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CORPORATE PARTICIPANTS

Jeff Harkins *Sally Beauty Holdings Inc - Vice President of Investor Relations and Treasurer*

Denise Paulonis *Sally Beauty Holdings Inc - Independent Director*

Marlo Cormier *Sally Beauty Holdings Inc - SVP & CFO*

CONFERENCE CALL PARTICIPANTS

Korinne Wolfmeyer *Piper Sandler - Analyst*

Ashley Helgans *Jefferies LLC - Analyst*

Simeon Gutman *Morgan Stanley - Analyst*

Olivia Tong *Raymond James - Analyst*

Oliver Chen *TD Cowen - Analyst*

Linda Bolton Weiser *D.A. Davidson - Analyst*

PRESENTATION

Operator

Good morning, everyone, and welcome to Sally Beauty Holdings conference call to discuss the company's first-quarter fiscal 2024 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 - Vice President of Investor Relations and Treasurer*

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 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 Paulonis - *Sally Beauty Holdings Inc - Independent Director*

Thank you, Jeff, and good morning, everyone. We're pleased with our start to fiscal 2024 marked by financial performance that was in line with our forecast. First-quarter net sales of $931 million declined 2.7%, primarily reflecting the lapping of store closures that occurred in December of 2022, while comparable sales declined 0.8% in the quarter. Adjusted gross margin was above 50% and in line with our expectations, and adjusted operating margin came in at 7.9%.

Additionally, we generated solid operating cash flow of more than $50 million, enabling us to return value to shareholders through $20 million of share repurchases. In our BSG segment, Q1 comparable sales were up 1% as we saw a modest strengthening in salon demand trends, coupled with strong momentum from recent product launches and our acquisition of Goldwell of New York. Comparable transactions increased 3%, while average ticket values declined 2%.

In our Sally segment, customer shopping behavior remains fairly consistent with recent quarters as they continued buying primarily (technical difficulty). Q1 comparable sales were down 3% with comparable transactions down 4% and average ticket value up 2%. Our teams continue to execute well against our core strategic initiatives of enhancing our customer centricity, growing our high-margin owned brands and amplifying innovation, and increasing the efficiency of our operations.

To that end, we continue to expect that product innovation, territory expansion, and new services will contribute 200 to 300 basis points to our topline performance this year. During the first quarter, in line with our expectations, these initiatives contributed over 200 basis points to our comparable sales results with product innovation being the predominant driver. Let me share a few highlights.

Starting with product innovation, we're seeing momentum across our both our own and third-party brands. In Q1, owned-brand sales penetration for the global Sally Beauty segment was 34%, up 20 basis points over the prior year. Additionally, our bondbar and ION lines continue to perform well with notable strength in bondbar care and ION color. Of note, ION remains our largest owned brand in the US and Canada, and bondbar has grown to be our fifth largest own brand in just over a year's time in the market.

We're also seeing strong performance in the textured hair category, where we have a pipeline of innovation planned for later this year. Beginning next month, we'll have several product launches happening throughout 2024 across color, care, styling tools, and appliances, encompassing both our proprietary lines and national brands.

Turning to innovation at BSG, standout performers include Amika, Wella's Ultimate Repair, Moroccan Oil, and Color Wow. During the first quarter, we expanded our distribution territory for both Moroccan Oil and Color Wow, and we have additional expansion opportunity across our brand portfolio.

Additionally, we captured the first full quarter of sales from our Goldwell of New York acquisition. The BSG segment also has a robust pipeline of innovation planned for this year, which will be particularly meaningful to our stylists as we partner with them to profitably grow their businesses. You can expect to see launches in both new and existing brands across blonding, glossing, and express coloring as well as conscious beauty and textured hair.

Our ongoing focus on customer centricity continues to serve us well. In Q1, we generated 77% of sales from our $16 million Sally US and Canada loyalty members while our BSG Rewards credit card purchases represented 8% of sales.

Our new concepts and services are building momentum, and we are tracking to our plans for full-year fiscal '24. Our licensed colorist on-demand initiative is helping us extend our reach and continues to gain traction. In Q1, 36% of our customers who engaged in this service were new to Sally. That's up from just north of 30% in Q4. At quarter end, we had 40 licensed colorists on the platform and plan to expand that to approximately 100 this fiscal year as demand for the service grows.

We're also gaining traction in our marketplace initiatives, which launched with Walmart in Q4 of last year, building on the success we've had with (inaudible). In the coming quarters, we plan to add DoorDash and Instacart, which will enable us to leverage in-store fulfillment.

Turning now to Happy Beauty Co. At fiscal year end, we had 10 pilot stores in operation, and we are very pleased with Q1 performance which included the holiday selling season. We expected the stores to be an attractive gift-giving destination, and we're gratified to see that take shape with consistent increases in traffic, conversion, and average transaction value throughout November and December. We are continuing to build awareness of Happy Beauty with grassroots marketing initiatives and remain enthusiastic about the potential to build a sizable portfolio over the long term.

When we look across the business at both our Sally and BSG segments and our customers and how they're behaving and at the same time consider the potential of our newer growth strategy, we're confident that we're on the right course to reignite sales.

Building on our Q1 results which were in line with our expectations, we're maintaining our full-year fiscal 2024 guidance which calls for net sales and comparable sales to be approximately flat. This reflects 200 to 300 basis points and anticipate growth from our strategic initiatives, as I mentioned earlier, offset by the expectation that macro factors will continue to pressure consumer spending. In the second half of the year, we expect to see sequential improvement in comparable sales as we further advanced our strategic initiatives.

We are also continuing to prioritize profitability. Our Fuel for Growth initiative is underway, and we remain on track to capture previously announced pre-tax benefit of $20 million in fiscal 2024. I want to highlight that this is a comprehensive program that is fundamentally changing the way we operate and support our long-term growth algorithm for a low double-digit operating margin. To that end, we recently partnered with an external resource and have begun to uncover incremental opportunities around merchandising margins, non-trade spend, inventory efficiency, supply chain, automation, and outsourcing that will take effect in fiscal years 2025 and 2026.

As an outgrowth of this initial assessment, we identified another tranche of potential pre-tax benefits totaling approximately $50 million in fiscal 2025, with cumulative run rate benefits in fiscal 2026 expected to approach $120 million. We'll have more to share on our roadmap as we continue our analysis in the coming months.

We're pleased to have started fiscal 2024 with strong execution and look forward to further advancing our initiatives across customer centricity, innovation, and efficiency throughout the year. We believe these focus areas are important pillars to attract new customers, increasing our share of wallet, and strengthening our competitive position. Our teams are highly engaged. Our deep understanding of shopping behavior and purchasing patterns among our retail customers and BSG stylists is enabling us to effectively navigate the dynamic macro environment.

Our strong market positioning, and the traction we're seeing in our initiative underpin our confidence in the long-term growth algorithm we've previously communicated, which calls for low to mid-single-digit topline growth and low double-digit operating margin. We greatly appreciate your continued support and remain committed to increasing value for all of our stakeholders.

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

Marlo Cormier - *Sally Beauty Holdings Inc - SVP & CFO*

Thank you, Denise, and good morning, everyone. We're pleased to begin the year with financial results in line with our expectations and continued progress against our strategic initiatives.

First quarter consolidated net sales of $931 million declined 2.7%, primarily reflecting the unfavorable impact from our December 2022 store closures and 90 basis points of favorable foreign currency exchange impact. Consolidated comparable sales declined 0.8%. Global e-commerce sales were $91 million and represented 10% of total net sales.

Looking at gross profit, we maintained strong adjusted gross margin which came in at 50.2%, down 60 basis points versus a year ago. Supply chain efficiencies drove lower distribution and freight costs in the quarter which were more than offset by sales mix shift between Sally Beauty and BSG, as well as unfavorable fixed cost absorption related to the timing of inventory receipts. First-quarter adjusted SG&A was up $3 million to $393 million, primarily reflecting increased labor costs and rent expense as well as other costs related to our strategic initiatives, partially offset by savings from our distribution center consolidation and store optimization actions last year.

For the full year, we expect SG&A dollars to be up modestly versus fiscal 2023. This primarily reflects increased labor costs as well as investments in upper funnel marketing and other expenses related to our strategic growth initiatives, partially offset by the favorable impact of our Fuel for Growth initiative. As a reminder, we expect to realize $20 million of pre-tax benefits to gross margin and SG&A during the second half of fiscal 2024. For perspective, approximately 75% of the benefits will be realized in SG&A.

As Denise mentioned, we're expanding the scope of our Fuel for Growth initiative and now expect to capture incremental cost of goods and SG&A savings in fiscal year 2025 of approximately $50 million. We are in the process of uncovering additional opportunities and building the roadmap for fiscal 2026, which should see us approach $120 million in cumulative benefits. We expect to incur pre-tax charges associated with the Fuel for Growth program in the range of $25 million to $30 million in the current fiscal year, including $5 million that was realized in Q1.

Turning now to earnings. Adjusted operating margin came in at 7.9%. Adjusted EBITDA margin was 11.5%, and adjusted diluted earnings per share was $0.39. Moving to segment results, Sally Beauty comparable sales declined 2%, while net sales were down 5% as we lapped our 2022 store closures and our Sally customer remained frugal buying primarily to need.

At constant currency, Sally e-commerce sales were $35 million and represented 7% of segment net sales. For the global Sally Beauty segment, color was down 4% and care was flat. At Sally US and Canada, color was down 7%, and care was down 5%, 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 and care remained stable over the prior year. Gross margin at Sally was 58.6%, down 30 basis points to last year driven primarily by an unfavorable sales mix shift between higher margin Sally US sales and lower margin Sally international sales, as well as unfavorable fixed cost absorption, partially offset by supply chain efficiencies which drove lower distribution and freight costs. Segment operating margin came in at 14.8%.

Moving to the BSG segment, we saw an improvement in salon demand trends as well as the benefit from expanded distribution and new brand innovation. Comparable sales were up 1%, while net sales were approximately flat on 20 fewer stores. On a constant currency basis, BSG e-commerce sales were $56 million representing 14% of segment net sales for the quarter.

The color category was up 4%, while care declined 1% of BSG on a wholesale basis. Adjusted gross margin at BSG declined 40 basis points year over year and came in at 39.4%. The decline was driven primarily by unfavorable fixed cost absorption and and shrink expense, partially offset by lower distribution and freight costs from supply chain efficiencies, as well as higher product margins. Segment operating margin was 10.9%.

Looking at the balance sheet and cash flow, we ended the first quarter with $121 million of cash and cash equivalents and no outstanding balance under our asset-based revolving line of credit. Our net debt leverage ratio stood at 2.2 times. Quarter end inventory was just north of $1 billion which is in line with our expectations and reflects a healthy overall position, including solid in-stock levels. We anticipate that inventory levels will hold relatively steady in the $1 billion range throughout the year. We generated positive cash flow from operations of $51 million, allowing us to repurchase $20 million of stock under our share repurchase plan.

We're pleased with our start to fiscal 2024, and we are maintaining our full-year outlook as follows. We expect net sales and comparable sales to be approximately flat, reflecting 200 to 300 basis points of growth from our strategic initiatives and investments in new services as well as expanded distribution in the BSG segment, offset by our expectation that consumer spending will continue to be affected by macro headwinds.

We expect growth 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 capital expenditures are planned to be approximately $100 million dollars.

Our outlook is based on the following assumptions. Comparable sales performance is expected to improve in the second half of the year, reflecting positive drivers in both of our business segments. At the BSG, the lapping of hair care headwinds from the last several quarters will lead to easier comparisons in the second half of the year. Additionally, the second half is also expected to benefit from continued momentum in new brand innovation and expanded distribution opportunities.

At Sally, we expect incremental improvement on the top line to be driven by the ramp of Walmart marketplace as well as the addition of Instacart and DoorDash, the expansion of license colorists on-demand, and benefits in Europe from pricing and new brand launches.

Lastly, the $20 million of benefits under our Fuel for Growth initiative are expected to be realized in the second half of the year and essentially boost full-year operating margins by approximately 50 basis points. Looking at the second quarter, we expect net sales and comps to be flat to down 2%. This includes approximately $10 million of impact from traffic softness in early January, coinciding with persistent bad weather across most of the country. Importantly, during the fourth week of January, we saw this pressure moderate and trends returned to a normalized cadence.

As a reminder, Q2 is usually our lowest quarter from the total sales dollars perspective. We expect to see sequential improvement in gross margin rate in Q2, driven in large part by diminishing impact from unfavorable fixed cost absorption related to the projected timing of inventory purchases. Additionally, we anticipate that adjusted operating margin will be approximately 8%.

Lastly, it is reasonable to expect investments and share repurchases in the second quarter that is similar to our last quarter. We appreciate your time this morning.

Now I'll ask the operator to open the call for Q&A.

QUESTIONS AND ANSWERS

Operator

Thank you. (Operator Instructions) Korinne Wolfmeyer, Piper Sandler.

Korinne Wolfmeyer - *Piper Sandler - Analyst*

First, I'd like to better understand how much of the comp this quarter was driven by performance in your owned brands versus national brands? And then, as well, how much -- can you break down how much was driven by price versus volume versus mix? And then going forward, how should we be thinking about that as well?

Denise Paulonis - *Sally Beauty Holdings Inc - Independent Director*

Let me start there. So in total, the comp performance that we delivered had about 200 basis points of goodness from our strategic initiatives overall. Within that, innovation was the largest driver. And to your question, there was contribution from both growth in our own brands and growth in our national brands. The national brands growth was pronounced on the BSG side where, of course, the own brands will be pronounced within Sally, but both were healthy portion of the business as we look to contribute to that comp base.

And then when you look at the mix of how that all came together, we really thought two different stories on the BSG side and the Sally side. On the BSG side, transactions were up. We saw nice customer accounts, particularly as we came to the end of the quarter coming through as stylists saw a modest uptick in demand, so that was really through incremental transactions. And ticket was slightly down, but great news that we saw the traffic of the customers coming into the store. And while we're watching that closely, we hope that it will persist, and we'll see that demand trend continue.

On the Sally side of the house, transactions were down while ticket was up a bit. That continues to reflect consumer spending a bit closer to need, buying into their core categories. But we are pleased to see overall that we continue to see strength in color. We continue to see strength in texture and believe that we're holding share in the space that we're in, really facing a bit of consumer pressure on purchasing behavior.

Korinne Wolfmeyer - *Piper Sandler - Analyst*

Very helpful. And then just on the gross margin line, can you walk through the puts and takes a little bit more? You gave a little bit of color in the prepared remarks, but want to better understand how much of the contraction was driven by shrink versus fixed cost absorption versus any other pressures you may be seeing? And then how much benefit were you getting from the higher product margin?

Denise Paulonis - *Sally Beauty Holdings Inc - Independent Director*

So on the gross margin line, we're still really pleased delivering above the 50% mark and strong gross margins there. We did see about 60 basis points of pressure in Q1. There were a handful of puts and takes. So on the positive side, as we continue to focus on driving supply chain efficiencies, we continue to see goodness coming out there with lower distribution and freight costs.

As offsets, there were few, but we did have a greater percentage of lower margin BSG sales in the quarter or a greater percentage of the BSG sales. We did incur some unfavorable fixed cost absorption. That's really due to timing. That ebbs and flows throughout the year. We expect to see that come back and diminish as we get into Q2.

And then lastly, we did have some shrink, I would say that's the most minor part. It was a minor headwind, and that was really in our BSG business.

Korinne Wolfmeyer - *Piper Sandler - Analyst*

Very helpful.

Operator

Our next question is from Oliver Chen from TD Cowen. Please go ahead. Oliver Chen, your line is open. We'll move to Ashley Helgans from Jefferies. Please go ahead.

Ashley Helgans - *Jefferies LLC - Analyst*

Hey, good morning. Thanks for taking our question. And I'm just curious if you could talk about how traffic trended throughout the quarter. And then we're also curious if you're seeing any new emerging trends. Bonding has been so popular over the last couple of years. Is there's anything else in hair care that's emerging on a trend level?

Denise Paulonis - *Sally Beauty Holdings Inc - Independent Director*

Yeah. Traffic was relatively stable throughout the quarter. If we had to pick anything, we saw a little bit softer October and a little bit softer -- but a little bit stronger December with December really supported by the BSG side of the business. But we didn't see any big changes month over month as we went through the quarter overall.

And in the purpose of trends, trends remained very consistent with what we've seen. On the hair care front, it really is about about bonding and about things that are efficacy in terms of improving the look and feel of your hair and the health of your hair overall. We see a little bit more interest in scalp care that goes right along with that type of trend.

And on the color front, when we think about it, the things that are ticking, we continue to see glossing important. We continue to see express important because that lets stylists turn their chairs a bit more often. So no major shift in trend but good, healthy, continued business across the board there.

Operator

Simeon Gutman, Morgan Stanley.

Simeon Gutman - *Morgan Stanley - Analyst*

My first question on consumer spending, the consumer being a little soft there, there was a time a while ago where this business, at least the Sally side, benefited from trade down while the consumer was under pressure. Can you talk about -- are you seeing that because it doesn't seem to be the case on a sequential basis, but do you see customers from different cohorts or people opting not to get serviced that are coming in and doing it themselves?

Denise Paulonis - *Sally Beauty Holdings Inc - Independent Director*

Overall, I think what we'd say is we have a very stable business. I mean, the businesses is pretty resistant to to some of the consumer demand trends that ebb and flow just because we can offset BSG and the Sally business to some extent. So when we see costs on our side of the world down 2%, we think that's a pretty good performance in a challenged macroenvironment. When we look within that, what we're seeing for customers is we see the particular trade down or increased frugality, no surprise, in the lower income, particularly below the $50,000 mark, where these folks are feeling outside pressure.

The build-up of all the inflation over time, we're seeing that come through. And we're also seeing them with a higher mix to credit card and buy now pay later for what they are buying, exhibiting that stress. But they are still coming in. They are still shopping. They are just very frugal about buying to need, and buying to need means, I buy color because I do touch up my roots, and I want to keep doing that. What I'm probably not going to do is be buying that styling tool, that extra hairbrush, the things that would be more splurges at this point in time.

So we see a little bit of trade down and around. But with the value point that we have with many of our own brands as well as our national brands in our stores, we're pretty reasonably priced to begin with in that mix of what's coming in. So I'd say behavior pretty consistent with what we've seen and, if anything, just see a little bit more stress in the way people are purchasing with that mix towards credit quality and buy now pay later.

Simeon Gutman - *Morgan Stanley - Analyst*

Okay. A follow-up on BSG. The press release is that it lifted first expanded distribution as the factor for improvement. At the end, there was improving salon demand trend. So can you talk about those two? Goldwell, what you bought, does that enter into the comp base or that stays out of it for a while? And then just related to it, the weather impact, did that impact BSG and Sally proportionally in January or was it more Sally?

Denise Paulonis - *Sally Beauty Holdings Inc - Independent Director*

So overall, when we think about what drove the BSG business, there were three key factors overall, so innovation, expanded distribution, and improving salon demand trends, I'd say, in that order. With innovation, very broadly, Amika, Wella's Ultimate Repair, Color Wow, Moroccan Oil are places where we saw our customers lean in into that mix. And in particular, when we have expanded distribution in a few of those brands with Color Wow and Moroccan Oil, that certainly helped.

In the Goldwell portion of the business, part of that acquisition goes into comp and part of it does not. So the new stores that came with the acquisition do not go into the comp, but the full service and rest of the business does go into comp. So it's a bit split there, but we had expected that to be a $10 million to $15 million build for the entire year. And we're seeing that perform in line with expectations, so we're really pleased with how that has come to bear.

And then finally, the improving salon demand trend, what we're really seeing that in as we saw traffic pick up and coming to the stores and shop the intercepts with customers just saying, I'm just a little busier. And that was great for us to see coming in and feeling that as part of the mix. And then if you could remind me what your second part of your question was.

Simeon Gutman - *Morgan Stanley - Analyst*

It was the weather where you talked about some softness, did that affect Sally and BSG?

Denise Paulonis - *Sally Beauty Holdings Inc - Independent Director*

Yeah. So the softness that we saw in the early part of January tied to weather, the great news is it really has turned around at the end of January. And as we launch into February today, we believe that that world will continue. It was predominantly Sally, but it was across both businesses. So if I have to split it, it was 60% Sally, 30% BSG, give or take, 40% BSG if we look at it that way. But it did affect both businesses.

Simeon Gutman - *Morgan Stanley - Analyst*

Makes sense. Okay, thanks. Be well.

Operator

Olivia Tong, Raymond James.

Olivia Tong - *Raymond James - Analyst*

You mentioned improving salon demand trends at BSG, could you just expand on what's driving that? You did leave the full-year comp outlook unchanged, but given that BSG was a bit better than expected, could you just talk about how that influences your full-year expectations to start?

Denise Paulonis - *Sally Beauty Holdings Inc - Independent Director*

Yeah. When we talked about seeing and improving salon demand trends, we talked about it being modest improvement in demand trends. And the way that we understand that is really just watching the purchase behavior of our stylists as they come into our stores, as they transact with us online and how they talk about their businesses. The way they phrased it was, coming into the holiday season, they saw a bit more normalcy and people wanting to come in ahead of the holiday, refresh their look, kind of filling their chair to a bit more extent than they had been in the earlier period of the year.

So you are encouraged that we've seen a little bit of that uptick for our stylists and their salon business, but it's a really knew trend line. So we're not really making an expectation that that's going to have further growth or continuation as we look to our projections for the remainder of the year. We'll certainly watch it and continue to react as we see that come through. Overall, in holding our guidance, the thing that I would come back to is we really performed in line with our expectations in the first quarter.

As we look to the second quarter, we did this unusually persistent weather very early in January to start things off. And overall retail traffic was certainly pressured through that point. It lasted long enough that in our minds, we're not betting that we are going to recoup a bit of the softness that we saw in those early couple of weeks but rather get back on the rest of the trend for the quarter has really happened at the last week of January and going forward.

So our guide for Q2 really reflects the fact that we think that that was a pocket of air and a little bit of lost sales that came from that, but the rest of the business underneath that quite healthy. So down 0% to 2% on comp sales for the quarter reflects that bit of early January pressure. But we believe that gross margins will continue to improve from Q1 to Q2 as Marlo had discussed in an earlier question.

And then we're really well prepared to ramp into the back half of the year. We also outlined that on the call, but we think about the strength of BSG that will find a lack of the haircare headwinds from one brand from last year. We're also continuing to be set up for this momentum with new brand innovation and expanded distribution.

And then Sally, as we continue to embark in the back half of the year with the growth that we see in marketplaces coming through, our licensed colorists on-demand, and then some improvements in Europe as well, where we've been working hard on pricing and new brand launches that we think are going to elevate the second half of the year. So all in all, the year is unfolding generally the way that we expected it to. And we do expect the second half of the year to be a bit stronger on the top line than what we see for the first half of the year but pleased with our start.

Olivia Tong - *Raymond James - Analyst*

That's very helpful. So if I could just summarize, it sounds like Q1, more or less in line, maybe a touch better. Q2, obviously impacted by the weather, but you don't expect that to get back. And then, second half, more or less no change in expectation relative to your expectations going into the December quarter?

Denise Paulonis - *Sally Beauty Holdings Inc - Independent Director*

Fair enough.

Olivia Tong - *Raymond James - Analyst*

Got it. Okay. And then just my -- my next question is around the Fuel for Growth program. You talked a little bit about incremental savings, could you talk about where that savings is coming from? Any new bucket or just as you continue that program, you're just seeing a little bit better success rate with achieving savings in the existing bucket.

Marlo Cormier - *Sally Beauty Holdings Inc - SVP & CFO*

Yeah. So as we called out last quarter, we were really in our early stages of our Fuel for Growth work. We had identified $20 million of benefits that we expect to flow through 2024. Most of that is back half loaded. And we talked about that being weighted 75% SG&A, 25% cost of goods.

We did talk about our partnership with an external advisor. We have completed that assessment. And now we believe we're on a path to identifying another $50 million that we can see flow through fiscal 2025. And then cumulative through the program, get to $120 million run rate as we get into 2026.

And where we see that coming from, on the early stages, it's programs that we were testing in our supply chain like our biweekly shipping frequency. We are approaching 80% of the fleet for Sally. We're shy of that on BSG. Our goal is to get to around 85% across both banners, and we're on path for that for this year.

But as we look forward, we're seeing greater opportunities within our our merchandising and vendor negotiations and relationships. We've got a goods not for resale opportunities within our nontrade payables. We see automation. We see outsourcing. So we see a variety of programs.

But as we look forward and we start to see where that falls, more so in the merchandising and supply chain areas, we'll get more benefits within gross margin. So you'll see that 75%, 25% start to balance out a bit as we get into the future years. But we're pretty excited about the program, and we're off to a great start.

Olivia Tong - *Raymond James - Analyst*

Great. Best of luck.

Operator

Oliver Chen, TD Cowen.

Oliver Chen - *TD Cowen - Analyst*

We were curious about the promotional environment now that you're seeing in terms of the landscape and how that's interplaying with how you're thinking about pricing. Also, as we look forward, do you expect volatility and traffic? Just curious about underlying trends there. And then finally, as we model inventory, I would love views on how you're planning inventory relative to sales.

Denise Paulonis - *Sally Beauty Holdings Inc - Independent Director*

So I'll start with the point on promotional landscape. It remains pretty consistent with how we described it last quarter. Value remains important for both of our Sally customers and our BSG stylists. On the BSG stylist point, we actually see a little bit higher promotional activity in play consistent with what we saw last quarter as compared to last year, and a lot of that is that we do see that unit demand pull through when that promotional activity happens. So we have that built into our model, like I said, nothing particularly outsized in terms of trend, but we do see the stylists there respond a bit better to promotion.

On the Sally side, I would call it a bit steady Eddy. At the end of the day, customers are just being frugal overall with their dollars. So with or without a promotion, we don't see meaningful changes in traffic coming into the store. And in turn, we are moderating that and ensuring that we're doing the right thing that will drive value for us overall.

I think importantly, in light of the landscape that's out there on both sides of the business, you can expect that we'll remain conservative on pricing. The good news is we're seeing fewer price increases come through for our vendors as commodity costs and other things have moderated. But importantly, we look right now and would not expect to be flowing through any significant increases that will drive AUR in the near term in light of the macro environment. So not much different than what we saw last quarter but certainly very value-oriented consumer on both sides of our business today.

In terms of volatility and traffic, we definitely see -- we saw volatility in the quarter, but I'd call it moderate volatility up and down. I think we've been seeing that now since inflation really started to tick up, which we're now probably six quarters in to see that impact where when people need to come to buy for for need for an event or something like that, you're going to see a little bit more strength. And then in the down periods, a little bit less traffic come through. I will expect to see that, but it's not wild swings. It's just customers are really tailoring their purchase habits as aligned with needs.

And then your final question was on inventory. I'll kick that one over to Marlo.

Marlo Cormier - *Sally Beauty Holdings Inc - SVP & CFO*

Yeah. With inventory, we expect it to run really in the $1 billion range. As you look at the quarterly cadence, fairly level loaded, a little bit of build as we progress into the year and then drop back down into the $1 billion range. One thing to keep in mind on inventory, we are on a weighted average cost method, so we've got a bit of a lag to those vendor price increases that we had seen previously. Those are still making their way through the process, but we continue to maintain improved levels of unit inventory.

More units are down to where where you see there level or increases. That's all due to the vendor cost increases making their way through the system. And we are hitting our unit weeks of supply targets, and our in-stock levels are at really healthy levels.

Oliver Chen - *TD Cowen - Analyst*

One follow-up. One on your competitive advantages of the company is your own brand portfolio. What are highlights of opportunities do you see there for innovation and change?

Denise Paulonis - *Sally Beauty Holdings Inc - Independent Director*

Yeah, spot on. We're very excited about the own brand portfolio. Of late, the biggest change that we had made with the launch of bondbar and the extension of bondbar from care into color. We're seeing good customer response there with a very modern brand bringing in new customers when we get that out there and in front of them. Innovation come forward is going to follow a similar track as being very aligned with maybe a younger consumer trend around desire for more natural products free-from products, certainly good for the environment spaces where we think we can play there particularly in the care side, and we'll talk about that.

And all things about how you can be more mindful as you shop coming through. You'll also see us continue to expand things like ION into a sunscreen for your hair and places where people are looking once again from more solution orientation that you'll see us push on as well. So I'd really focus on the dial-up on mindful natural items coming through as well as continued expansion of our bondbar business, and then problem solving tied to our ION brand.

Oliver Chen - *TD Cowen - Analyst*

Very helpful. Best regards.

Operator

Linda Bolton-Weiser, D.A. Davidson.

Linda Bolton Weiser - *D.A. Davidson - Analyst*

I was just curious about, you've been talking about your experimentation and pilot studies with these other store concepts. And I was wondering if you could quantify the costs related to those pilot tests in this fiscal year? And then, sorry if I missed it, but did you give any more color about your plans to expand the value concept, like in FY25, do you think you will open more of those stores?

Denise Paulonis - *Sally Beauty Holdings Inc - Independent Director*

Yeah, I appreciate the question. When I think about the concept initiatives that we're piloting right now, I'd really focus on two key areas. One is the Studio By Sally concept, and the other is our value initiative with Happy Beauty Co. So I'll start with it with Happy Beauty Co or maybe I'll back up one step.

You first asked about financial impact of this year. It's quite modest financial impact for what we've stood up this year, both in the remodel or relocation costs of opening the studio stores or in the case of Happy Beauty, it's 10 stores that we put into play last year, and this year is really about operating them. So no material impact to the bottom line from either initiative this year.

But if I look at the opportunity set, Happy Beauty Co, we have 10 stores up and running. We've been gaining traction in the first six months since our launch. And we're continuing to build awareness and traffic. And with 10 stores, we're really doing that grassroots social media coming through. We were very pleased with what we saw through the holiday season.

We thought that the brand was very well positioned for gifting, and that's what we saw. And our teams executed quite well. We're seeing ticket over $25, then UPT around 5. December and the holiday shopping weeks, we saw stronger performance than that and supporting that idea that is gifting.

So we're carrying through those learnings as we consider additional openings. More to come on future calls about a path there, but we remain excited about the potential and believe that if we see some of the metrics continue to perform as they could perform, we could be pushing an opportunity for over 500 stores over the long term where the real start of that expansion would be going into next year rather than meaningfully more this year.

And then on the studio side, we have six stores open. We're really reading performance there and understanding what they deliver to us. As you'll remember, these stores have the opportunity for people to participate in the salon environment with a DIY salon. But in addition, we made changes to the stores in terms of look and feel, so graphics, lower gondolas, better sightlines, much stronger navigation, difference in how we think about education and finance throughout the stores overall.

We're seeing very positive reaction to what the store experience is delivering to a customer and how they feel about the brand having gone into those stores. So we think that we're learning a lot there that can just inform overall how we think about relocations and remodels within the Sally fleet. And the studio is giving us a great opportunity to understand how people use our products, what their pain points are, how we can help them. And we're continuing to build on those learnings as well.

We have the potential as we go through the balance of the year to get a few dozen more of those out there if we see the potential of being what we'd like it to see. So on both cases, really seeing them come true. They are pilot, so they are not meaningful contributors to 2024. But we would look and hope that they will all be able to be great contributors as we look to the longer term.

Operator

Thank you, and there are no further questions in queue.

Denise Paulonis - *Sally Beauty Holdings Inc - Independent Director*

Thank you all for joining us today, and thank you to all our associates around the world. We appreciate what you do every day to serve our customers. And to all of our investors, thank you for dialing in this morning and hearing more of our story, and we look forward to keeping you posted in the coming quarters.

Operator

Thank you and, ladies and gentlemen, that does conclude our conference for today. Thans for your participation and for using AT&T teleconference. You may now disconnect.
