

Olaplex

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Dara Mohsenian: Good morning, everyone. I'm Dara Mohsenian, Morgan Stanley's Household Products and Beverage Analyst. I'm very pleased to welcome Olaplex to the fireside chat today. With us here today is Eric Tiziani, Olaplex's CFO. And just before we get started, for research disclosures, please see Morgan Stanley's website.

And maybe first, Eric, again, thanks for being here. You're still a fairly young company in general, but particularly in public markets. Can you just give a little bit of a brief overview for those who maybe aren't as familiar with the story, and really the key drivers behind the historical success as you look back over a longer period of time. And then we can get into where we stand today and growth priorities from here.

Eric Tiziani: Sure. Thank you, Dara. Thanks, everyone, for joining today. Thanks for those listening as well. It really started back in 2014. That's when the business started. We are a science- and technology-based beauty company. And in 2014, it started with the creation by Olaplex of the bond-building category within prestige hair care. And that came from a patented technology and molecule called bis-amino, which was designed to protect, repair, and strengthen the disulfide bonds in your hair. And it really was a game-changer in the prestige hair care category. It was launched into the professional channel as a hair repair treatment, both in the back bar as a treatment with chemical services and a take-home version of that product.

Over the years, then, on the back of really game-changing technology for the stylist and the stylist community building their affinity for the brand, you also started to see this just build of consumer love for the brand as well and this build of consumer community and user-generated content of what Olaplex is doing for their hair.

That led to expand the portfolio from those initial products into shampoo, conditioner, some styling products. It led in 2018 to broadening the channel distribution from just professional to also specialty retail and direct-to-consumer to build awareness and replenishment and also internationally. In the early days, it was taken into the professional channel outside of the US as well. All that came together to lead to, frankly, hyper growth for the business. From 2018 to 2021, that was about a 70% growth CAGR.

Advent International acquired the business in January of 2020. We took the company public in September of 2021.

Dara Mohsenian: Great. Maybe let's level-set where we are today. Obviously, some pressure points that have emerged in recent quarters relative to that great historical story. Can you talk about some of the initiatives you're putting in place to drive a reacceleration going forward, what the key ones are, where we stand in traction from those initiatives.

Eric Tiziani: Yes, I think just to be helpful to everyone, I'll list some of those pressure points and then I'll get into the initiatives. So in the back half of 2022, we did see our growth, this hyper growth, start to slow, and we've cited a couple of factors. One, that the macro did start to weaken, had a particular impact on the professional channel more so than direct-to-consumer and specialty retail. Because of the attractiveness of the category and because of our success, it also invited a lot of competitive intensity and, frankly, launches into the bond-building space with marketing claims. That started to have an impact.

And also some misinformation, this undercurrent of misinformation that started to surface around the brand. That really culminated in the first quarter of this year in 2023 with some negative media that became a headwind for us.

And therefore we set out in 2023 to execute an action plan around a reset to really build the foundation that we want in place to position Olaplex for consistent long-term growth. And those initiatives included a significant increase in our sales and marketing investment to build awareness of the brand, take control back of the narrative around the brand, and correct some of this misinformation, so it included education.

The second key initiative is really around our integrated business planning process, natural evolution for a company like ours, coming from as small as we were to a more mature organization. And that's really focused on performance, everything from the way we launch our innovations through our supply and demand planning to performance managing the business. We set out to become a more customer- and consumer-focused business with joint business planning with our key accounts in specialty retail, direct-to-consumer, and pro.

And finally, more recently in the back half of this year, some leadership changes. It started with JP Bilbrey joining us as the Executive Chair of the Board. JP has an incredible pedigree. He was the CEO of Hershey. He's currently on the boards of Colgate and Tapestry, just to name a few. And then more recently, a new CEO, so Amanda Baldwin is joining us as our new CEO next week. We were just saying a big week of onboarding scheduled for Amanda. We're very excited about those changes as well.

We believe all of those initiatives that we've put in place have helped us with progress against the goal that we stated for the balance of 2023, which was to stabilize our demand trends and put us back in a position to return to growth. And on our Q3 results call, we talked about that progress. We talked about sell-through that we're tracking through our key accounts stabilizing.

One of the headwinds we have been facing in the first half of the year because of that change in demand around customer inventory rebalancing as a headwind having normalized. And lastly, just seeing the results of the marketing investment we've put in place. We're taking a test, learn, and optimize approach to how we're deploying those investments, and we absolutely believe that we're seeing those investments yield this demand stabilization that we reported with our Q3 results.

Dara Mohsenian: Okay, great. And can you talk about the pace of recovery as you look out going forward? Obviously, you mentioned a lot of the initiatives, including marketing and education and other ones that should drive an improvement in the business. How do you think about that conceptually? Is it more of a slow return and slow build back up? Is it more of a more rapid recovery at some point? How do you think about that conceptually?

Eric Tiziani: Yes, and I'll answer it conceptually. We've stated our goal for the balance of this year is stabilization of the demand trend. That is what we're focused on. At the appropriate point in time, we'll get into 2024 guidance, of course.

So we're focused on stabilization. We are in an attractive category. Globally, prestige hair care is growing in the mid to high single digits, so that's a good start. And we believe that we still have significant opportunities across the board. We have opportunities in our core to continue growing penetration, both in the US and some of the international markets where we're more mature. We have opportunities in, frankly, more white space international spaces, like APAC, Middle East, Latin America, where our position is much smaller to start from.

And we continue to have a significant opportunity in building out our portfolio. So even today, we only have 18 unique products out there in the market. That's a lot tighter of an assortment than most other brands in the category. And so we still have the opportunity to enter into new sub-segments of the prestige hair care category that we believe are going to be very incremental for us over time.

And then on top of that, we've spoken about category adjacencies, adjacencies to hair care that we think Olaplex, we believe from our research, even from some of the applications of our patents on bis-amino, create really interesting and exciting opportunities for us in the longer term as well.

So all of those growth opportunities are still on the table. In terms of the pace of returning to that growth, we're not in a position to talk about that quite yet other than to say we feel very good about the progress we've made in the back half of this year on stabilization. We feel very good about the results we're seeing from our investments. And we have strong belief that we're going to be returning to growth at the appropriate time. We do have to lap at this point until we achieve the stabilization.

Dara Mohsenian: Okay, great. And you spent some time discussing the competition you've seen in the category, the PR piece of it. There's also the macro piece of it--higher-priced brands, clearly a consumer that's under some level of stress with the outsized inflation we've seen in general in CPG the last couple of years, and things like greater student loan payments, et cetera, et cetera. So just how do you think about the macro impact on your business,

what have you seen, and maybe give us some forward expectations on that front and how you see things playing out.

Eric Tiziani:

Absolutely. And I would just say up until this point as we reflect on the past few years, the macro impact on the category has been very consistent with what we expected in the sense of prestige beauty, specifically prestige hair care, has been very resilient to some of the macro challenges that we've all seen out there. Not immune, but very resilient. And again, this is a category that we believe is growing mid to single digits globally.

If I then zoom into the US market, you've actually got an important segmentation there. The category's been growing in the teens in specialty retail and direct-to-consumer, and it's been more challenged in the professional channel, which has been front of salon that is declining in the mid single digits in 2023. So there is a mix there that the stylist community, the professional channel, has been more impacted by some of the macro challenges as people are frequenting the salon a little less, stylists are buying a little bit closer to need.

As we look forward, we expect largely more of the same. We expect specialty retail and direct-to-consumer to continue to grow at a nice clip, and we actually expect professional to improve slightly. Tough to predict, but resilience, but not immune to macro challenges.

Dara Mohsenian:

Okay. And you guys really pioneered this category, as you mentioned earlier in the discussion. Can you talk a little bit about differentiation? Obviously, we've talked about lot of the competitive issues and the marketing and investment in education you're doing. But that differentiation versus the rest of the category, maybe dial down on that specifically, how you drive that, maybe how technology plays into that or innovation plays into that as you look out.

Eric Tiziani:

Absolutely. We still firmly believe that we have a set of competitive advantages that differentiate us within the industry and within the category, and it shows up through--the output of that is our financial profile as well. And that starts--number one is that the product really works. We do have patented technology. By definition, that is a differentiator versus other brands in the category. And this is this bis-amino technology that repairs the disulfide bonds in your hair. We still believe that while many others have entered the bond-building space and are making marketing claims, that our technology is truly the only one that repairs the disulfide bonds, which are the most important bonds in your hair, and has the best performance.

That then translates into a second advantage we have, which is our proven track record in taking that technology and translating it into new innovation. We continue to build out the portfolio. It's an advantage to us that we start from a small base, actually, that we still have all these white space segments to still go into, and that we have the track record of doing that successfully.

The third advantage and differentiator that we believe we have is this community that has been built over the years around the Olaplex brand. And that's the community of stylists that are this foundation for the brand as well as this highly engaged community of

consumers, and you see evidence of that. We're the number-one followed prestige hair care brand on Instagram.

Our earned media value, which is a key part of our marketing model, this multiplier effect on the marketing dollars that we spend, we are traditionally the number-one or number-two brand in the category, earned media value. That's an important part of our model that differentiates us.

The fourth one is our omnichannel model. We are a brand that succeeds in professional, in specialty retail, and in direct-to-consumer. That differentiates us against a lot of brands in the category. And lastly, it is our organization. We don't have the same legacy that many other organizations have, so we're building this foundation for the future.

Dara Mohsenian: Right, great. Well, that's helpful. Maybe we can shift to the professional channel, salons. You guys have done a great job penetrating that channel since the beginning of the company, a fairly young history and had a lot of success there over time. Obviously, there are a lot of volatile dynamics in recent quarters on that piece of the business. So can you just talk about your strategy there, some of the initiatives specifically targeted at the professional side of the business and maybe how you see that developing going forward from here?

Eric Tiziani: Absolutely, and I'll just start by saying that the professional channel and the stylist community remains critically important and strategic for us. All three channels--pro, specialty retail, direct-to-consumer--are strategically important. They play their own roles. And pro is really at the heart of that. And part of it is because of the importance of the recommendation from a stylist to their client and the weight that that has in the category and the credibility that it brings to the brand.

And so as a part of our reset, our focus has been to re-emphasize the importance of the pro in our business model and in our strategy. That has ranged from investments we're making in, frankly, some of the blocking and tackling that's important just to win in that channel. It's sampling. It's putting more feet on the street to engage with key opinion leader salons, to help us go increase our penetration of salons, even with our key distributors here in the US and internationally. It's been participating in some of the tent pole events that our key distributors have in the pro channel in the US and internationally as well.

And that's extended into how we recognize the stylist in some of our upper funnel marketing investments and tactics as well. Our Strength Starts Inside campaign, which we executed in the second quarter of this year and then again in the fourth quarter, predominantly has been featuring that relationship that a stylist has with their client, how important that is in the pro channel and for our business as well.

So we believe that all of those investments are part of what's yielding the stabilization and, over time, improvement in sentiment and return to growth.

Dara Mohsenian: Okay. And maybe can you talk about household penetration, consumer penetration in general? Obviously, the professional channel's one aspect of that, but clearly the retail

and digital side, too. Just how do you develop household penetration over time? What are the key strategies? What are realistic goals, looking out over the next few years, and how do you think about that?

Eric Tiziani:

Absolutely. So we do believe that increasing household penetration in the US and abroad is one of the biggest drivers of this growth opportunity we have for the business, for a very, very long time. It starts with this is a growing category, so there's the tailwind of the category growth and more consumers coming into prestige hair care, which is going to increase household penetration more broadly.

For ourselves, even with the success we've had, awareness of Olaplex is still relatively low. So unaided awareness is only in the teens; aided awareness, around 60%. And that leaves a lot of space in between ourselves and some of the leaders in the category. And so the investments we're putting in place, the full funnel investments, all geared to building awareness, is going to drive more household penetration.

We--I'll come back to the portfolio, the assortment that we have. While there's plenty of room to continue growing the core of that assortment, as we continue to come out with new products and entering into new segments, we also think that's an angle to get into additional households. Not just get into additional households, but continue to build the basket. So once we have a consumer and we're able to retain that consumer, getting their adoption rate up from three to four products, which it is today, into four to five products. That's another growth driver for us moving forward.

And that's just to speak of some examples in the US. We still have a large white space opportunity from a relatively low base in so many of the international markets.

Dara Mohsenian:

Okay. Well, let's stay there. Good segue. So maybe talk specifically about your strategies to grow the business in those international markets, and a lot of them in Europe where you exist today. I'll tease up the second part of the question, which is Asia and expansion there over time. But maybe start with more of the robust existing markets internationally, and then we can get into some of the growth opportunities over time.

Eric Tiziani:

Absolutely. So let me start by saying that our technology from bis-amino and the bond-building technology is what we call hair-agnostic. So the technology works on hair types, and that means that we have access to the entire world in terms of how we can deploy this brand with great performance.

And even in the early days of the company, it was brought to more developed markets, started with English-speaking markets like the UK, Canada, Australia, some of the other developed markets in western Europe like Germany, Italy, Spain. And the model had been similar to what happened in the US, start with the professional channel, build that credibility for the brand, and then take it omnichannel. And what has taken that 7 or 8 years in the US, that timeframe can be collapsed because the model is now better understood. There's already some existing awareness, even in those markets. And we intend to continue deploying that model.

So we've had great success growing that part of our international business. While it's slightly more mature, there is still lots of runway to continue to increase distribution. Like I said, it started in the professional channel. So in markets like Italy and the UK and Germany, we've continued to then build up the omnichannel part of that model into new specialty retails and direct-to-consumer channels. We're seeing great success, even with our own Olaplex.com variation in those markets now as well.

So I'll start there, but then I think you wanted to go to--?

Dara Mohsenian: Yes. Talk about the expansion opportunity in Asia, Asia ex-China, China itself. Obviously, the structure of the market's a little different, which maybe you can summarize for people who aren't as familiar. But how do you think about expanding more there over time, what the ultimate long-term opportunity may be.

Eric Tiziani: Yes, and so this is this whole other segment of the international opportunity that we consider more of this emerging opportunity, white space opportunity, where we have positions, but they're so small that it's mostly white space. And we talk about APAC, the Middle East, and Latin America as some of those examples.

In APAC specifically, let's break it apart. We announced earlier this year that we partnered with new distributors in Korea and in Southeast Asia, and those are more pro-led, pro-led growing into omnichannel models. And we've seen great success. We've seen great success in building the business in those parts of the region.

China specifically is one of the biggest international opportunities that we have that is almost entirely white space. We currently go to market through cross-border e-commerce through Hong Kong, and that's because of the animal testing requirements that China has on beauty products and our cruelty-free policy. So we won't do animal testing. That's why we have not gone into mainland China, general trade China, up until this point. So cross-border e-commerce represents about 15% of the total China market opportunity. That's based on the data we have. And we're happy to report we've been executing the business that way for several years now, and the brand is resonating really well with the Chinese consumer.

Like I said, hair-agnostic. We've seen good success. We've continued to build out the portfolio, et cetera. We still believe, and we've stated that we continue to develop plans that would allow us to enter into general trade in mainland China without changing our cruelty-free policy. And in the longer term, we still believe this going to be a really big opportunity for us.

Dara Mohsenian: Great. That's helpful. And innovation has been a piece of the business model historically. Can you talk a little bit about your innovation process, how important it is going forward. There's obviously a lot going on at the company. Give us a sense for the near-term forward pipeline and a bit of a longer-term look on that front.

Eric Tiziani: Absolutely. And I would just say a big part of our reset year has been to refocus on the core. I don't want to take away from that because we think there's so much opportunity to just getting the core back to growth. But that doesn't necessarily slow our plans on

innovation. And what we've stated and what we've been executing against is two to three new product launches per year into what I described earlier as these incremental sub-segments of the prestige hair care category.

So examples of that, earlier this year we launched our dry shampoo. Before we launched dry shampoo, you had to go off-brand to get a dry shampoo. And so we were happy to add that to the portfolio, and we believe it's entirely incremental because it's a new segment. That continues to be the plan--launch two to three new products a year into these new sub-segments, build out the assortment, build up the basket size and the regimen for a consumer, attract new consumers that want to participate in those segments. And we think that's a key pillar of our growth moving forward.

Dara Mohsenian: Okay. And on that front, maybe the next level of innovation is potential category expansion into new product categories. How do you think about that? That's sort of the opposite of the core refocus that you talked about, but is it something that's a priority, or is it really more of a focus on the existing business here driving growth there, or are new product categories on the horizon as you think out over the next couple of years? How do you think through that conceptually and strategically?

Eric Tiziani: Yes. Look, I would say in a sense, it is and, and, and. It is the core, and that will be a governor. We will use the priorities we have on the core, the health of the core as a governor for when the timing is right to do certain things on innovation, particularly around category adjacencies.

We did enter into a category adjacency in 2023. We launched our Lashbond serum in the first quarter of this year. We're happy with the success of that product. It is a smaller adjacency. It's a smaller category. We felt like it was a natural fit for us. It is the hair on your eyelash. We use our bis-amino technology but also complement that technology with a new peptide technology, prostaglandin-free, ophthalmologist tested. We think it's a differentiator in the marketplace.

And so I use that example because we absolutely believe we have the research that supports consumers, both Olaplex's existing and non-Olaplex consumers giving us permission to take the brand into adjacent categories. We've also stated we have, with bis-amino technology, the patent protection to use bis-amino in other categories like skin care.

And so yes the core, yes the closer-in hair care innovation. We absolutely believe category adjacencies are a part of our growth trajectory in the future, but the timing will be determined when we think it's the right time to do that.

Dara Mohsenian: Okay. Maybe we can shift to the margin side for a little bit. Marketing, obviously a big increase in marketing and education this year. Conceptually, how do you think about that? Are we at the right level, looking out longer term? I know we're not going to get into 2024 specifically, but more just as you think about the longer term and if you're leading this year, it's the right run rate. Perhaps it's undetermined and you have to see the greater success or yield from some of these initiatives. How do you just think about that, looking out longer term?

Eric Tiziani: Absolutely. If I come back to this history of the company and the business model we've been deploying and the reset that we've had in 2023, one of the key initiatives that we felt like it was important, it was time, given those headwinds as well as just being the right time, was to substantially increase our sales and marketing investment. And we did. We've taken that up to \$80 million to \$82 million is the guidance that we've given for the year in a test, learn, and optimize approach. And we've absolutely been learning and optimizing as we've gone.

Conceptually, what I'd say is that was a big step up this year. We think it was appropriate. We believe it's yielding the right results. But when you think about what should the level be in the future? One, a big part of the step-up is it just happened. That's in the 2023 base.

The second thing I'd say is priority number one is clearly returning to consistent sales growth that is appropriate and attractive relative to what is in our already attractive category growth. And we will invest what it takes to achieve that goal because we all know that that's where the long-term value creation really is sustained and really comes from.

And so we can't determine is this the exact right level. We believe we've taken the right steps in 2023 and that this was a sizable initiative that we've got in our base. But we'll determine the right level of investment to support that priority in our plan discussions with Amanda coming onboard and the discussions we have around that plan.

Dara Mohsenian: Okay. And maybe we could talk a little bit about the cost outlook. There's obviously been a lot of volatility in broader CPG in the last couple of years. Again, I know we're sensitive to getting into 2024 specifically, but maybe you can talk a little bit about what's embedded in Q4 and embedded in the guidance relative to recent history. And just looking out, your thoughts around the broader cost environment relative to what's been a pretty abnormal, volatile last few years here.

Eric Tiziani: And Dara, do you mean the cost inflation?

Dara Mohsenian: Product cost.

Eric Tiziani: Yes, yes, I'm with you. So I would say we have seen cost inflation in product costs and related costs abate, and so it's come down from those very high levels that we've been experiencing in the past several years, and we expect that to continue towards a pace of more normalized cost inflation levels. We always have a goal for ourselves to offset that through what we can control. And what we can control is putting savings initiatives in place. We've put a fuel for growth [indiscernible] cost savings initiative in place on cost of goods and the broader cost base. We're seeing really good results from that. We have a funnel that we're working on in 2024 and beyond as well.

What do I mean by that? One example is how we opened up new manufacturing through a 3PM in Europe, which saves a lot on transportation costs because we don't have to get that product from the US anymore. It's closer to the point of sale. That's driving some savings for us in 2023.

The other is price. We took a pricing action, average of 5%, in Q3 of last year. We expect price to be a part of our algorithm moving forward. And even more specifically, every time we come out with a new product, a new launch, we have the opportunity to assess what's the right price for that product in the marketplace. Lashbond, for example, was at a \$68.00 price point versus our core items are at \$30.00 in the US market.

And so that's my summary of our outlook on the cost inflation environment. If I can take that one step further to our own gross margin, because we have said that we expect to return to adjusted gross margins in the mid-70s in the medium term. And let me just help everyone with a little bit of a bridge there. We had been in the high 70s. We're currently in the low 70s. That's implied with the guidance that we've given for this year. So how do we get back to the mid 70s?

Well, from the high 70s, we have started to participate more in STUM promotions, and this has been a journey of the brand. When we were growing 100%, we didn't have to participate in any promotions. We're now at a point where we participate in a modest level of activity, key customer tent pole moments that we think are strategically important for the brand. And I won't go into examples of those, but you can start to think of a big promotion at key retailers or e-comm retailers here in the US. We think that's the right thing to do. That takes us from the high 70s to the mid 70s.

The additional headwind that we've been facing this year is related to this dynamic path we've had and some excess inventory that we were sitting on. And so there are some one-off inventory write-off costs that we've been experiencing this year that put us in the low 70s. Once we get past that headwind, that's what takes us back to the mid 70s.

Dara Mohsenian: Great. That's helpful. SG&A over time--any big headcount, infrastructure investments that you see? Obviously, a lot of that SG&A line is going to be a function of the sales growth. But curious for any big buckets of investment as you look out going forward versus this base year.

Eric Tiziani: Yes, I would say that similar to my comments on sales and marketing investment, putting the foundational organization in place, including the right tools or right processes, has been a big part of what we've been doing this year. And so a lot of that work has already started. It's in the reset. Of course, you have to annualize that as you get into 2024 and beyond. But that's a key part of our base. And just like sales and marketing investment, we will determine what the right pace of continued organization growth and capability investment is required to deliver that number-one priority, which is getting to that consistent sales growth relative to its attractive global prestige hair care category.

Dara Mohsenian: Okay. Well, that's a great place to end, so great to see you again. Thanks so much for being here. We appreciate it.

Eric Tiziani: Thank you, Dara. Thank you, everyone.