Olaplex

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Lauren Lieberman: Let's get started. Really happy to have OLAPLEX with us today. We have JuE Wong, the company's CEO, and Eric Tiziana, the company's CFO. Let's just start off. It's been a challenging year to say the least. If you could just maybe speak to what has been the greatest hurdles to your performance, but also what's gone better than what you expected over this time. And also, what gives you confidence that you can get to that stabilization in the second half of the year that's embedded in your guidance?

JuE Wong: Right. Thank you, Lauren, for having us. Thank you to everyone for being here and to the people on the webcast listening in. You are right, it has been a challenging year. But what is good about this is that we have focused and kind of like looked at what is important and what has caused us this slowdown. We look at the macroeconomics where some of our stylists are really buying closer to need because their clients are coming in for longer in between visits. We have seen more competition coming into the space, which is not a bad thing, because it raises awareness for the category. We have also seen more promotion activity and we have traditionally not participated. But we have decided very intentionally how we're going to do that. And then finally, there's also good information surrounding the brand that we need to address.

All of this has caused a slowdown, but given that we know that this is what's causing it, how are we addressing it? We are stepping up in sales and marketing. We are further -- in 2021 we spent about $20 million and this year we are budgeting an $80 million to $85 million spend on sales and marketing. And sales and marketing really focused on 4 key areas. It's a fully integrated marketing programming. Upper funnel, which is all about awareness build. Middle funnel which is all about consideration, that includes education. And lower funnel are about conversion, meaning that we want to make sure that the companies that engage with us will eventually convert with us.

What has -- to your next question, what has actually sort of like didn't work for us and that we are happy that things are continuing in that direction? It's the fact that despite the slowdown, despite the challenges that we are up against, the fact that we are the still the top beauty brand and the top haircare prestige brand in all the channels that we operate in. We have brand equity that when our consumers, when we track our brand health, still continue to say, it's a brand that they trust, it's a brand that leads through science and technology, and it's a brand that they would recommend to their family and friends.

We feel that all of this will help us get into what we call stabilization and then to eventually lead us to growth. We're still going to be maniacal in our focus in these key areas and continue to execute against our priorities.

Lauren Lieberman: Okay. Let's maybe talk a little bit about the increased investments that you're making in sales and marketing, education, and like you said, $80 million to $85 million for 2023 up from the initial expectation of $70 million and $40 million last year. I guess, how are you maybe allocating the investments differently than you did last year? And when should we expect to see the yield and positive inflection in demand? Because I think you've been on this path since the start of the year, but we're not really seeing the results in performance thus far.

JuE Wong: Let me cover, I'll give you a little bit of a timeline dimension. When we talk about the fully integrated full funnel marketing, a lot of the upper funnel, and upper funnel really refers to our home advertising, billboards that you see in the 5 key cities that we focus on. Which is in Chicago, New York, London, Toronto, and LA. And what we have done is that that started at the end of May. We will start -- and that is usually a slow result, so the result of that is going to be a little bit later. But what we have seen is that in the middle funnel, which is education, where we are able to go both online and offline, in-store as well as on a social media platform, to really educate on not only the product knowledge, but any account misinformation around the brand. We have seen a little bit more traction.

And then definitely we saw from our direct to consumer when we reported at our August 8 earnings, that it actually has shown improvements with the digital media that we are directing to OLAPLEX.com. I think what's going to happen primarily for everyone in this room and everyone listening in as well, is how are we tracking and measuring the success. And we believe that over time, we will be better able to share these results, but we are definitely testing, learning, and optimizing. And specifically with media, we can look at the rollout, and also with anything that is with conversion, our sampling program is working. Our expanded sales team that is in the field is delivering the conversion. All this help us get to that stabilization situation that we are aiming for.

Lauren Lieberman: Okay. Can we talk a little bit more specifically with the work you're doing to improve OLAPLEX getting into the professional community? I know late last year you'd spoken about reinstating the Pro Affiliate program. Maybe you could describe for us what that is and has that seen success to date?

JuE Wong: Sure. Thanks for that. The Pro Affiliate program is standard. It's what we allow the professional stylists to be able to tell their clients to buy from OLAPLEX.com. And for that, we get a commission. We have been very discreet in launching that program. The first time we launched it was during COVID and the reason why was all the salons were shut down and there was no means for them to make a living. We wanted to allow that opportunity where they can direct their clients to us without any kind of promotional activities. They were able to do that and were able to sustain at least some income.

The second time we implemented that was around about Q4, at the beginning of -- end of Q3, beginning of Q4 last year. And that was because of the macroeconomic condition where the slower times to meet and their client coming in less frequently. That was helpful. But we are mindful about that because we also work with distributors. And we do not want the distributors to think we are taking customers away from them, but it's adding value. We had those conversations with our distributors in the beauty supply locations prior to launching the program and they understood what we were doing. We know that that works.

But how you build affinity with a pro and build the love and the respect and the authority with them, it's really the attributions that we are putting in. That includes really more education on and offline, participating in events that are high profile or high activity, for instance our tradeshows and hair shows. But they are able to come to us and learn more about our brand. And then through those classes, they are able to buy their supplies for their salons. We are also looking at expanding our key sales team to include people in the beauty supply locations. Because when you do that, you are intersecting at the point of purchase.

And then finally, key opinion leader salons. And what key opinion leader salons are, they are generally very influential and they have a lot of reach. Because what they say matters to the other stylists in the community. We have built out a team that can go after those salons, what we call key opinion leader salons. By doing all that, the pros will see that we are investing in their channels and the stylists will know that they are important to us, because they have always been a key pillar of who we are.

Lauren Lieberman: Okay, great. Let's talk a bit international. International had been one of the key growth drivers you talked about since the IPO. In the near term, my understanding is there is similar challenges as we see in the U.S. and sort of English-speaking countries. But are the longer-term growth prospects internationally still intact?

Eric Tiziani: Yes. Thank you, Lauren. We absolutely see international growth as a major opportunity for our short, medium, and long-term growth potential. Just to frame it, we're already just over 50% of our sales coming from markets outside of the U.S. This is a proven opportunity, it's not something that we haven't already shown we've done, shown we can do, because our technology is truly hair agnostic. We've seen OLAPLEX brand, the products resonate across many different international markets.

And the opportunity is both in existing international markets where we already have some maturity, but still a lot of runway left for further penetration. Think of markets like Western Europe. As well as international markets where we're really just getting started. Where we've just entered in the last 18 months or so or we still consider them whitespace markets. That's a big part around APAC, Middle East and even Latin America. We do expect that international growth will even outpace U.S. growth in our long-term growth algorithm.

Lauren Lieberman: Okay. And how should we think about the margin differential between U.S. and non-U.S. markets? As international you said will be the biggest driver of growth, like how much of a negative mxix impact is that on margins?

Eric Tiziani: It's really not a factor of whether it's international or not. We go to market internationally in various ways, but we run the business from the U.S. We've been increasingly putting boots on the ground to help manage relationships in different time zones and with our distributors in those markets. The cost structure is actually quite similar. The bigger impact is the channel footprint. If we're going to start in a market, let's say through the professional channel and then build out the omnichannel model, then we've always talked about our margin differential between the channels as good, better, best. And the professional channel has a very good margin. The retail and pure play ecommerce has a better. And the best is our OLAPLEX.com. It's more of a factor of the maturity level of the channel footprint than it is the actual international market.

Lauren Lieberman: Okay. And notwithstanding what you just said, I'm curious if that changes as you establish a local supply chain in Europe. Does that -- how does that impact the profitably and what's the timeline ultimately of that?

Eric Tiziani: It's certainly a benefit. The most recent example of that is the co-manufacturer that we stood up in Europe to produces several of our core items, servicing that region of the world. And it significantly reduces the costs we incur on transportation which would have otherwise been coming from the U.S. And obviously, it's a tailwind to our gross margins in that part of that world. That's the model.

When we see scale at a certain level in different parts of the world, we'll make the decision to continue expanding our manufacturing network to get that production closer to that point of sale. That's also a proven lever we already demonstrated and that's already in place in Europe and it's what we'll continue to evaluate in other parts of the world.

Lauren Lieberman: Okay. Let's just discuss -- those are innovations. I was curious if you could talk a little bit about how you prioritize how to attack the different whitespaces. You recently entered dry shampoo, eyelash. But you've also opened other areas of potential growth over time including skin which I know you talked a lot about during the IPO. How do you prioritize which categories to go after? And again, the flip side, are there areas in which you'd rather not participate? And why?

JuE Wong: A good question, certainly. If you look at our sort of ability to focus innovations, first of all, we have a focus and a priority to make sure that we have a 70 to 1 rolling pipeline for innovation. And how our innovation gets informed is that we have a transformation team that really supplies the muscle, supplies the opportunity assessment for where we have permission to play and when. That data driven decision making really helps us really be more core. And then we now have built out an R&D facility that really is world class as far as I'm concerned. I'm rooted in some 5 other companies and on an emerging category, it is a 50,000 square foot space on the Pfizer campus which is on the border of New York and New Jersey. And what is exciting about a facility like that is we can formulate, we can do clinical testing, and we can batch. When you can do this kind of batch testing, you now attract world class scientists who want to collaborate with us. That helps us with our innovation, whether it's on the technology front or participating in sectors that are locked.

Yes, you've heard us talk about even at the IPO thing that our technology, as this is real technology, has applications in other categories of beauty including skincare. While we have gone into an adjacency like that, I think given that this is our reset year, we really want to focus hard on getting ourselves back to a stabilized situation and then looking at growth. While we know our technology has those applications, we can always have an opportunity to go into that direction. But until we get ourselves stabilized, I think that is where your last question on that is, why don't we want to get there sooner? And that's really the reason why. It's not because we don't think our technology can compete toe-to-toe. On the contrary, we have done testing on our technology and it is truly a really gamechanger when it comes to other adjacency categories. Just as we are seeing in lash, in lash bond.

I think time will tell but what is more important for us as a team is to focus on the present and making sure that we get this business to a good place. Then we can build off even more. Be a more resilient and a more stronger foundation OLAPLEX is definitely better for us.

Lauren Lieberman: Okay, great. One of the questions we've had in that vein is how OLAPLEX is sort of regimen-based approach with hair in a recessionary environment. And while we're I guess not technically in a recession, there's segments of the U.S. population that certainly are experiencing what would feel like a recession. And then there's the question of what's still to come. On your earnings call last month, you did call out several factors impacting your performance. But macro, actually interestingly, wasn't one of them. Just wondering if you're seeing any impact from lower basket size, less frequent purchasing, things that maybe would, you could presumably say would be tied to the macro?

JuE Wong: Right. We have shared that the (inaudible) by the professional stylist has somewhat of an impact. Because that is also driven by the client coming in on -- they usually come in at 6 to 7 weeks to color their hair. However, they are extending it by a week. By extrapolation, we can see the impact. What is I think good about the offerings and innovations we put through both for the professional community and for the end consumers, is that for the professional community, they know they have products and SKUs that we launch that truly is a totally exclusive what we call the back bar. The back bar is by prescription only, so when you are doing a service and you are mixing in the OLAPLEX prescription product, you are -- the product is never going to be sold at retail. That gives them a lot of sort of incentive to stay with us. But at the same time, our education and the ability to really show them how they can use the product to elevate their artistry and elevate the experience for their clients.

The other thing is, for the consumers, we have constantly launched products through our transformation tool, account information and data that they feed to us that are non-cannibalizing. And we actually add value to the offering so that we can recruit new customers to the brand. I'll give you a very specific example. We now have almost 5 shampoo SKUs in our offering. Yet not one of them cannibalize each other. We have a daily use shampoo. We have a clarifying shampoo. We have a plumper shampoo. And then we have a dry shampoo. If you think about it, all these new shampoos in the mix, particularly a customer that's already using them, in a way effectively allows them to buy deeper into the offering. But also attract new customers into the mix. And when you do that, it actually helps with the stylist professional community because that gives them another avenue to retail our products to their clients.

Lauren Lieberman: And then I guess what would you say is more important or achievable in a tough consumer environment? Is it getting more consumers to shop, to participate in and be at OLAPLEX and like building awareness? Or is it increasing the penetration with existing consumers?

JuE Wong: Right. There are two things you have to do. One is, the longer build with the professional in bringing them back to the fold and giving them good reason to continue with OLAPLEX, it's longevity for us. In terms of amplification of how they see us and how they communicate and advocate for us to clients. And because studies, other studies have shown, including our own independent research, shows that more than 60% of end customers would rather take a recommendation from their haircare professional than anyone else. Not a top influencer, not a celebrity, not any kind of media person. Layer on top of that, what is interesting is that when a stylist recommends that product, it allows us to understand what exactly are they looking for. That to me is an important piece of the ecosystem of the professionals coming to us.

But in terms of end consumer, that's important. Retaining them. Retaining the last customers and also acquiring new customers is just as important. Because they are the ones that will drive interest of the brand to the stylist. Because 90% of the stylists in the U.S. at least in the majority of their work are what we call single payroll entities. They don't have any money to market themselves. They need the brand to drive clients to them.

I would say the two-pronged approach, the longevity piece as well as the greenness piece to ultimately claim last customers. The number one reason why people move away from OLAPLEX, when questioned, it's never that, oh the product does not work for me anymore, or I don't believe in OLAPLEX. It's usually, I'd like to try something new. Which means that we are still top of mind which mean that they are still in the category and we can bring them back into the fold.

Eric Tiziani: The only thing I'd add there is, in this microenvironment, we're trying to remove the barriers, whether it's for trial or expanding the regimen. That's why sampling is so important for us to take a consumer that hasn't tried one of our styling products let's say and put a sample in their hands. Or to attract new consumers. It's why we put child kits out there at the right value proposition for someone to enter into the mix.

Lauren Lieberman: Okay, great. Let's maybe switch gears to some financial questions. Eric, I mean JuE, you're welcome to answer as well. On the earnings call last month, you had mentioned that your inventory position at key accounts is in a much better spot going into the second half of this calendar year. Should we expect that the destocking dynamic is largely behind you in 3Q? Is that fair?

Eric Tiziani: Yes, that's exactly as we said on the earnings call. Just to take one step back, after a period of very fast growth and a more uncertain supply chain environment, our customers were holding higher levels of inventory to support that growth. And just because that was the macro dynamic at the time, they were holding more months on hand. Over the past several quarters, we've been going through an inventory rebalancing headwind as our own growth momentum slowed. And we're in a more stable supply chain environment. A customer that may have been holding 4 months on hand, decided to hold 3 months or 2.5 months, etc. We believe that at our key customers, on our core items, we enter into the second half in a much better position. We have access to that data. Our planners are working with their planners on that rebalance to be able to say that. And therefore, we do feel like we're in a better position going into the second half.

It is dynamic. We have no control over a customer that says, you know what? I can even go further. I'm going to hold 1.5 months on hand. Those are always factors. But we're in a much better position.

Lauren Lieberman: Great. And then last quarter, direct to consumer sales were much stronger than we'd anticipated. You took shipments ahead of a major customer promotion in July which presumably was Prime Day. I knew you had mentioned the sales would decline on a sequential basis just due to that. Is there anything else you'd share in terms of how much of an impact that's had on second quarter results and how sales are trending on Brand.com?

Eric Tiziani: Yeah. I would just say that had more an impact on the absolute dollar sales in the direct-to-consumer channel in the second quarter versus the third quarter than the growth trend. Because it's the same event that we did the prior year as well. That's more of a comment on the sequential dollar progression as we go through the year.

In that sense, the trend that we started to see in the second quarter, where direct-to-consumer, just for everyone, that's both our own dot com as well as pure play ecommerce retailers like an Amazon, was much stronger. That's one of the green shoots that we pointed to, to say stabilization is our goal in the second half of the year and this one of the reasons, because our investments are very much funneling into that channel.

That includes within what we call direct to consumer our OLAPLEX.com business actually growing. And we believe Q2 was a good demonstration of that and that's a reason to believe the second half will follow with similar trends.

Lauren Lieberman: Okay. And Eric, when you talk about gross margins returning to the mid-70s level in the medium term, can you just walk through some of the moving pieces that bridge us back to that level?

Eric Tiziani: Yeah. Let me call out 3 drivers. From where we are right now, which is right around 70, how are we going to get back into the mid-70s range? One is, we are still sitting on higher levels of our own inventory than we've targeted for ourselves. There's some elements to that that we're in. Warehousing space. That cost can come down. And that could leverage impact as well as we return to growth. So that's one driver.

The second one is, as we've been dealing with that excess inventory, we've taken some provisions for obsolescence. We took a $3.5 million charge in the second quarter. That's an example of the headwind related to that that goes away for over time or at least normalizes over time. And that's material.

And the third one is actually mix. As we talked about earlier, the margin differential across our channels and direct to consumer is -- as we expect that to continue to grow relatively fast relative to other channels, that has a positive impact mix in the business as well. That's why we have a belief that we'll see gross margins normalize at that level in the medium term.

Lauren Lieberman: Okay. And I'm just curious, what level of sales growth do you need to have more favorable operating leverage for the P&L?

Eric Tiziani: Well, there's not a magic number there. In the sense that the fixed costs, which fall into cost of goods and fall into gross margin, are largely related to warehousing cost, so any growth is going to help. And then the other factor is the inventory coming down. When you look at our SG&A, it's largely our corporate costs which already are very efficient and we intend to keep them efficient even while we invest in parts of that SG&A. Modest growth even creates leverage opportunities on the P&L structure.

Lauren Lieberman: Okay, great. And then just last question on this topic was promotional activity. Should promotional activity remain elevated? And does that impact the timeline for getting back to that mid-70s?

Eric Tiziani: I would say that we strategically have maintained the position that we're not going to overpromote the brand. That's not good for the equity of the brand. But we are going to participate in key customer tentpole events that are strategic for us, that attract new customers, that we can gain information along with our partners to retarget those customers as well. That's a normal level of promotion. Even if it's less than a lot of our peers, we consider that a normalized level of promotion activity moving forward.

The only bit that's let's say yet to normalize is let's say we have an item at a customer that's in an excess inventory position and we need to promote through that a little bit. That's a little bit of what we're experiencing in 2023 that is a tailwind once we get past that hump as well.

Lauren Lieberman: And then just on the topic of sales and marketing investments, I know this year, as I said, $80 million to $85 million, about 18% of sales. How should we think about spend levels going forward? Should we assume there's always deleveraging on this line item to continue to skew the sales growth?

Eric Tiziani: Not necessarily. Even if you just to take a step back on the P&L structure, now we're around a half a billion dollars in sales business with gross margins in the 70s with the current level of marketing investment in the mid to high teens. Which is much more competitive in our peer set. And at a very efficient other SG&A structure to get to our EBITDA margins in the high 30s.

We feel very good about that investment level this year. We're focused on using that investment to stabilize the business and create this inflection point back to growth. We're focused on testing, learning, and optimizing as JuE said earlier. And it's too early for us to say whether that's going to go up a little bit or down a little bit as a percentage of sales in 2024 and beyond. But we start from a very attractive financial model and profile that we think is sustainable.

Lauren Lieberman: And when you gave the initial guidance in February, you discussed '23 as the reset year, and JuE, you referenced that again earlier today. But as the year has unfolded, it's taken longer to see sales stabilize. Is this still the right way to think about it? Could the reset probably continue into next year?

JuE Wong: I think let's look at it this way. We want to work towards stabilization. And think that's really what's going to be the key factor for us. Everything that we are implementing and putting in place really helps us get there. Because especially when we are able to measure anything that is measurable and tracked, we can feel very comfortable to -- I mean Eric will give us permission to spend deeper into it. And if it's not, Eric is going to tell us, look, this is insane, you need to relook at something. But on the upper funnel, we are going to still put our focus on education because as we say, it's building brand awareness. When we look at our brand health tracker, aided awareness is higher, but unaided awareness is still about 15%, which means that 85% of those people don't even know who we are. There's a lot of run way for us to help us to be more aware. And then really have people consider and engage with us and essentially convert them.

Lauren Lieberman: Just in our final minutes, I'd just be curious to hear from you both, what does success look like for each of you? We're hopefully sitting here and you have this in your calendar for next year. What does success look like a year from now?

JuE Wong: I think first of all, mostly we are able to come and show you that look, the business has stabilized. We are on a quarter-in-quarter healthy sort of trajectory. And very important, how for us to get there is that we need to make sure that our core competence continues to be strong which means that our stylist community continues to see the best fruits of our investment behind them and behind the category. That our core SKUs continue to resonate and be the best in class. Because we have seen them continue to be the top SKUs in the business and in the channels that we operate in. Definitely, our innovation. Our innovation is to halo our core. And then be able to also share with you that the culture that we have, that our people are motivated, that they are inspired to continue to deliver because we continue to invest behind them.

Eric Tiziani: Yeah, and I'll just say, delivering what we've said we intend to deliver this time next year, which is first stabilization and then an inflection point back to growth. I'll come back to the financial profile of this success which is very profitable, generates a lot of cash. We have incredibly engaged consumer and stylist space. We have excellent partnerships with our key accounts and distributors. We get this business back to growth this time next year and there's a tremendous value creation opportunity we believe.

Lauren Lieberman:: Great. We'll wrap there. Thank you so much for being here this year. We're going to go to a breakout session, but please join me in thanking JuE and Eric for being here.

Eric Tiziani: Thank you.