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PRESENTATION

Operator

Good morning, everyone, and welcome to the Sally Beauty Holdings Conference Call to discuss the company's Fourth Quarter and Full Year Fiscal 2023 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'd 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 obligations 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 to report full year financial results in line with the expectations we laid out at the beginning of fiscal 2023. We also advanced our strategic priorities during the year, engaging our Sally customers and BSG stylists through new concepts and services, product innovation and distinctive omnichannel experiences.

We delivered a comparable sales increase of 1.4% and net sales of $3.73 billion, down 2.3% versus a year ago on 308 fewer stores. We also maintained our healthy gross margin profile above 50% and captured $50 million of expense savings under our DC and store optimization program, while investing in wages and our strategic initiatives. In turn, we achieved adjusted operating margin of 9.1% and adjusted EBITDA of $459 million.

Additionally, the business generated strong free cash flow of $159 million. We concluded the year with fourth quarter results in line with our expectations. The primary shift in trend line we saw from Q3 to Q4 was on the Sally side, where the increase in average unit retail price year-over-year was lighter in Q3 -- in Q4 than Q3 as we lapped some pricing actions from the prior year, and saw a modestly higher mix of products sold on promotion as customers continue to seek value.

We believe the business remains healthy, most notably in our core categories of color and care, where we are holding share. Stepping back for a moment to look at fiscal 2023 as a whole. At the beginning of the year, we outlined a set of new strategic initiatives designed to advance our vision for the future and position us to achieve our long-term growth target of low to mid-single-digit top line growth and low double-digit operating margins.

Our 3 core initiatives include; enhancing our customer centricity, growing our high-margin owned brands and amplifying innovation, and increasing the efficiency of our operations. Our teams have delivered strong execution against these priorities over the past year, and I am pleased to share several highlights.

First, we introduced new value-added services and concepts, including Studio by Sally, Cosmo Prof Direct and most recently, Happy Beauty Company, which represents a new growth opportunity beyond our core. We delivered a robust pipeline of product innovation in both BSG and Sally, and increased our own brand penetration at Sally from 33% of sales in fiscal 2022 to 34% in fiscal 2023.

We completed a broad-based store optimization program, which enabled us to increase the productivity and profitability of our fleet while delivering an engaging omnichannel experience to our customers. Through this, we recaptured $50 million of savings from the program and exercised prudent cost control across the organization.

In the fourth quarter, BSG completed the strategic asset acquisition of Goldwell of New York, which adds 5 store locations to our Cosmo Prof fleet and 15 direct sales consultants to our team in this important market. The acquisition also brings several high-profile brands, such as Goldwell and Deva Curl, to our 28 Cosmo Prof locations in the upstate New York market.

We strengthened our balance sheet in fiscal 2023 with the refinancing of our term loan as well as reducing our ABL balance to 0 at year-end. And lastly, we returned value to shareholders through $15 million of share repurchases in Q4.

Looking at fiscal 2024, we are prioritizing top line growth and profitability and remain focused on returning value to shareholders. We expect to generate strong cash flow from operations of at least $260 million, which will allow us to reinvest for growth while maintaining a healthy balance sheet and continuing to repurchase shares. More on that later.

Now let me touch on our strategic initiatives designed to drive top line growth, best serve our customers and expand our reach. First is customer centricity. Our DIY customers and professional stylists value the services, education and innovation we provide. Moreover, they are loyal and highly engaged.

At fiscal year-end, we had more than 16 million loyalty members at Sally U.S. and Canada, representing 78% of sales, up from 77% in fiscal 2022. And our BSG Rewards credit card purchases comprised 9% of our sales for the year.

Let's talk about the concepts and services we're bringing to both of these customer segments as well as potential new shoppers. I'll start with Studio by Sally, which we launched at the beginning of fiscal 2023. We've been piloting 6 locations in various markets, and we're pleased with the level of customer engagement as we take key learnings into fiscal 2024 and build our expansion plans. We're prepared to relocate or remodel up to 30 existing stores to our studio concept later this year as we continue to read and react in the coming quarters.

Longer term, we believe there's opportunity to scale to over 100 studio locations with most of those stores being relocations or conversions. Of note, we're seeing about 30% of the service customers are new to Sally, and over 40% of all customers have already made a repeat purchase after their initial services.

Additionally, we're gaining great customer insights from this new concept that could be implemented across the rest of our Sally fleet in terms of product assortment and store navigation.

Moving now to Licensed Colorist On Demand. This is a successful initiative at Sally that is enabling us to provide a higher level of touch and service to our customers. We launched the capability online in the fourth quarter to 17 states. In addition, we completed the online rollout to all 50 states during October. Early response so far has validated Sally Beauty as the authority in hair color was over 30% of the customers that engage in this service being new to Sally and conversion rates running about 45%.

Additionally, 4 out of 5 customers are giving very high remarks on their experience. By the end of fiscal 2024, we anticipate having close to 100 licensed colors serving our DIY customers via the platform.

Finally, turning to e-commerce. In August, we launched a digital marketplace selling initiative with walmart.com, which will be expanding to other online sites in fiscal 2024 to fuel digital sales growth and attract new customers to our Sally brand. In the first half of the year, we'll be adding DoorDash and Instacart utilizing in-store fulfillment to minimize shipping expense and drive greater flow-through to the bottom line.

On the BSG side, we're building customer centricity through our Cosmo Prof Direct initiative which is continuing to gain traction. We ended fiscal 2023 with over 4,500 digital storefronts and 12 states officially rolled out on the platform.

This platform eliminates a lot of pain points for the professional stylists by enabling them to compete in a digital world, serve as a trusted resource to their clients and ultimately make more money for themselves.

They can set up an online storefront with the assortment they want and not have to go out-of-pocket to buy and hold inventory. We're continuing to educate our Sally's customers on how to utilize this platform as well as equipping them with new marketing tools.

Finally, our newest customer centricity growth vehicle is Happy Beauty Co. Our recently launched value concept that we believe has the potential to be a significant top line driver. After opening our first test location in the DSW market in Q3, we now have 10 pilot stores in operation in the DSW and Phoenix markets as of the end of September.

Currently, we are seeing average ticket values running in the $25 range, including 5 units per transaction on average, both exceeding our initial base case. We're beginning to build awareness through a dedicated marketing push that commenced this fall.

Looking at the long term, our analysis tells us there's an opportunity for 500 to 1,000 locations across the U.S. We'll be reading performance in the coming quarters as we consider additional openings and the potential for expansion into fiscal 2025.

Moving on to our second strategic initiative, own brand growth and product innovation. We delivered great innovation to both our DIY customers and the Sally's community in fiscal 2023. At BSG, we launched brands like Amika, Wella's Ultimate Repair and Danger Jones and expanded our distribution with Color Wow.

At Sally, we expanded our own brand portfolio with the launch of bondbar, a new line of pro-quality bonding product at accessible price points. And we followed that up with the launch of a new bondbar color line in Q4 that is gaining traction. We have an equally robust pipeline of innovation planned for fiscal '24 in both our own and third-party brands.

In our BSG segment, we are focused on growing our core and taking advantage of new opportunities. In fiscal '24, you can expect to see us engaging ourselves through several actions. We'll be bringing innovation across blonding, glossing and express coloring, expanding key brands, including Amika, Color Wow, Goldwell, Schwarzkopf, Moroccan Oil and Wella. Focusing on conscious beauty and textured hair, delivering new technology in tools and appliances, introducing new hair care brands and leveraging our updated nail assortments and nail walls.

In our Sally segment, we expect to drive growth in national brands through innovation in color, care and textured hair. On the proprietary side, we'll be launching new products in some of our most iconic and well-known brands, including bondbar and ION. As bondbar continues to enjoy momentum, we'll be expanding our assortment in color and care in the spring, including new lighteners, clarifying shampoo and a purple shampoo leader.

Our Ion brand has new tools and appliances planned for spring and fall as well as the new Sun-Care line coming ahead of next summer. As I mentioned earlier, our own brand penetration reached 34% of sales in fiscal 2023. We expect that will grow by approximately 200 basis points in fiscal 2024, further advancing our goal to achieve 50% over the coming years.

Moving now to initiative #3, capturing efficiencies and optimizing our capabilities. Underpinning our Fuel for Growth initiative, is a mandate to rethink the way we work, generate cost savings and modernize key parts of our business. Our transition to pool distribution, for example, has been a big win that not only helped us navigate difficult macro conditions, but also lowered our transportation costs and enabled our change in thin shipping frequency.

In turn, the execution of the new shipping frequency is allowing us to capture efficiencies across transportation and labor productivity while improving or maintaining in-stock levels. We'll be expanding this to 80% of the fleet in fiscal '24.

We have identified approximately $20 million of cost savings that are expected to benefit gross margin and SG&A in fiscal 2024 and with most of the benefit expected to be realized in the second half of the year. These efficiency and optimization initiatives are expected to help us offset inflationary pressures and continued growth investments in fiscal 2024, more on this shortly from Marlo.

In addition, we also recently engaged an external partner to assist with uncovering additional opportunities in areas such as non-trade spend, inventory efficiency, supply chain, automation and outsourcing that will benefit fiscal 2025.

Building on our strong foundation, we're focused on creating the Sally Beauty Holdings of the future. We have demonstrated our ability to develop and deploy new growth concepts and have tremendous conviction that we're on the right path to reignite top line and improve profitability.

Our outlook for 2024 reflects a few key factors. First, our strategic initiatives, including product innovation, territory expansion and new concepts and services, are expected to deliver 200 to 300 basis points of growth this year.

Second, our outlook assumes that continuing pressure on consumer spending will offset the anticipated growth from our strategic initiatives. To that end, against the more normalized macro backdrop, we believe our positioning and initiatives would enable us to drive low single-digit comp growth this year.

Longer term, we remain confident that our initiatives are setting us up to achieve a low to mid-single-digit top line growth algorithm with low double-digit operating margin.

In closing, I want to thank our talented teams across the organization and our shareholders for their continued support.

Now I'll turn the call to Marlo to discuss our financial results, capital priorities and fiscal 2024 outlook.

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

Thank you, Denise, and good morning, everyone. In the final quarter of the year, we navigated a tough top line environment while maintaining strong gross margins and strict cost control, and we landed our full year financial guidance that we laid out at the beginning of the year. We also utilized our strong cash flow in the quarter to strengthen our balance sheet, complete a small but important strategic acquisition and return value to shareholders through share repurchases.

Looking at the P&L. Fourth quarter consolidated net sales declined 4% to $921 million on 308 fewer stores. Consolidated comparable sales declined 2%, primarily reflecting the macro factors and consumer spending patterns we've seen in recent quarters. Global Ecommerce sales were down 4% on a constant currency basis to $87 million and represented 9% of total net sales.

Turning to gross profit. We maintained strong adjusted gross margins, which came in at 50.6%, up 50 basis points to last year. The increase can be attributed to higher product margin in both the Sally and BSG segment, as well as lower distribution and freight costs resulting from our initiatives to drive supply chain efficiency.

Fourth quarter adjusted SG&A expenses totaled $387 million, down more than $10 million to last year. This year-over-year improvement primarily reflects the savings from our DC consolidation and store optimization plan as well as lower advertising costs, partially offset by higher labor expenses.

Notably, the wage investments we made in fiscal 2023 have resulted in lower employee turnover and increased retention in stores, driving improved customer experiences, which we see in our high NPS scores.

As a reminder, on a full year basis, our DC consolidation and store optimization plan enabled us to capture approximately $50 million of expense savings and $10 million of operating income benefit. Looking at fiscal 2024, we expect SG&A dollars to be up modestly versus prior year.

This primarily reflects increased investments in labor, strategic growth initiatives and upper funnel marketing, partially offset by the benefit from our Fuel for Growth initiatives, which are expected to be realized in the second half of the year.

Moving to earnings. Our gross margin performance and continued cost control drove adjusted operating margin of 8.6%, adjusted EBITDA margin of 11.9% and adjusted diluted earnings per share of $0.42. On a full year basis, we delivered adjusted operating margin of 9.1%, adjusted EBITDA margin of 12.3% and adjusted diluted earnings per share of $1.83.

Looking at segment results. Sally Beauty comparable sales declined 1%, while net sales were down 5% on 291 fewer stores in operations versus a year ago. At constant currency, Sally Ecommerce sales declined 7% to $32 million and represented 6% of segment net sales for the quarter.

For the Global Sally Beauty segment, Color was down 3% and Care was flat. At Sally U.S. and Canada, Color and Care both decreased by 6%, including the impact of store closures. We believe the category data reflects macro-driven pressure on consumer spending and would highlight that market data shows our market share for Color increased over the prior year and Care remained stable.

Adjusted gross margin at Sally expanded 90 basis points to 59.2%, reflecting strong product margins and higher owned brand penetration as well as lower distribution in freight hub. Segment operating margins expanded by 50 basis points to 15%.

Moving to the BSG segment. Comparable sales declined 2%, while net sales were down 3% on 17 fewer stores. On a constant currency basis, BSG Ecommerce sales decreased 3% to $55 million or 14% and of segment net sales for the quarter. Of note in the quarter, we lapped the ramp-up of our Regis business last year.

The Color category was up 2%, while Care declined 8% at BSG on a total sales basis. Adjusted gross margin at BSG increased 40 basis points to 39.3%, reflecting higher product margins and a favorable mix shift between our higher-margin storage business and lower margin full service business. Segment operating margin expanded 350 basis points to 11.5%.

Moving to the balance sheet and cash flow. We ended the fiscal year with $123 million of cash and cash equivalents and no outstanding balance under our ABL, which we paid down in Q4. At the end of the year, our net debt leverage ratio stood at 2.1x. Our inventory balance at the end of the year was $975 million, up 4% from the close of fiscal 2022.

That level is in line with our expectations and reflect a healthy overall position, including strong in-stock levels. We generated strong cash flow from operations in fiscal 2023 of $249 million, including $117 million in the fourth quarter. Free cash flow generation was $159 million for the full year and $90 million in Q4.

During the fourth quarter, we deployed cash to repay the $16 million outstanding balance on our ABL and repurchased $15 million of our shares. And we ended the fiscal year with $580 million remaining under our share repurchase plan. We also utilized our strong cash flow to acquire the assets of Goldwell of New York, a $9 million deal has significantly strengthened BSG's position in a strategically important market.

One final note on the balance sheet. In the final weeks of the fiscal year, we were able to reprice our term loan B from SOFR plus 250 basis points to SOFR plus 225 basis points, which will result in $1 million of annual interest expense savings beginning in fiscal 2024.

We're pleased to be entering the new year in a solid financial condition with the optionality to invest in our strategic growth vehicles while continuing to optimize our capital structure and return value to shareholders.

Turning now to our fiscal 2024 outlook. We remain focused on driving top line growth through product innovation expanded distribution at BSG, the execution of our strategic initiatives and new growth base vehicles. Additionally, our Fuel for Growth initiative positions us to capture gross margin and SG&A benefits while also investing for growth and returning value to shareholders through our share repurchase program.

We expect net sales and comparable sales to be approximately flat to the prior year, reflecting growth from our strategic initiatives and investments in new concepts as well as expanded distribution in the BSG segment, offset by our expectation that consumer spending will continue to be affected by macro headwinds.

As Denise mentioned, our Fuel for Growth initiative is expected to drive both cost of goods and SG&A savings in fiscal 2024. We have identified $20 million of opportunity, including a combination of COGS and SG&A benefits that are expected to be realized in the second half of the year. We expect gross margin to remain above 50%.

Adjusted operating margin is expected to be at least 9%. Operating cash flow is expected to be at least $260 million, and we're planning full year capital expenditures similar to recent years at about $100 million. Of note, now that our ABL balance has been paid off, we expect our strong cash generation to be utilized in a hybrid approach to invest in the business, reduce our debt levels and buy back shares.

Two key call outs on that front. First, it is reasonable to expect a share repurchase amount in the first quarter, similar to our most recent fourth quarter. Second, we believe a leverage ratio in the range of 1.5x to 2x is appropriate for our business.

Looking more broadly at the shape of fiscal 2024, I'll share some incremental color to assist with modeling and help you understand how we're thinking about the cadence of the year. First, we anticipate that comparable sales performance will build throughout the year, with slight improvement quarter-to-quarter. Q1 will be the softest period of the year reflecting the only quarter of top line impact from the lapping of our December 2022 store closures from our Store Optimization Program.

To that end, we expect first quarter net sales to be down 2% to 4% and comparable sales to be approximately flat to down 2%, with net sales reflecting about 200 basis points of headwind from store closures. The impact of the closures on top line, taken together with our solid gross margin profile is expected to result in Q1 operating margin of approximately 7.5%.

As a reminder, for the remainder of fiscal 2024, we will not have any further impact from the December 2022 store closures. Additionally, given the strong contribution profile of our current portfolio, we do not anticipate another tragic closures in the foreseeable future. In fiscal 2024, we expect net store count to be approximately flat.

As Denise noted, the outlook we're providing today contemplates the positive impact of our strategic initiatives, offset by macro factors that continue to pressure consumer spending. 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) The first question is from the line of Oliver Chen from TD Cowen.

Oliver Chen - *TD Cowen, Research Division - MD & Senior Equity Research Analyst*

Denise and Marlo, regarding the next quarter's guidance, what's underpinning the flat to down to? And as you articulated, consumer spending pressure, I would love to hear how that's manifesting and if it's manifesting in traffic. Also at the Sally division, the comp was a little bit light relative to street expectations. Would love either contrast -- what's happening there.

Second question is, you have a lot of great modernization initiatives, including merchandise as well as store concepts, which ones would you say impact traffic and/or younger customer exposure most, if you had to help prioritize the needle movers?

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

Absolutely. It's Denise, I will start with those. Thanks for the questions. Let me start with Q1. In Q1, we expect to see the benefit from the strategic initiatives that we're working on. As we indicated, we believe for the full year, there are 200 to 300 basis points of comp goodness for us.

It will also be the last quarter where we see benefit to comp sales from the store closures last year. But we are expecting that more than offsetting that in Q1, we expect the trend from Q4 to continue. One important trend is the rapid in the care category at BSG. And then in general, just the macro headwinds that are out there.

Importantly, we see sequential comp improvement throughout the year. As the year progresses, strategic initiative benefits are going to accelerate, and the negative impact of that softness in the care category at DSG really lessens in Q2 and dissipates further as we get through the second half. So Q1, by all means, the lightest quarter of the year, but I think really well understood the trends that we're operating underneath that.

More broadly, I think your second question was just about consumer trends and what we're seeing. Overall, consumer and purchasing trends in our mind are largely consistent with Q3. Within that, Sally customers just remain frugal. They buy what they need versus perhaps what they want or a more impulse type of purchase. We actually saw transactions and UPT trends largely consistent with Q3.

And then Color and Care, the core categories remain the strongest performers. And based on the share data we have, we believe we're holding share in both of those categories.

When you asked about the impact of Sally comp, the impact to sales in Sally compared to the prior quarter trend was really driven by average unit retail prices being up only 4% in Q4 compared to being up 7% in Q3.

Two factors, the first one is by far the largest. We lapped price increases from that quarter last year. And so just less flow-through as we did that lapping. And then we did see a modest mix shift to products brought on promotion. We didn't promote more, but we did see customers gravitate a bit more to those value offerings.

And on the BSG side of the equation, I call it Steady-Eddie, right? Styles behavior really was pretty consistent over the past few quarters. Comps were consistent. Color was a little bit stronger in the quarter. Care pretty consistent with what we saw in Q3. We did see an interesting little shift in transactions being down a bit, but ticket growth made up the other side of that. So in fact, our comp was actually slightly stronger than the prior quarter. So we're monitoring those trends.

But I think in our minds right now, it's pretty consistent behavior. We believe we're holding share and in general, living in a world where macro is just having consumers be a little bit more frugal.

And then I think your second question, Oliver, was really around modernization. And when we're thinking about our initiatives, which ones can really impact traffic, which ones can impact a younger customer. A couple of pieces I would call out. On the Studio side, we think that is a traffic gainer.

If someone comes in for a service, and they want that service experience. And they might be a customer who doesn't shop as frequently, it could change their transaction behavior and have them shopping with us more often.

Similarly, when we think about innovation and our own brands right? Those are things that are real traffic drivers to us. And with the type of brands we're bringing in, they are definitely geared towards not just a younger consumer, but appealing to a younger consumer.

So on the BSG front with things like Danger Jones, Amika, very, very kind of high-profile brands. Certainly, that stylist shopper out there. And then our own brands front with bondbar, our continued focus on Strawberry Leopard, things that definitely gear towards a bit of that younger consumer.

And then the one we hope will build over time and help traffic is really our Licensed Colorist On Demand program. We have just launched into all 50 states. And with that, we are seeing about 30% of the customers taking advantage of that consultation being new to Sally, and we're starting to see them do repeat purchases as well.

So when we think about that, that's traffic building. And usually, if you're new to the category, you're trying to understand how do I color. This is a great way to kind of bring people in and give them the confidence to do that. So I believe that hit all of your questions.

Operator

The next question is from Korinne Wolfmeyer from Piper Sandler.

Korinne N. Wolfmeyer - *Piper Sandler & Co., Research Division - VP & Senior Research Analyst*

My first one is on operating margin. It does look like it came in a little bit towards the lower end of the range. And then I think you did mention some added wage pressure and some other things going on.

Can you just touch on what -- on the operating line, and I guess, the SG&A line, what is within your control to start to bring down a little bit more versus what are things that maybe will likely persist into next year? I know you gave a little bit of color on the cadence, but anything more specifically, you can think about in terms of modeling the cadence of SG&A over the course of fiscal '24?

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

Thanks, Korinne. As you think about operating margin and kind of areas as we're looking forward to influence that really comes down to our Fuel for Growth initiatives on top of all the sales growth initiatives that we're driving. But thinking about areas that we've been working through, we've now started to see some of the benefits come through in our supply chain with our shipping frequency, and we're seeing that flow through now just in a test environment. We're now working to ramp that up. We will be looking to bring about 80% of our fleet online with that.

But when we look to 2024, we've talked about a $20 million benefit that we're working to deliver as we go through that. It's about 75% of all to the SG&A line, 25% on the margin line. So within the margin, we've got expansion opportunities both within our own brand penetration, but also with the Fuel for Growth activities that we'll be driving. And that's happening largely in the back half of the year. as we start to deliver more on that.

From an SG&A point of view, again, more back half loaded. We'll have higher dollars overall. But from a cadence perspective, we'll start to see leverage as we get into the back half of the year. and that's being driven by the Fuel for Growth efforts. Things that we have in flight again that are going to continue to ramp. We are putting in energy management systems within our stores. We're also implementing LED lights across the fleet.

Like I said, we'll continue to ramp up the shipping frequency and a lot of the benefits that we're getting within our transportation efforts. And then we're also working on nontrade spend. So as we're going through contract negotiations, those will continue to come online as well as we get through the year.

Operator

The next question is from Ashley Helgans from Jefferies.

Ashley Elizabeth Helgans - *Jefferies LLC, Research Division - Equity Analyst*

I know you mentioned about traffic but do you think consumers trade down at all in any categories or even trade out. And then anything you can tell us about your expectations for the promotional landscape.

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

Sure. I think when we think about trade down or trade out, it's not really what we're seeing our customers do. As I mentioned in the prepared remarks, what we are seeing customers do is search more for value. So they do gravitate a bit more to when something is on promotion, more likelihood to be buying it on promotion.

And so with that, we certainly see a little shift in behavior from what we had seen earlier in the year about a little bit more frugality. The trend that's persistent from the beginning of the year as people does not buying things that they don't need.

So we talk all year along that things like styling tools have seen less demand simply because that's a bit more of a -- you only buy it if you need it, unless you feel like you have extra money in your wallet. So a general sense of frugality, but not much more than that in terms of new trend or new behavior.

And if you could remind me, what was your second question again?

Ashley Elizabeth Helgans - *Jefferies LLC, Research Division - Equity Analyst*

And then just anything you can tell us about your expectations for the promotional landscape as we move into the next fiscal year?

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

Absolutely. So overall, what we saw, if I separate Sally and BSG, so promotional activity at Sally this past year was generally consistent through fiscal 2023. So what we put out there on promotion. In Q4, we saw a bit of step up in the mix of products sold on promotion, as I just mentioned in terms of how people are searching for value. We expect value to be important as we go through '24.

In BSG, promotional activity was up modestly through '23. We expect that to remain constant in '24 as stylists also continue to seek out deals. When we think about that holistically, the way we're planning for the year is because our customers are remaining conservative, we're going to stay conservative on pricing.

And we'll also, though, continue to lean in where we see that there's a UPT opportunity, we'll lean on promotions. Importantly, our vendor partners are continuing to be supportive and aligned with that strategy.

So good confidence about our gross margin level staying above 50%, continuing to execute the business we did but being realistic that customers are searching for value and finding the right ways to do that. Underpinning it all is the focus on our strategic initiatives. Our strategic initiatives will actually help us drive units.

And at the end of the day, while we might not see as much coming through from pricing as we've seen in the last few years, that comp growth from the strategic initiatives is all about customers leaning in and buying more units.

Operator

Your next question is from Simeon Gutman from Morgan Stanley.

Unidentified Analyst

This is Zack on for Simeon. You guided to a flat comp and 9% margin. What can happen if the comp is negative or weaker than expected? How much cushion do you have for the 9% guidance? And in an adverse scenario, what type of negative comp would potentially jeopardize that 9%?

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

So guiding to the 9% is about where we are right now today. So flattish sales and overcoming some cost increases, typical cost increases like merit as an example, is what we're working to offset with our Fuel for Growth as well as to continue to invest in our strategic growth initiatives.

So we feel good about the gross margins, at least 9%. As sales trend differences come to be -- we do have good cost management that we've been able to deploy over the years. You should have seen us do that. So feel like we can protect that.

On the upside though, we talked about the growth initiatives, delivering 200 to 300 basis points. So in a more normalized environment, if the macro pressures were to dissipate, we see top line modest growth, and that's where we see some nice expansion on the operating margin line.

Operator

Our next question is from the line of Olivia Tong from Raymond James.

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

First, just on the Q1 guide, I just wanted to understand that a little bit better because the comp guy seems fairly straightforward and the closures haven't yet lapped in Q1. But you talk to what's driving the 7.5% op margin target versus the 9% for the year.

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

The key driver there is the ramp of our Fuel for Growth initiatives. So we're lapping the last quarter, our store closures from last year. So our sales number is a bit more pressured, which as you'd expect, pressures a bit SG&A leverage. But what really happens through the year is the Fuel for Growth initiatives, the $20 million that will be incremental is more realized later in the year than it is in Q1, which is really what's driving the operating margin being a bit softer in Q1, fully in line with our expectations as we're getting through that last quarter of the store closure impact.

You also have a bit of a ramp -- a sequential improvement, modest, but through the year with the top line as well. Beyond just the store closures, you've got the ramp of the strategic initiatives as well.

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

And then can you just touch a little bit more on the Walmart partnership you mentioned? I don't recall you talking about that before, but just what exactly is it? And -- and how many -- and what's involved in that, whether there's a store component as well?

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

Sure. As you guys know, we've been out there and participating on amazon.com with our marketplace for a number of years now. The initiative we have in place right now is recently fully launching our own brands on to the Walmart marketplace. So it's a digital play. It's really for us to get access to a new customer base that might not shop regularly at Sally today but that we can introduce them to our own brands.

And opportunity to sell through Walmart to accomplish that, but also opportunity for them to learn about the brands and learn a bit more about Sally. So we're excited about that and then furthering that growth within the digital space in Sally. We'll look as the first half of the year moves on to also start to participate in some other marketplaces, including Instacart and DoorDash.

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

Got it, but just to clarify, this doesn't impact your Amazon related actions in anyway?

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

Not at all, not at all. This is a build on to that. So just understanding that marketplace has been a great vehicle no matter who the partner happens to be, to be introducing some of our own brands and expanded the reach of those owned brands. Is the focus on walmart.com today. It will -- it's also the focus on amazon.com today, and that will continue.

Operator

And at this time, there are no further questions in queue. Please continue.

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

Well, I just want to thank everyone for joining the call today and thank all of our associates around the world. We delivered fiscal 2023 results in line with the expectations we laid out at the beginning of the year.

We also advanced our strategic priorities in the year with the launch of new concepts and services, product innovation and distinctive omnichannel experiences for our Sally customers and BSG stylists. We're looking forward to successful 2024 and appreciate your interest in the company. Thank you.

Operator

Thank you. And ladies and gentlemen, that does conclude your conference for today. Thank you for your participation and for using AT&T Event Conferencing. You may now disconnect.
