MODERATOR: Greetings. Welcome to Olaplex Holdings Inc Second Quarter 2023 Earnings Results conference call. At this time, all participants are in a listen only mode. A question and answer session will follow the formal presentation. If anyone should require operator assistance during the conference, please press star 0 on your telephone keypad. Please note this conference is being recorded. I will now turn the conference over to Patrick Flaherty, vice president of investor relations. Thank you. You may begin.

PATRICK FLAHERTY: Thank you and good morning. Joining me today are JuE Wong, president and chief executive officer, and Eric Tiziani, chief financial officer. Before we start, I would like to remind you that management will make certain statements today, which are forward looking including statements about the outlook of Olaplex Business and other matters referenced in the company's earnings release issued today.

Each forward looking statement is subject to risks and uncertainties that could cause actual results to differ materially from those projected in or implied by such statements. Additional information regarding these factors appears under the heading, Cautionary note regarding forward looking statements in the company's earnings release and in the filings the company makes with the Securities and Exchange Commission that are available at www.sec.gov and on the investor relations section of the company's website at ir.olaplex.com.

The forward looking statements on this call speak only as of the original date of this call, and we undertake no obligation to update or revise any of these statements. Also during this call, management will discuss certain non-GAAP financial measures which management believes can be helpful in evaluating the company's performance. The presentation of non-GAAP financial measures should not be considered in isolation or as a substitute for results prepared in accordance with GAAP.

You will find information regarding these non-GAAP financial measures and a reconciliation of these non-GAAP financial measures to the most directly comparable GAAP measures in the company's earnings release. A live broadcast of this call is also available on the investor relations section of the company's website at ir.olaplex.com.

Additionally, during this call, management will refer to certain data points, estimates, and forecasts that are based on industry publications or other publicly available information as well as our internal sources. The company has not independently verified the accuracy or completeness of the data contained in these industry publications and any other publicly available information. Furthermore, this information involves assumptions and limitations, and you are cautioned not to give undue weight to these estimates. With that, I will turn the call over to JuE Wong.

JUE WONG: Thank you, Patrick, and good morning, everyone. As outlined in our press release issued this morning, we had a challenging second quarter. Net sales of $109 million were below our expectations of modest sequential improvement from the first quarter. And adjusted EBITDA was $36.7 million or a margin of 33.6%. With weaker than expected results in the second quarter coupled with our updated assumptions for the remainder of the year, we are reducing our guidance for fiscal 2023 expecting net sales in the range of $445 million to $465 million.

Overall, our business continues to be negatively impacted by competition, a more promotional environment, and misinformation related to our brand. Despite this headwinds, we are continuing to invest by increasing efforts on upper funnel marketing designed to build brand equity and expanding our focus and support for the important professional community.

Let me take a step back and walk through the perspective of what drove the revision to our full year outlook. Earlier this year, we announced that we are approaching 2023 as a reset year to build a stronger and more resilient foundation to position Olaplex for long term growth. The prestige hair care category, which Olaplex revolutionized in 2014, has evolved into a healthy and vibrant category, but with more competition.

In order to support our future growth, we must continue to amplify our investments and expand our marketing and educational capabilities. And to that end, we initiated an integrated full-funnel marketing approach this year to build brand awareness, increase consideration, and drive conversion. And beginning in the second quarter, we invested heavily in upper funnel and other creative marketing activities aimed at building long term equity around the size and emotional connection associated with the Olaplex brand.

When we introduced annual guidance earlier this year, our visibility was limited as there was uncertainty regarding how shifting market dynamics would impact the business. We anticipated that trends would stabilize in the second quarter and sales demand would rebound in the second half of the year as our increased investments in sales, marketing, and education began to yield returns.

We also expected to benefit from New product introductions and new distribution gains. However, we have now seen a weaker sales trend persist since our first quarter earnings call in May through June. While our loyal customers remain highly engaged with Olaplex, we believe a continuation of negative factors have impacted the business.

We recognize that this factors are having a particularly negative impact on the performance of our professional channel and views of the brand with some members of the stylist community. As a result, we are revising our forecast for the balance of the year using this recent trend as the run rate for the business. We recognize that it will take a sustained and balanced approach to investing in marketing, education, innovation, and brand building activations to grow the business.

Several key assumptions have changed in this new outlook, but demand slowed as trends weakened in our professional and specialty retail channels due to slower sell out and some customers right sizing their inventory positions. Second, while we are beginning to see some positive early indicators from our upper funnel market campaigns, we are not yet experiencing the lift that we were anticipating across the business. And we expect that this activity will begin to deliver stabilization on an absolute basis rather than growth during the second half of the year.

And third, given our updated view on our trend line, we believe it is prudent to lower our expectations for consumer demand associated with new product introductions and new distribution gains. Eric will provide more details on our outlook later on in the call. We believe we made progress towards achieving stabilization. Based on data from a third party, we have seen a lift in awareness and positive opinion of Olaplex following the start of our upper funnel marketing campaign in June.

Similarly, olaplex.com has experienced increased traffic and improved conversion after the campaign launch. And because that channel tends to act as a leading indicator given its close proximity to the end consumer, we believe the messaging, content, and creative asset of the campaign are resonating. And as we balance scouting activities with demand, we believe the months on hand inventory positions at our major accounts on our core items are in a much better place relative to their targets.

We have worked to normalize inventory levels with these partners in response to slower than originally planned sales and decisions from these partners to lower overall months on hand levels than previously carried. To put this in context, in the first half of 2023, net sales all fell in declined 44% overall while sell out at key accounts was down approximately 26%.

Some of this difference can be attributed to the Lapping of previously communicated prior year one offs namely our 1 liter pipeline launch, Ulta-Pipeline in Q1 of 2022, and the impact of our July 1, 2022 price increase. The remainder of the difference between sell in and sell out can be attributed primarily to this continued customer destocking actions in response to our lower demand.

Our team is focused on executing and improving our sales trend through brand building and education activations that we believe are the strongest levers to engage loyal users and bring new and lapsed customers to Olaplex. We are increasing the amount of investment for this year, and are adjusting the mix of that investment as we test, learn, and optimize our initiatives.

We are raising our expectations for marketing, inclusive of sampling and certain sales and marketing payroll to increase to a range of $80 million to $85 million in 2023 compared to our previous expectation of $70 million and up from $40 million in 2022. With this change, we are increasing aspects of our new brand campaign, repurposing some of the upper funnel out of home activations towards media and connected TV, and focusing more efforts on improving our standing with the Pro community.

As we adjust our plans for the year, we continue to make progress against our four key priorities. These are--accelerating investments in sales and marketing, increasing and evolving our educational assets, re-asserting our position with our Pro and specialty retail partners, and improving our approach to PR. Let me now walk you through the progress we made on this initiative during the second quarter.

Beginning with sales and marketing. Year to date, we invested approximately $40 million of the planned $80 million to $85 million investments for the year. In May, we kicked off an integrated full-funnel creative campaign titled, Strength Starts Inside, featuring hate media, digital, social, connected TV, audio, and out-of-home activations.

With this campaign, we intend to amplify our scientific authority by highlighting how Olaplex built strength from the inside with our patented this amino technology, as well as strengthening emotional connections with our community of pros and customers who aspire to bring out their own inner strength. And in June, we generated excitement of our nine year anniversary as a company by celebrating National Olaplex day.

To celebrate this milestone, we hosted events with our professional ambassadors and activated fully branded guerrilla street sampling teams near local Sephora and Ulta Beauty Doors in New York, Los Angeles, and Chicago. Turning to education. We continuously look for new and better ways to inform stylists and consumers about the superior performance of our iconic products.

In that vein, we are implementing a more active and engaged approach to field education, and are establishing our own internal retail field sales team. You may recall that during the fourth quarter of last year, we deployed a pilot of a third party field sales team trained by Olaplex. And following positive results, expanded the program to 400 Sephora and Ulta Beauty doors during the first quarter.

This program has demonstrated the impact we can have in driving in-person education with consumers and beauty advisors. An internal retail field team is not only more cost efficient than engaging with a third party, but we believe that we will have even better control of training on the Olaplex brand. Our third priority is to re-assert our position with our professional and specialty retail partners.

The professional community remains at the foundation of our brand, and is core to maintaining our credibility in the category. We know it is critical to address and solve the issues we are facing in that channel by increasing our visibility and investing more to deepen engagement with stylus. To that end, the team is implementing new and incremental full 360 activations to show our support for the pro audience, driven primarily by participating in high visibility distributor led events, stylist appreciation days, and in-store activities.

In addition, we continue to increase in-person and virtual sales contacts and trainings with our new field sales managers and expanded education team, both in North America and in internationally. We piloted an expanded data driven program to help our distributor partners target and secure new Olaplex salons, and are advancing our key opinion Leader program by adding new salons and cultivating relationships with existing partner salons.

With specialty retail, we are continuing to partner with our key accounts to expand CRM campaigns and education content. We also introduced new visual merchandising reflective of our new brand campaign and made progress on international expansion. Our fourth priority this year is to build out and enhance our capabilities with a focus on strengthening our global reputation, scaling influencer marketing, and delivering growth in earned media value, our PR efforts are aimed at telling the story of our brand and educating consumers about our technology.

We are broadly distributing content in partnership with our brand ambassadors focused on Olaplex and hair health via digital and social channels. We intend to continue to develop the Olaplex Scientific Advisory Board program, which consists of a group of medical and scientific experts who will help guide us on ways to develop educational content that underscores the safety and scientific capabilities of our products.

We also continue to actively defend our brand against allegations that claim Olaplex products cause hair loss. In July, the court granted Olaplex's motion to sever and dismiss the claims. As a result, all 101 plaintiffs are currently dismissed without prejudice. Turning to our progress on investing in our people and building out our team. I am pleased that JP Bilbrey has joined our board in the newly created role of executive chair.

JP joined us about a month ago, bringing extensive experience with growing and evolving global consumer brands after having served as the president and chief executive officer of the Hershey Company and currently serving on the board of directors of Tapestry, Elanco Animal Health, and Colgate-Palmolive. It is a testament to the opportunities ahead of Olaplex that we could attract a leader of his caliber and credentials.

JP will be a valuable addition to the Olaplex team, and we are thrilled to welcome him to the board. I look forward to partnering with him, and receiving his guidance on ways to implement best practices and processes as the company scales. In summary, while it is a challenging period for Olaplex, we continue to be confident in the long term opportunities for this business. The prestige hair care category is in its early stages of growth, and we are an industry leader offering truly differentiated signs with our patented best amino technology.

We believe we can reach new customers and reclaim users as we invest in our marketing model and develop within the international markets. And we believe we have a compelling multi-year innovation pipeline that enables us to expand our product offering. With that, I will now pass it over to Eric to cover our second quarter results in more detail, and provide additional information on our revised outlook for 2023. Eric.

ERIC TIZIANI: Thank you, Julie, and good morning, everyone. Net sales in the second quarter declined 48.2% to $109.2 million. This was below our expectation of modest sequential improvement in absolute dollars from $113.8 million in the first quarter as our professional and specialty retail channels experienced slower demand, and some customers further rightsize their inventory positions in response to current trends.

We also lapped two challenging comparators from Q2 2022. First, we lapped an approximately $22 million net sales impact in the second quarter of 2022 from the introduction of 1 liter size offerings in the North America professional channel. Second, in the second quarter of last year, we experienced some pull forward in demand of approximately $10 million as some professional customers chose to buy ahead of our announced price increase, which took effect on July 1 last year.

By channel, the professional channel sales declined 61.2% to $40.9 million versus a 32.7% increase last year. Our direct to consumer channel sales were down 6.4% to $38.5 million compared to growth of 19.3% a year ago. And specialty retail sales decreased 53.7% to $29.8 million following an increase of 68.5% in the prior year period. Moving down to PnL Adjusted gross profit margin was 72.7%, down 250 basis points from 75.2% in the second quarter of 2022.

Approximately 320 basis points is related to higher inventory obsolescence reserves, 230 basis points related to promotional allowance, and 110 basis points from inflation on product costs with the remainder from deleverage and inflation in our warehousing and distribution costs. These more than offset the benefit of favorable channel mix as the overall mix shift to direct to consumer drove plus 350 basis points, as well as the price increase we took from July 1 2022, which contributed 100 basis points of favorability.

Adjusted SG&A grew 73.4% to $42.2 million from $24.4 million in Q2 2022. $17.8 million increase in adjusted from prior year is primarily the result of a $14.1 million increase in sales and marketing expense, including the upper funnel marketing campaign that launched during the second quarter, as well as an increase in payroll attributable to workforce expansion and other related expenses.

Adjusted SG&A excludes $3.5 million related to a one time settlement with a former distributor in the United Arab Emirates, which allowed us to establish a partnership with another distributor in the country. For the first half of 2023, we have spent $40 million in sales and marketing against our updated $80 million to $85 million full year investment.

Adjusted EBITDA declined 72.4% to $36.7 million versus $133.1 million in the second quarter of 2022. Adjusted EBITDA margin was 33.6% compared to 63.1% a year ago. Adjusted net income decreased 78.5% year over year to $21.2 million or $0.03 per diluted share from $98.8 million or $0.14 per diluted share in the 2022 second quarter.

Turning to our balance sheet. Inventory at the end of the first quarter was $128.5 million down from $132 million at the end of the first quarter. We continued to make progress on efforts to lower our inventory levels as the sequential reduction was driven by lower inventory levels of core SKUs to match a lower sales forecast, which more than offset building inventory of new SKUs as we prepared for product launches this year.

Turning to cash flow. During the first six months of 2023, we generated $71.1 million euros in cash from operations. As we shared in past calls, we anticipate another year of healthy cash generation as we have a highly profitable business model and improve our working capital position primarily through lower inventory. We ended the quarter with $378.4 million in cash and equivalents, which is generating interest income at around 5%.

Long term debt net of current portion and deferred fees was $651.7 million. Now turning to our financial outlook. As JuE mentioned earlier in the call, we are revising our guidance for 2023. Let me walk you through our revised guidance and assumptions for the remainder of the year starting with the top line. For fiscal year 2023, we expect net sales in the range of $445 million to $465 million, down from the previous range of $563 million to $634 million.

At the midpoint of both ranges, this represents a reduction of approximately $144 million, which can be broken down into three primary buckets. First, the combination of weaker than expected results in the second quarter and our assumption of lower baseline demand in the second half of the year amounts to approximately $60 million.

Second, we are no longer assuming baseline demand improvement in the second half of the year, and now believe the investments we're making will first deliver stabilization of baseline sales on an absolute dollar run rate basis. The removal of this lift amounts to approximately $50 million. Third, while we still expect to benefit from the impact of new product introductions and new distribution gains, we are lowering these assumptions by approximately $35 million compared to our original assumptions given recent sales trends.

With this new outlook, second half 2023 net sales at the midpoint are now expected to be $232 million versus $223 million in the first half of 2023. We expect to experience the addition of holiday kits in the second half of the year, which is a benefit relative to the first half of 2023. Given that our holiday kits are sold to professional and specialty retail customers primarily in the third quarter ahead of the winter holidays, we expect net sales in the third quarter to be higher than the fourth quarter of 2023 on an absolute basis.

For the same reason, we anticipate sequential improvement in sales on an absolute dollar basis in the third quarter versus the second quarter of 2023 for both the professional and specialty retail channels. Conversely, we expect our direct to consumer channel to decline sequentially on an absolute dollar sales basis in the third quarter due to timing as we shift inventory in Q2 ahead of a major customer promotion in July.

In the third quarter from the perspective of year over year net sales growth rates, in order of magnitude, we expect specialty retail to be the most pressured, followed by direct to consumer and professional. Specialty retail faces the most difficult comparison from a year ago when the channel experienced robust growth due to incremental distribution and a higher selling of holiday kits.

We now anticipate 500 to 600 basis points decline in gross margin for the year compared to our initial assumption of 300 to 400 basis points of contraction. The primary driver of this is deleverage from lower sales volumes on our fixed warehousing costs, as well as the actions we are taking to work through excess inventory. It's more than offsets the positive impacts of cost savings and price increases implemented in the second half of 2022.

In the medium term, as we work through higher costs and inventory obsolescence impacts and as baseline demand improves, we believe that we can return closer to our historical adjusted gross margin levels in the mid 70% range. Given the lower net sales forecast against our expectations for increased operating expenses, which includes increasing our sales and marketing investment for the year, as JuE previously discussed, we now expect more adjusted EBITDA margin deleverage than our prior assumption.

For 2023, we expect adjusted EBITDA in the range of $161 million to $176 million or margin of 36.2% to 37.8%. This compares to our previous range of $261 million to $322 million or margin of 46.4% to 50.8%. We continue to expect interest expense to be $40 million and adjusted effective tax rate of approximately 20% for the year.

In conclusion, despite our disappointment with this weaker outlook, we are reminded of the pillars that make Olaplex a unique brand and a great business. We are a science led company. And with our commitment to making people feel more confident with healthier, more beautiful hair, we have built an industry leading brand that enjoys trust and credibility from a highly engaged community of professional stylists and consumers.

We are driving a synergistic omnichannel strategy and have the support of our customers of US as a strategic partner of choice for the future, and our highly profitable model and strong cash generation afford us the opportunity to invest to improve our performance and capitalize on the long term growth opportunities ahead of us. This concludes our prepared remarks. We will now turn the call back over to the operator for questions. Operator.

MODERATOR: Thank you. If you would like to ask a question, please press star 1 on your telephone keypad. A confirmation tone will indicate your line is in the question queue. You may press star 2 if you would like to remove your question from the queue. For a participan Using speaker equipment, it may be necessary to pick up your handset before pressing the star keys. Please ask one question and one follow up question, and then requeue for additional questions. Our first question is from Susan Anderson with Canaccord Genuity. Please proceed.

UNIDENTIFIED PARTICIPANT 1: Alec Legg on for Susan. Just a question on your sell out comments. You said it was down about 26% at key accounts. How much do you think is driven due to misinformation driving demand down versus tougher comps. And then also, I believe there should be some headwinds from the sell off as 1 liter bottles, which extends the need for consumers to replenish. Just any details there. Thank you.

ERIC TIZIANI: Yes. Good morning, everyone. Eric Tiziani here. I'll take that. So that's right. We disclosed on the call that our net sales decline for the first half of the year was 44% against a minus 26% consumption decline at our key accounts. And that difference is partly explained by the one offs from the prior year in selling. So the 1 liter launch that you just mentioned in the first half of last year, our Ulta-pipeline shipments from Q1 of the prior year, and some impact from pricing pull forward in Q2 of last year as well, all of which we previously disclosed.

And while there are some ins and outs, the remainder of that difference between net sales decline and the consumption decline can primarily be explained by what we've seen is further customer inventory rightsizing. And as JuE mentioned earlier, we believe that based on current sales, our inventory position on core items at key accounts is in a much better place going into the second half of the year. This is, of course, dynamic.

You also asked, of the minus 26%, how much is being driven by these headwinds that we've talked about? So competition, misinformation, and a higher promotional environment. And we're not really breaking that minus 26% out in that way, just to say that those continue to be the primary headwinds that the business has been facing.

UNIDENTIFIED PARTICIPANT 1: Thanks. And then a follow up on the marketing spend, so you've been investing heavily in that this year. I guess, what type of ROI are you seeing, and then is it primarily top of funnel just to build awareness or are you also spending fairly equally or just how to think about on spending on retention?

JUE WONG: Right. Thanks for that question. This is JuE, and I will take that. So we have always said, the category that we have created is now more attractive. And therefore, in order for us to build on that awareness for the category, we really need to step up on our investment in upper funnel as well as to support our pro community.

So we will continue to test, learn, and optimize on our initiatives, and it is an integrated full funnel investment approach. So we will look at the mix, and as things work, we will figure out what is best to increase whether it's in consideration, whether it's in conversion, or continue with the upper funnel, which is building brand equity and brand awareness.

UNIDENTIFIED PARTICIPANT 1: Thanks all again.

JUE WONG: Thank you.

MODERATOR: Our next question is from Andrea Teixeira with JP Morgan. Please proceed.

ANDREA TEIXEIRA: Thank you. Good morning. JuE, can you comment on the exact rate of the consumption number you quoted, the consumption decline of 26%. I understand this is the first half against the first half of last year. So I was hoping to see if there is any improvement there in terms of consumption or conversely if things got worse as you progress the quarter. And then related to your investments, especially in Ulta in the salons and increased awareness of the brand, can you comment a bit on-- at this point, I think you've been through about eight months of the campaign where you get your sample one number three after a service.

Wondering if you can give us an idea how that converted? And lastly, on the shelf space, can you talk about-- I understand that part of the decline in guide was expectations for a more modest shelf space growth. So I was wondering if you can comment on, how are you feeling about Sephora the back the back wall if there is anything we should be aware of in terms of negotiating with Sephora next year? Thank you

JUE WONG: Well, thanks, Andrea, for the question. It's a three parter. So what I'm going to have is Eric to answer on the consumption first, and then I'll take the investment in the salon and Pro and the shelf space question. So Eric.

ANDREA TEIXEIRA: Great. Thank you.

JUE WONG: Thank you.

ERIC TIZIANI: Thanks, JuE. Good morning, Andrea. So on the exit rate, you're right, the number that we quoted the minus 26% was the consumption decline at key accounts for the first half of the year. We did say on the call that we saw some deterioration in that number in the second quarter, so it was moderately worse in the second quarter than the first quarter.

And what you see in our outlook and our updated forecast is we've taken that second quarter absolute dollar sales run rate and used that to project forward a new baseline level of demand for the back half of the year, the key assumption change. We're now focused on using the investments we put into the business to stabilize that sales trend in the back half of the year so that we can get into a point where we can rebound to growth in the future. So that's just a comment on the exit rate, and I'll turn it back over to JuE.

JUE WONG: Thanks, Eric. And Andrea, to answer your question on the investment in salon, professional, the sampling, we have always stayed true to the course, and this is why you are seeing us going into the field sales team with our own team members where it's not only more cost efficient, but we can also really communicate our message much more directly, and also train our own people in stores.

We are seeing positive impact, that's why we are moving into this direction. But it is still early for us to say where everything is tracking, and we are working towards, as you have heard us say, on the back half towards stabilizing the business so that we can look at continue as we go into the new year with a better foundation and a more resilient Olaplex as we have mentioned.

Both the salon channel, which is the Pro channel and our retail channel, are very supportive of our integrated full funnel approach. So you have seen that in conjunction, when we do all of this out of home activation, there is also people in store that help support traffic that's being driven in there, and there is also visual merchandising that conveys the same message. So that is a 360 approach when the customer see in out of home, in the billboards. Then they go into a store, and they are being intercepted by a sales beauty advisor that knows about the brand, and then seeing the same visual being expressed at our shelf space.

Your other question regarding shelf space, we obviously cannot speak on behalf of the retailers, but I can tell you we have top to top meetings where we continue to be able to show them the equities of Olaplex. We are still per numerator the brand that drives the most new customers into the category. We are in the top five ranking in terms of haircare prestige brand in all the channels that we are in. And we continue to score high on all the equities that is a brand that consumers trust that we are-- addresses damage and repair hair, that we are also a brand that is represented by science and technology.

When you have all that equities and when you have meetings top to top, these are considerations that they take. And my point about driving new customers into the space, into the category, that's a powerful kind of driver for both the retailers and our professionals because awareness is primarily what they need from a brand so that traffic into doors will materialize into conversion.

ANDREA TEIXEIRA: Thank you. I'll pass it on.

MODERATOR: Our next question is from Bill Chappell with Truist Securities. Please proceed.

BILL CHAPELL: Thanks. Good morning. One question on gross margin. Just trying to understand, I think, some of the pressures that you talked about are near term or short term as you work out inventory and obsolescence. Do you have a pretty good visibility-- I mean, when they will pop back? Because as we look to first quarter of 2024, should some of these things go away based on your sales forecast to feel some of the noncash or short term type stuff should go away pretty quickly. So any color there?

ERIC TIZIANI: Yeah. Hi, Bill. I'll take that one. We continue to believe that we can return to a normalized adjusted gross margin in the range of the mid 70%. And as you point out, some of the challenges we're facing in our gross margin in 2023 are near-term and we believe more temporary issues. Depressed in 2023 due to deleverage from lower sales on some of our fixed costs like warehousing, as well as what we cited as impacts from working down higher inventory levels. That includes the impacts of providing for inventory obsolescence risk as we have in the first half of the year.

So when you normalize-- when we get through stabilization in the second half of the year and a return to growth, we see those tailwinds returning, and are confident in an adjusted gross margin range in that mid 70s, which, of course, then gives us the ability to continue investing back into the business.

BILL CHAPELL: Got it. Just to clarify, so margins-- gross margins will I guess trough next quarter, and then maybe improve sequentially as you move to the fourth quarter?

ERIC TIZIANI: So as we mentioned in our guidance color, we now expect adjusted gross margin for the full year to be that minus 500 to 600 basis points versus last year. So it's a similar trend in the second half of the year that we've seen in the first half of the year. And as sales normalize and as we get through 2023, we believe we'll have less of these temporary headwinds and return into that adjusted gross margin level of the mid 70s, yes.

BILL CHAPELL: And then just a follow up the question we're getting, as you can imagine, is, what gives you confidence that this is a good number in terms of sales for this year? And trying to understand on consumer takeaway, where that fell this past quarter versus your expectations. We all knew it was going to decline. There was a lot of noise out there, but just trying to understand how much worse. And what you saw quarter and even as we went into July that gives you confidence in the updated guidance.

ERIC TIZIANI: Yeah, Bill, I'll take that one. We thought it was important to share quite specifically the changes in our key assumptions from our prior guidance to this guidance, which, as we mentioned, we're number one, the change in the assumption on baseline level of demand and this new approach to forecasting the back half based on just the run rate we've seen in absolute sales in the second quarter.

The second one was a more prudent view around, the fact that it's going to take time for our marketing investments, particularly those upper funnel investments, to show a lift. We believe it's going to help us stabilize the trend in the back half of the year, and we're very confident that it continues to be the right thing to do for the long term trajectory of the business.

And then the third change in the assumptions that we cited were around the impacts of our new innovation and new distribution in 2023, which we continue to be very proud of and believe are going to be drivers of growth into the future. It's really a call down that is more related to the overall headwinds that the brand is facing.

So we believe taking this run rate from the second quarter into the second half of the year, assuming stabilization with the green shoots that JuE mentioned on the call about where we see our investments working, particularly Dexcom, which is where we're driving a lot of traffic from our marketing investments, we believe could be a leading indicator for that inflection point for the business.

BILL CHAPELL: And just to clarify how July was shaping up or any improvement there?

ERIC TIZIANI: We're not commenting, Bill, on any inetrquarter trading. We'll just say that all the trends we've seen to date have been reflected in the outlook that we've provided.

BILL CHAPELL: OK, great. Thank you.

MODERATOR: Our next question is from Dana Telsey with Telsey Advisory Group. Please proceed.

DANA TELSEY: Hi, good morning, everyone. As you think about the hair care category, any updates on the performance of the hair care category and how it's done, how it's performed relative to your own performance? And with the updated guidance, are there any adjustments that are being made in terms of new product introductions or expectations on performance? Thank you.

JUE WONG: Thanks, Dana. This is JuE, and I will take that question. In terms of the hair care category, through Circana that really looks at the distribution that we participate in, it has shown that the category is up 14%. And obviously, you have seen that we are reporting in Q2 that is that-- our Q2 is down from the last quarter. But what is encouraging to see is that 14% is not an increase based on one or two brands but a collection of brands. Because as we have mentioned, we have seen a lot more competition coming into the space.

And then what happens is because Olaplex is the driver of new people coming into the category, you have a lot of people who were not familiar with the prestige hair category that is exploring and treasure hunting. And this is where we believe through our increased investment. I mean, I emphasize again, it is a category that we created in such a way that we know that the new normal here for us is to really focus on the communication, the investment, and the support of the Pro community.

And we have been doing that and we are double clicking on it. And we believe that as this category grows, we are leading it and we can participate in it, despite the current headwinds that we are seeing from the increased competition from the promotionally in the business, as well as some of the misinformation that is circulating in the market space.

The other question that you have regarding new product innovation, we are very intentional in terms of how we innovate and support our R&D launches. And that is because anytime we launch something, it has to meet two high bars. One, it is definitely going to add to our technology in such a way that it depends on the technology that we have to really drive performance. The second is that we participate in segments that are large, but yet not cannibalizing the products that we have.

So a good example is when we launch a clarifying shampoo or a purple shampoo, it does not cannibalize our existing shampoo and conditioner. So those are the very intentional strategy that we put behind our launches, and so innovation will continue to be a part of our growth. But again, we emphasize, it's not about just hyping in innovation for revenue, but piping in innovation that truly speaks to our technology and speaks to the segment we participate and lead in.

DANA TELSEY: Thank you. And just one follow up on inventory levels. How are you thinking about inventory planning through the balance of the year given the levels of demand for Q3 and Q4? Thank you.

ERIC TIZIANI: Hi, Dana. I'll take that one. So in terms of our own inventory levels, we continue to make sequential progress quarter to quarter in terms of bringing those inventory levels down to where we want them to be. We're not there yet, but it's very much a high priority and key focus for the team. So we're managing our production schedules, we're managing our inventory purchases very closely with our strategic suppliers, and we expect to continue making progress on bringing those inventory levels down through the year matched with our current forecast and an ongoing outlook for demand. So job's not done, but we're making good progress every quarter.

DANA TELSEY: Thank you.

MODERATOR: Our next question is from Rob Ottenstein with Evercore ISI. Please proceed.

ROBERT OTTENSTEIN: Great. Robert Ottenstein from Evercore. Thank you. A couple of follow up questions. Number one, the DTC business, I think you mentioned in the prepared remarks that that benefited from some shipments to a large customer if I recall right. Can you confirm that? And then maybe if you could back out those extraordinary shipments with the DTC business would have done.

ERIC TIZIANI: Hey, Rob. I'll take that one. So yes, we did mention that the direct to consumer channel was benefiting in the second quarter from two primary things. One, strength in our telecom business I'll come back to that, and the second was shipments related to a key e-commerce customer related to a key promotion that was running in July. So that was normal course in terms of phasing of those shipments.

I'd say pass that on an underlying basis, the direct to consumer channel is the one that performed actually better than our expectations in both sell in as well as sell out. So that's a channel where we've seen stronger trends, and it's a channel where we've actually been directing quite a lot of our investments both in lower funnel activities. And we're seeing very good ROAS in those activities, as well as our upper funnel activities driving to olaplex.com as an example.

ROBERT OTTENSTEIN: OK. And then did-- so it was down 6. If it wasn't for the shipments, would it have been down 15, down 20? Just trying to get an order of magnitude.

ERIC TIZIANI: So we're not supplying specific numbers on that, but you're directionally in the right place, I would say. And I'll just reiterate there that the sell out, the consumption levels at direct to consumer, were strong and this is not a channel where we've been dealing with any material customer inventory rightsizing. So what you see in selling is-- aside from this one impact from this shipments related to this promotion is very representative of the sell out as well.

ROBERT OTTENSTEIN: So the sell out would have been minus 6 roughly?

ERIC TIZIANI: Again, sell in, sell out, and direct to consumer are staying very close to each other. So we're not giving a number, but directionally, that's correct.

ROBERT OTTENSTEIN: OK. So that is-- it sounds to me like the strongest confirmation of the health of the brand and the business. That's fair?

ERIC TIZIANI: I think that's fair. And if JuE, I don't know want to add to that, but this is why we, especially called out olaplex.com as a leading indicator in a green shoot that we're continuing to support and invest behind.

JUE WONG: Absolutely. Nothing more to add than the fact that, well, it is gratifying to see that because they are the closest to the end consumer at olaplex.com, that content, that messaging, all that creative is definitely resonating.

ROBERT OTTENSTEIN: Terrific Thank you very much

JUE WONG: Thank you.

MODERATOR: Our next question is from Joanna Kim with TD Cowen. Please proceed.

JOANNA KIM: Thanks for taking my question. I just wanted to get a little bit more color on the professional channel. I know you talked about it, but do you think it's more of a function of stylists being more frugal or competition, just what you're seeing in that channel? And just another point. You talked about it a little bit, but how does the muted demand change or not change your new product launches for the year? Thank you.

JUE WONG: Thanks, Joanna. I'll take that question on the Pro and the demand piece of it. Yes, in our prepared remarks, we did mention that our loyal customers in the Pro channel continues to be highly engaged with us. They are the ones who continue to really support us, talk to their clients about US, and other stylists about us. But we also believe, as we mentioned, that the continuation of some of those negative factors have impacted them, and especially to some stylists that are in the mix where they are hearing some of those misinformation.

So what we have done as you have seen is that we believe that in order for us to continue to be successful in this area, we need to continue to invest in an integrated full-funnel marketing. And as we have said, before for the professionals, the number one thing they want is for brand to grow and build an awareness so that it can drive clients to their studios.

Some of them are single-- many of them rather are single payroll entity. So that really helps them to look at New clients acquisition on their part and their own clients who see the brand and basically say, look, I want to continue-- can you please continue having that Olaplex treatment in my services with you? So with the Pro, we are double downing on that.

We are also making sure education, helping them address any kind of product knowledge. How to use the product better? How to really allow their clients to not use a product because they feel like they need to cut some of the time and/or they need more time rather to use our product? We have been able to secure information for them and how to use for them that you can still benefit from our products with a shorter time.

And then just very quickly, in terms on the demand, we are believing that the Pro channel, while they will have the so the challenge of having solved their customers coming in between services leading it a lot longer, but the over-the-counter sales on retail is an area where they can really improve on, and we are spending efforts in terms of education training to help them look at retail as part of their revenue generating stream.

MODERATOR: We have reached the end of our question and answer session. I would like to turn the conference back to JuE Wong for closing comments.

JUE WONG: Well, thank you everyone for your time. We look forward to speaking with you at our next earnings call. Thank you.

MODERATOR: Thank you. This will conclude today's conference. You may disconnect your lines at this time, and thank you, again, for your participation.