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PRESENTATION

Operator

Good morning, ladies and gentlemen, and welcome to the Sally Beauty Holdings conference call to discuss the company's fiscal 2023 first quarter results. (Operator Instructions)

Now I would like to turn the call over to Jeff Harkins, Vice President of Investor Relations and Treasurer for Sally Beauty Holdings.

Jeff Harkins - *Sally Beauty Holdings, Inc. - VP of IR & Strategic Planning*

Thank you. Good morning, everyone, and thank you for joining us. With me on the call today are Denise Paulonis, President and Chief Executive Officer; and Marlo Cormier, Chief Financial Officer.

Before we begin, I would like to remind everyone that management's remarks on this call may contain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Actual results may differ materially from those indicated by these forward-looking statements as a result of various important factors, including those discussed in the Risk Factors section of our most recent annual report on Form 10-K and other filings with the SEC. Any forward-looking statements made on this call represent our views only as of today, and we undertake no obligation to update them.

The company has provided a detailed explanation and reconciliations of its adjusting items and non-GAAP financial measures in its earnings press release and on its website.

Now I'd like to turn the call over to Denise to begin the formal remarks.

Denise A. Paulonis - *Sally Beauty Holdings, Inc. - President, CEO & Director*

Thank you, Jeff, and good morning, everyone. We're pleased that fiscal 2023 is off to a solid start as our teams remained focused on serving our customers and made excellent progress on our new strategic initiatives to drive long-term growth and profitability.

First quarter net sales came in at $957 million. Comparable sales increased 1% versus last year and 7% on a 2-year stack basis. Adjusted gross margin remained strong at 51%. Adjusted EBITDA was $126 million, and we generated positive free cash flow of $30 million.

Our business remains resilient as we delivered strong performance in the first quarter against the backdrop of persistent inflationary pressures. Purchasing behavior among both our Sally customers and BSG stylists remain fairly consistent with the trends we've seen in recent quarters. At both Sally and BSG, average ticket increased, driven primarily by average unit retail, while transactions were down slightly compared to the prior year.

Promotional activity was up modestly at both Sally and BSG in the quarter as our customers responded to value messaging. Of note, this increased promotional activity was funded by support from our vendors, enabling us to maintain our strong gross margin profile.

During the quarter, we successfully implemented our distribution center consolidation and store optimization plan, which strengthens our supply chain network and positions us to maximize the value of our large store portfolio going forward. Inventory from our Oregon and Pennsylvania DCs has been successfully transferred to larger facilities, and the majority of our 350 planned store closures were completed with minimal disruption. Early reads on sales recapture are trending in line with our expectations, and we look forward to sharing a broader update next quarter.

In the first quarter, e-commerce sales increased 14% and comprises 9.5% of total sales, driven by the strength of our convenient fulfillment options, including 2-hour delivery and Buy Online / Pickup In-Store. On our last earnings call in November, we shared our vision for the Sally Beauty Holdings of the future and outlined that the three new strategic initiatives we'll be advancing in the coming years. As a reminder, these include: enhancing our customer centricity, growing high-margin owned brands at Sally Beauty and amplifying innovation and increasing the efficiency of operations and optimizing our capabilities.

Let me update you on our progress across each of these. First, enhancing our customer centricity. As an organization, we're focused on our loyal customers as well as acquiring new customers through our marketing programs, differentiated product offerings and professional color and care and our strategic initiatives. Our goal is to provide our customers with an unparalleled experience whenever and however they engage with us. We have 17 million active loyalty members at Sally U.S. and Canada, representing 77% of our sales in Q1. And our rewards credit card at BSG comprised 9% of sales for the quarter.

Additionally, our Net Promoter Scores continued to remain at all-time highs, with Sally at the low 80s and BSG in the high 60s. We know who our customers are, we understand their needs, and we're building on this strength to drive increased engagement and lifetime value.

At BSG, the launch of our strategic partnership with SalonHQ is meeting with positive response as we get to onboard stylists, help them create their digital storefront and provide them with marketing tools to engage with their customers. This new platform was created for our stylist community as a means to empower them to build more value-added and profitable businesses, and we're pleased with the initial traction we're seeing.

Turning now to Sally, where inspiration, education and advice are key tenets of the business. Our associates and certified color consultants take tremendous pride in serving our customers in store, and we're expanding upon this core competency by increasing our virtual color experts and piloting our studio by Sally stores. Our virtual color experts are accessible through live video calls conducted on-site in our stores, bringing our customers this higher level of touch and professional advice ensures they are set up for success across every step of their hair color journey and further elevates Sally as the leader in professional hair color and care.

Following a successful pilot, we brought this to 45 locations in fiscal 2022 and added another 30 stores in Q1 for a total of 75 at quarter end. Next, we'll be piloting this service on our Sally website, offering those scheduled appointments and on-demand consultation beginning in the second half of fiscal 2023.

Turning to our new studio by Sally concept stores. We're on track to launch our first pilot location in Dallas during the second quarter and plan to open an additional six studio stores this fiscal year. As a reminder, these stores will include a DIY-centric salon where customers will receive education and training on how to achieve their desired results.

Studio by Sally will allow us to leverage our competitive advantages and omnichannel infrastructure to engage, educate and empower our customers utilizing a digital first focus. We believe there's an opportunity to grow this concept to 100 locations throughout the U.S. over the next 3 to 4 years and look forward to keeping you updated on our progress in year one.

Moving on to our second strategic initiative, growing our high-margin owned brand penetration in Sally and amplifying product innovation in Sally and BSG. We're staying at the forefront of innovation and have demonstrated good progress towards our goal to grow our high-margin owned brands in Sally.

In the first quarter, we completed the initial rollout of bondbar, our new line of pro-quality bonding products at accessible price points and expect to be fully launched with all SKUs by the end of Q2. Also notable during the quarter was the strong performance of our Wunderbar, hair care brand, and XP-100 color brands in Europe.

Owned brand sales penetration for the Sally segment reached 34% of sales in the first quarter, up from 33% of sales at year-end, and we believe we can grow that to 50% penetration over the next 4 to 5 years, while growing our overall sales low to mid-single digits. We're also bringing units to key categories through store reset. For example, we're seeing positive customer response to our nail reset at both Sally and BSG. Additionally, we're leaning into textured hair space with the recent introduction of five new brands in our CosmoProf stores supported by a broad-based marketing campaign that will kick off this month.

Turning now to our third strategic initiative, increasing the efficiency of our operations and optimizing our capabilities. This encompasses three areas of focus, including optimizing our store base, consolidating and leveraging our enhanced supply chain and capturing efficiencies by rethinking the way we work. As I outlined earlier in the call, our teams have largely completed the DC and store optimization plan with minimal disruption and the successful transfer of product to our larger facilities. I'm also pleased to note that a significant portion of our workforce in the affected stores have accepted positions in other locations. Additionally, the integration of our expanded Regis partnership is complete, and we are on track to double our sales volume in fiscal 2023.

Lastly, the work under our Fuel for Growth initiative continues to be underway as we focus on ways to more efficiently steward the business as we seek to maximize profitability and increase shareholder value over the long term. We feel good about how we're positioned and the way we're advancing the business through our new strategic initiatives. We have incredibly talented associates across the organization who are passionate about delighting our customers and inspiring a more colorful, confident and welcoming world. We are confident that our [invented] new strategies in concert with our core capabilities and infrastructure provide us a significant runway for growth in the coming years. Over the long term, we believe the business is positioned to generate low to new single-digit net sales growth, gross margins over 50% and low double-digit operating margin.

Now I'll turn the call over to Marlo to cover the financials.

Marlo M. Cormier - *Sally Beauty Holdings, Inc. - Senior VP & CFO*

Thank you, Denise, and good morning, everyone. We're pleased to begin fiscal 2023 on strong footing, delivering first quarter results in line with our expectations and making consistent progress against our strategic initiatives. First quarter net sales of $957 million declined 2.4%, reflecting the combination of 395 fewer stores and 150 basis points of unfavorable foreign currency impact.

Comparable sales were up 1% versus a year ago and up 7% on a 2-year stack. We continue to see strong digital performance with global e-commerce sales increasing 14% to $91 million on a constant currency basis and representing 9.5% of total net sales. We maintained strong adjusted gross margins, which came in at 50.8%, down 20 basis points for last year. Increased product margin at Sally Beauty driven by pricing leverage and higher owned brand penetration was offset by lower margin at BSG due to a channel mix shift between stores and our expanded Regis business.

Turning now to operating expenses. Adjusted SG&A totaled $391 million, an increase of $7 million versus a year ago and reflects higher labor and personnel costs. Looking at the full year, we are on track to achieve the expected expense savings we announced last quarter under our DC consolidation and store optimization plan. Total anticipated savings of approximately $50 million is expected to serve as a partial offset to increasing pressure from labor costs as we move through fiscal 2023. We expect SG&A levels for the second quarter to remain similar to the first quarter, reflecting the timing of our wage investments and benefits from our optimization efforts.

The combination of our healthy gross margins and prudent cost control enabled us to invest in our new strategic initiatives, while also delivering on the bottom line. First quarter adjusted operating margin was 10%. Adjusted EBITDA margin was 13.1% and adjusted diluted earnings per share came in at $0.52.

Looking at segment results. First quarter comparable sales increased 3% at Sally Beauty and were up 7% on a 2-year stack. Let sales declined 2.1%, driven primarily by 210 basis points of unfavorable foreign currency impact and reflects the fact that we had 383 fewer stores in operation versus a year ago. At constant currency, segment e-commerce sales increased 13% to $35 million or 6.4% of segment net sales for the quarter. For the global Sally segment, color was up 3% and care declined 4%, including the impact from store closures. At Sally U.S. and Canada, color increased by 5%, while gray coverage was up 10% and comprised 77% of the color categories.

Gross margin at Sally expanded 50 basis points to 58.9%, and reflecting solid product margins, driven primarily by pricing leverage and higher owned brand penetration. Segment operating margin increased to 18%.

Moving to the BSG segment. Comparable sales declined 1.5% as BSG was lapping last year's strong demand from stylists, who were restocking their salons during the reopening. On a 2-year stack basis, BSG comps were up 7%. Net sales declined 2.7%, which reflects 60 basis points of unfavorable foreign currency impact and 12 fewer stores versus a year ago. On a constant currency basis, segment e-commerce sales increased 14% to $55 million or 13.6% of segment net sales for the quarter.

The colored category was down 3% and care declined 2% at BSG as our stylists continue purchasing closer to need. During the quarter, we did continue to see strong momentum with express coloring products. Adjusted gross margin at BSG decreased 130 basis points to 39.8%, primarily driven by product -- lower product margins due to the sales channel mix shift between the segment stores and expanded Regis partnership. Segment operating margin came in at 12.2%.

Moving to the balance sheet and cash flow. We ended the quarter with $99 million of cash and cash equivalents and $65 million outstanding under our asset-based revolving line of credit. Our net debt leverage ratio stood at 2.2x. Inventories have continued to normalize as the supply chain disruptions we experienced in 2022 have mostly subsided, notwithstanding some choppiness with inventory receipts in certain SKUs. Quarter-end inventories were $987 million, down 1.9% from a year ago. We generated strong free cash flow of $30 million in the first quarter. For the full year, we continue to expect to return to free cash flow generation in the range of $175 million to $200 million, providing us with the financial flexibility to invest in our new strategic initiatives to drive long-term growth.

Turning now to guidance. We are reiterating our full year expectations as follows: comparable sales, notwithstanding a notable change in consumer behavior are expected to increase by low single digits compared to the prior year, driven by growth in some categories, sales transfer from store closures, our expanded Regis distribution and our new strategic initiatives.

Net sales are expected to decline by low single digits compared to the prior year. This reflects approximately 150 to 200 basis points of unfavorable impact of store closures, net of expected sales recapture from our optimization efforts as well as approximately 150 basis points of anticipated impact from FX headwinds. At the end of fiscal 2023, store count is expected to be down 6% to 7% compared to the end of 2022 due to our store optimization plan and a small number of new store openings.

Gross margin is expected to remain above 50% and adjusted operating margin is expected to be in the range of 8.5% to 9.5%. This reflects increased investments in store labor, partially offset by an expected benefit to operating earnings of approximately $10 million related to our distribution center consolidation and store optimization plan.

From a cadence perspective, keep in mind that the second quarter is historically our lightest sales quarter. And as I outlined earlier, we anticipate that further investment in wages will begin ramping up this quarter. As a result, adjusted operating margin is expected to decline sequentially from the first quarter to the second quarter.

Looking further ahead, we remain confident that our initiatives to drive top line growth build scale and further optimize our operating model, will enable us to return to double-digit operating margin in fiscal 2024 and beyond.

We appreciate your time this morning. Now I'll ask the operator to open the call for Q&A.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) One moment please for our first question. And we'll go first to Oliver Chen with Cowen and Company.

Oliver Chen - *Cowen and Company, LLC, Research Division - MD & Senior Equity Research Analyst*

Denise and Marlo, regarding what you're seeing out there in the market, I would love your thoughts on the color trends relative to restocking. And Denise, as everybody thinks a bit about inflation. Is that still impacting traffic and customer behavior?

The second question I had is on customer lifetime value and engagement. You mentioned opportunities there as well as your loyalty program. Would love you to elaborate on what you see as lower hanging fruit.

And then Marlo, on the store progress in terms of store optimization, how have the recapture rates been looking relative to your expectations?

Denise A. Paulonis - *Sally Beauty Holdings, Inc. - President, CEO & Director*

Good morning, Oliver. I hope you're well. Let me start with the beginning of those questions, and then I'll throw it over to Marlo to help on store optimization. So first of all, we're seeing color, a very healthy in both of our businesses in both BSG and in Sally. In Sally, we were up 10% in gray coverage and 5% overall in Sally U.S. And interestingly, similar to some things I think folks are reading in the news, great trends around brunette colors, great trends around more copper colors.

So people going a little darker right now, but seeing the efficiency of the offering versus what bonding might be, which could be more expensive. But thrilled to see people resonating and coming in and shopping with us, in particular we have an always on buy 4 and save 20% on some of our brands. And we've seen that nicely have frequency, be consistent for our customers, where earlier last year, we did not have that promotion and we saw people trending back the frequency with which they colored. So we're really thinking that, that's helping them keep their pantry loaded and pantry stock.

On the BSG side, I think the important note to remember, color is still very healthy for us. But this time last year, so Q1 last year, stylists were heavily restocking as the end of the COVID restrictions were really coming to bear, and we are seeing supply chain disruptions. So customers bought what they could when it was available. I think this year, what we're seeing is they have been working through that inventory. They continue to buy closer to need. But color remains healthy in the business.

More broadly on the inflation front and customer behavior. We haven't seen a meaningful change in trend. Like I said, I think the change in trend we've seen a little bit more is people going a little darker color in their hair. But that same level of conservatism about extra items in the basket remains both for our stylists and for our customers coming in. But that said, we're pleased in our nail category with the reset. But when we can bring out some newness. We are able to get customers thinking about that category, maybe a little bit more than they were a few quarters ago.

On the customer lifetime value, we're very realistic that we don't capture all of the wallet share of our customers. And so our focus with our loyalty program are focused on education and expertise, our focus on convenience with 2-hour delivery and BOPIS are the things we're really pushing on to drive more of that share of wallet with our customers. And you'll see us continue to do that as we go forward, inclusive of things around our customer-centricity initiatives. So our Sally studio stores and focusing more on education, our virtual color expert making it that much more of a reason to come to value to get your expertise and advice that you need.

And with that, Marlo, how about you, talk about store optimization.

Marlo M. Cormier - *Sally Beauty Holdings, Inc. - Senior VP & CFO*

Thanks, Denise. Yes, in terms of our store optimization, just as a reminder, we spent the good part of a year really piloting and studying our closure model. And so as we analyze customer behavior, monitored recapture rates, we are pretty confident as we went into this closure plan. And so we did do our significant closures in the early part of December. So it is early days, but so far, it's tracking. According to plan, we are recapturing at rates consistent with what we planned. It's early days. But we are pleased with those initial results and very pleased with the smooth execution of the program. That was really limited disruption and a good delivering everything that we expected so far.

Oliver Chen - *Cowen and Company, LLC, Research Division - MD & Senior Equity Research Analyst*

Great hearing about all the innovation. Best regards.

Operator

And next, we can go to the line of Olivia Tong with Raymond James.

Olivia Tong Cheang - *Raymond James & Associates, Inc., Research Division - MD & Research Analyst*

First, I wanted to ask you on your long-term growth outlook. If you could remind us what gets you from close single-digit comp to low to mid-single-digit sales, particularly -- and sort of timing around that, particularly after part and parcel with that, the store closures. Could you just talk a little bit about some of the timing and cadence of store closures for the year where you think you need to go to longer term?

Denise A. Paulonis - *Sally Beauty Holdings, Inc. - President, CEO & Director*

Sure. Let me start there. So when we think about the store closures for this year, they are largely complete. As Marlo indicated, 350 stores were in the closure plan and the vast majority of those were completed late in December. So that is, for the most part, behind us, and we're moving forward and excited about the recapture rate that we're seeing with our customers there.

When we think about the broader path and what we're working on with our newer initiatives, and as we're going to build to our long-term algorithm, let me talk a little bit about it broken out into the years and how we see it evolving. So when we're talking about 2023, we've been focused on growing our own brands, which includes Ion, Strawberry Leopard, and bondbar, our newest launch, just to name a few of those, rebuilding our nail category and our care category, driving growth there as well.

Doubling our Regis business, we were very excited to pick up that business last year. It is fully onboarded at this point. And as we wrap around from last year, the opportunity we have there to double the business as well as take us as a learning to see where we have opportunity with additional chain customers.

Finally, with the store organization and DC consolidation complete, that's going to improve our operating profit performance. As we move later into 2023, we've talked about our stylist platform with SalonHQ and our virtual color expert experience. Both of those, we expect late in the year to start to ramp in terms of impact. And the stylist platform right now is in pilot in only one region today. So early on, but we're encouraged by our stylist response and continuing to grow that out.

When you look into 2024, we do anticipate acceleration on a number of fronts. That includes own brands. It includes the stylist platform, which we hope will be in the process of expanding in the U.S. and then tailwinds from our e-commerce channel and the virtual color expert. Our Studio by Sally initiative, we're excited that we're on track to get about updated this year to that new format, including a store here in the Dallas area later in Q2. And that -- but that's really going to impact us longer term. So we expect that to be a pilot this year into next year. And the hope would be if it's looking positive, we'd expand that to support later in 2024 and into 2025.

So hopefully, that gives you a shape of what we're working on. It all comes back to customer centricity, driving the business through innovation as well as own brands to really respond to what our customers want and need. And we're pleased that they continue to reward us with high NPS scores on both the Sally and BSG side as we are kind of on this journey with them.

Olivia Tong Cheang - *Raymond James & Associates, Inc., Research Division - MD & Research Analyst*

That's very helpful kind of sit well for my second question around your new own brands like bondbar, the ones you mentioned. But longer term, I mean, actually, right now, where is the contribution of own brands stands now? And where do you expect it to go longer term? And as you think about further penetration of your own brands, can you talk about like where you think it goes from here?

Denise A. Paulonis - *Sally Beauty Holdings, Inc. - President, CEO & Director*

Absolutely. This quarter, owned brands represented about 34% of the Sally segment. That's up about 1% from last quarter. but a nice steady growth through last year as we continue to roll out Strawberry Leopard and then just recently introduced bondbar. We're targeting that number for the Sally segment specifically to become about 50% of the business. We think it will take four or five years to get there in the path of getting there.

This quarter, we'll fully roll out the rest of the bondbar line. We only had the first four SKUs in market through the holidays. But had good customer reaction, good performance out of those as they were starting to come to market. So we're excited to see that come to fruition with the rest of those SKUs coming online in Q2. And we'll continue to build around that in future years and as well as the strength of owned brands in our European businesses. So that will be a source of growth for us for the time to come.

And importantly, as we move up that penetration curve with owned brands, it's a nice tailwind into our gross margin. We think that there's a nice complement between continuing to drive our owned brands and growing brands with our external vendors to have a great complement of product over time for our customers coming into their stores. And while owned brands is really a focus on the Sally segment, we are also excited about the innovation and continued growth that we can drive in our BSG business with a number of our pro-vendor partners, and we continue to see more innovation in the pipeline in that space as well.

Operator

And next, we can go to Simeon Gutman with Morgan Stanley.

Simeon Ari Gutman - *Morgan Stanley, Research Division - Executive Director*

Two parts on SBS. I think, Denise, you mentioned that store closures largely done. I wanted to get maybe the U.S. store count where it is and then where that will eventually land. It sounds like similar to where it is now. And then in terms of the drivers of the comp, can you talk about product initiative versus price? And then you said recapture rate was in line, but could you quantify how much of the comp could have been helped by some store closures?

Denise A. Paulonis - *Sally Beauty Holdings, Inc. - President, CEO & Director*

Sure. Let me work through this in order. So in SBS, the closures are largely done. So as I mentioned, 350 stores was the plan, vast majority completed in Q4. Sally U.S., that leaves our store count at the end of this quarter at about 2,430 to 2,440. And broadly in SBS, it's about 3,150. Those are down pretty notably from a year ago, and we'll finish the year, as Marlo said, as an entity, inclusive of BSG down 6% to 7%. We think that this is about the right place to be.

I think the piece I'd reemphasize is, all of the stores were 4-Wall EBITDA positive. The strength of the store optimization opportunity really came from such a positive reaction and ability to capture the sales transfer in the stores and into e-commerce. And we were very pleased with that in the test that we did, which enabled us to go after this incremental set of stores that we closed. So in our plan, we're targeting a 40% recapture rate. As Marlo mentioned, we're feeling good about where we are now. We're trending well, and we'll have more updates as we get beyond 3 to 4 weeks of those closures to be able to report out some numbers to you guys.

But overall, a good place to be. We will continue to watch and understand the store recapture and see if there would be any incremental opportunity. But right now, we're -- we think that this is the right spot to be in.

When you think about contribution to comp in the quarter, we actually -- it was late in December that we closed the stores. So in the first quarter, would not have been a meaningful count -- would not have been a meaningful contribution.

Simeon Ari Gutman - *Morgan Stanley, Research Division - Executive Director*

Got it. Okay. One follow-up on BSG. Can you talk about the competitive landscape. Promotionality, any brand changes that could positively or negatively impact your business? And then I don't know -- you don't guide by business segment, but I think the comp should flip back to positive for the remainder of the year. Is that a fair assumption?

Denise A. Paulonis - *Sally Beauty Holdings, Inc. - President, CEO & Director*

Yes. So in reverse order, yes, we would expect a positive trend in BSG comps for the remainder of the year. Give or take, we lap some certain small events here and there. But the nation of the business is this quarter having a negative comp was really about comping a really strong number last year as salons were reopening. When we think about the competitive intensity, I mean, this business is a competitive business.

Have we seen that strengthen or materially change? And not materially, right? We watch everyone at this point with stylists being a bit more conservative, continue to fight for every dollar of sales that we can get. We did see our vendors more willing to lean into some spot promotions that they fully funded to try to understand what might move their businesses, and we appreciated that support from the vendors as we went through the quarter. So overall, we're out there.

All of our brands have new innovation coming in one sense or another as we work our way through the year, feel great about the relationships that we have with our key vendors. And just look forward to growing that business with them through the rest of the year.

Operator

(Operator Instructions) Next, we'll go to Ashley Helgans with Jefferies.

Unidentified Analyst

It's Blake on for Ashley. On the continued shift to own brands, it sounds like a lot of impact there from innovation, do you expect any trade-down impact as well if inflation were to continue? And then you mentioned launching some new products with marketing campaigns starting this month. What type of products or trends are you focusing right now for innovation?

Denise A. Paulonis - *Sally Beauty Holdings, Inc. - President, CEO & Director*

Yes. So first of all, on own brands, interestingly, many of our own brands are actually not the value brand in the store. So they could be priced at a midpoint price point compared to what else is available in our store The differentiator that we have with many of our own brands is the efficacy of the product. That's true with our Ion products. It's true with Strawberry Leopard and the vivid color space and newly launched bondbar, which is really a bonding offering at a great value price point compared to other offerings that are out there.

So when we think about our owned brands, we call them owned brands for a reason because we do really focus on getting that right level of quality and cost of balance to be great value to the consumer, but pretty high-end products.

In general, have we seen consumers looking for sources of value? Absolutely. I mentioned to Simeon, that our BSG business, our vendors had supported some additional promotional activity. That's true on the Sally side as well. In aggregate, promotions are not up meaningfully but a little bit more lean in where we can get value to customers is something that they're certainly looking for and certainly taking advantage of when that comes to life.

Unidentified Analyst

That's super helpful. And then on the supply chain optimization, it sounds like you're going to be saving $50 million there and you've talked about a $10 million benefit to operating income this year. I was wondering if you -- should we think about you reinvesting the savings that the rest of that $40 million -- or is that just a timing benefit where that $10 million should grow over time?

Denise A. Paulonis - *Sally Beauty Holdings, Inc. - President, CEO & Director*

Yes. Marlo, do you want to explain the economics around that?

Marlo M. Cormier - *Sally Beauty Holdings, Inc. - Senior VP & CFO*

Yes, a little bit. So that's our optimization program, which includes both the DC consolidation as well as our store closures. And so the bulk of that work was done towards the end of Q1. So from a year-over-year perspective, you do get a little bit of wrap around. So what we described was a $50 million savings in SG&A, and that translates to $10 million of improvement on the operating earnings line. So we get a little bit of lift of that when you look at it on an annualized basis with a little bit of wrap around next year.

In terms of looking at it from what is offsetting that, that program is designed to help us offset much of the cost pressures that we've seen. And most of those have been coming in terms of labor. And so what also is happening this year is our increased investment in our wages, which also goes into effect at the beginning of the calendar year.

So there are times fairly close to each other so that you do see that offset as we progress through the year. We have made a conscious decision to invest in our labor. It's important. Our associates are a very important part of our differentiator. They are an important element of driving our growth initiatives. So we believe that's a very important investment to make, and that will step up as well as we have this current quarter in Q2.

And I would just add the important part of getting from $50 million to $10 million this year that we've talked about on our call is -- the difference between that is really the sales loss. So while we'd love to recapture every dollar of sales, the difference between there reflects the fact that we believe we'll recapture 40% of the sales from the closed stores. So that's really the differential we're getting from the $50 million to the $10 million.

Operator

And Next, we can go to Carla Casella with JPMorgan.

Unidentified Analyst

This is Mike on for Carla. Just wanted to ask, have you guys thought about how you think about addressing the 2024 term loan maturity.

Denise A. Paulonis - *Sally Beauty Holdings, Inc. - President, CEO & Director*

Yes. Marlo, you want to talk about that?

Marlo M. Cormier - *Sally Beauty Holdings, Inc. - Senior VP & CFO*

Sure. Yes. So we've reported in the past, we're continuing to monitor the market for opportunistic refinancing opportunities. We are a strong cash flow generator, and that gives us the flexibility to continue to watch those markets. So we're continuing to do that.

Unidentified Analyst

Great. And then this is a second one from us. Any difference in terms of kind of trade-down activity you're seeing on the Sally side or the BSG side?

Denise A. Paulonis - *Sally Beauty Holdings, Inc. - President, CEO & Director*

Yes, not materially different in terms of trade down. I think when you think about the BSG side, people are stickier to their brands. So they're just much more focused on getting value when value opportunities present themselves. But for the most part, stylists are pretty loyal particularly in color to what they know and what they use. So that's been pretty steady. And on the Sally side, it becomes a little bit more on the frugality side of just not adding the extra items to the basket.

So color sales have definitely remained strong as people are continuing to take care of themselves and that natural part of their hair that they want to maintain. It's the incremental -- inclusive of higher ticket items like styling tools that over the last few years had actually been quite strong. And then as inflation started to tick up mid last year, those higher ticket items became more -- people became more conservative in their choice around purchasing those. So I'd say it's much more of the basket adds have gone down rather than necessarily seeing people trade down in terms of price point to this point.

Operator

And currently, no further questions in queue.

Denise A. Paulonis - *Sally Beauty Holdings, Inc. - President, CEO & Director*

Great. Well, thank you all for joining this morning. We are very pleased with the start of our new fiscal year and excited about the strategy that we have in front of us, those to deliver this year and in future years to come and drive long-term shareholder value. As a final point, as I always do, I would like to thank all of our associates around the globe for serving our customers, taking care of each other and really helping us drive a successful business and a happy business.

So hopefully, everybody has a great day, and we look forward to talking to you again soon.

Operator

Thank you. And ladies and gentlemen, this conference will be available for a replay after 9:30 this morning and running through February 16 at midnight. You can access the AT&T replay system at any time by dialing 1866-207-1041 and entering the access code 723-2209. International parties may dial 402-970-0847. Those numbers again, 1866-207-1041. For international parties, 402-970-0847 with the access code 723-2209. That does conclude our call for today. Thanks for your participation and for using AT&T Teleconference. You may now disconnect.

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