

July 23, 2007

**Rating Information**

Sector Rating	Market Weight
Target Price YE '07	\$10.00
Long-Term Growth	20.05%

**Trading Data**

52-Wk Range	\$6.96 - \$10.35
Market Cap.	\$1,614 MM
Shares Out.	180.3 MM
Dividend Yield	0.0%
Avg Daily Vol.	870,000
Float	NA
Source: FactSet	

**Fundamental Data**

EV/EBITDA	7.0x
Enterprise Value	\$3,410.6 MM
LT Debt to Total Cap.	182.5%
Book Value	\$(4.60)
Source: FactSet	

**Price Performance Chart**



Source: FactSet

Securities in this report priced as of:

July 23, 2007 16:00 ET

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## Sally Beauty Holdings Inc. (SBH-\$8.83-Outperform)

### SBH: FAROUK ON THE WAY BACK TO BSG?

- **FAROUK MAY BE BACK IN BSG AFTER A FEW MONTHS AT L'OREAL.** We believe the Farouk line, which departed BSG's distribution this spring for L'Oreal, may be returning to Sally's BSG unit. This potential return could be a positive sign the loss of top lines such as L'Oreal's brands will stop weighing down SBH shares.
- **AFTER L'OREAL'S RECENT MOVES, WILL NON L'OREAL LINES SUCH AS FAROUK MOVE TO BSG? WE THINK SO.** We think Farouk went to L'Oreal hoping for better execution, or perhaps a sale of the company. However, L'Oreal's distribution unit contains L'Oreal brands, which they recently added to with PureOlogy. This may have left Farouk a tertiary priority and an unlikely candidate for purchase by L'Oreal. It may make more sense for brands like Farouk to be at BSG, where they will have focus, than with L'Oreal.
- **MINIMAL EPS IMPACT, BUT A STRATEGIC POSITIVE FOR SALLY.** We think EPS impact would be muted, since Farouk has already been largely replaced. Farouk's return would reinforce our view that BSG can survive the loss of L'Oreal. When L'Oreal left, we remained Outperform on SBH because we believed other brands would leave L'Oreal and join BSG to compensate for the loss. Losing Farouk tested this hypothesis. However, its quick return would show us that L'Oreal may lose other brands, due to conflicts from being a manufacturer, retailer, and distributor. We also have more confidence that other brands could follow, such as the Paul Mitchell brand out West, which could add \$0.02-\$0.05 to annual EPS.
- **REITERATE OUTPERFORM ON SBH.** At 10x CY08 EBITDA, we believe SBH is not cheap, and these are minor data points compared to the growth of Sally Beauty Stores. Nonetheless, this potential positive could help alleviate a major concern on SBH, allowing investors to focus on its compelling de-leveraging story. Sally reports Aug 9.

**Sector View:** Market Weight: Concerns on the global consumer and economy hurting HPC stocks, but investors may favor these more defensive names in 2H07.

**Pro Forma Estimates Post Option Expense †(All values are in USD)**

	Q1 Dec	Q2 Mar	Q3 Jun	Q4 Sep	Year	P/E
2006	0.19	0.19	0.20	0.18	0.76	11.6x
2007	0.09	0.06	0.08E	0.07E	0.31E	28.5x
2008	0.10E	0.12E	0.13E	0.10E	0.45E	19.6x

† All numbers are after stock-based compensation expense, normalized consistent with BSC option expense policy.

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Justin Hott

### Companies Analyzed

\* Sally Beauty Holdings Inc. (SBH) - \$8.83 (as of July 23, 2007 16:00 ET) - Outperform

Price Target ('07): \$10.00

Risk(s) to Price Target - Market multiples decline, leading to a P/E multiple contraction; the U.S. salon industry slows further.

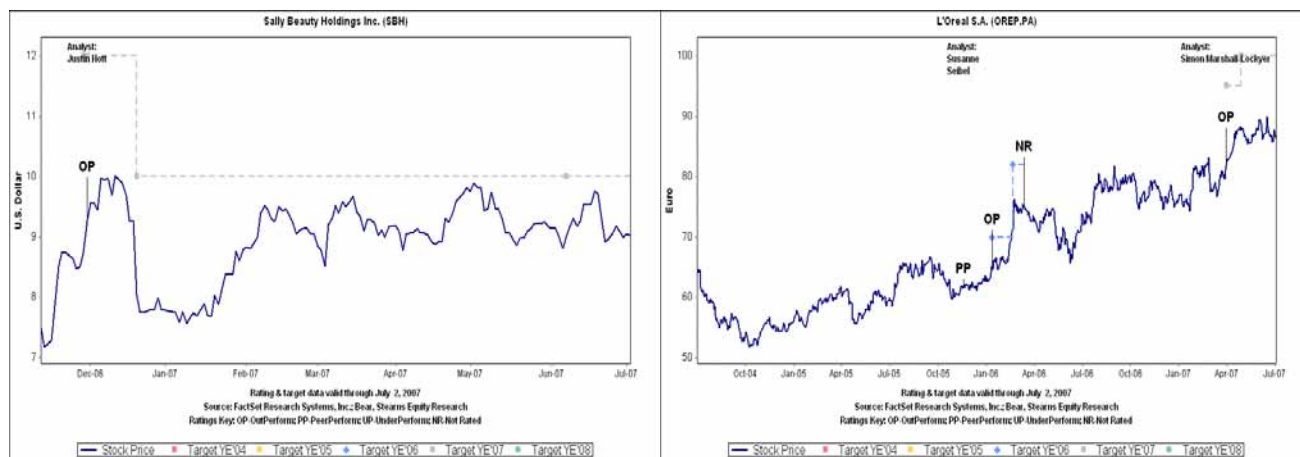
Valuation Methodology - P/E

L'Oreal S.A. (OREP.PA) – Outperform – 84.35 (as of July 23, 2007 16:00 ET)

Price Target ('07): \$100.00

Risk(s) to Price Target - A slowing US consumer trend more than offsets the benefits of a stabilising distribution platform in 2007, the European consumer only improves very gradually, the integration of The Body Shop fails to deliver on expectations, a major transformational acquisition, Sanofi-Aventis (in which L'Oreal holds a 10% stake) share price collapses for unforeseen reasons and if Nestle officially announces its intention not to bid for L'Oreal when Mme Bettencourt passes away.

Valuation Methodology - Peer Group, DCF (see [www.bearstearns.com](http://www.bearstearns.com) for details)



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Underperform (U) - Stock is projected to underperform analyst's industry coverage universe over the next 12 months.

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Market Overweight (MO) - Expect the industry to perform better than the primary market index for the region (S&P 500 in the US) over the next 12 months.

Market Weight (MW) - Expect the industry to perform approximately in line with the primary market index for the region (S&P 500 in the US) over the next 12 months.

Market Underweight (MU) - Expect the industry to underperform the primary market index for the region (S&P 500 in the US) over the next 12 months.

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Percentage of BSC universe with this rating / Percentage of these companies which were BSC investment banking clients in the last 12 months.

Outperform (Buy): 42.6 / 15.8

Peer Perform (Neutral): 49.8 / 11.1

Underperform (Sell): 7.6 / 7.5

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