Ulta Beauty, Inc.
Form 10-Q
August 31, 2017
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-Q

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the Quarterly Period Ended July 29, 2017

or

Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the transition period from _____ to _____

Commission File Number: 001-33764

ULTA BEAUTY, INC.

(Exact name of Registrant as specified in its charter)

Delaware	**38-4022268**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**
1000 Remington Blvd., Suite 120	
Bolingbrook, Illinois	**60440**
(Address of principal executive offices)	**(Zip code)**

Registrant s telephone number, including area code: (630) 410-4800

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company or an emerging growth company. See definition of large accelerated filer, accelerated filer, smaller reporting company and emerging growth company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer	Accelerated filer
Non-accelerated filer (Do not check if a smaller reporting company)	Smaller reporting company Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

The number of shares of the registrant s common stock, par value $0.01 per share, outstanding as of August 28, 2017 was 61,430,613 shares.

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ULTA BEAUTY, INC.

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Part I Financial Information

Item 1. Financial Statements

Ulta Beauty, Inc.

Consolidated Balance Sheets

(In thousands)	July 29, 2017 (Unaudited)	January 28, 2017	July 30, 2016 (Unaudited)
Assets			
Current assets:			
Cash and cash equivalents	$ 92,860	$ 385,010	$ 194,084
Short-term investments	180,000	30,000	110,000
Receivables, net	67,593	88,631	55,998
Merchandise inventories, net	1,144,702	943,975	930,205
Prepaid expenses and other current assets	98,215	88,621	82,720
Prepaid income taxes	9,124		3,075
Total current assets	1,592,494	1,536,237	1,376,082
Property and equipment, net	1,095,135	1,004,358	919,597
Deferred compensation plan assets	14,588	11,283	10,109
Total assets	$ 2,702,217	$ 2,551,878	$ 2,305,788
Liabilities and stockholders equity			
Current liabilities:			
Accounts payable	$ 313,483	$ 259,518	$ 285,238
Accrued liabilities	256,794	260,854	205,918
Accrued income taxes		8,971	1,089
Total current liabilities	570,277	529,343	492,245
Deferred rent	387,670	366,191	345,441
Deferred income taxes	85,181	86,498	58,477
Other long-term liabilities	23,739	19,628	17,688
Total liabilities	1,066,867	1,001,660	913,851
Commitments and contingencies (Note 3)			

See accompanying notes to consolidated financial statements.

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Ulta Beauty, Inc.

Consolidated Balance Sheets (continued)

(In thousands, except per share data)	July 29, 2017 (Unaudited)	January 28, 2017	July 30, 2016 (Unaudited)
Stockholders equity:			
Common stock, $0.01 par value, 400,000 shares authorized; 62,263, 62,733 and 63,005 shares issued; 61,645, 62,129 and 62,402 shares outstanding; at July 29, 2017 (unaudited), January 28, 2017 and July 30, 2016 (unaudited), respectively	$ 623	$ 627	$ 630
Treasury stock-common, at cost	(18,551)	(14,524)	(14,102)
Additional paid-in capital	683,156	658,330	635,582
Retained earnings	970,122	905,785	769,827
Total stockholders equity	1,635,350	1,550,218	1,391,937
Total liabilities and stockholders equity	$ 2,702,217	$ 2,551,878	$ 2,305,788

See accompanying notes to consolidated financial statements.

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Ulta Beauty, Inc.

Consolidated Statements of Income

(Unaudited)

(In thousands, except per share data)	13 Weeks Ended July 29, 2017	13 Weeks Ended July 30, 2016	26 Weeks Ended July 29, 2017	26 Weeks Ended July 30, 2016
Net sales	$ 1,289,854	$ 1,069,215	$ 2,604,733	$ 2,142,931
Cost of sales	820,528	684,377	1,659,399	1,367,663
Gross profit	469,326	384,838	945,334	775,268
Selling, general and administrative expenses	283,427	236,380	566,872	477,104
Pre-opening expenses	6,099	4,689	10,257	7,231
Operating income	179,800	143,769	368,205	290,933
Interest income, net	(555)	(248)	(893)	(563)
Income before income taxes	180,355	144,017	369,098	291,496
Income tax expense	66,162	54,013	126,682	109,516
Net income	$ 114,193	$ 90,004	$ 242,416	$ 181,980
Net income per common share:				
Basic	$ 1.84	$ 1.44	$ 3.91	$ 2.90
Diluted	$ 1.83	$ 1.43	$ 3.88	$ 2.89
Weighted average common shares outstanding:				
Basic	61,935	62,475	62,018	62,753
Diluted	62,379	62,813	62,483	63,067

See accompanying notes to consolidated financial statements.

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Ulta Beauty, Inc.

Consolidated Statements of Cash Flows

(Unaudited)

(In thousands)	26 Weeks Ended July 29, 2017	July 30, 2016
Operating activities		
Net income	$ 242,416	$ 181,980
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	125,582	97,552
Deferred income taxes	(1,317)	(1,050)
Non-cash stock compensation charges	11,649	8,862
Excess tax benefits from stock-based compensation		(4,685)
Loss on disposal of property and equipment	2,348	3,712
Change in operating assets and liabilities:		
Receivables	21,038	8,994
Merchandise inventories	(200,727)	(168,412)
Prepaid expenses and other current assets	(9,594)	(10,172)
Income taxes	(18,095)	(10,003)
Accounts payable	53,965	89,064
Accrued liabilities	(29,557)	(5,099)
Deferred rent	21,479	23,652
Other assets and liabilities	806	5,235
Net cash provided by operating activities	219,993	219,630
Investing activities		
Purchases of short-term investments	(240,000)	(60,000)
Proceeds from short-term investments	90,000	80,000
Purchases of property and equipment	(193,210)	(149,595)
Net cash used in investing activities	(343,210)	(129,595)
Financing activities		
Repurchase of common shares	(178,085)	(252,450)
Stock options exercised	13,179	8,391
Excess tax benefits from stock-based compensation		4,685
Purchase of treasury shares	(4,027)	(2,417)
Net cash used in financing activities	(168,933)	(241,791)
Net decrease in cash and cash equivalents	(292,150)	(151,756)
Cash and cash equivalents at beginning of period	385,010	345,840

Cash and cash equivalents at end of period	$ 92,860	$ 194,084
Supplemental cash flow information		
Cash paid for income taxes (net of refunds)	$ 145,494	$ 120,085
Non-cash investing activities:		
Change in property and equipment included in accrued liabilities	$ 25,497	$ 23,666

See accompanying notes to consolidated financial statements.

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Ulta Beauty, Inc.

Consolidated Statement of Stockholders Equity

(Unaudited)

(In thousands)	Common Stock Issued Shares	Common Stock Issued Amount	Treasury Common Stock Shares	Treasury Common Stock Amount	Additional Paid-In Capital	Retained Earnings	Total Stockholders Equity
Balance January 28, 2017	62,733	$ 627	(604)	$ (14,524)	$ 658,330	$ 905,785	$ 1,550,218
Stock options exercised and other awards	177	2			13,177		13,179
Purchase of treasury shares			(14)	(4,027)			(4,027)
Net income for the 26 weeks ended July 29, 2017						242,416	242,416
Stock compensation charge					11,649		11,649
Repurchase of common shares	(647)	(6)				(178,079)	(178,085)
Balance July 29, 2017	62,263	$ 623	(618)	$ (18,551)	$ 683,156	$ 970,122	$ 1,635,350

See accompanying notes to consolidated financial statements.

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Ulta Beauty, Inc.

Notes to Consolidated Financial Statements

(Unaudited)

1. Business and basis of presentation

On January 29, 2017, Ulta Salon, Cosmetics & Fragrance, Inc. implemented a holding company reorganization pursuant to which Ulta Beauty, Inc., which was incorporated as a Delaware corporation in December 2016, became the successor to Ulta Salon, Cosmetics & Fragrance, Inc., the former publicly traded company and now a wholly owned subsidiary of Ulta Beauty, Inc. As used in these notes and throughout this Quarterly Report on Form 10-Q, all references to we, us, our, Ulta Beauty or the Company refer to Ulta Beauty, Inc. and its consolidated subsidiarie

The Company was originally founded in 1990 to operate specialty retail stores selling cosmetics, fragrance, haircare and skincare products, and related accessories and services. The stores also feature full-service salons. As of July 29, 2017, the Company operated 1,010 stores in 48 states and the District of Columbia, as shown in the table below.

Location	Number of stores	Location	Number of stores
Alabama	17	Montana	5
Alaska	3	Nebraska	5
Arizona	25	Nevada	14
Arkansas	7	New Hampshire	7
California	128	New Jersey	26
Colorado	21	New Mexico	6
Connecticut	13	New York	36
Delaware	3	North Carolina	28
District of Columbia	1	North Dakota	3
Florida	68	Ohio	39
Georgia	32	Oklahoma	16
Idaho	7	Oregon	11
Illinois	49	Pennsylvania	37
Indiana	19	Rhode Island	3
Iowa	8	South Carolina	15
Kansas	9	South Dakota	2
Kentucky	10	Tennessee	19
Louisiana	16	Texas	97
Maine	3	Utah	12
Maryland	18	Virginia	25
Massachusetts	15	Washington	24
Michigan	43	West Virginia	6
Minnesota	13	Wisconsin	18
Mississippi	9	Wyoming	2
Missouri	17	**Total**	**1,010**

The accompanying unaudited consolidated financial statements and related notes have been prepared in accordance with U.S. generally accepted accounting principles (GAAP) for interim financial information and with the instructions to Form 10-Q and the U.S. Securities and Exchange Commission s Article 10, Regulation S-X. These consolidated financial statements were prepared on a consolidated basis to include the accounts of the Company and its wholly owned subsidiaries. All significant intercompany accounts, transactions and unrealized profit were eliminated in consolidation. In the opinion of management, the accompanying consolidated financial statements reflect all adjustments, which are of a normal recurring nature, necessary to fairly state the financial position and results of operations and cash flows for the interim periods presented.

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The Company s business is subject to seasonal fluctuation. Significant portions of the Company s net sales and net income are realized during the fourth quarter of the fiscal year due to the holiday selling season. The results for the 13 and 26 weeks ended July 29, 2017 are not necessarily indicative of the results to be expected for the fiscal year ending February 3, 2018, or for any other future interim period or for any future year.

These interim consolidated financial statements and the related notes should be read in conjunction with the consolidated financial statements and notes included in the Company s Annual Report on Form 10-K for the year ended January 28, 2017. All amounts are stated in thousands, with the exception of per share amounts and number of stores.

2. Summary of significant accounting policies

Information regarding the Company s significant accounting policies is contained in Note 2, Summary of significant accounting policies, to the consolidated financial statements in the Company s Annual Report on Form 10-K for the year ended January 28, 2017. Presented below and in the following notes is supplemental information that should be read in conjunction with Notes to Consolidated Financial Statements in the Annual Report.

Fiscal quarter

The Company s quarterly periods are the 13 weeks ending on the Saturday closest to April 30, July 31, October 31, and January 31. The Company s second quarter in fiscal 2017 and 2016 ended on July 29, 2017 and July 30, 2016, respectively.

Share-based compensation

The Company measures share-based compensation cost on the grant date, based on the fair value of the award, and recognizes the expense on a straight-line method over the requisite service period for awards expected to vest. The Company estimated the grant date fair value of stock options using a Black-Scholes valuation model using the following weighted-average assumptions for the periods indicated:

	26 Weeks Ended	
	July 29, 2017	July 30, 2016
Volatility rate	31.0%	35.0%
Average risk-free interest rate	1.6%	1.2%
Average expected life (in years)	3.5	3.5
Dividend yield	None	None

The Company granted 103 and 107 stock options during the 26 weeks ended July 29, 2017 and July 30, 2016, respectively. The compensation cost that has been charged against operating income for stock option grants was $2,235 and $1,999 for the 13 weeks ended July 29, 2017 and July 30, 2016, respectively. The compensation cost that has been charged against operating income for stock option grants was $4,377 and $3,982 for the 26 weeks ended July 29, 2017 and July 30, 2016, respectively. The weighted-average grant date fair value of these options was $70.12 and $52.72 for the 26 weeks ended July 29, 2017 and July 30, 2016, respectively. At July 29, 2017, there was approximately $22,633 of unrecognized compensation expense related to unvested stock options.

The Company issued 42 and 50 restricted stock units during 26 weeks ended July 29, 2017 and July 30, 2016, respectively. The compensation cost that has been charged against operating income for restricted stock units was $2,354 and $1,884 for the 13 weeks ended July 29, 2017 and July 30, 2016, respectively. The compensation cost that has been charged against operating income for restricted stock units was $4,453 and $3,445 for the 26 weeks ended July 29, 2017 and July 30, 2016, respectively. At July 29, 2017, there was approximately $17,224 of unrecognized compensation expense related to restricted stock units.

The Company issued 21 and 24 performance-based restricted stock units during the 26 weeks ended July 29, 2017 and July 30, 2016, respectively. The compensation cost that has been charged against operating income for performance-based restricted stock units was $1,569 and $957 for the 13 weeks ended July 29, 2017 and July 30, 2016, respectively. The compensation cost that has been charged against operating income for performance-based restricted stock units was $2,819 and $1,435 for the 26 weeks ended July 29, 2017 and July 30, 2016, respectively. At July 29, 2017, there was approximately $11,617 of unrecognized compensation expense related to performance-based restricted stock units.

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Recent accounting pronouncements not yet adopted

Revenue Recognition from Contracts with Customers

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2014-09, Revenue from Contracts with Customers, issued as a new Topic, Accounting Standards Codification Topic 606 (ASU 2014-09). The new revenue recognition standard provides a five-step analysis of transactions to determine when and how revenue is recognized. The core principle is that the Company will recognize revenue when the transfer of promised goods or services to customers occurs in an amount that reflects the consideration to which the Company expects to be entitled in exchange for those goods or services. In August 2015, the FASB issued ASU 2015-14 Revenue from Contracts with Customers (Topic 606), which delayed the effective date of ASU 2014-09 by one year. With the deferral, the revenue recognition standard is effective for annual reporting periods beginning after December 15, 2017, including interim reporting periods, with early adoption permitted. In March 2016, the FASB issued ASU 2016-08, Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations (ASU 2016-08), which further clarifies how to implement revenue recognition guidance related to determining whether an entity is a principal or an agent in a revenue transaction. In April 2016, the FASB issued ASU 2016-10, Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing (ASU 2016-10), which further clarifies the aspects of (a) identifying performance obligations and (b) the licensing implementation guidance. The effective date and transition requirements for ASU 2016-08 and ASU 2016-10 are the same as the effective date and transition requirements of ASU 2014-09. These standards allow for either full retrospective or modified retrospective adoption.

The Company is currently evaluating the overall impact that ASU 2014-09 and its related amendments will have on the consolidated financial statements. The Company will adopt the new guidance in fiscal 2018, and anticipates using the modified retrospective method. The Company s project team is in the process of finalizing the revised accounting policies based on the assessment of the effect of the standard. ASU 2014-09 will impact the recognition timing or classification of revenues and expenses for the sales refund reserve (by grossing up the balance sheet to record a refund obligation and right of return asset instead of recognizing revenue net of returns), gift card breakage (by including breakage within net sales instead of selling, general and administrative expenses under the proportional model), and loyalty program accounting (by using the deferred revenue method instead of the incremental cost method), however, the Company does not expect a significant impact to pretax income upon adoption. In addition, the Company continues to evaluate changes to business processes and controls to support recognition and disclosure under the new standard.

Leases

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842). This standard will change the way all leases of one year or more are treated. Under this guidance, lessees will be required to capitalize virtually all leases on the balance sheet as a right-of-use asset and recognize an associated financing lease liability or capital lease liability. The right-of-use asset represents the lessee s right to use, or control the use of, a specified asset for the specified lease term. The lease liability represents the lessee s obligation to make lease payments arising from the lease, measured on a discounted basis. Based on certain characteristics, leases are classified as financing leases or operating leases. Financing lease liabilities, those that contain provisions similar to capitalized leases, are amortized like capital leases under current GAAP as amortization expense and interest expense in the statement of operations. Operating lease liabilities are amortized on a straight-line basis over the life of the lease as lease expense in the statement of operations. Entities are required to use a modified retrospective approach for leases that exist or are entered into after the beginning of the earliest comparative period in the financial statements, and have the option to use certain relief. ASU 2016-02 is effective for public companies for annual reporting periods beginning after December 15, 2018,

including interim reporting periods. Early adoption is permitted.

The Company is evaluating whether to early adopt the new standard in fiscal 2018. The Company s ability to early adopt depends on system readiness, including software procured from third-party providers, and completing an analysis of information necessary to restate prior period consolidated financial statements. The Company formed a project team to review the current accounting policies and practices and assess the effect of the standard on the consolidated financial statements. The team has completed a preliminary assessment of the potential impact of adopting ASU 2016-02 on the consolidated financial statements. The adoption of ASU 2016-02 will have a material impact on the Company s consolidated financial position, however the Company does not believe adoption of this standard will have a material impact on the Company s consolidated results of operations or cash flows.

Liabilities Extinguishments of Liabilities

In March 2016, the FASB issued ASU 2016-04, Liabilities Extinguishments of Liabilities (Subtopic 405-20): Recognition of Breakage for Certain Prepaid Stored Value Products. This update entitles a company to derecognize amounts related to expected breakage to the extent that it is probable a significant reversal of the recognized breakage amount will not subsequently occur. ASU 2016-04 should be applied either using a modified retrospective transition method or retrospectively. ASU 2016-04 is effective for annual and interim periods beginning after December 15, 2017, and early adoption is permitted. The adoption of ASU 2016-04 is not expected to have a material impact on the Company s consolidated financial position, results of operations or cash flows.

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Statement of Cash Flows

In August 2016, the FASB issued ASU 2016-15, Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments (a consensus of the Emerging Issues Task Force). ASU 2016-15 provides classification guidance on certain cash receipts and cash payments, including, but not limited to, debt prepayment costs, contingent consideration payments made after a business combination, proceeds from the settlement of insurance claims, proceeds from the settlement of bank-owned life insurance policies and distributions received from equity method investees. The adoption of ASU 2016-15 requires a retrospective transition method applied to each period presented. ASU 2016-15 is effective for annual periods and interim periods beginning after December 15, 2017, and early adoption is permitted. The adoption of ASU 2016-15 is not expected to have a material impact on the Company s consolidated financial position, results of operations or cash flows.

In November 2016, the FASB issued ASU 2016-18, Statement of Cash Flows (Topic 230): Restricted Cash (a consensus of the Emerging Issues Task Force), which amends ASU Topic 230. ASU 2016-18 requires entities to show the changes in the total of cash, cash equivalents, restricted cash and restricted cash equivalents in the statement of cash flows. As a result, entities will no longer be required to present transfers between cash and cash equivalents and restricted cash and restricted cash equivalents in the statement of cash flows. When cash, cash equivalents, restricted cash and restricted cash equivalents are presented in more than one line item on the balance sheet, the new guidance requires a reconciliation of the totals in the statement of cash flows to the related captions in the balance sheet. Entities will also have to disclose the nature of their restricted cash and restricted cash equivalent balances. ASU 2016-18 is effective for fiscal years beginning after December 15, 2017 and interim periods within those years, and early adoption is permitted. Entities are required to apply the guidance retrospectively. The adoption of ASU 2016-18 is not expected to have a material impact on the Company s consolidated financial position, results of operations or cash flows.

Compensation Stock Compensation: Scope of Modification Accounting

In May 2017, the FASB issued ASU 2017-09, Compensation Stock Compensation (Topic 718): Scope of Modification Accounting, which provides clarification on when modification accounting should be used for changes to the terms or conditions of a share-based payment award. This ASU does not change the accounting for modifications but clarifies that modification accounting guidance should only be applied if there is a change to the value, vesting conditions, or award classification and would not be required if the changes are considered non-substantive. ASU 2017-09 is effective for fiscal years beginning after December 15, 2017 and interim periods within those fiscal years, and early adoption is permitted. The adoption of ASU 2017-09 is not expected to have a material impact on the Company s consolidated financial position, results of operations or cash flows.

Recently adopted accounting pronouncements

Compensation Stock Compensation

In March 2016, the FASB issued ASU 2016-09, Compensation Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting. This guidance changed how companies account for certain aspects of share-based payments to employees. Companies have to recognize all income tax effects of awards in the income statement when the awards vest or are settled, and additional paid-in capital pools were eliminated. The guidance on employer s accounting for an employee s use of shares to satisfy the employer s statutory income tax withholding obligation and for forfeitures changed, and two practical expedients for non-public entities were added. ASU 2016-09 was effective for annual and interim reporting periods beginning after December 15, 2016.

The Company adopted the new guidance prospectively in the first quarter of fiscal 2017. The adoption resulted in a decrease in the provision for income taxes of $1,406 and $9,139 for the 13 weeks and 26 weeks ended July 29, 2017, respectively, due to the recognition of excess tax benefits for options exercised and the vesting of equity awards. The extent of excess tax benefits or deficiencies is subject to variation in the Company s stock price and timing/extent of restricted stock units vesting and employee stock option exercises. Additionally, the consolidated statements of cash flows now present such tax benefits or deficiencies as an operating activity on a prospective basis. Based on the adoption methodology applied, the statement of cash flows classification of prior periods has not been adjusted. As allowed under the new guidance, the Company did not change its accounting principles relative to elements of this standard and continued its existing practice of estimating the number of awards that will be forfeited.

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3. Commitments and contingencies

Leases The Company leases retail stores, distribution and office facilities and certain equipment. Original non-cancelable lease terms range from three to ten years, and store leases generally contain renewal options for additional years. Total rent expense under operating leases was $57,812 and $49,685 for the 13 weeks ended July 29, 2017 and July 30, 2016, respectively. Total rent expense under operating leases was $114,595 and $98,844 for the 26 weeks ended July 29, 2017 and July 30, 2016, respectively.

General litigation The Company is involved in various legal proceedings that are incidental to the conduct of the business. In the opinion of management, the amount of any liability with respect to these proceedings, either individually or in the aggregate, will not have a material adverse effect on the Company s consolidated financial position, results of operations or cash flows.

4. Notes payable

In 2011, the Company entered into an Amended and Restated Loan and Security Agreement with Wells Fargo Bank, National Association, as Administrative Agent, Collateral Agent and a Lender thereunder, Wells Fargo Capital Finance LLC as a Lender, J.P. Morgan Securities LLC as a Lender, JP Morgan Chase Bank, N.A. as a Lender and PNC Bank, National Association, as a Lender, which has been amended multiple times since 2011 (as amended, the Loan Agreement). The Loan Agreement currently matures in December 2018, provides maximum revolving loans equal to the lesser of $200,000 or a percentage of eligible owned inventory, contains a $10,000 subfacility for letters of credit and allows the Company to increase the revolving facility by an additional $50,000, subject to consent by each lender and other conditions. The Loan Agreement contains a requirement to maintain a minimum amount of excess borrowing availability at all times. Substantially all of the Company s assets are pledged as collateral for outstanding borrowings under the facility. Outstanding borrowings will bear interest at the prime rate or London Interbank Offered Rate plus 1.50%, and the unused line fee is 0.20%.

As of July 29, 2017, January 28, 2017 and July 30, 2016, the Company had no borrowings outstanding under the credit facility and the Company was in compliance with all terms and covenants of the Loan Agreement.

5. Fair value measurements

The carrying value of cash and cash equivalents, accounts receivable and accounts payable approximates their estimated fair values due to the short maturities of these instruments.

Fair value is measured using inputs from the three levels of the fair value hierarchy, which are described as follows:

Level 1 observable inputs such as quoted prices for identical instruments in active markets.

Level 2 inputs other than quoted prices in active markets that are observable either directly or indirectly through corroboration with observable market data.

Level 3 unobservable inputs in which there is little or no market data, which would require the Company to develop its own assumptions.

As of July 29, 2017, January 28, 2017 and July 30, 2016, the Company held financial liabilities of $14,303, $10,474 and $10,206, respectively, related to its non-qualified deferred compensation plan. The liabilities have been categorized as Level 2 as they are based on third-party reported values which are based primarily on quoted market prices of underlying assets of the funds within the plan.

6. Investments

The Company s short-term investments as of July 29, 2017, January 28, 2017 and July 30, 2016 consist of $180,000, $30,000 and $110,000, respectively, in certificates of deposit. These short-term investments are carried at cost, which approximates fair value and are recorded in the Consolidated Balance Sheets in Short-term investments. The contractual maturity of the Company s investments was less than twelve months at July 29, 2017.

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7. Net income per common share

The following is a reconciliation of net income and the number of shares of common stock used in the computation of net income per basic and diluted share:

(In thousands, except per share data)	13 Weeks Ended July 29, 2017	13 Weeks Ended July 30, 2016	26 Weeks Ended July 29, 2017	26 Weeks Ended July 30, 2016
Numerator for diluted net income per share net income	$ 114,193	$ 90,004	$ 242,416	$ 181,980
Denominator for basic net income per share weighted-average common shares	61,935	62,475	62,018	62,753
Dilutive effect of stock options and non-vested stock	444	338	465	314
Denominator for diluted net income per share	62,379	62,813	62,483	63,067
Net income per common share:				
Basic	$ 1.84	$ 1.44	$ 3.91	$ 2.90
Diluted	$ 1.83	$ 1.43	$ 3.88	$ 2.89

The denominator for diluted net income per common share for the 13 weeks ended July 29, 2017 and July 30, 2016 excludes 112 and 117 employee stock options, respectively, due to their anti-dilutive effects. The denominator for diluted net income per common share for the 26 weeks ended July 29, 2017 and July 30, 2016 excludes 151 and 388 employee stock options, respectively, due to their anti-dilutive effects. Outstanding performance-based restricted stock units are included in the computation of dilutive shares only to the extent that the underlying performance conditions are satisfied prior to the end of the reporting period or would be considered satisfied if the end of the reporting period were the end of the related contingency period and the results would be dilutive under the treasury stock method.

8. Share repurchase program

On March 10, 2016, the Company announced that the Board of Directors authorized a new share repurchase program (the 2016 Share Repurchase Program) pursuant to which the Company may repurchase up to $425,000 of the Company s common stock. The 2016 Share Repurchase Program authorization revoked the previously authorized, but unused amounts of $172,386 from the earlier share repurchase program. The 2016 Share Repurchase Program did not have an expiration date, but provided for suspension or discontinuation at any time.

As part of the 2016 Share Repurchase Program, the Company entered into an Accelerated Share Repurchase (ASR) agreement with Goldman, Sachs & Co. to repurchase $200,000 of the Company s common stock. Under the ASR agreement, the Company paid $200,000 to Goldman, Sachs & Co. and received an initial delivery of 852 shares in the first quarter of 2016, which were retired and represented 80% of the total shares the Company expected to receive based on the market price at the time of the initial delivery. In May 2016, the ASR settled and an additional 153 shares were delivered to the Company and retired. The final number of shares delivered upon settlement was determined with reference to the average price of the Company s common stock over the term of the agreement. The transaction was accounted for as an equity transaction. The par value of shares received was recorded as a reduction to common stock with the remainder recorded as a reduction to additional paid-in capital and retained earnings. Upon receipt of the shares, there was an immediate reduction in the weighted average common shares calculation for basic and diluted earnings per share.

On March 9, 2017, the Company announced that the Board of Directors authorized a new share repurchase program (the 2017 Share Repurchase Program) pursuant to which the Company may repurchase up to $425,000 of the Company s common stock. The 2017 Share Repurchase Program authorization revokes the previously authorized but unused amount of $79,863 from the 2016 Share Repurchase Program. The 2017 Share Repurchase Program does not have an expiration date and may be suspended or discontinued at any time.

During the 26 weeks ended July 29, 2017, the Company purchased 647 shares of common stock for $178,085. During the 26 weeks ended July 30, 2016, excluding the shares repurchased under the ASR, the Company purchased 265 shares of common stock for $52,450.

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9. Subsequent event

On August 23, 2017, the Company entered into a Second Amended and Restated Loan Agreement (the Loan Amendment) with Wells Fargo Bank, National Association, as Administrative Agent, Collateral Agent and a Lender thereunder, Wells Fargo Bank, National Association and JPMorgan Chase Bank, N.A., as Lead Arrangers and Bookrunners, JPMorgan Chase Bank, N.A., as Syndication Agent and a Lender, PNC Bank, National Association, as Documentation Agent and a Lender, and the other Lenders party thereto. The Loan Amendment amended and restated the Loan Agreement. The Loan Amendment extends the maturity of the facility to August 23, 2022, provides maximum revolving loans equal to the lesser of $400,000 or a percentage of eligible owned inventory (which borrowing base may, at the election of the Company and satisfaction of certain conditions, include a percentage of eligible owned accounts and qualified cash), contains a $20,000 subfacility for letters of credit and allows the Company to increase the revolving facility by an additional $50,000, subject to the consent by each lender and other conditions. The Loan Amendment contains a requirement to maintain a fixed charge coverage ratio of not less than 1.0 to 1.0 during such periods when availability under the Loan Amendment falls below a specified threshold. Substantially all of the Company s assets are pledged as collateral for outstanding borrowings under the Loan Amendment. Outstanding borrowings will bear interest at either a base rate or the London Interbank Offered Rate plus 1.25%, and the unused line fee is 0.20% per annum.

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

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our financial statements and related notes included elsewhere in this quarterly report. This discussion contains forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended, and the safe harbor provisions of the Private Securities Litigation Reform Act of 1995, which reflect our current views with respect to, among other things, future events and financial performance. You can identify these forward-looking statements by the use of forward-looking words such as outlook, believes, expects, plans, estima targets, strategies or other comparable words. Any forward-looking statements contained in this Form 10-Q are based upon our historical performance and on current plans, estimates and expectations. The inclusion of this forward-looking information should not be regarded as a representation by us or any other person that the future plans, estimates, targets, strategies or expectations contemplated by us will be achieved. Such forward-looking statements are subject to various risks and uncertainties, which include, without limitation:

- the impact of weakness in the economy;
- changes in the overall level of consumer spending;
- the possibility that we may be unable to compete effectively in our highly competitive markets;
- the possibility that cybersecurity breaches and other disruptions could compromise our information or result in the unauthorized disclosure of confidential information;
- weather conditions that could negatively impact sales;
- our ability to gauge beauty trends and react to changing consumer preferences in a timely manner;
- our ability to attract and retain key executive personnel;
- the possibility that the capacity of our distribution and order fulfillment infrastructure and the performance of our newly opened and to be opened distribution centers may not be adequate to support our recent growth and expected future growth plans;
- our ability to sustain our growth plans and successfully implement our long-range strategic and financial plan;
- the possibility that our continued opening of new stores could strain our resources and have a material adverse effect on our business and financial performance;
- the possibility of material disruptions to our information systems;
- changes in the wholesale cost of our products;
- the possibility that new store openings and existing locations may be impacted by developer or co-tenant issues;
- customer acceptance of our rewards program and technological and marketing initiatives;
- our ability to successfully execute our common stock repurchase program or implement future common stock repurchase programs; and
- other risk factors detailed in our public filings with the Securities and Exchange Commission (the SEC), including risk factors contained in Item 1A, Risk Factors of our Annual Report on Form 10-K for the year ended January 28, 2017, as such may be amended or supplemented in our subsequently filed Quarterly Reports on Form 10-Q (including this report).

Except to the extent required by the federal securities laws, we undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

References in the following discussion to we, us, our, Ulta Beauty, the Company, and similar references mean U Beauty, Inc. and its consolidated subsidiaries, unless otherwise expressly stated or the context otherwise requires.

Overview

We were founded in 1990 as a beauty retailer at a time when prestige, mass and salon products were sold through distinct channels department stores for prestige products, drug stores and mass merchandisers for mass products and salons and authorized retail outlets for professional hair care products. We developed a unique specialty retail concept that offers All Things Beauty. All in One Place.™, a compelling value proposition and a convenient and welcoming shopping environment. We believe our strategy provides us with the competitive advantages that have contributed to our financial performance.

On January 29, 2017, we implemented a holding company reorganization (the Reorganization) pursuant to which Ulta Beauty, Inc., which was incorporated as a Delaware corporation in December 2016, became the successor to Ulta Salon, Cosmetics & Fragrance, Inc., the former publicly-traded company and now a wholly owned subsidiary of Ulta Beauty, Inc.

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We are the largest beauty retailer in the United States and the premier beauty destination for cosmetics, fragrance, skin care products, hair care products and salon services. We focus on providing affordable indulgence to our guests by combining unmatched product breadth, value and convenience with a distinctive specialty retail environment and experience. Key aspects of our business include: our ability to offer our guests a unique combination of more than 20,000 beauty products across the categories of prestige and mass cosmetics, fragrance, haircare, skincare, bath and body products and salon styling tools, as well as a full-service salon in every store featuring hair, skin and brow services; our focus on delivering a compelling value proposition to our guests across all of our product categories; and convenience, as our stores are predominantly located in convenient, high-traffic locations such as power centers.

The continued growth of our business and any future increases in net sales, net income and cash flows is dependent on our ability to execute our strategic imperatives: 1) acquire new guests and deepen loyalty with existing guests, 2) differentiate by delivering a distinctive and personalized guest experience across all channels, 3) offer relevant, innovative and often exclusive products that excite our guests, 4) deliver exceptional services in three core areas: hair, skin health and brows, 5) grow stores and e-commerce to reach and serve more guests, 6) invest in infrastructure to support our guest experience and growth, and capture scale efficiencies and 7) attract and retain talent that drives a winning culture. We believe that the expanding U.S. beauty products and salon services industry, and the shift in distribution channel of prestige beauty products from department stores to specialty retail stores, coupled with Ulta Beauty s competitive strengths, positions us to capture additional market share in the industry.

Comparable sales is a key metric that is monitored closely within the retail industry. Our comparable sales have fluctuated in the past and we expect them to continue to fluctuate in the future. A variety of factors affect our comparable sales, including general U.S. economic conditions, changes in merchandise strategy or mix and timing and effectiveness of our marketing activities, among others.

Over the long-term, our growth strategy is to increase total net sales through increases in our comparable sales, by opening new stores and by increasing sales in our e-commerce channel. Operating profit is expected to increase as a result of our ability to leverage our fixed store costs and supply chain investments.

Basis of presentation

We have determined the operating segments on the same basis that we use to internally evaluate performance. We have combined our three operating segments: retail stores, salon services and e-commerce, into one reportable segment because they have a similar class of consumers, economic characteristics, nature of products and distribution methods.

Net sales include store and e-commerce merchandise sales as well as salon service revenue. We recognize merchandise revenue at the point of sale in our retail stores and e-commerce sales are recorded based on delivery of merchandise to the guest. Store and e-commerce sales are recorded net of estimated returns. Salon service revenue is recognized at the time the service is provided. Gift card sales revenue is deferred until the guest redeems the gift card. Company coupons and other incentives are recorded as a reduction of net sales.

Comparable sales reflect sales for stores beginning on the first day of the 14th month of operation. Therefore, a store is included in our comparable store base on the first day of the period after one year of operations plus the initial one month grand opening period. Non-comparable store sales include sales from new stores that have not yet completed their 13th month of operation and stores that were closed for part or all of the period in either year as a result of remodel activity. Remodeled stores are included in comparable sales unless the store was closed for a portion of the current or prior period. Comparable sales include the Company s e-commerce business. There may be variations in the way in which some of our competitors and other retailers calculate comparable or same store sales.

Measuring comparable sales allows us to evaluate the performance of our store base as well as several other aspects of our overall strategy. Several factors could positively or negatively impact our comparable sales results:

- the general national, regional and local economic conditions and corresponding impact on customer spending levels;
- the introduction of new products or brands;
- the location of new stores in existing store markets;
- competition;
- our ability to respond on a timely basis to changes in consumer preferences;
- the effectiveness of our various marketing activities; and
- the number of new stores opened and the impact on the average age of all of our comparable stores.

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Cost of sales includes:

- the cost of merchandise sold (retail and e-commerce), including substantially all vendor allowances, which are treated as a reduction of merchandise costs;
- warehousing and distribution costs including labor and related benefits, freight, rent, depreciation and amortization, real estate taxes, utilities and insurance;
- shipping and handling costs;
- store occupancy costs including rent, depreciation and amortization, real estate taxes, utilities, repairs and maintenance, insurance, licenses and cleaning expenses;
- salon payroll and benefits;
- customer loyalty program expense; and
- shrink and inventory valuation reserves.

Our cost of sales may be negatively impacted as we open an increasing number of stores. Changes in our merchandise mix may also have an impact on cost of sales. This presentation of items included in cost of sales may not be comparable to the way in which our competitors or other retailers compute cost of sales.

Selling, general and administrative expenses include:

- payroll, bonus and benefit costs for retail and corporate employees;
- advertising and marketing costs;
- credit card program incentives;
- occupancy costs related to our corporate office facilities;
- stock-based compensation expense;
- depreciation and amortization for all assets, except those related to our retail and warehouse operations, which are included in cost of sales; and
- legal, finance, information systems and other corporate overhead costs.

This presentation of items in selling, general and administrative expenses may not be comparable to the way in which our competitors or other retailers compute selling, general and administrative expenses.

Pre-opening expenses include non-capital expenditures during the period prior to store opening for new, remodeled and relocated stores including rent during the construction period for new and relocated stores, store set-up labor, management and employee training, and grand opening advertising.

Interest income, net includes both interest income and expense. Interest income represents interest from cash equivalents and short-term investments with maturities of twelve months or less from the date of purchase. Interest expense includes interest costs and unused facility fees associated with our credit facility, which is structured as an asset-based lending instrument. Our credit facility interest is based on a variable interest rate structure which can result in increased cost in periods of rising interest rates.

Income tax expense reflects the federal statutory tax rate and the weighted average state statutory tax rate for the states in which we operate stores.

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Results of operations

Our quarterly periods are the 13 weeks ending on the Saturday closest to April 30, July 31, October 31 and January 31. The Company s second quarter in fiscal 2017 and 2016 ended on July 29, 2017 and July 30, 2016, respectively. Our quarterly results of operations have varied in the past and are likely to do so again in the future. As such, we believe that period-to-period comparisons of our results of operations should not be relied upon as an indication of our future performance.

The following table presents the components of our consolidated results of operations for the periods indicated:

	13 Weeks Ended		26 Weeks Ended	
(Dollars in thousands)	**July 29, 2017**	**July 30, 2016**	**July 29, 2017**	**July 30, 2016**
Net sales	$ 1,289,854	$ 1,069,215	$ 2,604,733	$ 2,142,931
Cost of sales	820,528	684,377	1,659,399	1,367,663
Gross profit	469,326	384,838	945,334	775,268
Selling, general and administrative expenses	283,427	236,380	566,872	477,104
Pre-opening expenses	6,099	4,689	10,257	7,231
Operating income	179,800	143,769	368,205	290,933
Interest income, net	(555)	(248)	(893)	(563)
Income before income taxes	180,355	144,017	369,098	291,496
Income tax expense	66,162	54,013	126,682	109,516
Net income	$ 114,193	$ 90,004	$ 242,416	$ 181,980
Other operating data:				
Number of stores end of period	1,010	907	1,010	907
Comparable sales increase:				
Retail and salon comparable sales	8.3%	12.6%	9.6%	13.3%
E-commerce comparable sales	72.3%	54.9%	71.6%	46.0%
Total comparable sales increase	11.7%	14.4%	13.0%	14.8%

	13 Weeks Ended		26 Weeks Ended	
(Percentage of net sales)	**July 29, 2017**	**July 30, 2016**	**July 29, 2017**	**July 30, 2016**
Net sales	100.0%	100.0%	100.0%	100.0%
Cost of sales	63.6%	64.0%	63.7%	63.8%

Gross profit	36.4%	36.0%	36.3%	36.2%
Selling, general and administrative expenses	22.0%	22.1%	21.8%	22.3%
Pre-opening expenses	0.5%	0.4%	0.4%	0.3%
Operating income	14.0%	13.5%	14.2%	13.6%
Interest income, net	0.0%	0.0%	0.0%	0.0%
Income before income taxes	14.0%	13.5%	14.2%	13.6%
Income tax expense	5.1%	5.1%	4.9%	5.1%
Net income	8.9%	8.4%	9.3%	8.5%

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Comparison of 13 weeks ended July 29, 2017 to 13 weeks ended July 30, 2016

Net sales

Net sales increased $220.6 million or 20.6%, to $1,289.9 million for the 13 weeks ended July 29, 2017, compared to $1,069.2 million for the 13 weeks ended July 30, 2016. Salon service sales increased $9.0 million or 15.3%, to $68.0 million compared to $59.0 million in the second quarter of 2016. E-commerce sales increased $40.4 million or 72.3%, to $96.3 million compared to $55.9 million in the second quarter of 2016. The net sales increase is due to comparable stores driving an increase of $123.9 million and an increase in non-comparable stores of $96.7 million compared to the second quarter of 2016.

The 11.7% comparable sales increase consisted of an 8.3% increase at the Company s retail and salon stores and a 72.3% increase in the Company s e-commerce business. The inclusion of the e-commerce business resulted in an increase of approximately 340 basis points to the Company s consolidated same store sales calculation for the 13 weeks ended July 29, 2017, compared to 180 basis points for the 13 weeks ended July 30, 2016. The total comparable sales increase included a 5.5% increase in transactions and a 6.2% increase in average ticket. We attribute the increase in comparable sales to our successful marketing and merchandising strategies.

Gross profit

Gross profit increased $84.5 million or 22.0%, to $469.3 million for the 13 weeks ended July 29, 2017, compared to $384.8 million for the 13 weeks ended July 30, 2016. Gross profit as a percentage of net sales increased 40 basis points to 36.4% for the 13 weeks ended July 29, 2017, compared to 36.0% for the 13 weeks ended July 30, 2016. The increase in gross profit margin was primarily due to improvements in merchandise margins and leverage in fixed store costs.

Selling, general and administrative expenses

Selling, general and administrative (SG&A) expenses increased $47.0 million or 19.9%, to $283.4 million for the 13 weeks ended July 29, 2017, compared to $236.4 million for the 13 weeks ended July 30, 2016. SG&A as a percentage of net sales decreased 10 basis points to 22.0% for the 13 weeks ended July 29, 2017, compared to 22.1% for the 13 weeks ended July 30, 2016. The decrease is due to leverage in corporate overhead and variable store expenses attributed to cost efficiencies and higher sales volume, partially offset by investments in store labor to support growth initiatives.

Pre-opening expenses

Pre-opening expenses increased $1.4 million to $6.1 million for the 13 weeks ended July 29, 2017, compared to $4.7 million for the 13 weeks ended July 30, 2016. During the 13 weeks ended July 29, 2017, we opened 20 new stores, relocated one store and remodeled four stores, compared to 24 new store openings, one store relocation and five remodeled stores during the 13 weeks ended July 30, 2016.

Interest income, net

Interest income, net was $0.6 million for the 13 weeks ended July 29, 2017 compared to $0.2 million for the 13 weeks ended July 30, 2016. Interest income results from cash equivalents and short-term investments with maturities of twelve months or less from the date of purchase. Interest expense represents various fees related to the credit facility. We did not utilize our credit facility during the second quarter of fiscal 2017 or 2016.

Income tax expense

Income tax expense of $66.2 million for the 13 weeks ended July 29, 2017 represents an effective tax rate of 36.7%, compared to $54.0 million of tax expense representing an effective tax rate of 37.5% for the 13 weeks ended July 30, 2016. The lower tax rate is primarily due to a tax benefit resulting from the Company s adoption of a new accounting standard for employee share-based payments. See Note 2 to our consolidated financial statements, Summary of significant accounting policies Recently adopted accounting pronouncements.

Net income

Net income increased $24.2 million or 26.9%, to $114.2 million for the 13 weeks ended July 29, 2017, compared to $90.0 million for the 13 weeks ended July 30, 2016. The increase is primarily related to the $84.5 million increase in gross profit, partially offset by a $47.0 million increase in SG&A expenses and a $12.1 million increase in income tax expense.

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Comparison of 26 weeks ended July 29, 2017 to 26 weeks ended July 30, 2016

Net sales

Net sales increased $461.8 million or 21.6%, to $2,604.7 million for the 26 weeks ended July 29, 2017, compared to $2,142.9 million for the 26 weeks ended July 30, 2016. Salon service sales increased $18.9 million or 16.0%, to $136.8 million compared to $117.9 million in the first 26 weeks of fiscal 2016. E-commerce sales increased $83.7 million or 71.6%, to $200.6 million compared to $116.9 million in the first 26 weeks of fiscal 2016. The net sales increase is due to comparable stores driving an increase of $275.7 million and an increase in non-comparable stores of $186.1 million compared to the first 26 weeks of fiscal 2016.

The 13.0% comparable sales increase consisted of a 9.6% increase at the Company s retail and salon stores and a 71.6% increase in the Company s e-commerce business. The inclusion of the e-commerce business resulted in an increase of approximately 340 basis points to the Company s consolidated same store sales calculation for the 26 weeks ended July 29, 2017 compared to 150 basis points for the 26 weeks ended July 30, 2016. The total comparable sales increase included a 7.1% increase in transactions and a 5.9% increase in average ticket. We attribute the increase in comparable sales to our successful marketing and merchandising strategies.

Gross profit

Gross profit increased $170.1 million or 21.9%, to $945.3 million for the 26 weeks ended July 29, 2017, compared to $775.3 million for the 26 weeks ended July 30, 2016. Gross profit as a percentage of net sales increased 10 basis points to 36.3% for the 26 weeks ended July 29, 2017, compared to 36.2% for the 26 weeks ended July 30, 2016. The increase in gross profit margin was primarily due to improvements in merchandise margins and leverage in fixed store costs.

Selling, general and administrative expenses

SG&A expenses increased $89.8 million or 18.8%, to $566.9 million for the 26 weeks ended July 29, 2017, compared to $477.1 million for the 26 weeks ended July 30, 2016. As a percentage of net sales, SG&A expenses decreased 50 basis points to 21.8% for the 26 weeks ended July 29, 2017, compared to 22.3% for the 26 weeks ended July 30, 2016. The decrease is due to leverage in corporate overhead and variable store expenses attributed to cost efficiencies and higher sales volume, partially offset by investments in store labor to support growth initiatives.

Pre-opening expenses

Pre-opening expense increased $3.1 million to $10.3 million for the 26 weeks ended July 29, 2017, compared to $7.2 million for the 26 weeks ended July 30, 2016. During the 26 weeks ended July 29, 2017, we opened 38 new stores, relocated three stores and remodeled five stores, compared to 37 new store openings, one relocated store and five remodeled stores during the 26 weeks ended July 30, 2016.

Interest income, net

Interest income, net was $0.9 million for the 26 weeks ended July 29, 2017, compared to $0.6 million for the 26 weeks ended July 30, 2016. Interest income results from cash equivalents and short-term investments with maturities of twelve months or less from the date of purchase. Interest expense represents various fees related to the credit facility. We did not utilize our credit facility during the first 26 weeks of fiscal 2017 or 2016.

Income tax expense

Income tax expense of $126.7 million for the 26 weeks ended July 29, 2017 represents an effective tax rate of 34.3%, compared to $109.5 million of tax expense representing an effective tax rate of 37.6% for the 26 weeks ended July 30, 2016. The lower tax rate is primarily due to a tax benefit resulting from the Company s adoption of a new accounting standard for employee share-based payments. See Note 2 to our consolidated financial statements, Summary of significant accounting policies Recently adopted accounting pronouncements.

Net income

Net income increased $60.4 million or 33.2%, to $242.4 million for the 26 weeks ended July 29, 2017, compared to $182.0 million for the 26 weeks ended July 30, 2016. The increase is primarily related to the $170.1 million increase in gross profit, partially offset by a $89.8 million increase in SG&A expenses and a $17.2 million increase in income tax expense.

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Liquidity and capital resources

Our primary cash needs are for capital expenditures for new, relocated and remodeled stores, increased merchandise inventories related to store expansion and new brand additions, in-store boutiques (sets of custom designed fixtures configured to prominently display certain prestige brands within our stores), supply chain improvements, share repurchases and for continued improvement in our information technology systems.

Our primary sources of liquidity are cash on hand, short-term investments and cash flows from operations, including changes in working capital, and borrowings under our credit facility. The most significant component of our working capital is merchandise inventories reduced by related accounts payable and accrued expenses.

Our working capital needs are greatest from August through November each year as a result of our inventory build-up during this period for the approaching holiday season. This is also the time of year when we are at maximum investment levels in our new store class and may not have collected all of the landlord allowances due to us as part of our lease agreements. Based on past performance and current expectations, we believe that cash on hand, short-term investments, cash generated from operations and available borrowings under our credit facility will satisfy the Company s working capital needs, capital expenditure needs, commitments, and other liquidity requirements through at least the next 12 months.

The following table presents a summary of our cash flows for the periods indicated:

	26 Weeks Ended	
(In thousands)	**July 29, 2017**	**July 30, 2016**
Net cash provided by operating activities	$ 219,993	$ 219,630
Net cash used in investing activities	(343,210)	(129,595)
Net cash used in financing activities	(168,933)	(241,791)
Net decrease in cash and cash equivalents	$ (292,150)	$ (151,756)

Operating activities

Operating activities consist of net income adjusted for certain non-cash items, including depreciation and amortization, non-cash stock-based compensation, realized gains or losses on disposal of property and equipment and the effect of working capital changes.

Merchandise inventories were $1,144.7 million at July 29, 2017, compared to $930.2 million at July 30, 2016, representing an increase of $214.5 million or 23.1%. Average inventory per store increased 10.5% compared to prior year. The increase in inventory is primarily due to the following:

- approximately $106 million due to the addition of 103 net new stores opened since July 30, 2016;
- approximately $57 million due to the opening of the Dallas, Texas distribution center; and

approximately $52 million due to increased sales, new brand additions and incremental inventory for in-store prestige brand boutiques.

Deferred rent liabilities were $387.7 million at July 29, 2017, an increase of $42.3 million compared to $345.4 million at July 30, 2016. Deferred rent includes deferred construction allowances, future rental increases, free rent and rent holidays, which are all recognized on a straight-line basis over their respective lease term. The increase is primarily due to the addition of 103 net new stores opened since July 30, 2016 and corporate and supply chain expansion.

Investing activities

We have historically used cash primarily for new and remodeled stores, supply chain investments, short-term investments and investments in information technology systems. Investment activities for capital expenditures were $193.2 million during the 26 weeks ended July 29, 2017, compared to $149.6 million during the 26 weeks ended July 30, 2016. The increase in capital expenditures is primarily due to our new store program, the expansion of prestige boutiques and related in-store merchandising upgrades during the 26 weeks ended July 29, 2017, compared to the 26 weeks ended July 30, 2016. As of July 29, 2017, we had $180.0 million of short-term investments, which consist of certificates of deposit with maturities of twelve months or less from the date of purchase.

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Financing activities

Financing activities in fiscal 2017 and 2016 consist principally of capital stock transactions and our stock repurchase program. Purchase of treasury shares in fiscal 2017 and 2016 represents the fair value of common shares repurchased from plan participants in connection with shares withheld to satisfy minimum statutory tax obligations upon the vesting of restricted stock.

We had no borrowings outstanding under our credit facility as of July 29, 2017, January 28, 2017 and July 30, 2016. The zero outstanding borrowings position is due to a combination of factors including strong sales growth and overall performance of management initiatives, such as expense control. We may require borrowings under the credit facility from time to time in future periods to support our new store program, capital expenditures, or seasonal inventory needs.

Share repurchase program

On March 10, 2016, we announced that our Board of Directors authorized a new share repurchase program (the 2016 Share Repurchase Program) pursuant to which the Company may repurchase up to $425.0 million of the Company s common stock. The 2016 Share Repurchase Program authorization revoked the previously authorized, but unused amounts of $172.4 million from the earlier share repurchase program. The 2016 Share Repurchase Program did not have an expiration date but provided for suspension or discontinuation at any time.

As part of the 2016 Share Repurchase Program, we entered into an Accelerated Share Repurchase (ASR) agreement with Goldman, Sachs & Co. to repurchase $200.0 million of the Company s common stock. Under the ASR agreement, the Company paid $200.0 million to Goldman, Sachs & Co. and received an initial delivery of 851,653 shares in the first quarter of 2016, which were retired and represented 80% of the total shares the Company expected to receive based on the market price at the time of the initial delivery. In May 2016, the ASR settled and an additional 153,418 shares were delivered to the Company and retired. The final number of shares delivered upon settlement was determined with reference to the average price of the Company s common stock over the term of the agreement. The transaction was accounted for as an equity transaction. The par value of shares received was recorded as a reduction to common stock with the remainder recorded as a reduction to additional paid-in capital and retained earnings. Upon receipt of the shares, there was an immediate reduction in the weighted average common shares calculation for basic and diluted earnings per share.

On March 9, 2017, we announced that the Board of Directors authorized a new share repurchase program (the 2017 Share Repurchase Program) pursuant to which the Company may repurchase up to $425.0 million of the Company s common stock. The 2017 Share Repurchase Program authorization revokes the previously authorized but unused amount of $79.9 million from the 2016 Share Repurchase Program. The 2017 Share Repurchase Program does not have an expiration date and may be suspended or discontinued at any time.

During the 26 weeks ended July 29, 2017, we purchased 647,088 shares of common stock for $178.1 million. During the 26 weeks ended July 30, 2016, excluding the shares repurchased under the ASR, we purchased 265,481 shares of common stock for $52.5 million.

Credit facility

In 2011, we entered into an Amended and Restated Loan and Security Agreement with Wells Fargo Bank, National Association, as Administrative Agent, Collateral Agent and a Lender thereunder, Wells Fargo Capital Finance LLC as a Lender, J.P. Morgan Securities LLC as a Lender, JP Morgan Chase Bank, N.A. as a Lender and PNC Bank, National

Association, as a Lender, which has been amended multiple times since 2011 (as amended, the Loan Agreement). The Loan Agreement currently matures in December 2018, provides maximum revolving loans equal to the lesser of $200 million or a percentage of eligible owned inventory, contains a $10 million subfacility for letters of credit and allows the Company to increase the revolving facility by an additional $50 million, subject to consent by each lender and other conditions. The Loan Agreement contains a requirement to maintain a minimum amount of excess borrowing availability at all times. Substantially all of the Company s assets are pledged as collateral for outstanding borrowings under the facility. Outstanding borrowings will bear interest at the prime rate or London Interbank Offered Rate plus 1.50% and the unused line fee is 0.20%.

See Note 9 to our consolidated financial statements, Subsequent event, for information on the new credit agreement entered into on August 23, 2017.

As of July 29, 2017, January 28, 2017 and July 30, 2016, we had no borrowings outstanding under the credit facility and the Company was in compliance with all terms and covenants of the Loan Agreement.

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Off-balance sheet arrangements

As of July 29, 2017, we have not entered into any off-balance sheet arrangements, as described by the SEC. We do, however, have off-balance sheet operating leases and purchase obligations incurred in the ordinary course of business.

Contractual obligations

Our contractual obligations consist of operating lease obligations, purchase obligations and our revolving line of credit. No material changes outside the ordinary course of business have occurred in our contractual obligations during the 26 weeks ended July 29, 2017.

Critical accounting policies and estimates

Management s discussion and analysis of financial condition and results of operations is based upon our consolidated financial statements, which have been prepared in accordance with U.S. generally accepted accounting principles (GAAP). The preparation of these consolidated financial statements required the use of estimates and judgments that affect the reported amounts of our assets, liabilities, revenues and expenses. Management bases estimates on historical experience and other assumptions it believes to be reasonable under the circumstances and evaluates these estimates on an ongoing basis. Actual results may differ from these estimates. There have been no significant changes to the critical accounting policies and estimates included in our Annual Report on Form 10-K for the fiscal year ended January 28, 2017.

Recent accounting pronouncements not yet adopted

See Note 2 to our consolidated financial statements, Summary of significant accounting policies Recent accounting pronouncements not yet adopted.

Recently adopted accounting pronouncements

See Note 2 to our consolidated financial statements, Summary of significant accounting policies Recently adopted accounting pronouncements.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Market risk represents the risk of loss that may impact our financial position due to adverse changes in financial market prices and rates. Our market risk exposure is primarily the result of fluctuations in interest rates. We do not hold or issue financial instruments for trading purposes.

Interest rate sensitivity

We are exposed to interest rate risks primarily through borrowings under our credit facility. Interest on our borrowings is based upon variable rates. We did not access our credit facility during the 26 week period ended July 29, 2017. Interest income from cash equivalents and short-term investments with maturities of twelve months or less from the date of purchase is partially offset by interest expense, which represents unused fees associated with the credit facility.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures over Financial Reporting

We have established disclosure controls and procedures to ensure that material information relating to the Company is made known to the officers who certify our financial reports and to the members of our senior management and Board of Directors.

Based on management s evaluation as of July 29, 2017, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, are effective to ensure that the information required to be disclosed by us in our reports that we file or submit under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission s rules and forms, and that such information is accumulated and communicated to our management, including the Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

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Changes in Internal Control over Financial Reporting

There were no changes to our internal controls over financial reporting during the 13 weeks ended July 29, 2017 that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

Part II Other Information

Item 1. Legal Proceedings

See Note 3 to our consolidated financial statements, Commitments and contingencies General litigation, for information on legal proceedings.

Item 1A. Risk Factors

In addition to the other information set forth in this report, you should carefully consider the factors discussed in Part I, Item 1A. Risk Factors in our Annual Report on Form 10-K for the year ended January 28, 2017, which could materially affect our business, financial condition, financial results or future performance. There have been no material changes from the risk factors previously disclosed in our Annual Report on Form 10-K for the year ended January 28, 2017.

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

The following table sets forth repurchases of our common stock during the second quarter of 2017:

Period	Total number of shares purchased (1)	Average price paid per share	Total number of shares purchased as part of publicly announced plans or programs (2)	Approximate dollar value of shares that may yet to be purchased under plans or programs (in thousands) (2)
April 30, 2017 to May 27, 2017	65,685	$ 293.51	65,685	$ 375,280
May 28, 2017 to June 24, 2017	102,037	294.63	102,037	345,217
June 25, 2017 to July 29, 2017	299,998	262.22	294,699	268,070
13 weeks ended July 29, 2017	467,720	273.68	462,421	268,070

(1) There were 462,421 shares repurchased as part of our publicly announced share repurchase program during the 13 weeks ended July 29, 2017 and there were 5,299 shares transferred from employees in satisfaction of

minimum statutory tax withholding obligations upon the vesting of restricted stock during the period.

(2) On March 10, 2016, we announced the 2016 Share Repurchase Program pursuant to which the Company may repurchase up to $425.0 million of the Company s common stock. The 2016 Share Repurchase Program did not have an expiration date, but provided for suspension or discontinuation at any time. On March 9, 2017, we announced the 2017 Share Repurchase Program pursuant to which the Company may repurchase up to $425.0 million of the Company s common stock. The 2017 Share Repurchase Program authorization revokes the previously authorized but unused amounts of $79.9 million from the 2016 Share Repurchase Program. As of July 29, 2017, $268.1 million remained available under the $425.0 million 2017 Share Repurchase Program.

Item 3. Defaults Upon Senior Securities

None

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Item 4. Mine Safety Disclosures

None

Item 5. Other Information

None

Item 6. Exhibits

The exhibits listed in the accompanying Exhibit Index are filed as part of this Quarterly Report on Form 10-Q.

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on August 31, 2017 on its behalf by the undersigned, thereunto duly authorized.

ULTA BEAUTY, INC.

By: /s/ Mary N. Dillon
Mary N. Dillon

Chief Executive Officer and Director

By: /s/ Scott M. Settersten
Scott M. Settersten

Chief Financial Officer, Treasurer and Assistant Secretary

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Ulta Beauty, Inc.

Exhibit Index to Quarterly Report on Form 10-Q

For the Quarterly Period Ended July 29, 2017

			Incorporated by Reference			
					File	
Exhibit Number	**Description of document**	**Filed Herewith**	**Form**	**Exhibit Number**	**Number**	**Filing Date**
3.1	Certificate of Incorporation of Ulta Beauty, Inc.		8-K	3.1	001-33764	1/30/2017
3.2	Certificate of Designations of Series A Junior Participating Preferred Stock of Ulta Beauty, Inc.		8-K	3.2	001-33764	1/30/2017
3.3	Bylaws of Ulta Beauty, Inc.		8-K	3.3	001-33764	1/30/2017
4.1	Stockholder Rights Agreement		S-1	4.4	333-144405	8/17/2007
4.2	Amendment to Stockholder Rights Agreement, dated as of January 29, 2017		8-K	4	001-33764	1/30/2017
10	Second Amended and Restated Loan Agreement, dated as of August 23, 2017, among Ulta Beauty Inc., Ulta Salon, Cosmetics & Fragrance, Inc., the subsidiaries of Ulta Beauty signatory thereto, Wells Fargo Bank, National Association, JPMorgan Chase Bank, N.A. and PNC Bank, National Association		8-K	10	001-33764	8/24/2017
31.1	Certification of the Chief Executive Officer pursuant to Rules 13a-14(a) and 15d-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to section 302 of the Sarbanes-Oxley Act of 2002	X				
31.2	Certification of the Chief Financial Officer pursuant to Rules 13a-14(a) and 15d-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to section 302 of the Sarbanes-Oxley Act of 2002	X				
32	Certification of the Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	X				
101.INS	XBRL Instance	X				

101.SCH	XBRL Taxonomy Extension Schema	X
101.CAL	XBRL Taxonomy Extension Calculation	X
101.LAB	XBRL Taxonomy Extension Labels	X
101.PRE	XBRL Taxonomy Extension Presentation	X
101.DEF	XBRL Taxonomy Extension Definition	X