Holdings and its subsidiaries to comply with maximum consolidated secured leverage ratio levels, which will decline over time. The consolidated secured leverage ratio will be tested quarterly, with a maximum ratio of 5.25 for the four quarter period ending September 30, 2007. The consolidated secured leverage ratio is a ratio of net consolidated secured debt to Consolidated EBITDA (as defined in the underlying agreements).

The term loan facilities and the ABL facility are secured by substantially all of our assets, those of Sally Investment Holdings LLC, a wholly-owned subsidiary of Sally Beauty and the direct parent of Sally Holdings, those of our domestic subsidiaries and, in the case of the ABL facility, those of our Canadian subsidiaries. The term loan facilities may be prepaid at our option at any time without premium or penalty and is subject to mandatory prepayment in an amount equal to 50% of excess cash flow (as defined in the agreement governing the term loan facilities) for any fiscal year (commencing in fiscal year 2008) unless a specified leverage ratio is met and 100% of the proceeds of specified asset sales that are not reinvested in the business or applied to repay borrowings under the ABL facility.

The senior notes and senior subordinated notes are unsecured obligations of the issuers and are guaranteed on a senior basis (in the case of the senior notes) and on a senior subordinated basis (in the case of the senior subordinated notes) by each material domestic subsidiary of the Company. The senior notes and the senior subordinated notes carry optional redemption features whereby the Company has the option to redeem the notes on or before November 15, 2010 and November 15, 2011, respectively, at par

plus a premium, plus accrued and unpaid interest, and on or after November 15, 2010 and November 15, 2011, respectively, at par plus a premium declining ratably to par, plus accrued and unpaid interest. Interest on the senior notes and senior subordinated notes is payable semi-annually.

On November 24, 2006, the Company entered into two interest rate swap agreements related to $500.0 million of the $1,070.0 million term loans A and B due in 2012 and 2013, respectively. See Note 13 for further information on the interest rate swap agreements.

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

Fiscal Year:		
2008	$	16,700
2009		24,200
2010		24,200
2011		39,200
2012		95,600
Thereafter		1,574,800
	$	1,774,700
Capital leases and other		1,041
Less: current portion		(17,147)
Total	$	1,758,594

At September 30, 2007 and 2006, the Company had no off balance sheet financing arrangements other than operating leases incurred in the ordinary course of business as disclosed in Note 11, and outstanding letters of credit related to inventory purchases and self-insurance programs which totaled $9.4 million and $3.0 million, respectively, at September 30, 2007 and 2006.

Sally Beauty Holdings, Inc. Stand-Alone Financial Information

Sally Beauty Holdings, Inc. is a holding company and has no material assets or operations other than ownership of equity interests of its subsidiaries. The Company's operations are conducted almost entirely through its subsidiaries. As such, Sally Beauty depends on its subsidiaries for cash to meet its obligations or to pay dividends. The agreements underlying the Company's credit facilities contain terms, which significantly restrict the ability of Sally Beauty's subsidiaries to pay dividends or otherwise transfer assets to Sally Beauty.

Sally Investment Holdings LLC, which is a wholly-owned subsidiary of Sally Beauty and the direct parent of Sally Holdings LLC, does not have any assets or operations of any kind. Prior to the Separation Transactions, Sally Beauty had no assets or operations of any kind. Summary financial data for Sally Beauty

Holdings, Inc. on a stand-alone basis as of and for the year ended September 30, 2007 is as follows (amounts in thousands):

		2007
Balance Sheet		
Assets:		
Deferred income tax assets	$	313
Other		264
Investment in subsidiaries		(761,461)
Total assets	$	(760,884)
Liabilities:		
Deferred income tax liabilities	$	22
Income taxes payable		6,649
Other		155
Total liabilities		6,826
Stockholders' deficit:		(767,710)
Total liabilities and stockholders' deficit	$	(760,884)
Statement of Earnings		
Operating loss	$	(7,118)
Loss before provision for income taxes		(7,118)
Provision (benefit) for income taxes		(3,048)
Net loss	$	(4,070)
Statement of Cash Flows		
Net cash used by operating activities	$	(1,931)
Net cash provided by financing activities		
Distribution from Sally Holdings LLC		1,809,740
Proceeds from exercise of stock options		1,717
Proceeds from equity, net of financing costs		532,622
Special cash dividend paid		(2,342,148)
Net cash provided by financing activities		1,931
Net change in cash		
Cash and cash equivalents, beginning of year		
Cash and cash equivalents, end of year	$	

13. Interest Rate Swaps

On November 24, 2006, the Company entered into two interest rate swap agreements with notional amounts of $150.0 million and $350.0 million. These agreements expire on November 24, 2008 and 2009, respectively. These agreements allow the Company to convert a portion of its variable rate interest to a fixed rate at 4.9975% plus (2.00% to 2.50%) and 4.94% plus (2.00% to 2.50%), respectively. These interest rate swap agreements relate to $500.0 million of the $1,070.0 million term loans A and B due in fiscal years 2013 and 2014, respectively, to manage the Company's cash flow risk associated with changing interest rates. The Company will pay fixed rates of 4.9975% plus (2.00% to 2.50%) and 4.94% plus (2.00% to 2.50%) on a quarterly basis in exchange for receiving floating rate payments based on the

three-month LIBOR rate.

The Company utilizes interest rate swaps to manage the cash flow risk associated with changing interest rates and accounts for them under SFAS 133, which requires that all derivatives be marked to market (fair value). The Company does not purchase or hold any derivative instruments for trading purposes. The interest rate swap agreements do not currently qualify as hedges and, therefore, the change in fair value of the interest rate swap agreements are recorded in the consolidated statements of earnings. The fair value of the swap agreements at September 30, 2007 was recorded as a liability of approximately $3.0 million.

Fair value estimates presented for the swap agreements are based on third-party information and were determined using proprietary models based upon well-recognized financial principles and reasonable estimates about relevant future market conditions.

The counter-parties to these swap instruments are large financial institutions which the Company believes are of high quality creditworthiness. While the Company may be exposed to potential losses due to the credit risk of nonperformance by these counter-parties, such losses are not anticipated.

The marked to market impact of the swap arrangements on interest expense was an increase of approximately $3.0 million in fiscal year 2007. Changes in the fair value of the interest rate swap agreements will either increase or decrease the Company's net interest expense and therefore may affect the Company's earnings.

14. 401(k) and Profit Sharing Plan

The Company sponsors the Sally Beauty 401(k) and Profit Sharing Plan (the "401k Plan"), which is a qualified defined contribution plan. The 401k Plan covers employees of the Company who meet certain eligibility requirements and who are not members of a collective bargaining unit. Under the 401k Plan, employees may contribute a percentage of their annual compensation to the 401k Plan up to certain maximums, as defined by the 401k Plan and by the Internal Revenue Service ("IRS"). The Company currently matches a percentage of employee contributions. Prior to the Separation Transactions, employees of the Company participated in the Sally Beauty 401(k) Savings Plan. The Company recognized expense of $3.3 million, $2.1 million and $2.2 million in fiscal years 2007, 2006 and 2005, respectively, related to these plans. These amounts are included in selling, general and administrative expenses.

In addition, pursuant to the 401k Plan, employees who meet certain eligibility requirements and who are not members of a collective bargaining unit may participate in the profit sharing program. The Company's profit sharing contributions to the 401k Plan are determined by the Compensation Committee of its board of directors. Prior to the Separation Transactions, employees of the Company participated in the Alberto-Culver Profit Sharing Plan. The Company's contributions to the plan were determined at the discretion of the Alberto-Culver board of directors. The Company recognized expense of $6.2 million, $8.6 million and $9.0 million in fiscal years 2007, 2006 and 2005, respectively, related to these plans. These amounts are included in selling, general and administrative expenses.

15. Income Taxes

In conjunction with the Separation Transactions, the Company became a separate entity for tax reporting purposes. Prior to the Separation Transactions, the Company was included in the U.S. Federal income tax return of Alberto-Culver; however, income taxes are provided in the accompany consolidated historical financial statements as if the Company was filing a separate return.

The provision for income taxes for the fiscal years 2007, 2006 and 2005 consists of the following (in thousands):

	Year Ended September 30,		
	2007	2006	2005
Current:			
Federal	$ 28,595	$ 57,025	$ 57,244
Foreign	6,446	3,141	1,288
State	3,545	9,197	6,334
Total current portion	38,586	69,363	64,866
Deferred:			
Federal	517	1,053	7,319
Foreign	(319)	(255)	1,246
State	(663)	(245)	(277)
Total deferred portion	(465)	553	8,288
Total provision for income tax	$ 38,121	$ 69,916	$ 73,154

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

	Year Ended September 30,		
	2007	2006	2005
Statutory tax rate	35.0%	35.0%	35.0%
State income taxes, net of federal tax benefit	2.1	3.2	2.1
Effect of foreign operations	(0.4)	(0.1)	1.5
Nondeductible transaction costs	6.9		
Other, net	2.5	0.7	
Effective tax rate	46.1%	38.8%	38.6%

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

	September 30,	
	2007	2006
Deferred tax assets attributable to:		
Share-based compensation expense	$ 7,810	$ 4,918
Accrued expenses	15,520	7,770
Inventory adjustments	2,437	2,557
Foreign loss carryforwards	8,718	7,303
Long-term liabilities	1,319	1,621
Other	1,439	
Total deferred tax assets	37,243	24,169
Valuation allowance	(9,823)	(6,977)
Total deferred tax assets, net	27,420	17,192
Deferred tax liabilities attributable to:		
Depreciation and amortization	42,391	28,194
Other income taxes		261
Total deferred tax liabilities	42,391	28,455
Net deferred tax liability	$ 14,971	$ 11,263

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

In fiscal year 2007, the Company made adjustments in connection with the reconciliation of tax balances transferred to the Company in connection with the Separations Transactions. This amount was included in the settlement of intercompany agreements with Alberto-Culver, as an adjustment to the Company's retained deficit.

Domestic earnings before provision for income taxes were $70.6 million, $174.6 million and $192.0 million in fiscal years 2007, 2006 and 2005, respectively. Foreign operations had earnings before provision for income taxes of $12.0 million in fiscal year 2007, earnings before provision for income taxes of $5.5 million in fiscal year 2006 and a loss before provision for income taxes of $2.4 million in fiscal year 2005.

Tax reserves are evaluated and adjusted as appropriate, while taking into account the progress of audits of various taxing jurisdictions. Management does not expect the outcome of tax audits to have a material adverse effect on the Company's financial condition, results of operations or cash flow.

Undistributed earnings of the Company's foreign operations are intended to remain permanently invested to finance anticipated future growth and expansion. Accordingly, no U.S. income taxes have been provided on those earnings at September 30, 2007.

The transactions separating us from Alberto-Culver were intended to qualify as a reorganization under Section 368(a)(1)(D) of the Code and a distribution eligible for non-recognition under Sections 355(a) and 361(c) of the Internal Revenue Code of 1986, as amended (the "Code"). In connection with the share distribution of Alberto-Culver common stock in the Separation Transactions, we received: (i) a private

letter ruling from the IRS; and (ii) an opinion of Sidley Austin LLP, counsel to Alberto-Culver, in each case, to the effect that the transactions qualify as a reorganization under Section 368(a)(1)(D) of the Code and a distribution eligible for non-recognition under Sections 355(a) and 361(c) of the Code. Certain internal restructurings also occurred at or immediately prior to the Separation Transactions. As a result of the internal restructurings and Separation Transactions, the Company inherited the federal tax identification number of the old Alberto-Culver parent for U.S. federal income tax purposes.

A tax allocation agreement was signed as part of the Separation Transactions. The agreement provides generally that the Company is responsible for its pre-separation income tax liabilities, calculated on a stand-alone basis, and Alberto-Culver is responsible for the remainder.

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

In the event an additional U.S federal income tax liability related to the period prior to the Separation Transactions were determined, the Company will be jointly and severally liable for these taxes, and there can be no assurance that Alberto-Culver would be able to fulfill its indemnification obligations to the Company under the tax allocation agreement if Alberto-Culver was determined to be responsible for these taxes thereunder.

The IRS has previously audited the consolidated federal income tax returns of Alberto-Culver through the fiscal year ending September 30, 2004. The Company has not recorded a reserve for Alberto-Culver related liability because the Company believes any exposure is immaterial.

16. Acquisitions

On February 15, 2007, the Company entered into and completed an Agreement for the Sale and Purchase of the Entire Issued Share Capital of Chapelton 21 Limited (the "Agreement"), a private company limited by shares and incorporated in Scotland ("Salon Services") by and among Ogee Limited, an indirect subsidiary of the Company, and the registered shareholders of Salon Services. Pursuant to the Agreement, the Company acquired all of the issued share capital of Salon Services for an aggregate cash purchase price of approximately $57.7 million. Certain of the Company's subsidiaries financed the purchase price through a draw down of approximately $57.0 million under the ABL facility. In addition, the Company extinguished approximately $3.9 million of Salon Services' debt. Salon Services, through its direct and indirect subsidiaries including Salon Services (Hair and Beauty Supplies) Ltd., supplies professional hair and beauty products primarily to salon and spa operators and independent hair and beauty professionals in the United Kingdom, Germany, Ireland, Spain and Norway. Goodwill of $29.3 million and certain identifiable intangible assets of $17.6 million were recorded as a result of acquisition and are not expected to be deductible for tax purposes. Of this amount, $14.4 million was assigned to registered trade names and $3.2 million to other identifiable intangible assets, which will be amortized over a weighted average life of approximately five years. The acquisition was accounted for using the purchase method and, accordingly, the results of operations of Salon Services have been included in the consolidated financial statements from the date of acquisition. Salon Services is included in the Sally Beauty Supply segment. Pro-forma information for Salon Services is not provided since it is not material to the Company's consolidated results of operations. The purchase price of Salon Services has been allocated to assets acquired and liabilities assumed based on their estimated fair values at the date of acquisition. We expect that the final valuation of the acquired assets and liabilities will be completed during fiscal year 2008.

In addition, during fiscal year 2007 the Company made five other acquisitions, which were accounted for using the purchase method. None of these acquisitions individually had a material impact on the

Company's consolidated results of operations. The results of operations for one of the acquisitions are included in the Sally Beauty Supply segment. Such acquisition included the recording of: (i) goodwill in the amount of $1.5 million; and (ii) certain intangible assets of $0.6 million. The results of operations for the remaining acquisitions are included in the BSG segment, and these acquisitions included the recording of: (i) goodwill in the amount of $3.7 million; and (ii) certain intangible assets of $1.4 million. The intangible assets will be amortized over a weighted average life of approximately one year. We expect that the final valuation of the acquired assets and liabilities related to these transactions will be completed during fiscal year 2008.

On June 8, 2006, the Company acquired Salon Success, a U.K. based distributor of professional beauty products, in order to expand the geographic area served by BSG, for a total purchase price as of September 30, 2007, of $23.2 million. Approximately $1.8 million of the purchase price was to be paid in equal annual amounts over the three years following the closing of the acquisition. In accordance with the purchase agreement, additional consideration of up to $2.1 million, plus interest, may be paid over the same three-year period based on sales to a specific customer. As of September 30, 2007, approximately $1.2 million has been paid pursuant to this agreement. Goodwill of $11.6 million and certain identifiable intangible assets of $7.6 million were recorded as a result of the acquisition and are not expected to be deductible for tax purposes. The acquisition was accounted for using the purchase method and, accordingly, the results of operations of Salon Success have been included in the consolidated financial statements from the date of acquisition. Salon Success is included in the BSG segment. Pro-forma information for Salon Success is not provided since it is not material to the Company's consolidated results of operations. The purchase price of Salon Success has been allocated to assets acquired and liabilities assumed based on their estimated fair values at the date of acquisition.

On December 31, 2004, the Company acquired Innovation Successful Salon Services, Inc., XRG Enterprises, Inc., Artistic Salon Services, Inc., and Pacific Salon Services, Inc., full-service distributors of professional beauty products under common ownership (collectively referred to as CosmoProf), in order to continue to expand the geographic area served by Beauty Systems Group. The acquisition was accounted for using the purchase method and, accordingly, the results of operations of CosmoProf have been included in the consolidated financial statements from the date of acquisition. CosmoProf is included in the BSG segment. The following table provides pro forma results for the fiscal year ended September 30, 2005 as if CosmoProf had been acquired on October 1, 2004 (in thousands). Anticipated cost savings and other effects of the integration of CosmoProf are not included in the pro forma results.

	2005
Pro-forma net sales	$ 2,278,690
Pro-forma net earnings	114,373

The valuation of identifiable intangible assets of Salon Services, Salon Success and CosmoProf was determined using discounted cash flow methods with the assistance of third party valuation experts. The acquired entities have been accounted for using the purchase method of accounting and, accordingly, the results of operations of the entities have been included in the consolidated financial statements since their respective dates of acquisition.

17. Related Party Transactions

In connection with the Separation Transactions, the Company terminated substantially all intercompany agreements with Alberto-Culver and its subsidiaries. All intercompany receivables, payables and loans between the Company, on the one hand, and Alberto-Culver and its subsidiaries, on the other hand, other

than those specifically designated to survive following the Separation Transactions, were cancelled. In addition, the Company became the parent company for all U.S. tax returns which were filed under the employer identification number of Alberto-Culver prior to the completion of the Separation Transactions.

Prior to the Separation Transactions, the Company conducted business with, and/or had transactions with, Alberto-Culver and its subsidiaries.

In fiscal years 2007, 2006 and 2005, the Company purchased inventory from Alberto-Culver of approximately $3.7 million, $26.9 million and $28.3 million, respectively.

Current income taxes payable of approximately $54.4 million at September 30, 2006 were netted against the amounts due from Alberto-Culver in the accompanying consolidated balance sheets, as Alberto-Culver made income tax payments on behalf of the Company for primarily all of the Company's tax liabilities.

Alberto-Culver and its affiliates performed certain administrative services for the Company and incurred certain direct expenses on behalf of the Company. Charges for these services based on Alberto-Culver's direct and allocated expenses are included in selling, general and administrative expenses in the consolidated statements of earnings. In addition, certain subsidiaries of the Company had entered into consulting, business development, and advisory services agreements with Alberto-Culver, pursuant to which Alberto-Culver charged a sales-based service fee.

Costs for certain administrative services and other corporate functions and direct expenses incurred on behalf of the Company were allocated by Alberto-Culver to the Company based on the most relevant allocation method to the specific costs being allocated, and totaled $1.0 million, $13.5 million and $13.3 million in fiscal years 2007, 2006 and 2005, respectively. These amounts are classified as part of unallocated expenses for the Company's segment reporting purposes in Note 18. The costs for direct expenses incurred on behalf of the Company and certain administrative services and corporate functions were allocated based on specific identification of activities performed or costs incurred by Alberto-Culver on behalf of the Company. Costs of certain other administrative services and corporate functions that benefited the consolidated Alberto-Culver entity were allocated equally between the Company and Alberto-Culver's consumer products business. Management believes the methods of allocation used were reasonable. Management estimates that had the Company been operating as a stand-alone entity not affiliated with Alberto-Culver during fiscal years 2007, 2006 and 2005, the costs incurred for administrative services and certain other corporate functions and direct expenses incurred on behalf of the Company would have been approximately the same as the amount charged by Alberto-Culver.

Alberto-Culver also charged the Company a sales-based service fee under the consulting, business development and advisory services agreement between Alberto-Culver and certain subsidiaries of the Company. The sales-based service fees totaled $3.8 million, $28.9 million and $27.6 million in fiscal years 2007, 2006 and 2005, respectively. Management believes that had the Company been operating as a stand-alone entity not affiliated with Alberto-Culver during the fiscal years 2007, 2006 and 2005, the Company likely would not have needed to engage any third party or incur additional costs as a stand-alone company for the services provided to its subsidiaries under these agreements.

The Company also had an agreement with Alberto-Culver that required the Company to make equity distributions to Alberto-Culver whenever employees of the Company exercised Alberto-Culver stock options. During fiscal years 2007, 2006 and 2005, the Company paid $4.8 million, $5.7 million and $11.8 million, respectively, to Alberto-Culver in connection with this agreement.

The Company had various notes payable and borrowings under revolving credit facilities with affiliated companies at September 30, 2005. All notes payable to affiliated companies were subsequently repaid in

December, 2005. These borrowings bore interest at market rates and interest expense was approximately $0.4 million and $2.5 million for fiscal years 2006 and 2005, respectively.

The Company had a note receivable and receivables under a credit facility with an affiliated company at September 30, 2005. All notes receivables from affiliated companies were subsequently repaid in December, 2005. These receivables bore interest at market rates and the interest income was approximately $0.1 million and $0.7 million for fiscal years 2006 and 2005, respectively.

18. Business Segments and Geographic Area Information

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

In connection with the Separation Transactions, the Company's management evaluated the structure of its internal organization to identify and separate the costs incurred at the corporate level from the business units, as well as costs incurred that benefit both the Sally Beauty Supply and BSG segments. Accordingly, management has defined its reportable segments as Sally Beauty Supply and BSG, to report these segments separately from the Company's shared corporate expenses, and has revised the comparable prior years for comparability purposes.

The accounting policies of the segments are the same as described in the summary of significant accounting policies in Note 2. The Company does not sell between segments.

Business Segments Information

Segment data for the fiscal years ended September 30, 2007, 2006 and 2005 is as follows (in thousands):

	Year Ended September 30,		
	2007	**2006**	**2005**
Net sales:			
Sally Beauty Supply	$ 1,567,365	$ 1,419,332	$ 1,358,899
BSG	946,407	953,768	895,408
Total	$ 2,513,772	$ 2,373,100	$ 2,254,307
Earnings before provision for income taxes:			
Segment operating profit:			
Sally Beauty Supply	$ 273,364	$ 235,419	$ 222,679
BSG	64,652	88,445	71,210
Segment operating profit	338,016	323,864	293,889
Unallocated expenses(a)	(71,085)	(68,150)	(69,642)
Share-based compensation expense	(13,065)	(5,186)	
Non-cash charge related to Alberto-Culver's conversion to one class of common stock			(4,051)
Sales based service fee charges by Alberto-Culver	(3,779)	(28,852)	(27,615)
Transaction expenses (b)	(21,502)	(41,475)	
Interest expense, net of interest income	(145,972)	(92)	(2,966)
Total	$ 82,613	$ 180,109	$ 189,615
Identifiable assets:			
Sally Beauty Supply	$ 555,252	$ 448,737	$ 418,942
BSG	757,276	759,714	715,986
Sub-total	1,312,528	1,208,451	1,134,928
Shared services	91,975	119,600	56,345
Other corporate(c)		10,790	34,234
Sub-total	91,975	130,390	90,579
Total	$ 1,404,503	$ 1,338,841	$ 1,225,507
Depreciation and amortization:			
Sally Beauty Supply	$ 20,377	$ 18,762	$ 17,065
BSG	17,686	14,872	13,287
Corporate	4,542	4,398	3,554
Total	$ 42,605	$ 38,032	$ 33,906
Capital expenditures:			
Sally Beauty Supply	$ 20,831	$ 19,493	$ 16,235
BSG	27,941	8,748	12,703
Corporate	4,573	2,101	23,298

	Year Ended September 30,		
Total	$ 53,345	$ 30,342	$ 52,236

(a) Unallocated expenses consist of corporate and shared costs. The amounts include $1.0 million, $13.5 million and $13.3 million of overhead charges allocated from Alberto-Culver for fiscal years 2007, 2006 and 2005, respectively.

(b) Transaction expenses are one-time charges associated with the Separation Transactions in fiscal year 2007, and one-time charges associated with the termination of the agreement with Regis in fiscal year 2006. See Note 3 for additional information.

(c) Other corporate identifiable assets consist of amounts due from Alberto-Culver, deferred tax assets and notes receivable from affiliated companies.

Geographic Area Information

Geographic data for the fiscal years ended September 30, 2007, 2006 and 2005 is as follows (in thousands):

	Year Ended September 30,		
	2007	**2006**	**2005**
Net sales:(a)			
United States	$ 2,110,864	$ 2,106,525	$ 2,007,947
Foreign	402,908	266,575	246,360
Total	$ 2,513,772	$ 2,373,100	$ 2,254,307
Identifiable assets:			
United States	$ 972,094	$ 994,551	$ 963,528
Foreign	340,434	213,900	171,400
Shared services	91,975	119,600	56,345
Other corporate(b)		10,790	34,234
Total	$ 1,404,503	$ 1,338,841	$ 1,225,507

(a) Net sales are attributable to individual countries based on the location of the customer.

(b) Prior to the Separation Transactions, other corporate identifiable assets consisted of amounts due from Alberto-Culver, deferred tax assets and notes receivable from affiliated companies.

19. Quarterly Financial Data (Unaudited)

Unaudited quarterly consolidated statement of earnings information for the fiscal years ended September 30, 2007 and 2006 is summarized below (in thousands):

Fiscal Year	**1st Quarter**	**2nd Quarter**	**3rd Quarter**	**4th Quarter**
2007:				
Net sales	$ 629,879	$ 609,276	$ 634,880	$ 639,737
Gross profit	$ 284,492	$ 283,018	$ 290,887	$ 295,350
Net earnings	$ 3,141	$ 11,039	$ 13,448	$ 16,864
Earnings per common share(a)				
Basic	$ 0.02(b)	$ 0.06	$ 0.07	$ 0.09
Diluted	$ 0.02(b)	$ 0.06	$ 0.07	$ 0.09
2006:				
Net sales	$ 586,355	$ 581,101	$ 599,534	$ 606,110
Gross profit	$ 266,868	$ 269,959	$ 276,407	$ 273,537
Net earnings	$ 33,804	$ 31,175	$ 14,551	$ 30,663
Earnings per common share				
Basic	N/A	N/A	N/A	N/A
Diluted	N/A	N/A	N/A	N/A

(a) The sum of the quarterly earnings per share may not equal the full year amount, as the computations of the weighted-average number of common basic and diluted shares outstanding for each quarter and the full year are

performed independently.

(b) Weighted average shares was calculated from November 16, 2006 through December 31, 2006, which represents the actual number of days that shares of the Company's common stock were publicly traded during the quarter.