

LRR Energy, L.P.
Form 425
May 28, 2015

Filed by Vanguard Natural Resources, LLC
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Subject Company: LRR Energy, L.P.
Commission File No. 001-35344

This filing relates to a proposed business combination (the “Merger”) involving Vanguard Natural Resources, LLC (“Vanguard”), a Delaware limited liability company, and LRR Energy, L.P. (“LRE”), a Delaware limited partnership.

Information about the Proposed Merger and Where to Find It

This communication does not constitute an offer to sell or the solicitation of an offer to buy any securities or a solicitation of any vote or approval. In connection with the proposed Merger, Vanguard intends to file with the Securities and Exchange Commission (the “SEC”) a Registration Statement on Form S-4 that will include a preliminary proxy statement of LRE that also constitutes a preliminary prospectus of Vanguard. A definitive proxy statement/prospectus will be sent to security holders of LRE seeking their approval with respect to the proposed Merger. Vanguard and LRE also plan to file other documents with the SEC regarding the proposed transaction. **INVESTORS AND SECURITY HOLDERS ARE URGED TO CAREFULLY READ THE PROXY STATEMENT/PROSPECTUS AND OTHER DOCUMENTS FILED WITH THE SEC WHEN THEY BECOME AVAILABLE BECAUSE THEY WILL CONTAIN IMPORTANT INFORMATION.** Investors and security holders will be able to obtain a free copy of the proxy statement/prospectus (if and when it becomes available) and other documents filed by Vanguard and LRE with the SEC through the website maintained by the SEC at <http://www.sec.gov>. Copies of the documents filed with the SEC by Vanguard will be available free of charge on Vanguard’s internet website at <http://www.vnrlc.com> or by contacting Vanguard’s Investor Relations Department by email at investorrelations@vnrlc.com or by phone at (832) 327-2234. Copies of the documents filed with the SEC by LRE will be available free of charge on LRE’s internet website at <http://www.lrrenergy.com> or by contacting LRE’s Investor Relations Department by email at info@lrrenergy.com or by phone at (713) 345-2145.

Participants in the Solicitation

This communication does not constitute an offer to sell or the solicitation of an offer to buy any securities or a solicitation of any vote or approval. In connection with the proposed Merger, Vanguard intends to file with the Securities and Exchange Commission (the “SEC”) a Registration Statement on Form S-4 that will include a preliminary proxy statement of LRE that also constitutes a preliminary prospectus of Vanguard. A definitive proxy statement/prospectus will be sent to security holders of LRE seeking their approval with respect to the proposed Merger. Vanguard and LRE also plan to file other documents with the SEC regarding the proposed transaction. **INVESTORS AND SECURITY HOLDERS ARE URGED TO CAREFULLY READ THE PROXY STATEMENT/PROSPECTUS AND OTHER DOCUMENTS FILED WITH THE SEC WHEN THEY BECOME AVAILABLE BECAUSE THEY WILL CONTAIN IMPORTANT INFORMATION.** Investors and security holders will be able to obtain a free copy of the proxy statement/prospectus (if and when it becomes available) and other documents filed by Vanguard and LRE with the SEC through the website maintained by the SEC at

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<http://www.sec.gov>. Copies of the documents filed with the SEC by Vanguard will be available free of charge on Vanguard's internet website at <http://www.vnrlc.com> or by contacting Vanguard's Investor Relations Department by email at investorrelations@vnrlc.com or by phone at (832) 327-2234. Copies of the documents filed with the SEC by LRE will be available free of charge on LRE's internet website at <http://www.lrrenergy.com> or by contacting LRE's Investor Relations Department by email at info@lrrenergy.com or by phone at (713) 345-2145.

Forward-Looking Statements

This communication includes "forward-looking statements" as defined by the SEC. All statements other than historical facts, including, without limitation, statements regarding the expected benefits of the proposed transaction to Vanguard

and LRE and their unitholders, the anticipated completion of the proposed transaction or the timing thereof, the expected future reserves, production, financial position, business strategy, revenues, earnings, costs, capital expenditures and debt levels of the combined company, and plans and objectives of management for future operations, are forward-looking statements. When used in this press release, words such as “may,” “can,” “expect,” “intend,” “plan,” “estimate,” “anticipate,” “predict,” “project,” “foresee,” “believe,” “will” or “should,” “would,” “could,” or the negative thereof variations thereon or similar terminology are generally intended to identify forward-looking statements. It is uncertain whether the events anticipated will transpire, or if they do occur what impact they will have on the results of operations and financial condition of Vanguard, LRE or of the combined company. Such forward-looking statements are subject to risks and uncertainties that could cause actual results to differ materially from those expressed in, or implied by, such statements.

These risks and uncertainties include, but are not limited to: the ability to obtain unitholder approval of the proposed transaction; the ability to complete the proposed transaction on anticipated terms and timetable; Vanguard’s and LRE’s ability to integrate successfully after the transaction and achieve anticipated benefits from the proposed transaction; the possibility that various closing conditions for the transaction may not be satisfied or waived; risks relating to any unforeseen liabilities of Vanguard or LRE; declines in oil, NGL or natural gas prices; the level of success in exploitation, development and production activities; adverse weather conditions that may negatively impact development or production activities; the timing of exploitation and development expenditures; inaccuracies of reserve estimates or assumptions underlying them; revisions to reserve estimates as a result of changes in commodity prices; impacts to financial statements as a result of impairment write-downs; risks related to level of indebtedness and periodic redeterminations of the borrowing base under Vanguard’s and LRE’s credit agreements; the ability of Vanguard and LRE to comply with covenants contained in the agreements governing their indebtedness; ability to generate sufficient cash flows from operations to meet the internally funded portion of any capital expenditures budget; ability to obtain external capital to finance exploitation and development operations and acquisitions; federal, state and local initiatives and efforts relating to the regulation of hydraulic fracturing; failure of properties to yield oil or gas in commercially viable quantities; uninsured or underinsured losses resulting from oil and gas operations; inability to access oil and gas markets due to market conditions or operational impediments; the impact and costs of compliance with laws and regulations governing oil and gas operations; ability to replace oil and natural gas reserves; any loss of senior management or technical personnel; competition in the oil and gas industry; risks arising out of hedging transactions; and other risks described under the caption “Risk Factors” in Vanguard’s and LRE’s Annual Reports on Form 10-K for the period ended December 31, 2014. Readers are cautioned not to place undue reliance on forward-looking statements, which speak only as of their dates. Except as required by law, neither Vanguard nor LRE intends to update or revise its forward-looking statements, whether as a result of new information, future events or otherwise.

The following is the transcript of the Vanguard Natural Resources LLC and Eagle Rock Energy Partners LP acquisition overview conference call on Tuesday, May 26, 2015.

VANGUARD NATURAL RESOURCES, LLC

Moderator: Lisa Godfrey
May 26, 2015
10:00 am CT

Please stand by. We're about to begin. Good day and welcome to the Vanguard Natural Resources Merger Operator: Call. Today's conference is being recorded. At this time, I would like to turn the conference over to Ms. Lisa Godfrey, Director of Investor Relations. Please go ahead, ma'am.

Good morning, everyone. And welcome to the Vanguard Natural Resources LLC and Eagle Rock Energy Partners LP acquisition overview conference call. We appreciate you joining us today. Before I introduce Lisa Godfrey: Richard Robert, our Executive Vice President and Chief Financial Officer, I have some information to provide you.

If you would like to listen to a replay of today's call, it will be available through June 25, 2015 and maybe accessed by dialing 888-203-1112 and using the passcode 6168215. For more information or if you'd like to be on our email distribution list to receive future news releases, please contact me at 832-327-2234 or via email at lgodfrey@vnrlc.com.

This information was also provided in last Thursday's press release. Please note the information reported on this call speaks only as of today, May 26, 2015. And therefore you are advised that time sensitive information may no longer be accurate as of the time of any replay. Before we get started, please note that some of the comments today could be considered forward looking statements and are based on certain assumptions and expectations of management.

For a detailed list of all the risk factors associated with our business, please refer to our 10Q that was filed on May 4, 2015 and is available on our website under the Investor Relations tab and on Edgar. Now, I would like to turn the call over to Richard Robert, our Executive Vice President and CFO of Vanguard Natural Resources, LLC.

Thank you, Lisa. Good morning, everyone and thanks for joining us as we discuss the details of the Richard Robert: transaction where Vanguard will acquire Eagle Rock Energy Partners LP. Before I continue let me just say that Scott Smith, our President and CEO is traveling out of the country and is not available to join us today to share with in person his remarks on this exciting news.

Last Thursday, we were pleased to announce that we signed a merger agreement with Eagle Rock Energy Partners pursuant to which Vanguard will acquire all the outstanding units of Eagle Rock in a unit for unit exchange for a total consideration of \$614 million which includes the assumption of \$140 million in net debt at March 31, 2015.

Let me start by saying we appreciate the significant time and effort put forward by Eagle Rock Management and Board of Directors in thoroughly evaluating the merits of combining our entities consistent with the LRR Energy management and Board of Directors. They selflessly concluded that one larger, more diversified company was better equip to handle the challenges of the current commodity price environment.

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We take their trusting us and the responsibility they have placed at our hands very seriously and will do everything in our power to earn and justify that trust. With that, let me provide an overview of the proposed transaction. As part of this conference call, we have included a PowerPoint slide deck on our website at www.vnrllc.com in the Investor Relations section under Presentations.

I'll pause for a moment to allow people to pull up the presentation if you haven't already done so. Okay. Hopefully everyone's had a chance to pull up that presentation. To follow along, please turn to Slide 3 of the slide deck. The transaction which has been approved by the Board of Directors of both companies is structured as a tax-free unit-for-unit transaction with an exchange ratio of 0.185 VNR units for each EROC unit.

As consideration, Vanguard will issue approximately 29 million new common units to holders of Eagle Rock's common units. As the new issuance will be more than 20% of our combined total outstanding common units, VNR unitholders will have to vote to approve this merger. As we are also in the process of acquiring LRR energy, Vanguard has obtained a consent from LRR Energy to move forward with the Eagle Rock plan of merger simultaneously with the LRR Energy plan of merger.

Considering that both the LRR Energy and the Eagle Rock transactions are consummated, LRR Energy unitholders will earn 12% and Eagle Rock unitholders will own 22% of the combined Vanguard entity. The consideration we received by Eagle Rock unitholders is valued at \$3.05 per unit based on Vanguard closing's price on May 21 of \$16.48.

This consideration represents a 24% premium to the closing price for Eagle Rock units on May 21. We anticipate closing will occur in the Third Quarter of 2015 and is subject to unitholder approval by the EROC unitholders and the VNR unitholders. I want to point out that affiliates of NGP own more than 30% of EROC's outstanding units and have agreed to vote their units in favor of the transaction.

Turning to Slide 4, you'll find an overview of Eagle Rock's properties. This transaction is another excellent strategic fit for Vanguard and will strengthen Vanguard's existing footprint in the Mid-Continent region in particular. Eagle Rock operates in 3 regions, the Anadarko and Arkoma Basins in the Mid-Continent, Permian Basin and the Gulf Coast area which includes properties in Texas, Mississippi and Alabama.

The Mid-Continent is by far the largest area encompassing approximately 70% of Eagle Rock's proved reserves. These properties overlay nicely with our existing assets. And with a high proved developed percentage of 78% and a proved reserve life of 12 years, they are highly complementary to our existing asset base.

If you turn to Slide 5, you will see more details how Eagle Rock's assets fit into our existing properties. As many of you may know, Eagle Rock has established a great position in the SCOOP and STACK horizontal play in Anadarko Basin with approximately 20,000 net acres in Grady, McClain, Garvin and Stephens counties.

Currently, Eagle Rock is producing approximately 17 million cubic feet equivalent per day from 6 operated and 21 non-operated wells. We feel very fortunate to be adding another prolific Basin that is in the beginning stages of development. At a March luncheon, a person from the consulting firm of Wood McKenzie made a presentation on the SCOOP/STACK and Cana Woodford economics and one of the slides compared to break even economics of the lower 48 top players. The slide was titled, "The Core of the SCOOP Has Best in Class Rocks" and so it should be no surprise that 3 sub-plays from the SCOOP and STACK were top quartile performers. In fact, two of the SCOOP sub-plays were rated the No. 1 and the No. 3 most economic plays in the lower 48.

Fortunately, Eagle Rock has a very strong position in the core of these sub-plays. As confirmation of the quality of Eagle Rock's excellent position in this developing window, I believe there are 28 active rigs in the SCOOP and 4 active rigs in the STACK area and Eagle Rock has an interest in most of those wells that are being drilled.

We are confident that this asset will provide a significant amount of future upside potential. And we look forward to being active in this trend over the long term. Turning to Slide 6, we show the pre forma effect of the two mergers on our reserve base. On a combined basis, VNR's total reserves are approximately 2.6 TCFE and 71% proved developed

at December 31st.

As with the LRR acquisition, this transaction further diversifies our regional production while also adding more liquids to the portfolio. Slide 7 details the many benefits of the transactions to both parties. I won't read each point on the slide but in a nutshell, it isn't often that a transaction provides an opportunity to increase the scale and diversity and improve liquidity, increase cash flow on a per unit basis and materially de-lever the company all at the same time.

I did notice there is one very important benefit that isn't on the slide. This transaction gives Vanguard an opportunity to attract and retain experienced oil and gas professionals from Eagle Rock. The LRR acquisition did not come with any employees other than those out in the field. So this allows Vanguard to help fill the positions that would ultimately be needed after the LRR closing.

Creating a top notch employee base is critical if we're to successfully continue on growth through acquisition strategy. We believe the transaction delivers significant benefits to the Eagle Rock unitholders who through their holdings in Vanguard will have the ownership in a much larger MLP with an established track record of growth through acquisitions.

Additionally, with a larger operating platform spread across 9 regions, the combined entity will have a more diversified area of operations. Ultimately, distribution stability, distribution coverage and growth potential should all be enhanced. In addition, the Eagle Rock unitholders are receiving a meaningful premium to its recent trading price.

Finally and probably most importantly, the Eagle Rock unitholders will continue to participate in the future growth and upside of the combined company and will continue to be well-positioned when a commodity price recovery occurs. If you turn to Slide 8, we show a pro forma capitalization table of the combined entities.

We intend to refinance Eagle Rock's approximately \$162 million of outstanding debt under its credit facility under our existing credit facility. And the table on Slide 8 indicates that the \$51 million in senior notes remain outstanding as there are no change of control provisions for these notes. One very important benefit of both mergers is the beneficial impact of VNR's pro forma leverage metrics.

These transactions will lower VNR's combined 2015 and 2016 pro forma leverage to approximately 4 times debt to adjusted last 12 month EBITDA which is approximately a full turn improvement over the VNR standalone leverage metric. Historically, Vanguard targets and has operated with a leverage ratio of approximately 3 times.

The 2014 year end leverage metric as computed for our credit facility was 3.5 times debt to adjusted EBITDA. Although we were very fortunate last year to close two large acquisitions in the Third Quarter, we were unfortunate in that we did not have time to refinance our credit facility debt with additional equity or unsecured bonds before the capital markets deteriorated.

However, as I have alluded to in the past, there are many different solutions to remedy the issues that we were facing, and I am very pleased to say that the two mergers offer a very attractive solution. Post the acquisition of both LRR and Eagle Rock, the combined entity will have significantly reduced its' leverage and is positioned to come out of the current commodity cycle a much larger and stronger entity.

Turning to Slide 9, we show the pro forma impact of Eagle Rock's hedge book. Eagle Rock is very well hedged with its' oil and natural gas production hedge at approximately 80% in 2015 and 70% in 2016. Additionally, they have significant hedges related to their NGL production in both 2015 and 2016.

The hedging was done in the form of plain vanilla swaps which provide significant stability in cash flows over this time period. On a pro forma basis, this modestly improves the combined entities' hedge percentages while also adding longer dated oil swaps in 2017 through 2019. In summary, we're very excited about this transaction and the immediate benefit it brings to VNR unitholders, Eagle Rock unitholders and LRR unitholders.

We certainly view this transaction as a win/win scenario for all unitholders and all of our other debt and equity investors for that matter. We believe that all 3 companies' stakeholders will benefit from a larger, more diversified entity with lower financial leverage and stronger positions in several U.S. basins.

Standard & Poors credit rating agency has apparently come to the same conclusion as they placed Vanguard on positive credit watch which suggests an improvement to our credit rating is likely after the mergers are consummated. The all unit nature of these transactions will allow Vanguard, LRR Energy and Eagle Rock unitholders to jointly reap the value growth in an improving commodity price cycle.

We look forward to welcoming both the LRR and Eagle Rock unitholders to Vanguard. With that, we'll now open the line for Q&A.

Operator: Thank you. Ladies and gentlemen, if you would like to ask a question, please signal by pressing star 1 on your telephone keypad. If you're using a speakerphone, please make sure your mute function is turned off to allow your signal to reach our equipment. Again, that is Star 1 to ask a question on today's call. And we'll pause for just a moment to allow everyone an opportunity to signal into the queue.

Once again, ladies and gentlemen, that is star 1 to ask a question on today's call. And ladies and gentlemen, if you did queue into the queue, please press star 1 again to ask your question. Once again, that is star 1 to ask a question on today's call.

And ladies and gentlemen, if you do have a question on today's call, please press star 1 at this time. And we'll now take our first question from Sachin Shah with Albert Fried.

Sachin Shah: Hello.

Operator: And it appears there are no further questions in the queue at this time. And I'm going to go ahead and turn it over to our speakers for any closing remarks.

Richard Robert: I see I must have done a pretty good job with our presentation if there's no question. Hopefully, everyone - any questions they may have had before we started the call have now been answered. But as always, we're available. And we'd be happy to answer questions when you think of them. We're always available.

So again, thank you for taking the time this morning. And we will look forward to talking you at some later date.

Operator: And I do apologize, this is the operator. We do have a few questions in the queue. Would you like to take those now?

Richard Robert: Sure.

Operator: Okay. We'll go first to our first question from John Ragozzino with RBC Capital Markets. Caller, please check your mute function.

John Ragozzino: How about now?

Operator: Caller, please check your mute function.

John Ragozzino: I don't have my mute function on.

Richard Robert: Okay. We can here you now.

John
Ragozzino: Alright. This is a little bit frustrating start to the call. But let me just say congratulations. And Richard, great job with really looking out to create value in a difficult environment. It's been quite a terror over the last couple of weeks.

Richard Robert: Thank you.

John Ragozzino: Anyway, could you give us the pro forma decline rate on the portfolio. Then you bake in both the LRE and the Eagle Rock assets.

Richard Robert: Well, I mean the LRR transaction as I read in their 10K, they had suggested that their (PDP) decline rate was in the 11% range. I anticipate that the Eagle Rock decline rate is higher than that due to the nature of their - of their SCOOP/STACK assets. They've been doing a lot of drilling in that area obviously.

And so they're going to have higher decline rates. I don't know what that number is off the top of my head. But I'm being motioned here that says the assets about 20%. So you know obviously with that combined with ours, you know I think between the two of them, we always project ours to be somewhere in the 14% range.

And so I would anticipate the combination of the two, it may modestly increase our decline rate. But - and frankly, I'm not too concerned about it. And that's one of the nice things about you know how this asset fits in with ours as a larger entity with more production. You know is there going to be some volatility in our production?

Perhaps a little bit. Obviously, we're very hopeful that those SCOOP and STACK wells continue to be very productive. So I'd like to think that they maybe a little bit volatile. But we also anticipate a fairly consistent rig count in that area. And so you know that volatility on an overall production basis won't be quite as large.

John Ragozzino: Okay. And when I think about to the last time I check in with Joe, you know one of his key strategic initiatives was managing that decline rate which I think last time I heard, it was like around 23%. Obviously, that's a little bit above what we'd like to see in this sector. Can you comment on perhaps what your plans are for the STACK and SCOOP plays?

I mean given the current environment, they do have you know robust economics. But to the extent that they offer such a high decline rate, I don't know that they necessarily make the most sense absent a sort of a drill ((inaudible)) structure or some sort of farm out where you know the take tail end of the production or something like that. Have you given that much thought?

Richard Robert: Yes. Certainly we have. There's clearly a lot of optionality related to earning that type of asset. You know new fields. Continental and ((inaudible)) are all very active in the area. So Eagle Rock has an interest. And so you know I'm sure Joe has - has had a lot of ((inaudible)) about selling that acreage. And frankly, we've already had some ((inaudible)) ourselves.

So clearly, there's a lot of interest in earning more of that acreage. Could we do something that will potentially increase our interest over a wider area and reduce some of the maybe higher working interest areas to a lower one and as a result, take a larger - or take a more diverse interest in a larger part of the play?

That's possible. You know there's a lot of ways to manager that position. And again, we like the optionality of it. You know as far as the decline rate is concerned, I mean it only becomes a problem from my perspective if you try to pay distribution based on that high decline rate. And you get on that treadmill.

That's not a treadmill we plan on getting on frankly. I think to the extent we have fresh cash flow you know new wells, that's going to be your mark to introduce leverage further. So you know we will manage that cash flow. We will manage that decline rate and certainly look for opportunities to improve our position in the overall play going forward.

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John Ragozzino: Alright. And just one more quick housekeeping question. Looking at Slide 8 on the capitalization tables, you still have \$73 million on the RGP unit value form Eagle Rock. I presume when the deal

closes and the \$8.375 senior notes, I think those are net - mostly a wash when you consider the distributions and the coupon on the notes.

What are the plans - or do you plan on liquidating that? Paying that off? And would that give you further de-leveraging on the 3 times number that you have at the yearend 2014?

Richard Robert: We are anticipating that Eagle Rock will continue to monetize those EPP units. You know RGP is acquired by EPP. So they're now EPP units. And the expectation is that Eagle Rock will continue on their plan of divesting those units through the end of the Second Quarter. So we expect at the time that our transaction is consummated, they will no longer have those units.

And their revolving credit facility will be at a lower number.

John Ragozzino: Okay.

Richard Robert: As far as the \$51 million in notes, there's no intentions to do anything with those at the moment. And those are included in our 3-time - in our 4-times number that we're anticipating on a consolidated basis.

John Ragozzino: Alright. Well, thanks very much. And gain, congrats on an active start to the year.

Richard Robert: Yes. Thank you.

Operator: Once again, ladies and gentlemen, that is star 1 to ask a question. We'll now take our next question from Adam Fackler with MLV& Company.

Adam Fackler: Good morning, guys. And congratulations.

Richard Robert: Thank you very much.

Adam Fackler: Just a quick follow up to John's question. I believe Eagle Rock had talked about maybe deferring some operated drilling activity until the Second Half of the year. I was wondering if at this point, you had any feel for if you plan to also pick up a rig or two in the SCOOP or how you were going to specifically look to handle that operated piece.

Richard Robert: We're going to be very patient I guess is the right word. We're going to want to get very - you know we're going to want to get up to speed with what our options are before we proceed down any path. So I would not look for us to becoming active drillers on an operated basis in the near term. We're going to study kind of what our options are and then make a plan.

But I wouldn't expect us to do anything this year, any significant way on the drilling.

Adam Fackler: Okay. Fair enough. I appreciate it. And then just one more if I could. Could you provide any additional detail on expected G&A synergies in terms of either quantifying it or giving some color on the timing?

Richard Robert: Sure. You know clearly when you enter into transactions like this, there are a number of duplicative public company costs that get eliminated from Day 1. You know, i.e. the Board of Directors for example. You know we certainly do anticipate you know some consolidation of operations. There will be some employees that are hired. And some employees that are going to be redundant.

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So you know there's a number you know audit fees, K1. There's just a whole host of public company costs that do go away. And we've looked at it fairly extensively. And we do expect that number to be quite meaningful. That's what makes these transactions work at the end of the day. So you know some are probably in the \$15 to \$20 million range.

It's kind of what we're anticipating from a synergy standpoint on the G&A front.

Adam Fackler: Excellent. Thank you. And that's 15 to 20 on an annualized basis?

Richard Robert: That's correct.

Adam Fackler: Thank you. Appreciate the time. And once again, congrats on the transaction.

Richard Robert: Thank you, Adam.

Operator: And we'll now take our next question from Jay Dobson with Wunderlich Securities.

Jay Dobson: Hey, good morning, Richard. It's Jay Dobson. Can you hear me okay?

Richard Robert: I sure can, Jay.

Jay Dobson: Hey, great. Most of my questions have been answered. But as we look to the last I guess month or five weeks, you've announced two transactions. Plate's awfully full. Maybe just talk a little bit about the M&A environment that you're seeing and perhaps Vanguard's appetite you know in the near to intermediate term for additional activity.

Richard Robert: Oh, we always have an appetite. But we do have to be realistic in terms of you know the efforts that are going to be required to integrate both entities. The LRR transaction frankly is a much easier transaction to integrate as it's much more like an asset transaction because it doesn't have a whole host of employees other than those that are out in the field.

And we're - you know we're not trying to get ((inaudible)) to talk to one another etcetera, etcetera. So I like the LRR transaction much more to an asset transaction. The Eagle Rock transaction is going to require you know much more time and effort not unlike the Encore transaction that we executed back in 2010 and 2011.

You know and I point out you know 2011 was the year we were intergrading Encore. And that is the year we've had more transactions close than any other year. We actually had 8 transactions that we - that we closed in that year at the same time we were intergrading Encore. So I mean I think we have the bandwidth to do it.

But the reality is, we've got to stand down for a period of time. Every time we do what's considered a material transaction to the SEC guidelines, we would have to change our S4 that's on file with the SEC. So in order to actually end up closing these transactions, we will have to stand down and not do any material transactions for a period of time until the transaction's closed.

So I would anticipate that we're going to be a little bit slower. There's still some good deals out there. You know fortunately, a lot of deals take quite a while to close. And so I frankly don't anticipate that we're going to slow down. And we'll continue to look for deals that we can close after these mergers are closed.

Jay Dobson: No. That's great. And then just one quick follow on the SG&A. I think you said 15 to 20 in this one and then about 8 in the LRE transaction. Since those are largely public company expenses, I assume you can achieve that run rate within the first 6 to 9 months so that you know looking out six months, you'd be on that run rate.

Richard Robert: We're certainly going to try and put ourselves in a position to do it as quickly as possible. I'd say certainly say no longer than six months. You know there are some costs that we're - you're contractually going to continue to incur until those contracts run off. You know leases and other things that we don't - that we can't get rid of.

So yes, there will be some improvement even beyond the first 6 to 9 months. But yes, we anticipate the majority of the cost savings to incur fairly quickly.

Jay Dobson: That's great. Well, congratulations on the transaction.

Richard Robert: Thank you very much.

Operator: And there are no further questions in the queue at this time.

Richard Okay. Well, again thank you everyone for taking the time to listen in. And as always, we're available to
Robert: answer any questions that come up after the fact. Have a good day.

Operator: And ladies and gentlemen, that concludes today's conference call. We thank you for your participation.

END

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90,227

Net earnings per share:

Basic	
\$	0.36
\$	0.27
\$	0.53
\$	0.49
Diluted	
\$	0.35
\$	0.26
\$	0.51
\$	

Weighted average shares:

Basic

186,335

182,831

185,514

182,644

Diluted

191,684

187,724

190,662

187,431

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, 2011, 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)

	March 31, 2012 (Unaudited)	September 30, 2011
Assets		
Current assets:		
Cash and cash equivalents	\$ 64,810	\$ 63,481
Trade accounts receivable, less allowance for doubtful accounts of \$2,374 at March 31, 2012 and \$2,086 at September 30, 2011	56,000	61,996
Accounts receivable, other	37,073	33,530
Inventory	689,367	665,246
Prepaid expenses	25,492	26,360
Deferred income tax assets, net	28,588	28,535
Total current assets	901,330	879,148
Property and equipment, net of accumulated depreciation of \$336,530 at March 31, 2012 and \$317,677 at September 30, 2011	187,393	182,489
Goodwill	532,833	505,873
Intangible assets, excluding goodwill, net of accumulated amortization of \$52,210 at March 31, 2012 and \$45,467 at September 30, 2011	135,981	129,658
Other assets	32,395	31,432
Total assets	\$ 1,789,932	\$ 1,728,600
Liabilities and Stockholders Deficit		
Current liabilities:		
Current maturities of long-term debt	\$ 2,096	\$ 3,004
Accounts payable	250,265	262,114
Accrued liabilities	167,264	185,509
Income taxes payable	2,865	9,379
Total current liabilities	422,490	460,006
Long-term debt	1,354,068	1,410,111
Other liabilities	26,530	26,154
Deferred income tax liabilities, net	56,057	51,311
Total liabilities	1,859,145	1,947,582
Stockholders deficit:		
Common stock, \$0.01 par value. Authorized 500,000 shares; 187,040 and 184,502 shares issued and 186,707 and 184,057 shares outstanding at March 31, 2012 and September 30, 2011, respectively	1,867	1,841
Preferred stock, \$0.01 par value. Authorized 50,000 shares; none issued		
Additional paid-in capital	721,037	681,256
Accumulated deficit	(781,358)	(879,305)
Treasury stock, 15 shares at March 31, 2012 and September 30, 2011, at cost	(103)	(103)
Accumulated other comprehensive loss, net of tax	(10,656)	(22,671)
Total stockholders deficit	(69,213)	(218,982)
Total liabilities and stockholders deficit	\$ 1,789,932	\$ 1,728,600

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, 2011, 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)

	Six Months Ended	
	March 31,	
	2012	2011
Cash Flows from Operating Activities:		
Net earnings	\$ 97,947	\$ 90,227
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation and amortization	31,493	28,888
Share-based compensation expense	10,976	10,275
Amortization of deferred financing costs	2,992	3,495
Excess tax benefit from share-based compensation	(9,124)	(776)
Net loss (gain) on disposal of property and equipment	5	(1,504)
Net loss on extinguishment of debt	35,145	1,741
Deferred income taxes	(285)	509
Changes in (exclusive of effects of acquisitions):		
Trade accounts receivable	8,076	1,288
Accounts receivable, other	(2,805)	(9,462)
Inventory	(10,631)	(12,671)
Prepaid expenses	1,463	(670)
Other assets	1,121	44
Accounts payable and accrued liabilities	(30,440)	9,632
Income taxes payable	1,838	1,886
Other liabilities	319	2,723
Net cash provided by operating activities	138,090	125,625
Cash Flows from Investing Activities:		
Capital expenditures	(27,047)	(29,370)
Proceeds from sale of property and equipment	91	145
Acquisitions, net of cash acquired	(43,154)	(81,170)
Net cash used by investing activities	(70,110)	(110,395)
Cash Flows from Financing Activities:		
Change in book cash overdraft		2,516
Proceeds from issuance of long-term debt	929,200	379,505
Repayments of long-term debt	(1,010,474)	(397,221)
Debt issuance costs	(15,191)	(5,284)
Proceeds from exercises of stock options	20,111	3,807
Excess tax benefit from share-based compensation	9,124	776
Net cash used by financing activities	(67,230)	(15,901)
Effect of foreign exchange rate changes on cash and cash equivalents	579	279
Net increase (decrease) in cash and cash equivalents	1,329	(392)
Cash and cash equivalents, beginning of period	63,481	59,494
Cash and cash equivalents, end of period	\$ 64,810	\$ 59,102
Supplemental Cash Flow Information:		
Interest paid (a)	\$ 77,819	\$ 51,311
Income taxes paid	\$ 60,746	\$ 50,249

(a) For the six months ended March 31, 2012, interest paid includes \$24.4 million in call premiums paid upon the redemption of certain notes.

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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, 2011, are an integral part of these financial statements.

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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 in the U.S., Puerto Rico, Canada, Mexico, Chile, 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. 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 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 March 31, 2012 and September 30, 2011, its consolidated results of operations for the three and six months ended March 31, 2012 and 2011, and its consolidated cash flows for the six months ended March 31, 2012 and 2011.

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, 2011. 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 these interim periods 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 and Accounting Changes

Recent Accounting Pronouncements

In December 2010, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2010-28 which amended Accounting Standards Codification (ASC) Topic 350, *Intangibles-Goodwill and Other* (ASC 350). This amendment modified the goodwill impairment test for reporting units with a zero or negative carrying amount, by requiring that Step 2 of the goodwill impairment test be performed for such reporting units if it is more likely than not that an impairment of goodwill exists. The Company adopted this amendment during the first quarter of its fiscal year 2012 and its adoption did not have a material effect on the Company's consolidated financial position, results of operations or cash flows.

In December 2010, the FASB issued ASU No. 2010-29 which amended ASC Topic 805, *Business Combinations*. This amendment requires that a public company that enters into business combinations that are material on an individual or aggregate basis disclose certain pro-forma information for the current and the immediately preceding fiscal year. This amendment also expands the supplemental pro-forma disclosures to include a description of the nature and amount of material, non-recurring pro-forma adjustments directly attributable to such business combination or business combinations. The Company adopted this amendment during the first quarter of its fiscal year 2012 and its adoption did not have a material effect on the Company's consolidated financial position, results of operations or cash flows.

In May 2011, the FASB issued ASU No. 2011-04 which amended ASC Topic 820, *Fair Value Measurements and Disclosures* (ASC 820). This amendment changed the title of ASC 820 to Fair Value Measurement and adopted fair value measurement and disclosure guidance that is generally consistent with the corresponding International Financial Reporting Standards (IFRS) guidance. More specifically, this amendment changed certain requirements for measuring fair value or for disclosing

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Sally Beauty Holdings, Inc. and Subsidiaries

Condensed Notes to Consolidated Financial Statements

(Unaudited)

information about fair value measurements or, alternatively, clarified the FASB's intent about the application of existing fair value measurement and disclosure guidance. The Company adopted this amendment during the second quarter of its fiscal year 2012 and its adoption did not have a material effect on the Company's consolidated financial position, results of operations or cash flows.

In September 2011, the FASB issued ASU No. 2011-08 which amended ASC 350. This amendment allows an entity to first assess relevant qualitative factors in order to determine whether it is necessary to perform the two-step quantitative goodwill impairment test otherwise required under ASC 350. In effect, the amendment eliminates the need to calculate the fair value of a reporting unit in connection with the goodwill impairment test unless the entity determines, based on the qualitative assessment, that it is more likely than not that the reporting unit's fair value is less than its carrying amount. As permitted, the Company adopted this amendment during the second quarter of its fiscal year 2012 and its adoption did not have a material effect on the Company's consolidated financial position, results of operations or cash flows.

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

In June 2011, the FASB issued ASU No. 2011-05 which amended ASC Topic 220, *Comprehensive Income* (ASC 220). This amendment, which must be applied retrospectively, will allow an entity the option to present the components of net income, as well as total comprehensive income and the components of other comprehensive income, either in a single continuous statement of comprehensive income or in two separate consecutive statements. This amendment also eliminates the option to present the components of other comprehensive income in the statement of stockholders' equity but does not change the items that must be reported. In addition, in December 2011, the FASB issued ASU No. 2011-12 which further amended ASC 220. More specifically, this amendment provided for deferral, until further action by the FASB, of the effective date for changes to the presentation of reclassifications of items out of accumulated other comprehensive income required by ASU No. 2011-05. For public companies, these amendments are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2011. Early application is permitted.

Accounting Changes

The Company made no accounting changes during the six months ended March 31, 2012.

4. Fair Value Measurements

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The Company's financial instruments consist of cash and cash equivalents, trade and other accounts receivable, accounts payable, interest rate swap agreements, foreign currency option, collar and forward agreements and debt. The carrying amounts of cash and cash equivalents, trade and other accounts receivable, and accounts payable approximate fair value due to the short-term nature of these financial instruments.

The Company measures on a recurring basis and discloses its financial instruments under the provisions of ASC 820, as amended. 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.

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Sally Beauty Holdings, Inc. and Subsidiaries

Condensed Notes to Consolidated Financial Statements

(Unaudited)

Consistent with this hierarchy, the Company categorized certain of its financial assets and liabilities as follows at March 31, 2012 (in thousands):

	As of March 31, 2012			
	Total	Level 1	Level 2	Level 3
Assets				
Foreign currency forwards (a)	\$ 7		\$ 7	
Foreign currency collars (a)	327		327	
Total assets	\$ 334		\$ 334	
Liabilities				
Long-term debt (b)(c)	\$ 1,404,914	\$ 798,750	\$ 606,164	
Hedged interest rate swaps (a)	1,678		1,678	
Foreign currency forwards (a)	86		86	
Total liabilities	\$ 1,406,678	\$ 798,750	\$ 607,928	

Consistent with this hierarchy, the Company categorized certain of its financial assets and liabilities as follows at September 30, 2011 (in thousands):

	As of September 30, 2011			
	Total	Level 1	Level 2	Level 3
Assets				
Foreign currency forwards (a)	\$ 424		\$ 424	
Foreign currency collars (a)	680		680	
Total assets	\$ 1,104		\$ 1,104	
Liabilities				
Long-term debt (b)(c)	\$ 1,420,337	\$ 725,288	\$ 695,049	
Hedged interest rate swaps (a)	6,450		6,450	
Foreign currency forwards (a)	528		528	
Total liabilities	\$ 1,427,315	\$ 725,288	\$ 702,027	

(a) Foreign currency options, collars and forwards, and interest rate swaps are valued for purposes of this disclosure using widely accepted valuation techniques, such as discounted cash flow analyses, and reasonable estimates, such as projected market interest rates and projected foreign currency exchange rates, as appropriate. Please see Note 10 for more information about the Company's foreign currency options, collars and forwards, and interest rate swaps.

(b) Long-term debt, which is carried at amortized cost in the Company's consolidated financial statements, 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, except for the senior and senior subordinated notes (prior to their December 2011 redemption) and the 6.875% senior notes due 2019 (the new senior notes). The senior and senior subordinated notes (prior to their December 2011 redemption) were, and the new senior notes

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are, valued using unadjusted quoted market prices for such debt securities. Please see Note 9 for more information about the Company's debt.

(c) In November 2011, the Company, through certain of its domestic subsidiaries, issued \$750.0 million aggregate principal amount of the Company's new senior notes. In December 2011, the Company redeemed its senior notes due 2014 and its senior subordinated notes due 2016 with the net proceeds from the new senior notes. Please see Note 9 for more information about the Company's debt.

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Sally Beauty Holdings, Inc. and Subsidiaries

Condensed Notes to Consolidated Financial Statements

(Unaudited)

5. Net Earnings Per Share

Basic net earnings per share, is calculated by dividing net earnings by the weighted average number of shares of common stock outstanding during the period. Diluted net 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):

Net earnings	\$	67,813	\$	49,278	\$	97,947	\$	90,227
Dilutive securities:								
Total weighted average diluted shares		191,684		187,724		190,662		187,431
Basic	\$	0.36	\$	0.27	\$	0.53	\$	0.49

At March 31, 2012, options to purchase 44,340 and 1,964,831 shares of the Company's common stock were outstanding but not included in the computation of diluted earnings per share for the three and six months ended March 31, 2012, respectively, 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 unrecognized compensation expense, exceeds the average price per share for the period. At March 31, 2011, all outstanding options to purchase shares of the Company's common stock were dilutive.

6. Comprehensive Income and Accumulated Other Comprehensive (Loss) Income

Comprehensive income consists of net earnings, foreign currency translation adjustments and deferred gain on interest rate swaps as follows (in thousands):

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	Three Months Ended		Six Months Ended	
	March 31,		March 31,	
	2012	2011	2012	2011
Net earnings	\$ 67,813	\$ 49,278	\$ 97,947	\$ 90,227
Other comprehensive income adjustments:				
Foreign currency translation adjustments (a)	10,975	11,324	9,095	12,015
Deferred gain on interest rate swaps (b)	1,425	1,308	2,920	2,837
Comprehensive income	\$ 80,213	\$ 61,910	\$ 109,962	\$ 105,079

(a) There were no income tax amounts related to foreign currency translation adjustments recorded in other comprehensive income for the three and six months ended March 31, 2012 and 2011.

(b) Amounts are net of income tax of \$0.9 million and \$0.8 million for the three months ended March 31, 2012 and 2011; and net of income tax of \$1.9 million and \$1.8 million for the six months ended March 31, 2012 and 2011, respectively.

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Sally Beauty Holdings, Inc. and Subsidiaries

Condensed Notes to Consolidated Financial Statements

(Unaudited)

The components of accumulated other comprehensive loss, net of tax, as of March 31, 2012 and September 30, 2011 are as follows (in thousands):

	March 31, 2012		September 30, 2011
Cumulative foreign currency translation adjustments (a)	\$	(9,629)	\$ (18,724)
Deferred (losses) on interest rate swaps, net of tax (b)		(1,027)	(3,947)
Total accumulated other comprehensive loss, net of tax	\$	(10,656)	\$ (22,671)

(a) There were no income tax amounts related to foreign currency translation adjustments at March 31, 2012 and September 30, 2011.

(b) Amounts are net of income tax of \$0.7 million and \$2.5 million at March 31, 2012 and September 30, 2011, respectively. Please see Note 10 for more information about the Company's interest rate swaps.

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 2.0 million and 3.0 million stock options and approximately 32,000 and 199,000 restricted share awards to its employees and consultants during the six months ended March 31, 2012 and 2011, respectively. Upon issuance of such grants, the Company recognized accelerated share-based compensation expense of \$5.3 million and \$5.0 million in the six months ended March 31, 2012 and 2011, 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. 2010 Omnibus Incentive Plan (the 2010 Plan) and certain predecessor share-based compensation plans such as the Sally Beauty Holdings, Inc. 2007 Omnibus Incentive Plan (the 2007 Plan). In addition, the Company granted approximately 26,000 and 43,000 restricted stock units to its non-employee directors during the six months ended March 31, 2012 and 2011, respectively.

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

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	Three Months Ended March 31,		Six Months Ended March 31,	
	2012	2011	2012	2011
Share-based compensation expense	\$ 2,945	2,437	\$ 10,976	\$ 10,275
Income tax benefit related to share-based compensation expense	\$ 1,143	946	\$ 4,259	\$ 3,987

Stock Options

Each option has an exercise price that equals 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 2007 Plan.

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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 stock option awards for the six months ended March 31, 2012:

	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, 2011	13,778	\$ 8.50	6.8	\$ 111,571
Granted	1,979	19.21		
Exercised	(2,528)	7.96		
Forfeited or expired	(113)	10.48		
Outstanding at March 31, 2012	13,116	\$ 10.21	6.9	\$ 191,413
Exercisable at March 31, 2012	7,023	\$ 8.29	5.7	\$ 115,978

The following table summarizes information about stock options under the Company's share-based compensation plans at March 31, 2012:

Range of Exercise Prices	Options Outstanding			Options Exercisable		
	Number Outstanding at March 31, 2012 (in Thousands)	Weighted Average Remaining Contractual Term (in Years)	Weighted Average Exercise Price	Number Exercisable at March 31, 2012 (in Thousands)	Weighted Average Exercise Price	
\$ 2.00 - 5.24	2,007	5.7	\$ 4.72	1,402	\$ 4.49	
\$ 7.42 - 19.21	11,109	7.1	11.20	5,621	9.23	
Total	13,116	6.9	\$ 10.21	7,023	\$ 8.29	

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:

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	Six Months Ended	
	March 31,	
	2012	2011
Expected life (in years)	5.0	5.0
Expected volatility	58.4%	59.0%
Risk-free interest rate	1.1%	1.1%
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 expected volatility used for awards made during the six months ended March 31, 2012, reflects the average volatility for the Company's common stock. For awards made prior to the fiscal year 2012, the expected volatility used was derived using the average volatility of both the Company and similar companies (based on industry sector) since it was not practicable to estimate the Company's expected volatility on a stand-alone basis due to a lack of sufficient trading history. The risk-free interest rate is based on the five-year zero-coupon U.S. Treasury notes as of the date of the grant. Since the Company does not currently expect to pay dividends, the dividend yield used is 0%.

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Sally Beauty Holdings, Inc. and Subsidiaries

Condensed Notes to Consolidated Financial Statements

(Unaudited)

The weighted average fair value of the stock options issued to the Company's grantees at the date of grant in the six months ended March 31, 2012 and 2011 was \$9.60 and \$5.74 per option, respectively. The total intrinsic value of options exercised during the six months ended March 31, 2012 was \$31.7 million. Cash proceeds from these option exercises were \$20.1 million and the income tax benefit realized from these option exercises was \$12.3 million.

At March 31, 2012, approximately \$19.8 million of total unrecognized compensation costs related to unvested stock option awards are expected to be recognized over the weighted average period of 2.7 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 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 and certain predecessor share-based compensation plans such as the 2007 Plan.

The Company expenses the cost of the restricted stock awards, which is determined to equal the fair value of the restricted stock award at the date of grant, on a straight-line basis over the period (the vesting period) 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.

The following table presents a summary of the activity for the Company's restricted stock awards for the six months ended March 31, 2012:

	Number of Shares (in Thousands)	Weighted Average Fair Value Per Share	Weighted Average Remaining Vesting Term (in Years)
Restricted Stock Awards			
Unvested at September 30, 2011	445	\$ 9.12	3.1

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Granted	32	19.21	
Vested	(144)	8.70	
Forfeited			
Unvested at March 31, 2012	333	\$ 10.27	2.7

At March 31, 2012, approximately \$2.2 million of total unrecognized compensation costs related to unvested restricted stock awards are expected to be recognized over the weighted average period of 2.7 years.

Restricted Stock Units

The Company currently grants Restricted Stock Unit awards (RSU or RSUs), which generally vest less than 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 common stock of the Company. Upon vesting, such RSUs 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.

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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 RSUs for the six months ended March 31, 2012:

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, 2011		\$	
Granted	26	19.21	
Vested			
Forfeited			
Unvested at March 31, 2012	26	\$ 19.21	0.5

At March 31, 2012, approximately \$0.2 million of total unrecognized compensation costs related to unvested RSUs are expected to be recognized over the weighted average period of 0.5 years.

8. Goodwill and Intangible Assets

The change in the carrying amounts of goodwill by operating segment for the six months ended March 31, 2012 is as follows (in thousands):

	Sally Beauty Supply	Beauty Systems Group	Total
Balance at September 30, 2011	\$ 75,536	\$ 430,337	\$ 505,873
Additions and purchase price adjustments (a)	14,982	9,189	24,171
Foreign currency translation	510	2,279	2,789
Balance at March 31, 2012	\$ 91,028	\$ 441,805	\$ 532,833

(a) Please see Note 12 for additional information about businesses acquired.

The Company performs its goodwill impairment test during the second quarter of its fiscal year. As permitted, the Company adopted the provisions of ASU 2011-08 in connection with its goodwill impairment test for the fiscal year 2012. There were no goodwill impairment losses recognized in our financial statement in the current or prior periods presented.

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The following table provides the carrying value for intangible assets with indefinite lives, excluding goodwill, and the gross carrying value and accumulated amortization for intangible assets subject to amortization by operating segment at March 31, 2012 (in thousands):

	Sally Beauty Supply	Beauty Systems Group	Total
Balance at March 31, 2012:			
Intangible assets with indefinite lives:			
Trade names	\$ 27,666	\$ 27,421	\$ 55,087
Total	27,666	27,421	55,087
Intangible assets subject to amortization:			
Gross carrying amount	27,028	106,076	133,104
Accumulated amortization	(8,172)	(44,038)	(52,210)
Net value	18,856	62,038	80,894
Total intangible assets, excluding goodwill, net	\$ 46,522	\$ 89,459	\$ 135,981

As described in Note 12, during the six months ended March 31, 2012, intangible assets subject to amortization in the amount of \$11.8 million were recorded in connection with the Company's November 2011 acquisition of Kappersservice Floral B.V. and two related companies (together, the Floral Group) based on their estimated fair values.

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Sally Beauty Holdings, Inc. and Subsidiaries

Condensed Notes to Consolidated Financial Statements

(Unaudited)

Amortization expense was \$3.6 million and \$3.0 million for the three months ended March 31, 2012 and 2011, respectively; and \$6.7 million and \$6.1 million for the six months ended March 31, 2012 and 2011, respectively. As of March 31, 2012, future amortization expense related to intangible assets subject to amortization is estimated to be as follows (in thousands):

Fiscal Year:		
2012	\$	6,935
2013		12,311
2014		11,914
2015		11,392
2016		10,244
Thereafter		28,098
	\$	80,894

9. Short-term Borrowings and Long-term Debt

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

	As of	Maturity	Interest Rates
	March 31, 2012	Dates	
ABL facility	\$	Nov. 2015	(i) Prime plus (1.25% to 1.75%) or; (ii) LIBOR plus (2.25% to 2.75%)
Term loan B	596,856	Nov. 2013	(i) Prime plus (1.25% to 1.50%) or; (ii) LIBOR plus (2.25% to 2.50%) (a)
Senior notes	750,000	Nov. 2019	6.875%
Other (b)	3,214	2012-2015	4.05% to 5.79%
Total	\$ 1,350,070		
Capital leases and other	\$ 6,094		
Less: current portion	(2,096)		
Total long-term debt	\$ 1,354,068		

(a) At March 31, 2012, the contractual interest rate for the term loan B is 2.49%. The interest rate on \$300.0 million of principal outstanding under this loan is fixed by interest rate swaps which expire in May 2012.

(b) Represents pre-acquisition debt of Pro-Duo NV and Sinelco Group BVBA (Sinelco).

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The Company, through its subsidiaries (Sally Investment Holdings LLC (Sally Investment) and Sally Holdings LLC (Sally Holdings)), incurred \$1,850.0 million of indebtedness in connection with the Company's separation from its former parent, Alberto-Culver Company, in November 2006. These borrowings included: (i) drawing on a revolving (asset-based lending (ABL)) credit facility in the amount of \$70.0 million, (ii) entering into two senior term loan facilities (term loans A and B) in an aggregate amount of \$1,070.0 million and (iii) together (jointly and severally) with another of the Company's indirect subsidiaries, Sally Capital Inc., issuing senior notes in an aggregate amount of \$430.0 million and senior subordinated notes in an aggregate amount of \$280.0 million. Borrowings under the term loan A facility were paid in full in the fiscal year 2010.

In November 2010, Sally Holdings entered into a new \$400 million, five-year revolving credit facility (the new ABL facility or the ABL facility) and terminated its prior ABL credit facility (the prior ABL facility). The terms of the new ABL facility contain a commitment fee of 0.50% on the unused portion of the facility. Borrowings under the senior term loan facilities and the ABL facility are secured by substantially all of our assets, those of Sally Investment, 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 and a pledge of certain intercompany notes. Borrowings under the ABL facility bear interest at Prime plus 1.25% to 1.75% or LIBOR plus 2.25% to 2.75%. In connection with our termination of the prior ABL facility we expensed approximately \$1.6 million in unamortized deferred financing costs. This amount is included in interest expense in the Company's consolidated statements of earnings.

In November 2011, Sally Holdings and Sally Capital Inc. (collectively, the Issuers), both wholly-owned subsidiaries of the Company, the Company and certain of its domestic subsidiaries entered into an agreement pursuant to which the Issuers sold in a private placement \$750.0 million aggregate principal amount of the Issuers' 6.875% Senior Notes due 2019 (the Senior

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Notes). The Senior Notes bear interest at an annual rate of 6.875% and were issued at par. In connection with the issuance of the Senior Notes, the Company incurred and capitalized financing costs of approximately \$15.2 million. These deferred financing costs are included in other assets on our consolidated balance sheets and are being amortized over the term of the Senior Notes using the effective interest method. The Company intends to exchange the Senior Notes for notes that will be registered pursuant to a registration statement filed with the SEC in February 2012 and will otherwise be identical to the Senior Notes. The Company expects to complete such exchange during the third quarter of its fiscal year 2012.

In December 2011, the Issuers used the net proceeds from their issuance of the Senior Notes: (i) to redeem \$430.0 million aggregate principal amount outstanding of the Issuers' 9.25% senior notes due 2014, (ii) to redeem \$275.0 million aggregate principal amount outstanding of the Issuers' 10.50% senior subordinated notes due 2016 (together with the senior notes due 2014, the "Old Notes"), pursuant to the terms of the indentures governing the Old Notes, and (iii) to pay accrued and unpaid interest on the Old Notes, and fees and expenses incurred in connection with issuance of the Senior Notes and redemption of the Old Notes. In connection with our redemption of the Old Notes we recorded a charge to earnings in the amount of approximately \$34.6 million, including approximately \$24.4 million in call premiums paid and approximately \$10.2 million in unamortized deferred financing costs expensed. This amount is included in interest expense in the Company's consolidated statements of earnings.

Borrowings under the senior term loan facilities and the ABL facility are secured by substantially all of our assets, those of Sally Investment, those of our domestic subsidiaries and, in the case of the ABL facility, those of our Canadian subsidiaries and a pledge of certain intercompany notes. Borrowings under the senior term loan B facility may be prepaid at the option of Sally Holdings at any time without premium or penalty and are subject to mandatory prepayment in an amount equal to 50% of excess cash flows (as defined in the agreement governing the senior term loan facilities) for any fiscal year unless a specified leverage ratio is met. Amounts paid pursuant to said provision may be applied, at the option of the Company, against minimum loan repayments otherwise required of us over the twelve-month period following any such payment under the terms of the loan agreement. Additionally, borrowings under the senior term loan facilities would be subject to mandatory prepayment in an amount equal to 100% of the proceeds of specified asset sales that are not reinvested in the business or applied to repay borrowings under the ABL facility.

During the six months ended March 31, 2012, the Company made optional prepayments in the aggregate amount of \$100.0 million on the senior term loan B facility. In connection with such prepayments the Company expensed approximately \$0.6 million in unamortized deferred financing costs. This amount is included in interest expense in the Company's consolidated statements of earnings.

The Senior Notes 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 who had guaranteed obligations under Sally Holdings' senior credit facilities, existing notes and other indebtedness outstanding prior to issuance of the Senior Notes. Interest on the Senior Notes is payable semi-annually. The Senior Notes 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; and on or after November 15, 2015 at par plus a premium declining ratably to par, plus accrued and unpaid interest. 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. In addition, on or prior to November 15, 2014, the Company has the right to redeem at par plus a specified premium, plus accrued and unpaid interest, up to 35% of the aggregate principal amount

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of notes originally issued, subject to certain limitations, with the proceeds from certain kinds of equity offerings, as defined in the indenture.

The agreements underlying the Company's credit facilities, including the indenture governing the Senior Notes, contain terms which significantly restrict the ability of Sally Beauty's subsidiaries to pay dividends or otherwise transfer assets to Sally Beauty. Please see the Company's Annual Report on Form 10-K for the fiscal year ended September 30, 2011, for additional information about the Company's credit facilities.

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Maturities of the Company's long-term debt are as follows as of March 31, 2012 (in thousands):

Twelve months ending March 31:

2013	\$	1,328
2014		598,064
2015		678
2016		
2017		
Thereafter		750,000
	\$	1,350,070
Capital leases and other		6,094
Less: current portion		(2,096)
Total	\$	1,354,068

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.

Under the credit agreement and/or indenture governing the senior term loans and the Senior Notes, Sally Holdings and its subsidiaries may not make certain restricted payments, including dividends and other restricted payments to us, if a default then exists under the credit agreement and/or the indenture or, in the case of the senior term loans, if Sally Holdings' consolidated interest coverage ratio is less than 2.0 to 1.0 at the time of such restricted payment. As of March 31, 2012, Sally Holdings' consolidated interest coverage ratio was approximately 5.7 to 1.0. In addition, Sally Holdings and its subsidiaries may not make certain restricted payments, including dividends and other restricted payments, to us if at the time of such restricted payment Sally Holdings' indebtedness had reached certain limitations specified in the indenture governing the Senior Notes. Further, the aggregate amount of restricted payments Sally Holdings and its subsidiaries are able to make is limited pursuant to various baskets as calculated pursuant to the credit agreement and/or the indenture.

Under our ABL facility, Sally Holdings may pay dividends and make other equity distributions to us if availability under the facility exceeds certain thresholds and no default then exists under the facility. For dividends and distributions up to \$30.0 million during each fiscal year, borrowing availability must exceed the lesser of \$80.0 million or 20% of the borrowing base for 45 days prior to such dividend and distribution. For dividends in excess of that amount, it must maintain that same borrowing availability and its fixed-charge coverage ratio must exceed 1.1 to 1.0. As of March 31, 2012, its fixed-charge coverage ratio was approximately 3.4 to 1.0. As of March 31, 2012, the net assets of our consolidated subsidiaries that were unrestricted from transfer under our credit arrangements totaled \$552.3 million, subject to certain adjustments. The ABL facility and the senior term loan facilities, as well as the Company's Senior Notes indenture contain customary cross-default and/or cross-acceleration provisions.

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 interest rates and in foreign currency exchange 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 (including interest rate swaps, and foreign currency options, collars and forwards) by Sally Holdings.

The Company uses interest rate swaps, as part of its overall economic risk management strategy, to add stability to the interest payments due in connection with its term loan obligations. Interest payments related to the senior term loans are impacted by changes in LIBOR. The Company's interest rate swap agreements involve the periodic receipt by Sally Holdings of amounts based on a variable rate in exchange for Sally Holdings making payments based on a fixed rate over the term of the interest rate swap agreements, without exchange of the underlying notional amount.

The Company uses foreign currency options, collars and forwards, 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 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 thus

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providing a natural hedge against its foreign currency risk. In connection with the remaining foreign currency risk, the Company uses foreign currency options, collars and forwards 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.

As of March 31, 2012, the Company did not purchase or hold any derivative instruments for trading or speculative purposes.

Designated Cash Flow Hedges

In 2008, Sally Holdings entered into certain interest rate swap agreements with an aggregate notional amount of \$300 million. These agreements expire in May 2012 and are designated and qualify as effective cash flow hedges, in accordance with ASC Topic 815, *Derivatives and Hedging* (ASC 815). Accordingly, changes in the fair value of these derivative instruments (which are adjusted quarterly) are recorded, net of income tax, in accumulated other comprehensive (loss) income (OCI) until the hedged obligation is settled or the swap agreements expire, whichever is earlier. Any hedge ineffectiveness, as this term is used in ASC 815, is recognized in interest expense in our consolidated statements of earnings. No hedge ineffectiveness on cash flow hedges was recognized during the six months ended March 31, 2012 or 2011.

Amounts reported in OCI related to interest rate swaps are reclassified into interest expense, as a yield adjustment, in the same period in which interest on hedged variable-rate debt obligations affects earnings. Interest expense resulting from such reclassifications was \$2.5 million during each of the three months ended March 31, 2012 and 2011; and \$5.1 million and \$5.0 million during the six months ended March 31, 2012 and 2011, respectively. The entire amount reported in OCI (\$1.7 million, before income tax) as of March 31, 2012 will be reclassified into interest expense by May 2012.

Non-designated Cash Flow Hedges

The Company uses foreign currency options and collars including, at March 31, 2012, collars with an aggregate notional amount of \$7.0 million to manage the exposure to the U.S. dollar resulting from certain of our Sinelco Group subsidiaries' purchases of merchandise from third-party suppliers. Sinelco's functional currency is the Euro. The foreign currency collar agreements held by the Company at March 31, 2012, have contractual Euro to U.S. dollar exchange rates between 1.4000 and 1.4612 and expire in varying amounts monthly through September 2012.

In addition, the Company currently uses foreign currency forwards to mitigate its exposure to changes in foreign currency exchange rates in connection with certain intercompany balances not permanently invested. At March 31, 2012, we hold: (a) a foreign currency forward which

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enables us to sell approximately 26.2 million (\$35.0 million, at the March 31, 2012 exchange rate) at the contractual exchange rate of 1.331, (b) a foreign currency forward which enables us to sell approximately \$2.0 million Canadian dollars (\$2.0 million, at the March 31, 2012 exchange rate) at the contractual exchange rate of 0.9989, (c) a foreign currency forward which enables us to buy approximately \$2.7 million Canadian dollars (\$2.7 million, at the March 31, 2012 exchange rate) at the contractual exchange rate of 0.9988, (d) a foreign currency forward which enables us to sell approximately 19.3 million Mexican pesos (\$1.5 million, at the March 31, 2012 exchange rate) at the contractual exchange rate of 12.849 and (e) a foreign currency forward which enables us to buy approximately £0.6 million (\$1.0 million, at the March 31, 2012 exchange rate) at the contractual exchange rate of 1.590. All foreign currency forwards held by the Company at March 31, 2012 expire on or before June 1, 2012.

The Company's foreign currency derivatives are not designated as hedges and do not currently meet the hedge accounting requirements of ASC 815. Accordingly, the changes in fair value of these derivative instruments, which are adjusted quarterly, are recorded in our consolidated statements of earnings. Selling, general and administrative expenses reflect net losses of \$1.3 million and \$1.0 million for the three months ended March 31, 2012 and 2011, respectively; and net gains of \$0.4 million and net losses of \$0.4 million for the six months ended March 31, 2012 and 2011, respectively, including marked-to-market adjustments, in connection with all of the Company's foreign currency derivatives.

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The table below presents the fair value of the Company's derivative financial instruments as well as their classification on the balance sheet as of March 31, 2012 (in thousands):

Tabular Disclosure of Fair Values of Derivative Instruments

Derivatives designated as hedging instruments:				
Interest Rate Swaps	Other assets	\$	Accrued liabilities	\$ 1,678
Total derivatives designated as hedging instruments		\$		\$ 1,678
Derivatives not designated as hedging instruments:				
Foreign Currency Collars and Forwards	Prepaid expenses	\$ 334	Accrued liabilities	\$ 86
Total derivatives not designated as hedging instruments		\$ 334		\$ 86

The table below presents the fair value of the Company's derivative financial instruments as well as their classification on the balance sheet as of September 30, 2011 (in thousands):

Tabular Disclosure of Fair Values of Derivative Instruments

	Asset Derivatives As of September 30, 2011		Liability Derivatives As of September 30, 2011	
	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
Derivatives designated as hedging instruments:				
Interest Rate Swaps	Other assets	\$	Accrued liabilities	\$ 6,450
Total derivatives designated as hedging instruments		\$		\$ 6,450
Derivatives not designated as hedging instruments:				
Foreign Currency Collars and Forwards	Prepaid expenses	\$ 1,104	Accrued liabilities	\$ 528
Total derivatives not designated as hedging instruments		\$ 1,104		\$ 528

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The table below presents the effect of the Company's derivative financial instruments on the statements of earnings for the three months ended March 31, 2012 (in thousands):

Tabular Disclosure of the Effect of Derivative Instruments on the**Statement of Earnings for the****Three Months Ended March 31, 2012**

	Amount of Gain or (Loss) Recognized in OCI on Derivative (Effective Portion), net of tax	Location of Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)	Amount of Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)	Location of Gain or (Loss) Recognized in Income on Derivative (Ineffective Portion and Amount Excluded from Effectiveness Testing)	Amount of Gain or (Loss) Recognized in Income on Derivative (Ineffective Portion and Amount Excluded from Effectiveness Testing)
Derivatives in Cash Flow Hedging Relationships					
Interest Rate Swaps	\$ 1,425	Interest expense	\$ (2,508)	Interest expense	\$

	Location of Gain or (Loss) Recognized in Income on Derivative	Amount of Gain or (Loss) Recognized in Income on Derivative
Derivatives Not Designated as Hedging Instruments		
Foreign Currency Options, Collars and Forwards	Selling, general and administrative expenses	\$ (1,337)
Total derivatives not designated as hedging instruments		\$ (1,337)

The table below presents the effect of the Company's derivative financial instruments on the statements of earnings for the three months ended March 31, 2011 (in thousands):

Tabular Disclosure of the Effect of Derivative Instruments on the**Statement of Earnings for the****Three Months Ended March 31, 2011**

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	Amount of Gain or (Loss) Recognized in OCI on Derivative (Effective Portion), net of tax	Location of Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)	Amount of Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)	Location of Gain or (Loss) Recognized in Income on Derivative (Ineffective Portion and Amount Excluded from Effectiveness Testing)	Amount of Gain or (Loss) Recognized in Income on Derivative (Ineffective Portion and Amount Excluded from Effectiveness Testing)
Derivatives in Cash Flow Hedging Relationships					
Interest Rate Swaps	\$ 1,308	Interest expense	\$ (2,488)	Interest expense	\$

	Location of Gain or (Loss) Recognized in Income on Derivative	Amount of Gain or (Loss) Recognized in Income on Derivative
Derivatives Not Designated as Hedging Instruments		
Foreign Currency Options and Forwards	Selling, general and administrative expenses	\$ (1,018)
Total derivatives not designated as hedging instruments		\$ (1,018)

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(Unaudited)

The table below presents the effect of the Company's derivative financial instruments on the statements of earnings for the six months ended March 31, 2012 (in thousands):

Tabular Disclosure of the Effect of Derivative Instruments on the**Statement of Earnings for the****Six Months Ended March 31, 2012**

	Amount of Gain or (Loss) Recognized in OCI on Derivative (Effective Portion), net of tax	Location of Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)	Amount of Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)	Location of Gain or (Loss) Recognized in Income on Derivative (Ineffective Portion and Amount Excluded from Effectiveness Testing)	Amount of Gain or (Loss) Recognized in Income on Derivative (Ineffective Portion and Amount Excluded from Effectiveness Testing)
Derivatives in Cash Flow Hedging Relationships					
Interest Rate Swaps	\$ 2,920	Interest expense	\$ (5,061)	Interest expense	\$

	Location of Gain or (Loss) Recognized in Income on Derivative	Amount of Gain or (Loss) Recognized in Income on Derivative
Derivatives Not Designated as Hedging Instruments		
Foreign Currency Options, Collars and Forwards	Selling, general and administrative expenses	\$ 372
Total derivatives not designated as hedging instruments		\$ 372

The table below presents the effect of the Company's derivative financial instruments on the statements of earnings for the six months ended March 31, 2011 (in thousands):

Tabular Disclosure of the Effect of Derivative Instruments on the**Statement of Earnings for the****Six Months Ended March 31, 2011**

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	Amount of Gain or (Loss) Recognized in OCI on Derivative (Effective Portion), net of tax	Location of Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)	Amount of Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)	Location of Gain or (Loss) Recognized in Income on Derivative (Ineffective Portion and Amount Excluded from Effectiveness Testing)	Amount of Gain or (Loss) Recognized in Income on Derivative (Ineffective Portion and Amount Excluded from Effectiveness Testing)
Derivatives in Cash Flow Hedging Relationships					
Interest Rate Swaps	\$ 2,837	Interest expense	\$ (5,033)	Interest expense	\$

	Location of Gain or (Loss) Recognized in Income on Derivative	Amount of Gain or (Loss) Recognized in Income on Derivative
Derivatives Not Designated as Hedging Instruments		
Foreign Currency Options and Forwards	Selling, general and administrative expenses	\$ (408)
Total derivatives not designated as hedging instruments		\$ (408)

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Credit-risk-related Contingent Features

The agreements governing the Company's interest rate swaps contain provisions pursuant to which the Company could be declared in default on its interest rate swap obligations in the event the Company defaulted under certain terms of the loan documents governing the Company's ABL facility. As of March 31, 2012, the fair value of interest rate swaps in a liability position related to these agreements was \$1.7 million and the Company was under no obligation to post and had not posted any collateral related to these agreements. If the Company breached any of these provisions, it would be required to settle its obligations under the agreements at their termination value of \$1.7 million, including accrued interest and other termination costs.

The Company's foreign operations expose the Company to fluctuations in foreign currency exchange rates and foreign interest rates. These fluctuations may impact, among other things, the amount of the Company's future cash flows in terms of the functional currencies of the Company and certain of its foreign subsidiaries. The Company currently uses foreign currency collars to manage the exposure to certain non-Euro currencies resulting from our Sinelco Group subsidiaries' purchases of merchandise from third-party suppliers. Sinelco's functional currency is the Euro. In addition, at March 31, 2012, Sally Holdings held certain foreign currency forward agreements which expire on or before June 1, 2012. These derivative instruments are intended to mitigate the Company's exposure to changes in foreign currency exchange rates in connection with certain non-U.S. dollar denominated intercompany balances not permanently invested. The Company's functional currency is the U.S. dollar.

The counterparties to all our derivative instruments are 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 a counterparty. The financial crisis affecting 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 a 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. Income Taxes

The Company and its subsidiaries file consolidated income tax returns in the U.S. federal jurisdiction and most state jurisdictions, as well as in various foreign jurisdictions.

In January 2012, the IRS concluded the field work associated with their examination of the Company's consolidated federal income tax returns for the fiscal years ended September 30, 2007 and 2008 and issued their examination report. The Company is appealing certain disputed items and it does not anticipate the ultimate resolution of these items to have a material impact on the Company's financial statements.

The IRS is currently conducting an examination of the Company's consolidated federal income tax returns for the fiscal years ended September 30, 2009 and 2010. The examination is also expected to include the Company's consolidated federal income tax return for the fiscal year ended September 30, 2011, upon the filing of such return. The IRS had previously audited the Company's consolidated federal income tax returns through the tax year ended September 30, 2006, thus our statute remains open from the year ended September 30, 2007 forward. Our foreign subsidiaries are impacted by various statutes of limitations, which are generally open from 2004 forward. Generally, states' statutes in the United States are open for tax reviews from 2005 forward.

12. Business Combinations

On November 1, 2011, the Company acquired the Floral Group for approximately 22.8 million (approximately \$31.2 million), subject to certain adjustments. The Floral Group is a distributor of professional beauty products with 19 stores located in the Netherlands. The results of operations of the Floral Group are included in the Company's consolidated financial statements subsequent to the acquisition date. The assets acquired and liabilities assumed were recorded at their respective fair values at the acquisition date. Goodwill of \$15.0 million (which is not expected to be deductible for tax purposes) and intangible assets subject to amortization of \$11.8 million were recorded as a result of this acquisition based on their estimated fair values. The acquisition was funded with cash from operations and with borrowings on our ABL facility in the amount of approximately \$17.0 million. In addition, during the six months ended March 31, 2012, the Company completed several other individually immaterial acquisitions at an aggregate cost of approximately \$12.4 million and recorded additional goodwill in the amount of \$9.2 million (the majority of which is expected to be deductible for tax purposes) in connection with such acquisitions. Generally, we funded these acquisitions with cash from operations. The assets acquired and liabilities assumed in connection with these acquisitions were recorded based on their respective fair values at the acquisition date.

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13. 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 South America and Europe 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 generally exclusive geographical territories in North America, Puerto Rico and parts of Europe.

Sales between segments, which were eliminated in consolidation, were not material during the six months ended March 31, 2012 and 2011. Segment data for the three and six months ended March 31, 2012 and 2011 is as follows (in thousands):

	Three Months Ended March 31,		Six Months Ended March 31,	
	2012	2011	2012	2011
Net sales:				
Sally Beauty Supply	\$ 553,973	\$ 490,845	\$ 1,090,331	\$ 971,851
BSG	335,308	310,960	663,765	623,518
Total	\$ 889,281	\$ 801,805	\$ 1,754,096	\$ 1,595,369
Earnings before provision for income taxes:				
Segment operating profit:				
Sally Beauty Supply	\$ 111,334	\$ 93,945	\$ 212,400	\$ 177,497
BSG	45,597	33,527	88,924	68,669
Segment operating profit	156,931	127,472	301,324	246,166
Unallocated expenses (a)	(22,329)	(19,379)	(45,401)	(37,863)
Share-based compensation expense	(2,945)	(2,437)	(10,976)	(10,275)
Interest expense (b)	(22,355)	(27,793)	(86,316)	(57,316)
Earnings before provision for income taxes	\$ 109,302	\$ 77,863	\$ 158,631	\$ 140,712

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

(b) For the six months ended March 31, 2012, interest expense includes a loss on extinguishment of debt of \$34.6 million in connection with the Company's December 2011 redemption of its senior notes due 2014 and senior subordinated notes due 2016 with the net proceeds of the Company's new senior notes due 2019, issued in November 2011.

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14. Guarantor and Non-Guarantor Condensed Consolidated Financial Statements

The following condensed consolidating financial information presents the condensed consolidated balance sheets as of March 31, 2012 and September 30, 2011, the condensed consolidated statements of earnings for the three and six months ended March 31, 2012 and 2011, and the condensed consolidated statements of cash flows for the six months ended March 31, 2012 and 2011 of: (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 subsidiary guarantors have not been provided as management believes the following information is sufficient, as guarantor subsidiaries are 100 percent indirectly owned by the Parent and all guarantees are full and unconditional. Additionally, substantially all of the assets of the guarantor subsidiaries are pledged under the senior term loan facilities and the ABL facility and consequently may not be available to satisfy the claims of general creditors.

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(Unaudited)

SALLY BEAUTY HOLDINGS, INC. AND SUBSIDIARIES

Condensed Consolidating Balance Sheet

March 31, 2012

(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	\$	\$	\$ 35,719	\$ 29,091	\$	\$ 64,810
Trade accounts and accounts receivable, other, less allowance for doubtful accounts		2	59,632	33,439		93,073
Due from affiliates	90,263	3	915,055	1,517	(1,006,838)	
Inventory			512,813	176,554		689,367
Prepaid expenses	458	175	11,146	13,713		25,492
Deferred income tax assets, net	(346)		31,661	(2,727)		28,588
Property and equipment, net			130,108	57,285		187,393
Investment in subsidiaries	(168,290)	2,025,964	343,364		(2,201,038)	
Goodwill and other intangible assets, net			480,457	188,357		668,814
Other assets		21,869	5,681	4,845		32,395
Total assets	\$ (77,913)	\$ 2,048,011	\$ 2,525,636	\$ 502,074	\$ (3,207,876)	\$ 1,789,932
Liabilities and Stockholders (Deficit) Equity						
Accounts payable	\$ 5	\$	\$ 201,952	\$ 48,308	\$	\$ 250,265
Due to affiliates		843,310	91,780	71,748	(1,006,838)	
Accrued liabilities	480	22,903	118,614	25,267		167,264
Income taxes payable	(7,823)	4,534	3,287	2,867		2,865
Long-term debt		1,346,856	292	9,016		1,356,164
Other liabilities			25,132	1,398		26,530
Deferred income tax liabilities, net	(1,362)	(1,302)	58,615	106		56,057
Total liabilities	(8,700)	2,216,301	499,672	158,710	(1,006,838)	1,859,145
Total stockholders (deficit) equity	(69,213)	(168,290)	2,025,964	343,364	(2,201,038)	(69,213)
Total liabilities and stockholders (deficit) equity	\$ (77,913)	\$ 2,048,011	\$ 2,525,636	\$ 502,074	\$ (3,207,876)	\$ 1,789,932

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Sally Beauty Holdings, Inc. and Subsidiaries

Condensed Notes to Consolidated Financial Statements

(Unaudited)

SALLY BEAUTY HOLDINGS, INC. AND SUBSIDIARIES

Condensed Consolidating Balance Sheet

September 30, 2011

(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	\$	\$	\$ 22,583	\$ 40,898	\$	\$ 63,481
Trade accounts and accounts receivable, other, less allowance for doubtful accounts			62,749	32,777		95,526
Due from affiliates	59,249	3	763,741	3,597	(826,590)	
Inventory			505,893	159,353		665,246
Prepaid expenses	1,233	63	11,397	13,667		26,360
Deferred income tax assets, net	(346)		31,661	(2,780)		28,535
Property and equipment, net	1		130,165	52,323		182,489
Investment in subsidiaries	(281,690)	1,862,684	331,346		(1,912,340)	
Goodwill and other intangible assets, net			476,206	159,325		635,531
Other assets		20,411	5,650	5,371		31,432
Total assets	\$ (221,553)	\$ 1,883,161	\$ 2,341,391	\$ 464,531	\$ (2,738,930)	\$ 1,728,600
Liabilities and Stockholders (Deficit) Equity						
Accounts payable	\$ 2	\$	\$ 204,300	\$ 57,812	\$	\$ 262,114
Due to affiliates		728,546	62,846	35,198	(826,590)	
Accrued liabilities	380	33,165	124,888	27,076		185,509
Income taxes payable	(1,679)	4,438	2,453	4,167		9,379
Long-term debt		1,401,855	340	10,920		1,413,115
Other liabilities			24,975	1,179		26,154
Deferred income tax liabilities, net	(1,274)	(3,153)	58,905	(3,167)		51,311
Total liabilities	(2,571)	2,164,851	478,707	133,185	(826,590)	1,947,582
Total stockholders (deficit) equity	(218,982)	(281,690)	1,862,684	331,346	(1,912,340)	(218,982)
Total liabilities and stockholders (deficit) equity	\$ (221,553)	\$ 1,883,161	\$ 2,341,391	\$ 464,531	\$ (2,738,930)	\$ 1,728,600

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Sally Beauty Holdings, Inc. and Subsidiaries

Condensed Notes to Consolidated Financial Statements

(Unaudited)

SALLY BEAUTY HOLDINGS, INC. AND SUBSIDIARIESCondensed Consolidating Statement of Earnings
Three Months Ended March 31, 2012

(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	\$	\$	\$ 725,321	\$ 163,960	\$	\$ 889,281
Related party sales			685		(685)	
Cost of products sold and distribution expenses			362,559	90,621	(685)	452,495
Gross profit			363,447	73,339		436,786
Selling, general and administrative expenses	2,605	147	221,710	64,727		289,189
Depreciation and amortization	1		11,213	4,726		15,940
Operating earnings (loss)	(2,606)	(147)	130,524	3,886		131,657
Interest income			(1)	(30)		(31)
Interest expense		22,177	34	175		22,386
Earnings (loss) before provision for income taxes	(2,606)	(22,324)	130,491	3,741		109,302
Provision (benefit) for income taxes	(869)	(8,658)	49,084	1,932		41,489
Equity in earnings of subsidiaries, net of tax	69,550	83,216	1,809		(154,575)	
Net earnings	\$ 67,813	\$ 69,550	\$ 83,216	\$ 1,809	\$ (154,575)	\$ 67,813

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Sally Beauty Holdings, Inc. and Subsidiaries

Condensed Notes to Consolidated Financial Statements

(Unaudited)

SALLY BEAUTY HOLDINGS, INC. AND SUBSIDIARIESCondensed Consolidating Statement of Earnings
Three Months Ended March 31, 2011

(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	\$	\$	\$ 654,490	\$ 147,315	\$	\$ 801,805
Related party sales			681		(681)	
Cost of products sold and distribution expenses			330,949	79,723	(681)	409,991
Gross profit			324,222	67,592		391,814
Selling, general and administrative expenses	2,004	326	212,898	56,153		271,381
Depreciation and amortization			10,637	4,140		14,777
Operating earnings (loss)	(2,004)	(326)	100,687	7,299		105,656
Interest income			(7)	(74)		(81)
Interest expense		27,625	17	232		27,874
Earnings (loss) before provision for income taxes	(2,004)	(27,951)	100,677	7,141		77,863
Provision (benefit) for income taxes	(754)	(10,840)	38,417	1,762		28,585
Equity in earnings of subsidiaries, net of tax	50,528	67,639	5,379		(123,546)	
Net earnings	\$ 49,278	\$ 50,528	\$ 67,639	\$ 5,379	\$ (123,546)	\$ 49,278

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Sally Beauty Holdings, Inc. and Subsidiaries

Condensed Notes to Consolidated Financial Statements

(Unaudited)

SALLY BEAUTY HOLDINGS, INC. AND SUBSIDIARIES

Condensed Consolidating Statement of Earnings

Six Months Ended March 31, 2012

(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	\$	\$	\$ 1,417,235	\$ 336,861	\$	\$ 1,754,096
Related party sales			1,485		(1,485)	
Cost of products sold and distribution expenses			712,506	184,432	(1,485)	895,453
Gross profit			706,214	152,429		858,643
Selling, general and administrative expenses	5,309	289	447,712	128,893		582,203
Depreciation and amortization	1		22,317	9,175		31,493
Operating earnings (loss)	(5,310)	(289)	236,185	14,361		244,947
Interest income			(1)	(66)		(67)
Interest expense		85,963	58	362		86,383
Earnings (loss) before provision for income taxes	(5,310)	(86,252)	236,128	14,065		158,631
Provision (benefit) for income taxes	(1,870)	(33,452)	90,544	5,462		60,684
Equity in earnings of subsidiaries, net of tax	101,387	154,187	8,603		(264,177)	
Net earnings	\$ 97,947	\$ 101,387	\$ 154,187	\$ 8,603	\$ (264,177)	\$ 97,947

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Sally Beauty Holdings, Inc. and Subsidiaries

Condensed Notes to Consolidated Financial Statements

(Unaudited)

SALLY BEAUTY HOLDINGS, INC. AND SUBSIDIARIES

Condensed Consolidating Statement of Earnings

Six Months Ended March 31, 2011

(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	\$	\$	\$ 1,295,330	\$ 300,039	\$	\$ 1,595,369
Related party sales			1,480		(1,480)	
Cost of products sold and distribution expenses			661,733	163,911	(1,480)	824,164
Gross profit			635,077	136,128		771,205
Selling, general and administrative expenses	3,930	313	427,085	112,961		544,289
Depreciation and amortization	1		21,032	7,855		28,888
Operating earnings (loss)	(3,931)	(313)	186,960	15,312		198,028
Interest income			(57)	(102)		(159)
Interest expense		57,013	32	430		57,475
Earnings (loss) before provision for income taxes	(3,931)	(57,326)	186,985	14,984		140,712
Provision (benefit) for income taxes	(1,480)	(22,233)	71,500	2,698		50,485
Equity in earnings of subsidiaries, net of tax	92,678	127,771	12,286		(232,735)	
Net earnings	\$ 90,227	\$ 92,678	\$ 127,771	\$ 12,286	\$ (232,735)	\$ 90,227

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Sally Beauty Holdings, Inc. and Subsidiaries

Condensed Notes to Consolidated Financial Statements

(Unaudited)

SALLY BEAUTY HOLDINGS, INC. AND SUBSIDIARIESCondensed Consolidating Statement of Cash Flows
Six Months Ended March 31, 2012

(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	\$ (20,111)	\$ 94,574	\$ 31,884	\$ 31,743	\$	\$ 138,090
Cash Flows from Investing Activities:						
Capital expenditures, net of proceeds from sale of property and equipment			(17,217)	(9,739)		(26,956)
Acquisitions, net of cash acquired			(10,607)	(32,547)		(43,154)
Net cash used by investing activities			(27,824)	(42,286)		(70,110)
Cash Flows from Financing Activities:						
Proceeds from issuance of long-term debt		929,200				929,200
Repayments of long-term debt		(1,008,583)	(48)	(1,843)		(1,010,474)
Debt issuance costs		(15,191)				(15,191)
Proceeds from exercises of stock options	20,111					20,111
Excess tax benefit from share-based compensation			9,124			9,124
Net cash provided (used) by financing activities	20,111	(94,574)	9,076	(1,843)		(67,230)
Effect of foreign exchange rate changes on cash and cash equivalents				579		579
Net increase (decrease) in cash and cash equivalents			13,136	(11,807)		1,329
Cash and cash equivalents, beginning of period			22,583	40,898		63,481
Cash and cash equivalents, end of period	\$	\$	\$ 35,719	\$ 29,091	\$	\$ 64,810

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Sally Beauty Holdings, Inc. and Subsidiaries

Condensed Notes to Consolidated Financial Statements

(Unaudited)

SALLY BEAUTY HOLDINGS, INC. AND SUBSIDIARIESCondensed Consolidating Statement of Cash Flows
Six Months Ended March 31, 2011

(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	\$ (3,807)	\$ 22,284	\$ 91,666	\$ 15,482	\$	\$ 125,625
Cash Flows from Investing Activities:						
Capital expenditures, net of proceeds from sale of property and equipment			(19,841)	(9,384)		(29,225)
Acquisitions, net of cash acquired			(80,598)	(572)		(81,170)
Net cash used by investing activities			(100,439)	(9,956)		(110,395)
Cash Flows from Financing Activities:						
Change in book cash overdraft		2,516				2,516
Proceeds from issuance of long-term debt		372,200	404	6,901		379,505
Repayments of long-term debt		(389,200)	(80)	(7,941)		(397,221)
Debt issuance costs		(5,284)				(5,284)
Proceeds from exercises of stock options	3,807					3,807
Excess tax benefit from share-based compensation			776			776
Net cash provided (used) by financing activities	3,807	(19,768)	1,100	(1,040)		(15,901)
Effect of foreign exchange rate changes on cash and cash equivalents				279		279
Net increase (decrease) in cash and cash equivalents		2,516	(7,673)	4,765		(392)
Cash and cash equivalents, beginning of period		20	32,975	26,499		59,494
Cash and cash equivalents, end of period	\$	\$ 2,536	\$ 25,302	\$ 31,264	\$	\$ 59,102

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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, 2011, 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 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 For the Six Months Ended March 31, 2012:

- Our consolidated same store sales increased by 8.1% for the six months ended March 31, 2012, compared to the six months ended March 31, 2011;
- Our consolidated net sales for the six months ended March 31, 2012, increased by \$158.7 million, or 9.9%, to \$1,754.1 million compared to \$1,595.4 million for the six months ended March 31, 2011;
- Our consolidated gross profit for the six months ended March 31, 2012, increased by \$87.4 million, or 11.3%, to \$858.6 million compared to \$771.2 million for the six months ended March 31, 2011. As a percentage of net sales, gross profit increased by 70 basis points to 49.0% for the six months ended March 31, 2012, compared to 48.3% for the six months ended March 31, 2011;
- Our consolidated operating earnings for the six months ended March 31, 2012, increased by \$46.9 million, or 23.7%, to \$244.9 million compared to \$198.0 million for the six months ended March 31, 2011. As a percentage of net sales, operating earnings increased by 160 basis points to 14.0% for the six months ended March 31, 2012, compared to 12.4% for the six months ended March 31, 2011;
- Net earnings increased by \$7.7 million, or 8.6%, to \$97.9 million for the six months ended March 31, 2012, compared to \$90.2 million for the six months ended March 31, 2011. For the six months ended March 31, 2012, net earnings reflect charges of \$34.6 million related to our redemption of the senior notes and senior subordinated notes. As a percentage of net sales, net earnings decreased by 10 basis points to 5.6% for the six months ended March 31, 2012, compared to 5.7% for the six months ended March 31, 2011;
- Cash provided by operations increased by \$12.5 million to \$138.1 million for the six months ended March 31, 2012, compared to \$125.6 million for the six months ended March 31, 2011;
- In November 2011, the Company acquired Kappersservice Floral B.V. and two related companies (together, the "Floral Group"), a distributor of professional beauty products with 19 stores located in the Netherlands, for approximately \$22.8 million (approximately \$31.2 million), subject to certain adjustments; and
- In December 2011, the Company redeemed its 9.25% senior notes due 2014 and its 10.50% senior subordinated notes due 2016 with the net proceeds from its November 2011 issuance of \$750.0 million principal amount of 6.875% senior notes due 2019. For the six months ended March 31, 2012, interest expense includes a loss on extinguishment of debt of \$34.6 million in connection with the redemption of the senior notes and the senior subordinated notes, including unamortized deferred financing costs expensed and call premiums paid.

Overview

Description of Business

We operate primarily through two business units, Sally Beauty Supply and Beauty Systems Group, or BSG. Through Sally Beauty Supply and BSG, we operated a multi-channel platform of 4,210 company-operated stores and supplied 182 franchised stores, primarily in North America, South America and selected European countries, as of March 31, 2012. We are 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, hair 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 six months ended March 31, 2012, our consolidated net sales and operating earnings were \$1,754.1 million and \$244.9 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 March 31, 2012, Sally Beauty Supply operated 3,204 company-operated retail stores, including 2,543 of which are located in the U.S. (with the remaining 661 company-operated stores located in Puerto Rico, Canada, Mexico, Chile, the United Kingdom, Ireland, Belgium, France, Germany, the Netherlands and Spain) and Sally Beauty Supply supplied 24 franchised stores located outside the U.S. 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

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professional beauty supplies for both retail customers and salon professionals, with between 5,000 and 8,000 SKUs (primarily in

the U.S. and Canada) 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®, Revlon® and Conair®, as well as a broad selection of exclusive-label merchandise. Store formats, including average size and product selection, for Sally Beauty Supply stores outside the U.S. and Canada vary by marketplace. For the six months ended March 31, 2012, Sally Beauty Supply's net sales and segment operating profit were \$1,090.3 million and \$212.4 million, respectively.

We believe BSG is the largest full-service distributor of professional beauty supplies in the U.S., exclusively targeting salons and salon professionals. As of March 31, 2012, BSG had 1,006 company-operated stores, supplied 158 franchised stores and had a sales force of approximately 1,113 professional distributor sales consultants in all states in the U.S., in portions of Canada, and in Puerto Rico, Mexico and certain European countries. Through BSG's large store base and sales force, BSG is able to access a significant portion of the highly fragmented U.S. professional beauty sales channel. Company-operated BSG stores, which primarily operate under the CosmoProf banner, average approximately 2,700 square feet in size and are primarily located in secondary strip shopping centers. BSG stores provide a comprehensive selection of between 5,000 and 10,000 beauty product SKUs that include hair color and care, skin and nail care, beauty sundries and electrical appliances. Certain BSG products are sold under exclusive distribution agreements with suppliers, whereby BSG is designated as the sole distributor for a product line within certain geographic territories. For the six months ended March 31, 2012, BSG's net sales and segment operating profit were \$663.8 million and \$88.9 million, respectively.

Industry and Business Trends

We operate within the large and growing professional beauty supply industry primarily in North America, Puerto Rico and parts of South America and Europe. Potential growth in the industry is expected to be driven by increases in hair color, hair loss prevention and hair styling products. 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 channel is highly fragmented with nearly 250,000 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, booth renters have 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 a broad range of exclusive-label products. 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 the growth in sales of these products will likely enhance our overall gross margins. Please see Risk Factors We depend upon manufacturers who may be unable to

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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, 2011.

- *Favorable demographic and consumer trends.* We expect the aging baby-boomer population to drive future growth in professional beauty supply sales 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 changes in consumer preferences and buying trends or manage our product lines and inventory commensurate with consumer demand in Item 1A of our Annual Report on Form 10-K for the fiscal year ended September 30, 2011.

- *International growth strategies.* A key element of our growth strategy depends on our ability to capitalize on growth opportunities in the international marketplace and to grow our current level of non-U.S. operations. For example, in

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November 2011, we acquired the Floral Group, a distributor of professional beauty products with 19 stores located in the Netherlands; in December 2009, we acquired Sinelco, a wholesale distributor of professional beauty products located in Belgium with sales throughout Europe; and, in September 2009, we acquired Intersalon, a distributor of premier beauty supply products then with 16 stores located in Chile. These acquisitions furthered our expansion plans in Europe and Latin America, key targets of the Company's international growth initiative. We intend to continue to identify and evaluate non-U.S. acquisition and/or organic international growth targets. 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 targets 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, 2011.

- *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 competitive 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. We also believe 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, L'Oréal recently acquired distributors that compete with BSG in the Midwest, Southeast and West Coast regions of the U.S. and, as a result, L'Oréal directly competes with BSG in certain geographic areas. If L'Oréal 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 further revenue over time (including within its franchise-based business) due to potential losses of additional products (both from L'Oréal and from other suppliers) as well as from the increased competition from distribution networks affiliated with L'Oréal or any of our other 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, 2011.

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 the brand name or exclusive-label products we sell. We purchase our 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 (including the expansion or loss of distribution rights in various geographies and the addition or loss of product lines). Since we purchase products from many 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 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, 2011.

- *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, salons, mass merchandisers, drug stores and supermarkets, as well as sellers on the internet and 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,

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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, 2011.

- *Economic conditions.* We appeal to a wide demographic consumer profile and offer a broad 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, 2011.
- *Controlling expenses.* Another important aspect of our business is our ability to control costs, especially in our BSG business segment, by right-sizing the business and maximizing the efficiency of our business structure. For example, we completed a \$22.0 million capital spending program to consolidate warehouses and reduce administrative expenses related to BSG's distribution network which has resulted in annualized cost savings of at least \$14.0 million. 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, 2011.
- *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. The capital requirements to open a U.S.-based Sally Beauty Supply or BSG store, excluding inventory, average approximately \$70,000 and \$80,000, respectively, with the capital requirements for international stores costing less or substantially more depending upon the marketplace. 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, 2011.
- *Changes to our information technology systems.* As our operations grow in both size and scope, we will continuously need to improve and upgrade our information systems and infrastructure while maintaining the reliability and integrity of our systems and infrastructure. The expansion of our systems and infrastructure will require us to commit substantial financial, operational and technical resources in advance of any increase in the volume of our business, with no assurance that the volume of business will increase. For example, we are in the process of designing and implementing a standardized enterprise resource planning (ERP) system internationally, which we anticipate will be completed over the next few years. In addition, we are currently implementing a point-of-sale system upgrade program in a number of our divisions (primarily in our Sally Beauty Supply operations in the U.S.), which we anticipate will provide significant benefits, including enhanced tracking of customer sales and store inventory activity. These and any other required upgrades to our information systems and information technology (or new technology), now or in the future, will require that our management and resources be diverted from our core business to assist in completion of these projects. Many of our systems are proprietary, and as a result our options are limited in seeking third-party help with the operation and upgrade of those systems. There can be no assurance that the time and resources our management will need to devote to these upgrades, service outages or delays due to the installation of any new or upgraded technology (and customer issues therewith), or the impact on the reliability of our data from any new or upgraded technology will not have a material adverse effect on our financial reporting, business, financial condition or results of operations. Please see *Risk Factors* We may be adversely affected by any disruption in our information technology systems in Item 1A of our Annual Report on Form 10-K for the fiscal year ended September 30, 2011.

Significant Recent Acquisitions

On November 1, 2011, we acquired the Floral Group, a distributor of professional beauty products with 19 stores located in the Netherlands, for approximately 22.8 million (approximately \$31.2 million), subject to certain adjustments. The results of operations of the Floral Group are included in the Company's consolidated financial statements subsequent to the acquisition date. The assets acquired and liabilities assumed were recorded at their respective fair values at the acquisition date. Goodwill of \$15.0 million (which is not expected to be deductible for tax purposes) and intangible assets subject to amortization of \$11.8 million were recorded as a result of this acquisition based on their estimated fair values. The acquisition was funded with cash

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from operations and with borrowings on our ABL credit facility in the amount of approximately \$17.0 million. In addition, during the six months ended March 31, 2012, we completed several other individually immaterial acquisitions at an aggregate cost of approximately \$12.4 million and recorded additional goodwill in the amount of \$9.2 million (the majority of which is expected to be deductible for tax purposes) in connection with such acquisitions. Generally, we funded these acquisitions with cash from operations. The assets acquired and liabilities assumed in connection with these acquisitions were recorded based on their respective fair values at the acquisition date.

In October 2010, we acquired Aerial, an 82-store professional-only distributor of beauty products operating in 11 states in the mid-western region of the United States, for approximately \$81.8 million. The results of operations of Aerial are included in the Company's consolidated financial statements subsequent to the acquisition date. The assets acquired and liabilities assumed were recorded at their respective fair values at the acquisition date. Goodwill of \$25.3 million (which is expected to be deductible for tax purposes) and intangible assets subject to amortization of \$34.7 million were recorded as a result of this acquisition. The acquisition of Aerial was funded with borrowings in the amount of \$78.0 million under our ABL credit facility and with cash from operations.

Other Significant Items

Derivative Instruments

As a multinational corporation, we are subject to certain market risks including the potential impact of changes in market interest rates and foreign currency fluctuations on our business. 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.

Interest Rate Swap Agreements

The Company is exposed to a wide variety of economic risks, including risks arising from changing market interest rates. The Company manages its exposure to certain economic risks (including liquidity, credit risk and changes 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 interest rate swaps by Sally Holdings LLC (Sally Holdings). The Company uses interest rate swaps, as part of its overall economic risk management strategy, to add stability to the interest payments due in connection with its senior term loan obligations. Interest payments related to our senior term loans are impacted by changes in LIBOR. The Company's interest rate swap agreements involve the periodic receipt by Sally Holdings of amounts based on a variable rate in exchange for Sally Holdings making payments based on a fixed rate over the term of the interest rate swap agreements, without exchange of the underlying notional amount.

In May 2008, Sally Holdings entered into certain interest rate swap agreements with an aggregate notional amount of \$300 million. These agreements expire in May 2012 and are designated and qualify as effective cash flow hedges. Accordingly, changes in the fair value of these derivative instruments (which are adjusted quarterly) are recorded, net of income tax, in accumulated other comprehensive (loss) income until the hedged obligation is settled or the swap agreements expire, whichever is earlier. Any hedge ineffectiveness is recognized in interest expense in the Company's consolidated statements of earnings. Please see Item 3 Quantitative and Qualitative Disclosures about Market Risk Interest rate risk contained in Part I of this Quarterly Report on Form 10-Q and Note 16 of the Notes to Consolidated Financial Statements in Item 8 -

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Financial Statements and Supplementary Data contained in our Annual Report on Form 10-K for the fiscal year ended September 30, 2011 for additional information about the Company's interest rate swaps.

Foreign Currency Option, Collar and Forward Contracts

The Company is exposed to potential gains or losses resulting from foreign currency fluctuations affecting its net investments in subsidiaries (including intercompany notes not permanently invested) and earnings denominated in foreign currencies. The Company's primary exposures are to changes in the exchange rates for the U.S. dollar versus the Euro, the British pound sterling, the Canadian dollar, the Chilean peso, and the Mexican peso. The Company's foreign currency exposures at times offset each other, providing a natural hedge against its foreign currency risk. In connection with the remaining foreign currency risk, the Company from time to time uses foreign currency options, collars and forwards 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 currently uses foreign currency options and collars, including, at March 31, 2012, collars with an aggregate notional amount of \$7.0 million to manage the exposure to the U.S. dollar resulting from our Sinelco Group subsidiaries' purchases of merchandise from third-party suppliers. Sinelco's functional currency is the Euro. The foreign currency collar

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agreements held by the Company at March 31, 2012 have contractual Euro to U.S. dollar exchange rates between 1.4000 and 1.4612 and expire in varying amounts monthly through September 2012.

In addition, the Company currently uses foreign currency forwards to mitigate its exposure to changes in foreign currency exchange rates in connection with certain intercompany balances not permanently invested. At March 31, 2012, we hold: (a) a foreign currency forward which enables us to sell approximately 26.2 million (\$35.0 million, at the March 31, 2012 exchange rate) at the contractual exchange rate of 1.331, (b) a foreign currency forward which enables us to sell approximately \$2.0 million Canadian dollars (\$2.0 million, at the March 31, 2012 exchange rate) at the contractual exchange rate of 0.9989, (c) a foreign currency forward which enables us to buy approximately \$2.7 million Canadian dollars (\$2.7 million, at the March 31, 2012 exchange rate) at the contractual exchange rate of 0.9988, (d) a foreign currency forward which enables us to sell approximately 19.3 million Mexican pesos (\$1.5 million, at the March 31, 2012 exchange rate) at the contractual exchange rate of 12.849 and (e) a foreign currency forward which enables us to buy approximately £0.6 million (\$1.0 million, at the March 31, 2012 exchange rate) at the contractual exchange rate of 1.590. All the foreign currency forwards held by the Company at March 31, 2012 expire on or before June 1, 2012.

The Company's foreign currency option, collar and forward agreements 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. Please see Item 3 Quantitative and Qualitative Disclosures about Market Risk Foreign currency exchange rate risk contained in Part I of this Quarterly Report on Form 10-Q and Note 16 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, 2011 for additional information about the Company's foreign currency derivatives.

Share-Based Compensation Plans

The Company granted approximately 2.0 million and 3.0 million stock options and approximately 32,000 and 199,000 restricted share awards to its employees and consultants during the six months ended March 31, 2012 and 2011, respectively. Upon issuance of such grants, the Company recognized accelerated share-based compensation expense of \$5.3 million and \$5.0 million in the six months ended March 31, 2012 and 2011, 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. 2010 Omnibus Incentive Plan and certain predecessor share-based plans such as the Sally Beauty Holdings, Inc. 2007 Omnibus Incentive Plan. For the six months ended March 31, 2012 and 2011, total share-based compensation costs charged against earnings was \$11.0 million and \$10.3 million, respectively.

Non-recurring Charges

In December 2011, the Company redeemed \$430.0 million aggregate principal amount outstanding of its 9.25% senior notes due 2014 and \$275.0 million aggregate principal amount outstanding of its 10.50% senior subordinated notes due 2016, pursuant to the terms of the indentures governing the senior notes and the senior subordinated notes. During the six months ended March 31, 2012, the Company recorded a charge to earnings of approximately \$34.6 million (including approximately \$24.4 million in call premiums paid and approximately \$10.2 million in unamortized deferred financing costs expensed) in connection with the redemption of the senior notes and the senior subordinated notes. These amounts are included in interest expense in the Company's consolidated statements of earnings.

Table of Contents**Results of Operations**

The following table shows the condensed results of operations of our business for the three and six months ended March 31, 2012 and 2011 (in thousands):

	Three Months Ended March 31,		Six Months Ended March 31,	
	2012	2011	2012	2011
Net sales	\$ 889,281	\$ 801,805	\$ 1,754,096	\$ 1,595,369
Cost of products sold and distribution expenses	452,495	409,991	895,453	824,164
Gross profit	436,786	391,814	858,643	771,205
Total other operating costs and expenses	305,129	286,158	613,696	573,177
Operating earnings	131,657	105,656	244,947	198,028
Interest expense	22,355	27,793	86,316	57,316
Earnings before provision for income taxes	109,302	77,863	158,631	140,712
Provision for income taxes	41,489	28,585	60,684	50,485
Net earnings	\$ 67,813	\$ 49,278	\$ 97,947	\$ 90,227

The following table shows the condensed results of operations of our business for the three and six months ended March 31, 2012 and 2011, expressed as a percentage of net sales for each respective period shown:

	Three Months Ended March 31,		Six Months Ended March 31,	
	2012	2011	2012	2011
Net sales	100.0%	100.0%	100.0%	100.0%
Cost of products sold and distribution expenses	50.9%	51.1%	51.0%	51.7%
Gross profit	49.1%	48.9%	49.0%	48.3%
Total other operating costs and expenses	34.3%	35.7%	35.0%	35.9%
Operating earnings	14.8%	13.2%	14.0%	12.4%
Interest expense	2.5%	3.5%	5.0%	3.6%
Earnings before provision for income taxes	12.3%	9.7%	9.0%	8.8%
Provision for income taxes	4.7%	3.6%	3.4%	3.1%
Net earnings	7.6%	6.1%	5.6%	5.7%

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 March 31,		Six Months Ended March 31,	
	2012	2011	2012	2011
Net sales:				
Sally Beauty Supply	\$ 553,973	\$ 490,845	\$ 1,090,331	\$ 971,851
BSG	335,308	310,960	663,765	623,518
Consolidated	\$ 889,281	\$ 801,805	\$ 1,754,096	\$ 1,595,369
Gross profit	\$ 436,786	\$ 391,814	\$ 858,643	\$ 771,205
Gross profit margin	49.1%	48.9%	49.0%	48.3%
Selling, general and administrative expenses	\$ 289,189	\$ 271,381	\$ 582,203	\$ 544,289
Depreciation and amortization	\$ 15,940	\$ 14,777	\$ 31,493	\$ 28,888
Earnings before provision for income taxes:				
Segment operating profit:				
Sally Beauty Supply	\$ 111,334	\$ 93,945	\$ 212,400	\$ 177,497
BSG	45,597	33,527	88,924	68,669
Segment operating profit	156,931	127,472	301,324	246,166
Unallocated expenses (a)	(22,329)	(19,379)	(45,401)	(37,863)
Share-based compensation expense	(2,945)	(2,437)	(10,976)	(10,275)
Operating earnings	131,657	105,656	244,947	198,028
Interest expense (b)	(22,355)	(27,793)	(86,316)	(57,316)
Earnings before provision for income taxes	\$ 109,302	\$ 77,863	\$ 158,631	\$ 140,712
Segment operating profit margin:				
Sally Beauty Supply	20.1%	19.1%	19.5%	18.3%
BSG	13.6%	10.8%	13.4%	11.0%
Consolidated operating profit margin	14.8%	13.2%	14.0%	12.4%
Number of stores at end-of-period (including franchises):				
Sally Beauty Supply			3,228	3,083
BSG			1,164	1,124
			4,392	4,207
Same store sales growth (c)				
Sally Beauty Supply	9.3%	6.2%	8.7%	6.3%
BSG	8.7%	5.6%	6.9%	6.7%
Consolidated	9.1%	6.0%	8.1%	6.4%

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

(b) For the six months ended March 31, 2012, interest expense includes a loss on extinguishment of debt of \$34.6 million, including unamortized deferred financing costs expensed and call premiums paid, in connection with the Company's December 2011 redemption of its senior notes due 2014 and senior subordinated notes due 2016 with the net proceeds from the Company's issuance, in November 2011, of \$750.0 million aggregate principal amount of 6.875% senior notes due 2019.

(c) Same stores are defined as company-operated stores that have been open for at least 14 months as of the last day of a month. Our same store sales are calculated in constant dollars and include internet-based sales and the effect of store expansions, if applicable, but do not

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generally include the sales from stores relocated until at least 14 months after the relocation. The sales from stores acquired are excluded from our same store sales calculation until at least 14 months after the acquisition date.

Table of Contents***The Three Months Ended March 31, 2012 compared to the Three Months Ended March 31, 2011***

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

	Three Months Ended March 31,				
	2012	2011	Increase (Decrease)		
Net sales:					
Sally Beauty Supply	\$ 553,973	\$ 490,845	\$ 63,128		12.9%
BSG	335,308	310,960	24,348		7.8%
Consolidated net sales	\$ 889,281	\$ 801,805	\$ 87,476		10.9%
Gross profit:					
Sally Beauty Supply	\$ 300,069	\$ 267,017	\$ 33,052		12.4%
BSG	136,717	124,797	11,920		9.6%
Consolidated gross profit	\$ 436,786	\$ 391,814	\$ 44,972		11.5%
Gross profit margin:					
Sally Beauty Supply	54.2%	54.4%	(0.2)%		
BSG	40.8%	40.1%	0.7%		
Consolidated gross profit margin	49.1%	48.9%	0.2%		

Net Sales

Consolidated net sales increased by \$87.5 million, or 10.9%, for the three months ended March 31, 2012, compared to the three months ended March 31, 2011, primarily a result of increases in unit volume (including the incremental sales from 189 company-operated stores opened or acquired during the last twelve months). Company-operated Sally Beauty Supply and BSG stores that have been open for at least 14 months contributed an increase of approximately \$90.1 million, or 11.2%, and sales through our BSG distributor sales consultants contributed an increase of approximately \$11.6 million, or 1.5%. For the three months ended March 31, 2012, incremental sales from businesses acquired in the preceding 12 months contributed approximately \$20.2 million, or 2.5%, less to the sales increase than for the three months ended March 31, 2011. Other sales channels (including sales through our BSG franchise-based businesses, from stores that have been open for less than 14 months and our Sally Beauty Supply non-store sales), in the aggregate, contributed an increase of approximately \$6.0 million, or 0.7%, compared to the three months ended March 31, 2011. Consolidated net sales for the three months ended March 31, 2012, are inclusive of approximately \$4.5 million in negative impact from changes in foreign currency exchange rates.

Sally Beauty Supply. Net sales for Sally Beauty Supply increased by \$63.1 million, or 12.9%, for the three months ended March 31, 2012, compared to the three months ended March 31, 2011, primarily a result of increases in unit volume (including the incremental sales from 149 company-operated stores opened or acquired during the last twelve months). In the Sally Beauty Supply segment, company-operated stores that have been open for at least 14 months contributed an increase in segment net sales of approximately \$52.6 million, or 10.7%. In addition, for the three months ended March 31, 2012, incremental sales from businesses acquired in the preceding 12 months were approximately \$7.5 million with no comparable amount for the three months ended March 31, 2011. Other sales channels (including sales from stores that have been open for less than 14 months and non-store sales), in the aggregate, contributed an increase of approximately \$3.0 million, or 0.6%, compared to the three months ended March 31, 2011. Net sales for Sally Beauty Supply for the three months ended March 31, 2012, are inclusive of approximately \$3.8 million in negative impact from changes in foreign currency exchange rates.

Beauty Systems Group. Net sales for BSG increased by \$24.3 million, or 7.8%, for the three months ended March 31, 2012, compared to the three months ended March 31, 2011, primarily a result of increases in unit volume (including the incremental sales from 40 company-operated stores opened or acquired during the last twelve months). In the BSG segment, company-operated stores that have been open for at least 14 months contributed an increase in segment net sales of approximately \$37.5

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million, or 12.1%, and sales through our distributor sales consultants contributed an increase of approximately \$11.6 million, or 3.7%. For the three months ended March 31, 2012, incremental sales from businesses acquired in the preceding 12 months contributed approximately \$27.8 million, or 8.9%, less to the sales increase than for the three months ended March 31, 2011. Other sales channels (including sales through our franchise-based businesses and from stores that have been open for less than 14 months), in the aggregate, contributed an increase of approximately \$3.0 million, or 1.0%, compared to the three months ended March 31, 2011. Net sales for BSG for the three months ended March 31, 2012, are inclusive of approximately \$0.7 million in negative impact from changes in foreign currency exchange rates.

Gross Profit

Consolidated gross profit increased by \$45.0 million, or 11.5%, for the three months ended March 31, 2012, compared to the three months ended March 31, 2011, principally due to higher sales volume in both business segments and improved BSG gross margins, as more fully described below.

Sally Beauty Supply. Sally Beauty Supply's gross profit increased by \$33.1 million, or 12.4%, for the three months ended March 31, 2012, compared to the three months ended March 31, 2011, as a result of higher sales volume, partially offset by a decrease in the segment's gross margin. Sally Beauty Supply's gross profit as a percentage of net sales decreased to 54.2% for the three months ended March 31, 2012, compared to 54.4% for the three months ended March 31, 2011. This decrease was primarily the result of an increase in distribution expenses, particularly in some of the segment's international operations, partially offset by a favorable shift in product and customer mix (including a year-over-year increase in sales of exclusive-label products and other higher-margin products). This decrease also reflects a \$1.7 million negative impact from changes in foreign currency exchange rates.

Beauty Systems Group. BSG's gross profit increased by \$11.9 million, or 9.6%, for the three months ended March 31, 2012, compared to the three months ended March 31, 2011, principally as a result of higher sales volume and improved gross margin. BSG's gross profit as a percentage of net sales increased to 40.8% for the three months ended March 31, 2012, compared to 40.1% for the three months ended March 31, 2011. This increase was principally the result of a favorable change in the sales mix across the business, product cost reduction initiatives and continued synergies from businesses acquired during the last 24 months.

Selling, General and Administrative Expenses

Consolidated selling, general and administrative expenses increased by \$17.8 million, or 6.6%, for the three months ended March 31, 2012, compared to the three months ended March 31, 2011. This increase was attributable to incremental expenses (including employee compensation, rent and other occupancy-related expenses) resulting from stores opened and from businesses acquired in the preceding 12 months (including approximately 189 additional company-operated stores added since March 31, 2011), as well as higher shipping and handling costs (including certain freight and distribution expenses) of \$2.2 million. Selling, general and administrative expenses, as a percentage of net sales, decreased to 32.5% for the three months ended March 31, 2012, compared to 33.8% for the three months ended March 31, 2011 primarily due to the increase in net sales described above.

Depreciation and Amortization

Consolidated depreciation and amortization was \$15.9 million for the three months ended March 31, 2012, compared to \$14.8 million for the three months ended March 31, 2011. 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.

Table of Contents**Operating Earnings**

The following table sets forth, for the periods indicated, information concerning our operating earnings for each reportable segment (dollars in thousands):

	2012		Three Months Ended March 31, 2011		Increase		
Operating Earnings:							
Segment operating profit:							
Sally Beauty Supply	\$	111,334	\$	93,945	\$	17,389	18.5%
BSG		45,597		33,527		12,070	36.0%
Segment operating profit		156,931		127,472		29,459	23.1%
Unallocated expenses		(22,329)		(19,379)		2,950	15.2%
Share-based compensation expense		(2,945)		(2,437)		508	20.8%
Operating earnings	\$	131,657	\$	105,656	\$	26,001	24.6%

Consolidated operating earnings increased by \$26.0 million, or 24.6%, for the three months ended March 31, 2012, compared to the three months ended March 31, 2011. The increase in consolidated operating earnings was primarily due to an increase in the operating profits of both segments, partially offset by higher unallocated expenses and share-based compensation, as more fully discussed below. Operating earnings, as a percentage of net sales, increased to 14.8% for the three months ended March 31, 2012, compared to 13.2% for the three months ended March 31, 2011.

Sally Beauty Supply. Sally Beauty Supply's segment operating earnings increased by \$17.4 million, or 18.5%, for the three months ended March 31, 2012, compared to the three months ended March 31, 2011. The increase in Sally Beauty Supply's segment operating earnings was primarily a result of increased sales volume, partially offset by lower segment gross margin, higher advertising costs of approximately \$1.6 million, higher freight and distribution expenses of \$1.6 million and the incremental costs related to approximately 149 additional company-operated stores (stores opened or acquired during the past twelve months) operating during the three months ended March 31, 2012. Segment operating earnings, as a percentage of net sales, increased to 20.1% for the three months ended March 31, 2012, compared to 19.1% for the three months ended March 31, 2011. This increase reflects a reduction in the segment's operating expenses as a percentage of the segment's gross profit, partially offset by the decline in the segment's gross margin described above.

Beauty Systems Group. BSG's segment operating earnings increased by \$12.1 million, or 36.0%, for the three months ended March 31, 2012, compared to the three months ended March 31, 2011. The increase in BSG's segment operating earnings was primarily a result of increased sales volume and higher segment gross margin, partially offset by the incremental costs related to approximately 40 additional company-operated stores (stores opened or acquired during the past twelve months) operating during the three months ended March 31, 2012. Segment operating earnings, as a percentage of net sales, increased to 13.6% for the three months ended March 31, 2012, compared to 10.8% for the three months ended March 31, 2011. This increase reflects the growth in the segment's gross margin described above, as well as a reduction in the segment's operating expenses as a percentage of the segment's gross profit.

Unallocated Expenses. Unallocated expenses, which represent corporate costs (such as payroll, employee benefits and travel expenses for corporate staff, certain professional fees and corporate governance expenses) that have not been charged to our operating segments, increased by \$3.0 million, or 15.2%, for the three months ended March 31, 2012, compared to the three months ended March 31, 2011. This increase was

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primarily due to higher professional fees (\$0.8 million) and other corporate expenses related primarily to on-going upgrades to our information technology systems (\$2.2 million).

Share-based Compensation Expense. Total compensation cost charged against income for share-based compensation arrangements increased by \$0.5 million to \$2.9 million for the three months ended March 31, 2012, compared to \$2.4 million for the three months ended March 31, 2011. This increase was mainly due to the incremental expenses related to, as well as the higher fair value at the grant date of, equity awards during the six months ended March 31, 2012, compared to equity awards during the six months ended March 31, 2011, partially offset by the impact of equity awards that became fully vested since March 31, 2011.

Interest Expense

Interest expense decreased by \$5.4 million to \$22.4 million for the three months ended March 31, 2012, compared to \$27.8 million for the three months ended March 31, 2011 primarily due to lower expense associated with our new senior notes compared to the expense associated with our senior notes and senior subordinated notes redeemed in December 2011, as well as lower outstanding principal balances on our senior term loan facility (please see [Liquidity and Capital Resources](#) below).

Table of Contents***Provision for Income Taxes***

The provision for income taxes was \$41.5 million and \$28.6 million, and the effective income tax rate was 38.0% and 36.7%, for the three months ended March 31, 2012 and 2011, respectively. The increase in the effective tax rate was primarily due to tax benefits associated with certain discrete items during the period ended March 31, 2011, with no comparable items during the period ended March 31, 2012.

The annual effective tax rate for the fiscal year 2012 is currently expected to be in the range of 37.0% to 38.0%, versus a comparable actual tax rate for the full fiscal year 2011 of 36.4%.

Net Earnings

As a result of the foregoing, consolidated net earnings increased by \$18.5 million, or 37.6%, to \$67.8 million for the three months ended March 31, 2012, compared to \$49.3 million for the three months ended March 31, 2011. Net earnings, as a percentage of net sales, increased to 7.6% for the three months ended March 31, 2012, compared to 6.1% for the three months ended March 31, 2011.

The Six Months Ended March 31, 2012 compared to the Six Months Ended March 31, 2011

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

	2012	Six Months Ended March 31, 2011		Increase	
Net sales:					
Sally Beauty Supply	\$ 1,090,331	\$ 971,851	\$ 118,480		12.2%
BSG	663,765	623,518	40,247		6.5%
Consolidated net sales	\$ 1,754,096	\$ 1,595,369	\$ 158,727		9.9%
Gross profit:					
Sally Beauty Supply	\$ 589,196	\$ 522,797	\$ 66,399		12.7%
BSG	269,447	248,408	21,039		8.5%
Consolidated gross profit	\$ 858,643	\$ 771,205	\$ 87,438		11.3%
Gross profit margin:					
Sally Beauty Supply	54.0%	53.8%	0.2%		
BSG	40.6%	39.8%	0.8%		
Consolidated gross profit margin	49.0%	48.3%	0.7%		

Net Sales

Consolidated net sales increased by \$158.7 million, or 9.9%, for the six months ended March 31, 2012, compared to the six months ended March 31, 2011, primarily a result of increases in unit volume (including the incremental sales from 189 company-operated stores opened or acquired during the last twelve months). Company-operated Sally Beauty Supply and BSG stores that have been open for at least 14 months contributed an increase of approximately \$166.7 million, or 10.4%, and sales through our BSG distributor sales consultants contributed an increase of approximately \$23.6 million, or 1.5%. In addition, our Sally Beauty Supply non-store sales channels contributed an increase of approximately \$16.7 million, or 1.0%. For the six months ended March 31, 2012, incremental sales from businesses acquired in the preceding 12 months contributed approximately \$54.1 million, or 3.4%, less to the sales increase than for the six months ended March 31, 2011. Other sales channels (including sales through our BSG franchise-based businesses and from stores that have been open for less than 14 months), in the aggregate, contributed an increase of approximately \$5.9 million, or 0.4%, compared to the six months ended March 31, 2011. Consolidated net sales for the six months ended March 31, 2012, are inclusive of approximately \$7.0 million in

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negative impact from changes in foreign currency exchange rates.

Sally Beauty Supply. Net sales for Sally Beauty Supply increased by \$118.5 million, or 12.2%, for the six months ended March 31, 2012, compared to the six months ended March 31, 2011, primarily a result of increases in unit volume (including the incremental sales from 149 company-operated stores opened or acquired during the last twelve months). In the Sally Beauty Supply segment, company-operated stores that have been open for at least 14 months contributed an increase in segment net sales of approximately \$99.3 million, or 10.2%, and our non-store sales channels (which include the catalog and internet sales of our Sinelco Group subsidiaries) contributed an increase of approximately \$16.7 million, or 1.7%. Other sales channels (including sales from stores that have been open for less than 14 months and incremental sales from businesses acquired in the preceding 12 months), in the aggregate, contributed an increase of approximately \$2.4 million, or 0.3%, compared to the six months ended March 31, 2011. Net sales for Sally Beauty Supply for the six months ended March 31, 2012, are inclusive of approximately \$5.8 million in negative impact from changes in foreign currency exchange rates.

Beauty Systems Group. Net sales for BSG increased by \$40.2 million, or 6.5%, for the six months ended March 31, 2012, compared to the six months ended March 31, 2011, primarily a result of increases in unit volume (including the incremental sales from 40 company-operated stores opened or acquired during the last twelve months). In the BSG segment, company-operated stores that have been open for at least 14 months contributed an increase in segment net sales of approximately \$67.3 million, or 10.8%, and sales through our distributor sales consultants contributed an increase of approximately \$23.6 million, or 3.8%. For the six months ended March 31, 2012, incremental sales from businesses acquired in the preceding 12 months contributed approximately \$55.2 million, or 8.9%, less to the sales increase than for the six months ended March 31, 2011. Other sales channels (including sales through our franchise-based businesses and from stores that have been open for less than 14 months), in the aggregate, contributed an increase of approximately \$4.6 million, or 0.7%, compared to the six months ended March 31, 2011. Net sales for BSG for the six months ended March 31, 2012, are inclusive of approximately \$1.2 million in negative impact from changes in foreign currency exchange rates.

Gross Profit

Consolidated gross profit increased by \$87.4 million, or 11.3%, for the six months ended March 31, 2012, compared to the six months ended March 31, 2011, principally due to higher sales volume and improved gross margins in both business segments as more fully described below.

Sally Beauty Supply. Sally Beauty Supply's gross profit increased by \$66.4 million, or 12.7%, for the six months ended March 31, 2012, compared to the six months ended March 31, 2011, principally as a result of higher sales volume and improved gross margins. Sally Beauty Supply's gross profit as a percentage of net sales increased to 54.0% for the six months ended March 31, 2012, compared to 53.8% for the six months ended March 31, 2011. This increase was the result of a shift in product and customer mix (including a year-over-year increase in sales of exclusive-label products and other higher-margin products) and continued benefits from low-cost sourcing initiatives, partially offset by an increase in distribution expenses, particularly in some of the segment's international operations.

Beauty Systems Group. BSG's gross profit increased by \$21.0 million, or 8.5%, for the six months ended March 31, 2012, compared to the six months ended March 31, 2011, principally as a result of higher sales volume and improved gross margins. BSG's gross profit as a percentage of net sales increased to 40.6% for the six months ended March 31, 2012, compared to 39.8% for the six months ended March 31, 2011. This increase was principally the result of a favorable change in the sales mix across the business, product cost reduction initiatives and synergies from businesses acquired during the last 24 months.

Selling, General and Administrative Expenses

Consolidated selling, general and administrative expenses increased by \$37.9 million, or 7.0%, for the six months ended March 31, 2012, compared to the six months ended March 31, 2011. This increase was attributable to incremental expenses (including employee compensation, rent and other occupancy-related expenses) resulting from stores opened and from businesses acquired in the preceding 12 months (including approximately 189 additional company-operated stores added since March 31, 2011), as well as higher advertising costs in the Sally Beauty Supply segment of \$4.7 million and higher shipping and handling costs (including certain freight and distribution expenses) of \$3.9 million. Selling, general and administrative expenses, as a percentage of net sales, decreased to 33.2% for the six months ended March 31, 2012, compared to 34.1% for the six months ended March 31, 2011 primarily due to the increase in net sales described above.

Depreciation and Amortization

Consolidated depreciation and amortization was \$31.5 million for the six months ended March 31, 2012, compared to \$28.9 million for the six months ended March 31, 2011. 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

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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):

	2012		Six Months Ended March 31, 2011		Increase	
Operating Earnings:						
Segment operating profit:						
Sally Beauty Supply	\$	212,400	\$	177,497	\$	34,903
BSG		88,924		68,669		20,255
Segment operating profit		301,324		246,166		55,158
Unallocated expenses		(45,401)		(37,863)		7,538
Share-based compensation expense		(10,976)		(10,275)		701
Operating earnings	\$	244,947	\$	198,028	\$	46,919
						23.7%

Consolidated operating earnings increased by \$46.9 million, or 23.7%, for the six months ended March 31, 2012, compared to the six months ended March 31, 2011. The increase in consolidated operating earnings was primarily due to an increase in the operating profits of both segments, partially offset by higher unallocated expenses and share-based compensation, as more fully discussed below. Operating earnings, as a percentage of net sales, increased to 14.0% for the six months ended March 31, 2012, compared to 12.4% for the six months ended March 31, 2011.

Sally Beauty Supply. Sally Beauty Supply's segment operating earnings increased by \$34.9 million, or 19.7%, for the six months ended March 31, 2012, compared to the six months ended March 31, 2011. The increase in Sally Beauty Supply's segment operating earnings was primarily a result of increased sales volume and improved gross margins, partially offset by higher advertising costs of approximately \$4.7 million, higher freight and distribution expenses of \$3.0 million and the incremental costs related to approximately 149 additional company-operated stores (stores opened or acquired during the past twelve months) operating during the six months ended March 31, 2012. Segment operating earnings, as a percentage of net sales, were 19.5% for the six months ended March 31, 2012, compared to 18.3% for the six months ended March 31, 2011. This increase reflects the growth in the segment's gross margin described above, as well as a reduction in the segment's operating expenses as a percentage of the segment's gross profit.

Beauty Systems Group. BSG's segment operating earnings increased by \$20.3 million, or 29.5%, for the six months ended March 31, 2012, compared to the six months ended March 31, 2011. The increase in BSG's segment operating earnings was primarily a result of increased sales volume and higher segment gross margin, partially offset by the incremental costs related to approximately 40 additional company-operated stores (stores opened or acquired during the past twelve months) operating during the six months ended March 31, 2012. Segment operating earnings, as a percentage of net sales, increased to 13.4% for the six months ended March 31, 2012, compared to 11.0% for the six months ended March 31, 2011. This increase reflects the growth in the segment's gross margin described above, as well as a reduction in the segment's operating expenses as a percentage of the segment's gross profit.

Unallocated Expenses. Unallocated expenses, which represent corporate costs (such as payroll, employee benefits and travel expenses for corporate staff, certain professional fees and corporate governance expenses) that have not been charged to our operating segments, increased by \$7.5 million, or 19.9%, for the six months ended March 31, 2012, compared to the six months ended March 31, 2011. This increase was primarily due to higher employee compensation and compensation-related expenses (\$2.8 million), professional fees (\$1.2 million) and other corporate expenses related primarily to on-going upgrades to our information technology systems (\$3.5 million).

Share-based Compensation Expense. Total compensation cost charged against income for share-based compensation arrangements increased by \$0.7 million to \$11.0 million for the six months ended March 31, 2012, compared to \$10.3 million for the six months ended March 31, 2011. This increase was mainly due to the incremental expenses related to, as well as the higher fair value at the grant date of, equity awards during the six months ended March 31, 2012, compared to equity awards during the six months ended March 31, 2011, partially offset by the impact of equity awards that became fully vested since March 31, 2011.

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Interest Expense

Interest expense increased by \$29.0 million to \$86.3 million for the six months ended March 31, 2012, compared to \$57.3 million for the six months ended March 31, 2011. The increase in interest expense was primarily attributable to a loss on extinguishment of debt of \$34.6 million in connection with our December 2011 redemption of our 9.25% senior notes due 2014 and 10.50% senior subordinated notes due 2016. This amount includes a call premium of approximately \$24.4 million paid and unamortized deferred financing costs of approximately \$10.2 million expensed in connection with such redemption. This increase is partially offset by the impact of lower expense associated with our new senior notes compared to the expense associated with our senior notes and senior subordinated notes redeemed in December 2011, as well as lower outstanding principal balance on our senior term loan facility (please see [Liquidity and Capital Resources](#) below).

Provision for Income Taxes

The provision for income taxes was \$60.7 million and \$50.5 million, and the effective income tax rate was 38.3% and 35.9%, for the six months ended March 31, 2012 and 2011, respectively. The increase in the effective tax rate was primarily due to tax benefits associated with certain intercompany transactions that resulted in the release of a valuation allowance during the period ended March 31, 2011, with no comparable items during the period ended March 31, 2012.

The annual effective tax rate for the fiscal year 2012 is currently expected to be in the range of 37.0% to 38.0%, versus a comparable actual tax rate for the full fiscal year 2011 of 36.4%.

Net Earnings

As a result of the foregoing, consolidated net earnings increased by \$7.7 million, or 8.6%, to \$97.9 million for the six months ended March 31, 2012, compared to \$90.2 million for the six months ended March 31, 2011. Net earnings, as a percentage of net sales, were 5.6% for the six months ended March 31, 2012, compared to 5.7% for the six months ended March 31, 2011.

Financial Condition

March 31, 2012 Compared to September 30, 2011

Working capital (current assets less current liabilities) increased by \$59.7 million to \$478.8 million at March 31, 2012, compared to \$419.1 million at September 30, 2011. The ratio of current assets to current liabilities was 2.13 to 1.00 at March 31, 2012, compared to 1.91 to 1.00 at September 30, 2011. The increase in working capital reflects an increase of \$22.2 million in current assets and a decrease of \$37.5 million in current liabilities. The increase in current assets as of March 31, 2012, includes an increase of \$24.1 million in inventory. The decrease in current

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liabilities includes a decrease of \$18.2 million in accrued liabilities, a decrease of \$11.8 million in accounts payable and a decrease of \$6.5 million in income taxes payable as discussed below.

Inventory increased by \$24.1 million to \$689.4 million at March 31, 2012, compared to \$665.2 million at September 30, 2011 primarily due to the effect of stores opened and businesses acquired in the six months ended March 31, 2012.

Accounts payable decreased by \$11.8 million to \$250.3 million at March 31, 2012, compared to \$262.1 million at September 30, 2011, primarily due to the timing of payments to suppliers mainly in connection with recent purchases of merchandise inventory. Accrued liabilities decreased by \$18.2 million to \$167.3 million at March 31, 2012, compared to \$185.5 million at September 30, 2011, primarily due to the timing of payments of interest on our long-term debt and employee compensation and compensation-related expenses. Income taxes payable decreased by \$6.5 million to \$2.9 million at March 31, 2012, compared to \$9.4 million at September 30, 2011, primarily due to the timing of estimated federal income tax payments, partially offset by the effect of increased earnings and the income taxes payable of businesses acquired.

Long-term debt, including current portion, decreased by \$57.0 million to \$1,356.2 million at March 31, 2012, compared to \$1,413.1 million at September 30, 2011 primarily due to our optional prepayments in the aggregate amount of \$100.0 million on the senior term loan B, as well as our redemption, in December 2011, of \$430.0 million aggregate principal amount of our 9.25% senior notes due 2014 and \$275.0 million aggregate principal amount of our 10.50% senior subordinated notes due 2016. These decreases were partially offset by the issuance, in November 2011, of \$750.0 million aggregate principal amount of our 6.875% senior notes due 2019 (Please see Liquidity and Capital Resources below).

Total stockholders' deficit, for the six months ended March 31, 2012, decreased by \$149.8 million primarily as a result of net earnings of \$97.9 million, an increase in additional paid-in capital of \$39.8 million, principally resulting from share-based compensation expense and the exercise of stock options, and a decrease in accumulated other comprehensive loss of \$12.0 million, net of income tax. The decrease in accumulated other comprehensive loss reflects foreign currency translation adjustments of \$9.1 million and a reduction in deferred losses on hedged interest rate swaps of \$2.9 million, net of income tax.

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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 our Annual Report on Form 10-K for the fiscal year ended September 30, 2011 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 indebtedness incurred primarily in connection with our separation from our former parent, Alberto-Culver Company, in November 2006 and, from time to time, from funding the costs of operations, working capital, acquisitions and capital expenditures. As a holding company, we depend on our subsidiaries, including Sally Holdings, to distribute funds to us so that we may pay our obligations and 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, 2011.

During the fiscal year 2010, the Company prepaid in full the borrowings under the term loan A facility. Borrowings under the term loan B facility may be prepaid at the option of Sally Holdings at any time without premium or penalty and are subject to mandatory prepayment in an amount equal to 50% of excess cash flow (as defined in the agreement governing the senior term loan facilities) for any fiscal year unless a specified leverage ratio is met. Amounts paid pursuant to said provision may be applied, at the option of Sally Holdings, against minimum loan repayments otherwise required of it over the twelve-month period following any such payment under the terms of the loan agreement.

During the six months ended March 31, 2012, the Company made optional prepayments in the aggregate amount of \$100.0 million on the senior term loan B facility. In connection with such prepayments the Company expensed approximately \$0.6 million in unamortized deferred financing costs. This amount is included in interest expense in the Company's consolidated statements of earnings.

In November 2010, Sally Holdings entered into a new \$400 million, five-year revolving credit facility (the new ABL facility or the ABL facility) and replaced its prior ABL credit facility (the prior ABL facility). The terms of the new ABL facility contain a commitment fee of 0.50% on the unused portion of the facility. Borrowings under the senior term loan facilities and the ABL facility are secured by substantially all of our assets, those of Sally Investment Holdings LLC (Sally Investment), 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 and a pledge of certain intercompany notes. Borrowings under the ABL facility bear interest at Prime plus 1.25% to 1.75% or LIBOR plus 2.25% to 2.75%. During the six months ended March 31, 2011, in connection with our termination of our prior ABL facility, we expensed approximately \$1.6 million in unamortized deferred financing costs. This amount is included in interest expense in the Company's consolidated statements of earnings.

In November 2011, Sally Holdings and Sally Capital Inc. (collectively, the Issuers), both wholly-owned subsidiaries of the Company, the Company and certain of its domestic subsidiaries entered into an agreement pursuant to which the Issuers sold in a private placement \$750.0 million aggregate principal amount of the Issuers' 6.875% Senior Notes due 2019 (the Senior Notes). The Senior Notes bear interest at an annual rate of 6.875% and were issued at par. In connection with the issuance of the Senior Notes, the Company incurred and capitalized financing costs of approximately \$15.2 million. These deferred financing costs are included in other assets on our consolidated balance sheets and are being amortized over the term of the Senior Notes using the effective interest method. The Company intends to exchange the Senior Notes for notes that will be registered pursuant to a registration statement filed with the SEC in February 2012 and will otherwise be identical to the Senior

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Notes. The Company expects to complete such exchange during the third quarter of its fiscal year 2012.

In December 2011, the Issuers used the net proceeds from their issuance of the Senior Notes: (i) to redeem \$430.0 million aggregate principal amount outstanding of the Issuers' 9.25% senior notes due 2014, (ii) to redeem \$275.0 million aggregate principal amount outstanding of the Issuers' 10.50% senior subordinated notes due 2016 (together with the senior notes due 2014, the "Old Notes"), pursuant to the terms of the indentures governing the Old Notes, and (iii) to pay accrued and unpaid interest on the Old Notes, and fees and expenses incurred in connection with issuance of the Senior Notes and redemption of the Old Notes. During the six months ended March 31, 2012, in connection with the Company's redemption of the Old Notes, the Company recorded a charge to earnings in the amount of approximately \$34.6 million, including approximately \$10.2 million in unamortized deferred financing costs expensed, and approximately \$24.4 million in call premiums paid. These amounts are included in interest expense in the Company's consolidated statements of earnings.

Based upon the current level of operations and anticipated growth, we anticipate that existing cash balances, funds expected to be generated by operations and funds available under the ABL facility will be sufficient to meet our working capital requirements and to finance anticipated capital expenditures and potential acquisitions over the next 12 months.

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There can be no assurance that our business will generate sufficient cash flows from operations, that anticipated net sales growth 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 Item 1A of our Annual Report on Form 10-K for the year ended September 30, 2011.

We utilize our ABL facility for the issuance of letters of credit, as well as to manage normal fluctuations in operational cash flow. In that regard, we may from time to time draw funds under the revolving credit facility for general corporate purposes including acquisitions and interest payments due on our indebtedness. The funds drawn on individual occasions during the six months ended March 31, 2012 have varied in amounts of up to \$32.0 million, with total amounts outstanding ranging from zero up to \$70.5 million. During the six months ended March 31, 2012, the weighted average interest rate on our borrowings under the ABL facility was 3.4%. The amounts drawn are generally paid down with cash provided by our operating activities.

As of March 31, 2012, all borrowings under our ABL facility had been paid in full and Sally Holdings had \$378.9 million available for borrowings under the ABL facility, subject to borrowing base limitations, as reduced by outstanding letters of credit.

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 increase our debt or otherwise alter our balance sheet. These actions may include open market repurchases of our senior notes due 2019, prepayments of our term loan B or other retirements or refinancing of outstanding or anticipated debt. We currently expect to take advantage of favorable debt market conditions to refinance our term loan B in the near future. The timing and amount of debt that may be repurchased or otherwise retired, refinanced or issued, if any, would be decided upon at 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.

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. However, we may from time to time repurchase shares of our common stock or pay dividends on our common stock, if our Board of Directors determines that such repurchases or the payment of such dividends are in the best interests of the Company and its stockholders.

Under the agreements and indenture governing the senior term loan facilities and the Senior Notes, Sally Holdings may not make certain restricted payments to us if a default then exists under the credit agreement or the indentures or if its consolidated interest coverage ratio is less than 2.0 to 1.0 at the time of the making of such restricted payment. As of March 31, 2012, its consolidated interest coverage ratio was approximately 5.7 to 1.0. Further, the aggregate amount of restricted payments it is able to make is limited pursuant to various baskets as calculated pursuant to the credit agreement and indenture.

Under our ABL facility, Sally Holdings may pay dividends and make other equity distributions to us if availability under the facility exceeds certain thresholds and no default then exists under the facility. For dividends and distributions up to \$30.0 million during each fiscal year, borrowing availability must exceed the lesser of \$80.0 million or 20% of the borrowing base for 45 days prior to such dividend and distribution. For dividends in excess of that amount, Sally Holdings must maintain that same borrowing availability and its fixed charge coverage ratio must exceed 1.1 to 1.0. As of March 31, 2012, its fixed charge coverage ratio was approximately 3.4 to 1.0. As of March 31, 2012, the net assets of

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our consolidated subsidiaries that were unrestricted from transfer under our credit arrangements totaled \$552.3 million, subject to certain adjustments. The ABL facility and the senior term loan facilities, as well as the Company's 6.875% Senior Notes indenture contain customary cross-default and/or cross-acceleration provisions.

On November 1, 2011, we acquired the Floral Group, a distributor of professional beauty products with 19 stores located in the Netherlands, for approximately 22.8 million (approximately \$31.2 million), subject to certain adjustments. The results of operations of the Floral Group are included in the Company's consolidated financial statements subsequent to the acquisition date. The assets acquired and liabilities assumed were recorded at their respective fair values at the acquisition date. The acquisition was funded with cash from operations and with borrowings on our ABL facility in the amount of approximately \$17.0 million. At March 31, 2012, all borrowings under our ABL facility had been paid in full.

Table of Contents*Historical Cash Flows*

Our primary source of cash has been from funds provided by operating activities and borrowings under our ABL facility for the six months ended March 31, 2012 and 2011. Historically, our primary use of cash has been for acquisitions, capital expenditures and repayments of debt. The following table shows our sources and uses of funds for the six months ended March 31, 2012 and 2011 (in thousands):

	Six Months Ended March 31,	
	2012	2011
Net cash provided by operating activities	\$ 138,090	\$ 125,625
Net cash used by investing activities	(70,110)	(110,395)
Net cash used by financing activities	(67,230)	(15,901)
Effect of foreign currency exchange rates on cash and cash equivalents	579	279
Net increase (decrease) in cash and cash equivalents	\$ 1,329	\$ (392)

Net Cash Provided by Operating Activities

Net cash provided by operating activities, which excludes cash used for acquisitions completed during the period, during the six months ended March 31, 2012 increased by \$12.5 million to \$138.1 million compared to \$125.6 million during the six months ended March 31, 2011. The increase was primarily due to an improvement of approximately \$46.9 million in operating earnings and net changes in trade and other accounts receivable of \$13.4 million, partially offset by net changes in accounts payable and accrued liabilities of \$40.1 million and an increase in excess tax benefits from share-based compensation of \$8.3 million for the six months ended March 31, 2012, compared to the six months ended March 31, 2011.

Net Cash Used by Investing Activities

Net cash used by investing activities during the six months ended March 31, 2012 decreased by \$40.3 million to \$70.1 million compared to \$110.4 million during the six months ended March 31, 2011. This change was primarily due to a decrease of \$38.0 million in cash used for acquisitions, net of cash acquired, and a decrease of \$2.3 million in capital expenditures.

Net Cash Used by Financing Activities

Net cash used by financing activities during the six months ended March 31, 2012 increased by \$51.3 million to \$67.2 million compared to \$15.9 million during the six months ended March 31, 2011. This change was primarily due to (a) cash used to redeem, in December 2011, our 9.25% senior notes due 2014 and our 10.50% senior subordinated notes due 2016 in the aggregate amount of \$729.4 million (including a call premium paid to redeem such notes of \$24.4 million), (b) an increase in optional prepayments on our senior term loan facility of \$83.0 million and (c) an increase in debt issuance costs paid of \$9.9 million during the six months ended March 31, 2012, compared to the six months ended March 31, 2011. This increase was partially offset by proceeds from the issuance, in November 2011, of our 6.875% Senior Notes of \$750.0

million (please see Liquidity and Capital Resources above) and by an increase in proceeds from exercises of stock options awarded under our share-based compensation plans of \$16.3 million.

Credit Facilities

In November 2011, two wholly-owned subsidiaries of the Company, the Company and certain of its domestic subsidiaries entered into an agreement pursuant to which the Issuers sold in a private placement \$750.0 million aggregate principal amount of the Issuers' 6.875% Senior Notes due 2019. The Senior Notes bear interest at an annual rate of 6.875% and were issued at par. The Issuers used the net proceeds from the Senior Notes to redeem, in December 2011, their 9.25% senior notes due 2014 and their 10.50% senior subordinated notes due 2016.

In December 2011, the Company and Sally Investment entered into certain supplemental indenture and joinder agreements providing that the Company and Sally Investment will fully and unconditionally guarantee the obligations of Sally Holdings and/or Sally Capital Inc. under: (i) the indenture governing the Senior Notes, (ii) the credit agreement governing the senior term loan facilities and (iii) the credit agreement governing the ABL facility.

Capital Requirements

During the six months ended March 31, 2012, capital expenditures were \$27.0 million. For fiscal year 2012, we anticipate total capital expenditures in the range of approximately \$65.0 million to \$70.0 million, excluding acquisitions. We expect that capital expenditures will be primarily for the addition of new stores and the remodeling, expansion or relocation of existing stores in the ordinary course of our business as well as certain corporate projects.

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Contractual Obligations

In November 2011, the Company and certain of its subsidiaries issued \$750.0 million aggregate principal amount of the Company's 6.875% Senior Notes due 2019. In December, the Company redeemed its 9.25% senior notes due 2014 and 10.50% senior subordinated notes due 2016 from the proceeds of the Senior Notes. Accordingly, at March 31, 2012, the Company's long-term debt obligations by future payment dates, including interest are as follows (in thousands): less than 1 year - \$68,615; 1-3 years - \$712,780; 3-5 years - \$104,669; more than 5 years - \$887,276 and total - \$1,773,340.

There have been no other material changes outside the ordinary course of business in any of our contractual obligations since September 30, 2011.

Off-Balance Sheet Financing Arrangements

At March 31, 2012 and September 30, 2011, we had no off-balance sheet financing arrangements other than operating leases incurred in the ordinary course of business, as well as outstanding letters of credit related to inventory purchases and self insurance programs. Such letters of credit totaled \$21.1 million and \$16.0 million at March 31, 2012 and September 30, 2011, respectively.

Inflation

We believe that inflation currently does not have a material effect on our results of operations.

Critical Accounting Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States (GAAP) requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses and disclosure of contingent assets and liabilities in the financial statements. Actual results may differ from these estimates. We believe these estimates and assumptions are reasonable. We consider accounting policies to be critical when they require us to make assumptions about matters that are highly uncertain at the time the accounting estimate is made and when different estimates that our management reasonably could have used have a material effect on the presentation of our financial condition, changes in financial condition or results of operations.

Our critical accounting policies, as described in our Annual Report on Form 10-K for the fiscal year ended September 30, 2011, include but are not limited to the valuation of inventory, vendor rebates and concessions, retention of risk, income taxes, assessment of long-lived assets and intangible assets for impairment and share-based payments. There have been no material changes to our critical accounting policies, estimates or assumptions since September 30, 2011.

Recent Accounting Pronouncements

In December 2010, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2010-28 which amended Accounting Standards Codification (ASC) Topic 350, *Intangibles-Goodwill and Other* (ASC 350). This amendment modified the goodwill impairment test for reporting units with a zero or negative carrying amount, by requiring that Step 2 of the goodwill impairment test be performed for such reporting units if it is more likely than not that an impairment of goodwill exists. The Company adopted this amendment during the first quarter of its fiscal year 2012 and its adoption did not have a material effect on the Company's consolidated financial position, results of operations or cash flows.

In December 2010, the FASB issued ASU No. 2010-29 which amended ASC Topic 805, *Business Combinations*. This amendment requires that a public company that enters into business combinations that are material on an individual or aggregate basis disclose certain pro-forma information for the current and the immediately preceding fiscal year. This amendment also expands the supplemental pro-forma disclosures to include a description of the nature and amount of material, non-recurring pro-forma adjustments directly attributable to such business combination or business combinations. The Company adopted this amendment during the first quarter of its fiscal year 2012 and its adoption did not have a material effect on the Company's consolidated financial position, results of operations or cash flows.

In May 2011, the FASB issued ASU No. 2011-04 which amended ASC Topic 820, Fair Value Measurements and Disclosures (ASC 820). This amendment changed the title of ASC 820 to Fair Value Measurement and adopted fair value measurement and disclosure guidance that is generally consistent with the corresponding International Financial Reporting Standards (IFRS) guidance. More specifically, this amendment changed certain requirements for measuring fair value or for disclosing information about fair value measurements or, alternatively, clarified the FASB's intent about the application of existing fair value measurement and disclosure guidance. The Company adopted this amendment during the second quarter of its fiscal year 2012 and its adoption did not have a material effect on the Company's consolidated financial position, results of operations or cash flows.

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In September 2011, the FASB issued ASU No. 2011-08 which amended ASC 350. This amendment allows an entity to first assess relevant qualitative factors in order to determine whether it is necessary to perform the two-step quantitative goodwill impairment test otherwise required under ASC 350. In effect, the amendment eliminates the need to calculate the fair value of a reporting unit in connection with the goodwill impairment test unless the entity determines, based on the qualitative assessment, that it is more likely than not that the reporting unit's fair value is less than its carrying amount. As permitted, the Company adopted this amendment during the second quarter of its fiscal year 2012 and its adoption did not have a material effect on the Company's consolidated financial position, results of operations or cash flows.

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

In June 2011, the FASB issued ASU No. 2011-05 which amended ASC Topic 220, *Comprehensive Income* (ASC 220). This amendment, which must be applied retrospectively, will allow an entity the option to present the components of net income, as well as total comprehensive income and the components of other comprehensive income, either in a single continuous statement of comprehensive income or in two separate consecutive statements. This amendment also eliminates the option to present the components of other comprehensive income in the statement of stockholders' equity but does not change the items that must be reported. In addition, in December 2011, the FASB issued ASU No. 2011-12 which further amended ASC 220. More specifically, this amendment provided for deferral, until further action by the FASB, of the effective date for changes to the presentation of reclassifications of items out of accumulated other comprehensive income required by ASU No. 2011-05. For public companies, these amendments are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2011. Early application is permitted.

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Item 3. Quantitative and Qualitative Disclosures About Market Risk.

As a multinational corporation, we are subject to certain market risks including foreign currency fluctuations, interest rates and government actions. We consider a variety of practices to manage these market risks, including, when deemed appropriate, the occasional use of derivative financial instruments. At March 31, 2012, we did not purchase or hold any derivative instruments for speculative or trading purposes.

Foreign currency exchange rate risk

We are exposed to potential gains or losses from foreign currency fluctuations affecting our net investments in subsidiaries and earnings denominated in foreign currencies. Our primary exposures are to changes in exchange rates for the U.S. dollar versus the British pound sterling, the Canadian dollar, the Euro, the Chilean peso, and the Mexican peso. Our various foreign currency exposures at times offset each other providing a natural hedge against foreign currency risk. For the fiscal years 2011, 2010 and 2009, approximately 18%, 18% and 16%, respectively, of our net sales were made in currencies other than the U.S. dollar. For the six months ended March 31, 2012, our consolidated net sales reflect approximately \$7.0 million in net negative impact from changes in foreign currency exchange rates and other comprehensive income reflects \$9.1 million in favorable foreign currency translation adjustments. Fluctuations in foreign currency exchange rates did not otherwise have a material effect on our consolidated financial condition and consolidated results of operations.

A 10% increase or decrease in the exchange rates for the U.S. dollar versus the foreign currencies to which we have exposure would have impacted consolidated net sales by approximately 1.8% in the six months ended March 31, 2012 and would have impacted consolidated net assets by approximately 2.7% at March 31, 2012, without considering the effect of any foreign currency derivative agreements we may have from time to time.

The Company uses foreign currency options and collars, including, at March 31, 2012, collars with an aggregate notional amount of \$7.0 million to manage the exposure to the U.S. dollar resulting from our Sinelco Group subsidiaries' purchases of merchandise from third-party suppliers. Sinelco's functional currency is the Euro. The foreign currency collar agreements held by the Company at March 31, 2012 have contractual Euro to U.S. dollar exchange rates between 1.4000 and 1.4612 and expire in varying amounts monthly through September 2012.

In addition, the Company currently uses foreign currency forwards to mitigate its exposure to changes in foreign currency exchange rates in connection with certain intercompany balances not permanently invested. At March 31, 2012, we hold: (a) a foreign currency forward which enables us to sell approximately 26.2 million (\$35.0 million, at the March 31, 2012 exchange rate) at the contractual exchange rate of 1.331, (b) a foreign currency forward which enables us to sell approximately \$2.0 million Canadian dollars (\$2.0 million, at the March 31, 2012 exchange rate) at the contractual exchange rate of 0.9989, (c) a foreign currency forward which enables us to buy approximately \$2.7 million Canadian dollars (\$2.7 million, at the March 31, 2012 exchange rate) at the contractual exchange rate of 0.9988, (d) a foreign currency forward which enables us to sell approximately 19.3 million Mexican pesos (\$1.5 million, at the March 31, 2012 exchange rate) at the contractual exchange rate of 12.849 and (e) a foreign currency forward which enables us to buy approximately £0.6 million (\$1.0 million, at the March 31, 2012 exchange rate) at the contractual exchange rate of 1.590. All foreign currency forwards held by the Company at March 31, 2012 expire on or before June 1, 2012.

Our foreign currency option, collar and forward agreements are not designated as hedges and do not currently meet the hedge accounting requirements of ASC 815. Accordingly, the changes in fair value of these derivative instruments, which are adjusted quarterly, are recorded in our consolidated statements of earnings. For the six months ended March 31, 2012, selling, general and administrative expenses reflect net gains of \$0.4 million, including marked-to-market adjustments, in connection with all of the Company's foreign currency derivatives.

Interest rate risk

We and certain of our subsidiaries are subject to interest rate market risk principally in connection with borrowings under our term loan B and ABL credit facilities.

Based on the approximately \$596.9 million of aggregate borrowings under our term loan B and ABL credit facilities as of March 31, 2012, a change in the estimated interest rate up or down by 1/8% would increase or decrease earnings before provision for income taxes by approximately \$0.7 million on an annual basis, without considering the effect of any interest rate swap agreements we may have from time to time.

We and certain of our subsidiaries are sensitive to interest rate fluctuations. In order to enhance our ability to manage risk relating to cash flow and interest rate exposure, we and/or our other subsidiaries who are borrowers under the term loan B and ABL credit facilities may from time to time enter into and maintain derivative instruments, such as interest rate swap agreements, for periods consistent with the related underlying exposures.

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In May 2008, we entered into certain interest rate swap agreements with an aggregate notional amount of \$300 million. These agreements expire on May 31, 2012 and enable us to convert a portion of our variable interest rate obligations to fixed rate obligations with interest ranging from 5.818% to 6.090%. These agreements are designated as effective cash flow hedges, in accordance with ASC 815. Accordingly, changes in the fair value of these derivative instruments are recorded quarterly, net of income tax, in accumulated other comprehensive (loss) income (OCI) until the hedged obligation is settled or the swap agreements expire, whichever is earlier. Any hedge ineffectiveness, as this term is used in ASC 815, is recognized in interest expense in our consolidated statements of earnings.

Credit risk

We are exposed to credit risk on certain assets, primarily cash equivalents, short-term investments and accounts receivable. We believe that the credit risk associated with cash equivalents and short-term investments, if any, is largely mitigated by our policy of investing in a diversified portfolio of securities with high credit ratings.

We provide credit to customers in the ordinary course of business and perform ongoing credit evaluations. We believe that our exposure to concentrations of credit risk with respect to trade receivables is largely mitigated by our broad customer base. We believe our allowance for doubtful accounts, as of March 31, 2012, is sufficient to cover customer credit risks.

Item 4. Controls and Procedures.

Controls Evaluation and Related CEO and CFO Certifications. Our management, with the participation of our principal executive officer (CEO) and principal financial officer (CFO), conducted an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures as of March 31, 2012. The controls evaluation was conducted by our Disclosure Committee, comprised of senior representatives from our finance, accounting, internal audit, and legal departments under the supervision of our CEO.

Certifications of our CEO and our CFO, which are required in accordance with Rule 13a-14 of the Exchange Act, are attached as exhibits to this report. This Controls and Procedures section includes the information concerning the controls evaluation referred to in the certifications and it should be read in conjunction with the certifications for a more complete understanding of the topics presented.

Limitations on the Effectiveness of Controls. We do not expect that our disclosure controls and procedures will prevent all errors and all fraud. A system of controls and procedures, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the system are met. Because of the limitations in all such systems, no evaluation can provide absolute assurance that all control issues and instances of fraud, if any, have been detected. Furthermore, the design of any system of controls and procedures is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions, regardless of how unlikely. Because of these inherent limitations in a cost-effective system of controls and procedures, misstatements or omissions due to error or fraud may occur and not be detected.

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Scope of the Controls Evaluation. The evaluation of our disclosure controls and procedures included a review of their objectives and design, our implementation of the controls and procedures and the effect of the controls and procedures on the information generated for use in this report. In the course of the evaluation, we sought to identify whether we had any data errors, control problems or acts of fraud and to confirm that appropriate corrective action, including process improvements, was being undertaken if needed. This type of evaluation is performed on a quarterly basis so that conclusions concerning the effectiveness of our disclosure controls and procedures can be reported in our Quarterly Reports on Form 10-Q and our Annual Reports on Form 10-K. Many of the components of our disclosure controls and procedures are also evaluated by our internal audit department, our legal department and by personnel in our finance organization. The overall goals of these various evaluation activities are to monitor our disclosure controls and procedures on an ongoing basis and to maintain them as dynamic systems that change as conditions warrant.

Conclusions regarding Disclosure Controls. Based on the required evaluation of our disclosure controls and procedures, our CEO and CFO have concluded that, as of March 31, 2012, we maintain disclosure controls and procedures that are effective in providing reasonable assurance that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our CEO and CFO, as appropriate to allow timely decisions regarding required disclosure.

Changes in Internal Control over Financial Reporting. During our last fiscal quarter, there have been no changes in our internal control over financial reporting identified in connection with the evaluation described above that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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PART II OTHER INFORMATION

Item 1. Legal Proceedings.

There were no material legal proceedings pending against us or our subsidiaries as of March 31, 2012. We are involved in various claims and lawsuits incidental to the conduct of our business in the ordinary course. We carry insurance coverage in such amounts in excess of our self-insured retention as we believe to be reasonable under the circumstances and that may or may not cover any or all of our liabilities in respect of claims and lawsuits. We do not believe that the ultimate resolution of these matters will have a material adverse impact on our consolidated financial position, cash flows or results of operations.

We are subject to a number of U.S., federal, state and local laws and regulations, as well as the laws and regulations applicable in each foreign country or jurisdiction in which we do business. These laws and regulations govern, among other things, the composition, packaging, labeling and safety of the products we sell, the methods we use to sell these products and the methods we use to import these products. We believe that we are in material compliance with such laws and regulations, although no assurance can be provided that this will remain true going forward.

Item 1A. Risk Factors.

In addition to the other information set forth in this report, you should carefully consider the factors contained in Part I, Item 1A. Risk Factors in our Annual Report on Form 10-K for the fiscal year ended September 30, 2011, which could materially affect our business, financial condition or future results. There have been no material changes from the risk factors disclosed in such Annual Report. The risks described in that report are not the only risks facing our company.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.

(a) Not applicable

(b) Not applicable

(c) Not applicable

Item 3. Defaults Upon Senior Securities.

Not applicable

Item 4. Mine Safety Disclosures.

Not applicable

Item 5. Other Information.

(a) Not applicable

(b) Not applicable

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Item 6. Exhibits.

Exhibit No.	Description
2.1	Investment Agreement, dated as of June 19, 2006, among Alberto-Culver Company, New Aristotle Company, Sally Holdings, Inc., New Sally Holdings, Inc. and CDRS Acquisition LLC, which is incorporated herein by reference from Exhibit 2.1 to Amendment No. 3 to the Company's Registration Statement on Form S-4 (File No. 333-136259) filed on October 10, 2006
2.2	First Amendment to the Investment Agreement, dated as of October 3, 2006, among Alberto-Culver Company, New Aristotle Company, Sally Holdings, Inc., New Sally Holdings, Inc. and CDRS Acquisition LLC, which is incorporated herein by reference from Exhibit 2.2 to Amendment No. 3 to the Company's Registration Statement on Form S-4 (File No. 333-136259) filed on October 10, 2006
2.3	Second Amendment to the Investment Agreement, dated as of October 26, 2006, among Alberto-Culver Company, New Aristotle Company, Sally Holdings, Inc., New Sally Holdings, Inc. and CDRS Acquisition LLC, which is incorporated herein by reference from Exhibit 2.02 to the Company's Current Report on Form 8-K filed on October 30, 2006
2.4	Separation Agreement, dated as of June 19, 2006, among Alberto-Culver Company, Sally Holdings, Inc., New Sally Holdings, Inc. and New Aristotle Holdings, Inc., which is incorporated herein by reference from Exhibit 2.3 to Amendment No. 3 to the Company's Registration Statement on Form S-4 (File No. 333-136259) filed on October 10, 2006
2.5	First Amendment to the Separation Agreement, dated as of October 3, 2006, among Alberto-Culver Company, Sally Holdings, Inc., New Sally Holdings, Inc. and New Aristotle Holdings, Inc., which is incorporated herein by reference from Exhibit 2.4 to Amendment No. 3 to the Company's Registration Statement on Form S-4 (File No. 333-136259) filed on October 10, 2006
2.6	Second Amendment to the Separation Agreement, dated as of October 26, 2006, among Alberto-Culver Company, Sally Holdings, Inc., New Sally Holdings, Inc. and New Aristotle Holdings, Inc., which is incorporated herein by reference from Exhibit 2.01 to the Company's Current Report on Form 8-K filed on October 30, 2006
3.1	Second Amended and Restated Certificate of Incorporation of Sally Beauty Holdings, Inc., dated January 27, 2012, which is incorporated herein by reference from Exhibit 3.1 to the Company's Current Report on Form 8-K filed on January 27, 2012
3.2	Third Amended and Restated Bylaws of Sally Beauty Holdings, Inc., dated October 23, 2008, which is incorporated herein by reference from Exhibit 3.1 to the Company's Current Report on Form 8-K filed on October 23, 2008
4.1	Stockholders Agreement, dated as of November 16, 2006, by and among the Company, CDRS Acquisition LLC, CD&R Parallel Fund VII, L.P. and the other stockholders party thereto, which is incorporated herein by reference from Exhibit 4.8 to the Company's Current Report on Form 8-K filed on November 22, 2006
4.2	First Amendment to the Stockholders Agreement, dated as of December 13, 2006, between the Company and CDRS Acquisition LLC and Carol L. Bernick, as representative of the other stockholders, which is incorporated herein by reference from Exhibit 4.2 to the Company's Annual Report on Form 10-K filed on December 22, 2006
4.3	Credit Agreement, dated November 16, 2006, with respect to a Term Loan Facility, by and among Sally Holdings LLC, the several lenders from time to time parties thereto, and Merrill Lynch Capital Corporation, as Administrative Agent and Collateral Agent, which is incorporated herein by reference from Exhibit 4.5.1 to the Company's Current Report on Form 8-K filed on November 22, 2006
4.4	Guarantee and Collateral Agreement, dated as of November 16, 2006, made by Sally Investment Holdings LLC, Sally Holdings LLC and certain subsidiaries of Sally Holdings LLC in favor of Merrill Lynch Capital Corporation, as Administrative Agent and Collateral Agent, which is incorporated herein by reference from Exhibit 4.5.2 to the Company's Current Report on Form 8-K filed on November 22, 2006

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- 4.5 Intercreditor Agreement, dated as of November 16, 2006, by and between Merrill Lynch Capital Corporation, as Administrative Agent and Collateral Agent under the Term Loan Facility, and Merrill Lynch Capital, a division of Merrill Lynch Business Financial Services Inc., as Administrative Agent and Collateral Agent under the Asset-Based Loan Facility, which is incorporated herein by reference from Exhibit 4.7 to the Company's Current Report on Form 8-K filed on November 22, 2006
- 4.6 Assumption Agreement, dated as of December 20, 2011 made by Sally Beauty Holdings, Inc. in favor of Merrill Lynch Capital Corporation, as collateral agent and as administrative agent, which is incorporated herein by reference from Exhibit 4.6 to the Company's Quarterly Report on Form 10-Q filed on February 2, 2012

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- 4.7 Credit Agreement dated as of November 12, 2010 among Sally Holdings LLC, Beauty Systems Group LLC, Sally Beauty Supply LLC, as domestic borrowers, Beauty Systems Group (Canada), Inc., as Canadian borrower, SBH Finance B.V., as foreign borrower, the guarantors from time to time party hereto, Bank of America, N.A., as administrative agent and collateral agent, Bank of America, N.A. (acting through its Canada branch), as Canadian agent, the other lenders party hereto, JPMorgan Chase Bank, N.A., as documentation agent, Wells Fargo Capital Finance, LLC, as syndication agent, Banc of America Securities LLC, Wells Fargo Capital Finance, LLC, as joint lead arrangers and joint book managers, which is incorporated herein by reference from Exhibit 4.13 to the Company's Quarterly Report on Form 10-Q filed on February 3, 2011
- 4.8 Security Agreement by Sally Holdings LLC, Beauty Systems Group LLC, Sally Beauty Supply LLC, as the domestic borrowers and the other domestic borrowers and domestic guarantors party hereto from time to time and Bank of America, N.A. as collateral agent dated as of November 12, 2010, which is incorporated herein by reference from Exhibit 4.14 to the Company's Quarterly Report on Form 10-Q filed on February 3, 2011
- 4.9 Security Agreement by Beauty Systems Group (Canada), Inc., as the Canadian borrower and Bank of America, N.A., (acting through its Canada branch), as Canadian agent dated as of November 12, 2010, which is incorporated herein by reference from Exhibit 4.15 to the Company's Quarterly Report on Form 10-Q filed on February 3, 2011
- 4.10 Joinder to Loan Documents, dated as of December 20, 2011, by and among Sally Holdings LLC, Beauty Systems Group LLC, Sally Beauty Supply LLC, Beauty Systems Group (Canada), Inc., SBH Finance B.V., the Guarantors named therein, Sally Beauty Holdings, Inc., Sally Investment Holdings LLC and Bank of America, N.A., as administrative agent and as collateral agent, which is incorporated herein by reference from Exhibit 4.10 to the Company's Quarterly Report on Form 10-Q filed on February 2, 2012
- 4.11 Indenture, dated as of November 8, 2011, by and among Sally Holdings LLC, Sally Capital Inc., the guarantors listed therein and Wells Fargo Bank, National Association (including the form of Note attached as an exhibit thereto), which is incorporated herein by reference from Exhibit 4.1 to the Company's Current Report on Form 8-K filed on November 9, 2011
- 4.12 First Supplemental Indenture, dated as of December 20, 2011, among Sally Beauty Holdings, Inc., Sally Investment Holdings LLC, Sally Holdings LLC, Sally Capital Inc., each existing Subsidiary Guarantor listed therein and Wells Fargo Bank, National Association, which is incorporated herein by reference from Exhibit 4.12 to the Company's Quarterly Report on Form 10-Q filed on February 2, 2012
- 4.13 Registration Rights Agreement, dated as of November 8, 2011, by and among Sally Holdings LLC, Sally Capital Inc., the guarantors listed therein and Merrill Lynch, Pierce, Fenner & Smith Incorporated, Credit Suisse Securities (USA) LLC, Goldman, Sachs & Co., J.P. Morgan Securities LLC and Wells Fargo Securities, LLC, which is incorporated herein by reference from Exhibit 4.2 to the Company's Current Report on Form 8-K filed on November 9, 2011
- 10.1 Purchase Agreement, dated as of November 3, 2011, by and among Sally Holdings LLC, Sally Capital Inc., the guarantors listed therein and Merrill Lynch, Pierce, Fenner & Smith Incorporated, Credit Suisse Securities (USA) LLC, Goldman, Sachs & Co., J.P. Morgan Securities LLC and Wells Fargo Securities, LLC, which is incorporated herein by reference from Exhibit 10.1 to the Company's Current Report on Form 8-K filed on November 9, 2011
- 31.1 Rule 13a-14(a)/15d-14(a) Certification of Gary G. Winterhalter*
- 31.2 Rule 13a-14(a)/15d-14(a) Certification of Mark J. Flaherty*
- 32.1 Section 1350 Certification of Gary G. Winterhalter*
- 32.2 Section 1350 Certification of Mark J. Flaherty*
- 101 Pursuant to Rule 406T of Regulation S-T, the following financial information from our Quarterly Report on Form 10-Q for the fiscal quarter ended March 31, 2012, formatted in XBRL (Extensible Business Reporting Language) and furnished electronically herewith: (i) the Consolidated Statements of Earnings; (ii) the Consolidated Balance Sheets; (iii) the Consolidated Statements of Cash Flows; and (iv) the Condensed Notes to Consolidated Financial Statements.

* Included herewith

Certain schedules and exhibits have been omitted pursuant to Item 601(b)(2) of Regulation S-K. The Company agrees to furnish supplementally to the Securities and Exchange Commission a copy of any omitted schedule or exhibit upon request.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

SALLY BEAUTY HOLDINGS, INC.
(Registrant)

Date: May 3, 2012

By: /s/ Mark J. Flaherty
Mark J. Flaherty
Senior Vice President and Chief Financial Officer
For the Registrant and as its Principal Financial Officer