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PRESENTATION

Operator

Good morning, ladies and gentlemen, and welcome to the Sally Beauty Holdings conference call to discuss the company's fiscal 2022 second quarter results. (Operator Instructions)

Now I would like to turn the call over to Jeff Harkins, Vice President of Investor Relations and Treasurer for Sally Beauty Holdings.

Jeff Harkins - *Sally Beauty Holdings, Inc. - VP of IR & Strategic Planning*

Thank you. Good morning, everyone, and thank you for joining us. With me on the call today are Denise Paulonis, President and Chief Executive Officer; and Marlo Cormier, Chief Financial Officer. Before we begin, I want to remind everyone that we have made a presentation available for today's call that can be viewed from the link provided on our investor site at sallybeautyholdings.com.

I'd also like to remind you that management's remarks on this call may contain forward-looking statements within the meaning of the Private Litigation Reform Act of 1995. Actual results may differ materially from those indicated by these forward-looking statements as a result of various important factors, including those discussed in the Risk Factors section of our most recent annual report on Form 10-K and other filings with the SEC.

Any forward-looking statements made on this call represent our views only as of today and we undertake no obligations to update them. The company has provided a detailed explanation and reconciliations of its adjusting items and non-GAAP financial measures in its earnings press release and on its website.

Now I'd like to turn the call over to Denise to begin the formal remarks.

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

Thank you, Jeff, and good morning, everyone. I'm pleased to be here today to share our quarterly results and how we are managing through some interesting and challenging macro dynamics. As we anticipated, disruption from the Omicron surge began to recede in early February. In subsequent weeks, global inflationary pressures and supply chain challenges intensified. These factors, in addition to the lapping of stimulus benefits in January and March of 2021 muted our sales performance.

That said, we see these as point-in-time challenges and remain confident that our strong competitive positioning, loyal customer base and strategic growth initiatives position us well to drive profitable growth over the longer term.

For the full quarter, we posted slightly positive comparable sales and a net sales decline of 1.6% as we operated 142 fewer stores than last year. Despite industry-wide increases in distribution and freight costs, we maintained our strong gross margin profit profile, with adjusted gross margins coming in above 51%.

Let me share a bit more detail on the sales performance of our 2 largest businesses, Sally U.S. and Canada and BSG. In our Sally business, both inflation and supply chain challenges impacted purchasing behavior among our core Sally customers. First, inflation. Both our internal and third-party data indicate that discretionary spending is under pressure due to elevated fuel and grocery prices and higher inflation generally. We know this creates tough decision-making for our lower income Sally customer, and we saw her reduce trips as she stretched her time between coloring her hair.

While her basket was up sequentially in Q2 from Q1, it was down on a year-over-year basis as she shifted her basket mix to lower-priced to core categories, including color and care, and away from higher-priced categories, such as styling tools that performed well during last year's stimulus period. This category mix shift was further reinforced by softness in stock levels in styling tools due to supply chain challenges.

It's important to note that we expect in-stocks in secondary categories, such as appliances and tools, to begin to improve later this fiscal year.

In our BSG segment, demand was strong, and we were chasing it all quarter as supply chain disruptions resulted in a shortage of raw materials for some of our vendors, negatively impacting stock levels of some of our top-performing SKUs. At this point in time, we expect this pressure to begin to alleviate in our fiscal fourth quarter, with a more pronounced improvement in our stock levels in fiscal 2023.

As I mentioned a moment ago, our loyal customer base is stronger than ever. When we look at key factors such as Sally U.S. and Canada's Net Promoter Score of 83, and 17 million loyalty members comprising 76% of sales in Q2, we know our core customer is highly engaged. In our BSG segment, our stylists are engaged, demand is strong and we are confident in the underlying health of the business. We have data on 100% of our BSG customers, and we are continuing to gain traction on our rewards credit card that was launched just 18 months ago, with 9% of our BSG sales coming from the cards in the first half of this year.

We believe our ability to leverage our loyal customer base through personalization, education, and highly targeted marketing initiatives at both Sally and BSG will be instrumental to helping us navigate the challenging environment in the second half of 2022 and beyond. More on this shortly.

As we look to the second half of the year, we're evaluating macro forces and making adjustments as needed. Our revised full year outlook for fiscal 2022 assumes that current macro issues, including inflation and supply chain disruptions, will persist to varying degrees for the foreseeable future. During this time, our teams are remaining nimble and continue to be laser-focused on delighting and engaging the customer through our 4 strategic growth pillars. These include: leveraging our digital platform; driving loyalty and personalization; delivering product innovation; and advancing our supply chain. I'll briefly provide an update on each one.

First, from a digital perspective, we're continuing to focus on leveraging the robust omnichannel platform we built over the last 4 years. E-commerce sales penetration continues to increase, reaching 8.9% of sales in Q2 of this year, driven by BSG's e-commerce sales growth of 37%. During the quarter, our Sally U.S. and Canada stores fulfilled 37% of e-commerce sales as BOPIS comprised 16%, rapid 2-hour delivery represented 14% and ship from store accounted for 7%. We're seeing greater adoption of 2-hour delivery, including lower cancel rates driven by improved supply chain efficiency as well as increases in average ticket and conversion.

Additionally, we're expanding our partnership with DoorDash for both Sally and BSG, and recently added 2-hour delivery to the Sally mobile app, which provides another convenience to our Sally customer, 80% of whom engage with us using a mobile device. Response to our new virtual color experts at Sally has been strong with the store pilot program currently at 35 stores in the Dallas-Fort Worth and Northeast markets. We're planning on expanding our pilot program to another 20 stores in the second half of this year, and we'll evaluate further as we look to scale in fiscal year 2023.

At BSG, we're expanding our distribution partnership with Regis by taking over servicing of the remaining 2,500 salon accounts from a competitor beginning in the fourth quarter. To that end, we're implementing a new Regis portal to streamline the ordering process for those salons, which also gives us a great ecosystem for the future growth of our large chain accounts.

Moving on to our second growth pillar, loyalty and personalization. As I mentioned earlier, in the second quarter, approximately 76% of sales at Sally U.S. and Canada came from our loyalty program. Active member count continues to climb and stood at an all-time high at quarter end. In fact, we're particularly proud to note that Newsweek recently reported that Sally's loyalty program ranked in the top 10 out of 238 programs overall, and ranked #2 in the food, health and beauty category.

We have a number of initiatives underway in personalization, encompassing product suggestions, imagery and educational content. We recently rolled out individualized journeys and personalized website views based on historical search and purchasing behavior. The majority of our Sally customers, the view on our site will be unique to her when she logs in via her browser or from mobile device. Next up, we'll be expanding our customized communication to SMS, social media and direct mail. This will be rolling out during the second half of this year, with full implementation in fiscal 2023.

Additionally, in the second quarter, we implemented marketing mix modeling, a new data science tool that enables us to measure ROI on our marketing investments. In recent years, we brought in new marketing leadership and built a robust team, now layering on an important finance tool that will allow us to more effectively balance and optimize spend going forward.

Turning now to our third pillar, product innovation. We are continuing to deliver a rich pipeline of innovation that is expected to fuel long-term growth. At Sally, we saw positive response to our launches in color, care, tools and extension. Supporting the personalization trend, we recently launched, Urban Alchemy's new customizable hair care line at Sally. And in Q3, we have more exciting hair care [roll up] planned from brands like Wella and our own Strawberry Leopard.

The innovation pipeline is equally robust at BSG. We saw positive response to our Q2 launches across color, care and nails, including Wella's new Shinefinity line, our most significant BSG launch of fiscal 2022. On deck for Q3, we have exciting innovation coming in color, care and tools, including Olaplex No. 9, Goldwells [Weslaco] and the new Urban Alchemy line.

In the nail category, we're rolling out a reset of this category in both Sally and BSG during the second half, bringing in new fixturing with more visible in-store placement. This will be complemented by the recent launch of Kiara Sky nails at BSG and forthcoming innovation at Sally in our own fiscal Q4.

Moving to our final and fourth pillar, supply chain. At a high level, we're leveraging the important investments made in our systems, processes and teams over the past several years to build a best-in-class merchandising and supply chain platform for the future. Outside of the macro supply chain issues that are affecting us right now, we continue to make progress in being in stock in color and care every time.

Additionally, our teams are continuing the work of transforming our transportation network to pool distribution, which is expected to increase our speed to market, improve reliability and reduce cost. We're also piloting overnight deliveries in several markets in order to minimize disruptions during operating hours.

Looking ahead, we are leaning into our strong competitive positioning, loyal and growing customer base and trusted vendor partners, and we remain confident in our key growth pillars. We believe these attributes will enable us to drive growth and shareholder value in the coming years. I greatly appreciate the dedication of our team as they keep our customers at the forefront of everything we do and their ongoing commitment to the journey ahead.

With that, I'll turn the call over to Marlo to discuss financials, and then we'll open the call to questions.

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

Thank you, Denise, and good morning, everyone. Second quarter net sales decreased 1.6% to $911 million, and comparable sales were up slightly. As Denise previously mentioned, the net sales decline is primarily attributable to operating 142 fewer stores versus last year and a combination of macro factors at both Sally and BSG. Global e-commerce sales increased 12% to $81 million, representing 8.9% of total net sales. The year-over-year increase reflects our ability to scale our digital capabilities and utilize our new tools and resources to drive customer engagement.

Looking at gross profit. Second quarter adjusted gross margin increased 20 basis points to 51.4%, reflecting strength in both the Sally and BSG segments, which both delivered increases in product margins. These benefits were partially offset by higher distribution and freight costs, and unfavorable sales mix shift between our higher-margin salad U.S. and lower-margin Sally International operations.

Moving to operating expense. Adjusted SG&A totaled $378 million, up 4% versus a year ago. The increase is primarily attributable to higher labor costs and expenses related to reopening international territories that were closed last year, which were partially offset by lower variable and accrued bonus expenses. As a percentage of sales, adjusted SG&A increased by 240 basis points compared to the prior year, driven primarily by the lower sales volume in combination with the incremental expenses.

We continue to expect that our store optimization program will begin serving as an offset to wage inflation beginning in the latter part of 2022 and into fiscal 2023.

Turning now to earnings. While we experienced top line pressure, our ability to maintain our strong gross margin profile, enabled us to minimize some of the bottom line impact. Second quarter adjusted operating income totaled $90 million, adjusted EBITDA came in at $116 million and adjusted diluted earnings per share was $0.47.

Looking at segment results. Sally Beauty's net sales declined 3.1% with comparable sales down 0.5%, while operating 126 fewer stores versus a year ago. The sales decline was highly concentrated in the U.S. and Canada, which had a decline in comparable sales of 9% and accounted for 79% of our segment net sales in Q2. Sales from our operations in Europe and Latin America were very strong, with comparable sales growth of over 50% as they lap significant COVID disruption from the prior year.

For the Global Sally segment, the color category increased 3% and hair care was up 7% compared to the prior year. For Sally U.S. and Canada, vivid colors continued to outperform the overall color category and represented 27% of color sales. Additionally, as we stated previously, some of our secondary categories, like styling tools and appliances that support the customers' basket adds, were down in the U.S. and Canada due to supply chain challenges.

Gross margin at Sally expanded 40 basis points to 58.8% compared to the prior year as we continue to generate solid product margins, driven primarily by pricing leverage, in addition to a smaller write-down of COVID-related personal protective equipment inventory compared to our second quarter last year. These benefits were partially offset by higher distribution and freight costs and an unfavorable sales mix shift between the higher margin Sally U.S. and lower-margin Sally International operations. Segment operating margin came in at 15.4%.

In the BSG segment, net sales increased 0.5%, with comparable sales growth of 1.3% despite the impact of Omicron in January and lower-than-expected stock levels of our top-performing SKUs. We estimate that the sales loss from raw material shortages was approximately $10 million or just over 250 basis points of impact on net sales growth. The color category was essentially flat, while hair care increased 3% compared to the prior year. Gross margin at BSG strengthened by 140 basis points, driven by improved product margins as a result of pricing leverage in combination with a smaller write-down of COVID-related personal protective equipment inventory compared to the prior year. These benefits were partially offset by higher distribution and freight costs. Segment operating margin came in at 11.9%.

Moving to the balance sheet and cash flow. We ended the second quarter in strong financial condition with $227 million of cash and cash equivalents and a $0 balance outstanding under our asset-based revolving line of credit. At March 31, inventories were approximately flat to last year at $963 million. For the quarter, cash from operations was slightly positive. Capital expenditures in the quarter totaled $18 million. We restarted our share repurchase program in fiscal 2022, repurchasing approximately $75 million in the first quarter and $55 million in the second quarter. This leaves approximately $600 million remaining under our current authorization.

At the end of the second quarter, our net debt leverage ratio was 2.07x. We expect operating cash flow to strengthen in the second half of fiscal 2022 and remain committed to prudently investing for growth while creating long-term value for shareholders.

Subsequent to the end of our second quarter, we filed a redemption notice on April 29, announcing our intention to retire our $300 million 8.25% senior secured notes. The repayment date is scheduled for May 31, and the payment will be funded by both excess cash and our ABL facility.

After seeing the macro environment intensify in Q2 and given the level of external pressures, including escalating inflation, supply chain disruptions and geopolitical unrest, we are managing the business to a more conservative outlook and have revised our full year 2022 guidance accordingly.

For the full year, we now expect the following: net sales approximately flat to down 2%, net store count to decrease by approximately 1% to 2%, driven primarily by Sally U.S. stores as we continue to optimize our portfolio; gross margin expansion of 40 to 60 basis points; and GAAP operating margins and adjusted operating margins to be approximately 11%.

Regarding the pacing of sales for the remainder of the fiscal year, we expect Q4 to be stronger than Q3 in both total sales volumes and year-over-year growth. We expect the supply chain issues to start improving in Q4, and we will be further along into expanding our distribution partnership with Regis as well as the personalization and marketing initiatives at Sally, as we previously mentioned. Also keep in mind that last year's Q3 was a record quarter with sales well over $1 billion as we had reopening momentum from markets that were previously restricted earlier in the year.

We appreciate your time this morning. Now I'll ask the operator to open the call for Q&A.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And our first question will come from the line of Rupesh Parikh with Oppenheimer.

Rupesh Dhinoj Parikh - *Oppenheimer & Co. Inc., Research Division - MD & Senior Analyst*

So I guess I just want to start with, first, the top line guidance. Is there any way to frame the reduction that you guys took between the supply chain headwinds and maybe the inflation and weaker consumer dynamics that you're discussing?

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

Sure, Rupesh. This is Denise. I'll start and Marlo can join in here. I think Q2 is a good example that we'll just walk through a bit of what the change in behavior was on the Sally side and then Marlo can pick up a bit on how we're pushing that through to the balance of the year.

Fundamentally, we're really pleased with our Sally customer base. We've got strong customer loyalty. We did not see customers decline in the quarter where we did see them impact a bit with their frequency of their trips and then the degree of expense in their basket adds that they put into the basket. And when we really looked back and contrasted how we came out of Q1 and how we moved into our fiscal Q2, you think about it mean the business ran at 2 comps in Q1 and ran a minus 9% in Q2 in the Sally U.S. and Canada side of the business.

When we spoke to all of you guys in February, we really have a line of sight to about half of that gap. We knew that there was a big change in the impact from stimulus last year that had always been built into our plans for the year and then we knew what Omicron was doing in January. And

I'll actually say Omicron, in terms of the downside, played out about the way that we expected it to play out. And as you'll remember, most of that was driven by availability of keeping stores open because of store associates, less so maybe the home bring down of the customer base.

The rest of the change really came from both supply chain challenges in the secondary categories and the inflation impact for our customers. And that inflation piece is really the piece that we think we spend a lot of time digging into, right? So we looked at how our customer trends that we're changing in addition to our transaction and basket trends, and what the data really showed us is we were losing frequency not customers. Let us to do some more digging, do some more direct customer market research, and what subset of our customers told us was that they were really feeling some cost pressures and where they could, they were just taking a little bit more frugal approach to spending. So lengthening a little bit of time between color and maybe not leaning into those larger ticket items that last year they really -- they felt flush to go buy like styling tools when they had a stimulus check in their pockets.

But with that, the things we're really focused on are the things in our control. So leveraging our strategic initiatives with personalization, the nail reset that we're very excited about, strengthen our own brands and fundamentally getting some products back in stock as we know it will take a little bit of time, but really working that forward.

In general, we've taken a pretty conservative approach to how we've looked at the second half and what will be happening with that Sally customer. I think we talked about it as saying, we believe inflationary pressures will remain the same, not better, not worse, but we see that living out. We do see supply chain products availability getting a little better, particularly towards the end of the year, less so maybe as we're right now in this portion of Q3.

And then as I mentioned, the strategic pillars. There are some great things going on there with the nail business, with marketing personalization efforts that we think will help bend the trend just a bit. So that was the Sally side of the business. And I think that I would just close and being complete in the thinking for the balance of the year. We think the BSG business is very healthy. Stylist demand remains strong.

What we're really focused on and working with our vendors, and they've been great partners is managing through some of the supply chain challenges they've had with raw materials and ingredients coming in. And we really see line of sight to that starting to improve in the fourth quarter, and we're excited about that.

We're also really pleased with the opportunity to expand the Regis business even further, adding another 2,500 storefronts, and that being a win versus our largest competitor in the distribution space. So hopefully, that's a fair amount of color to help you understand how we're thinking about both Q2 as well as looking forward.

Rupesh Dhinoj Parikh - *Oppenheimer & Co. Inc., Research Division - MD & Senior Analyst*

Okay. Great. And just related to -- and I know you may not comment on this, but just quarter-to-date in April, are trends stable in terms of what you saw in March? Or I don't know if there's any color you can provide in terms of the consumer pressures you're seeing in April.

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

Yes. I would tell you what we are stable to is the forecast that we see going forward. We think here April pretty much spot on, on top of what we expected to see, which is what is giving us a lot of reassurance that we really do understand the drivers as they exist today and are managing those the best we can.

Operator

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

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

I wanted to talk about the greater impact of higher gas prices on your core customer. Because if I remember correctly, last quarter, you talked about how you put in pricing and that generate better gross margin. So it seems like a pretty big contract. And realizing, of course, how much gas prices have come up and the more value to -- of your consumer, can you just talk a little bit about your view on pricing going forward? Is there -- does there continue to be opportunity or other ways that you are planning to improve the momentum on sales despite lower frequency of trips by your consumer?

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

Yes. Let me start with the pricing concept and then we can work in some of the other kind of customer behaviors that we're seeing. But in terms of pricing itself, we're consistently looking at price. Not only where we can take it, but also just the competitive actions that are inside the market. We constantly have test end market to understand how the customer will react and is reacting. Price increases so far have been used to cover costs from suppliers, but we have also been able to drive some increases in margin rate, mostly in our core categories, the color and care.

We do believe there is still some more pricing leverage in color and care. We have been building out our strategic pricing and promotion capabilities and tools for some time now. Our ability to leverage those new capabilities with expanding data sets and insights is more robust than really it's ever been before. So we're constantly evaluating pricing opportunities. We're closely monitoring the impact on consumer behavior. So far, we haven't seen that that's what's driving the change in behavior. We are seeing some on the Sally side, the frequency change, but we haven't seen that they are going away from the product due to pricing.

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

And I think the one thing I'd add to the second part of your question, which is what else do we have to think about if the consumer is feeling pressure from gas pressures -- from gas prices, what else can we do? It's something that we've spent quite a bit of time. And we've been testing some different items and seeing some good success that you'll see us continue as we go through the balance of the year. And what that really is, is offering some promotional activity that really lets the customer see value in the core categories that they're in and hopefully build their basket a little bit more.

I'll note, these are not margin declining promo activities. These are pretty smart plans from those that are out there, but are things that really resonate with the customer. Two really good examples on the Sally side would be we'll create bundles for her color purchase. So a tube of color, a bowl, a brush, put those together in a bit of a value equation. But we tie it to our own brands business, where the margin is a really robust profile, but gives her extra value when she shows up in the store and she's really come to appreciate that.

And we're also leaning into having full-fledged supply in stocks when we run -- one of our key regular sales is a hair care line where we offer 4 items for $20. Where we really have opportunity is to continue to do that as we've always done, but ensure that we're in stock for that promotion for the entire month and capture the full value of that.

So those are the places where we're just wanting to get a little bit sharper to be sure that she understands that, that extra basket add doesn't add that much to her overall spend that she has with us. So very conscious of how she might be feeling and really trying to nibble around the edges with some constructive offers for her that still fit within the margin profile we're working to deliver.

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

Got it. And then just following up on gross margin. Can you just talk about the puts and takes that are embedded in your expectation for second half to drive continued gross margin expansion? Because what we've seen across many companies is, quite frankly, lower gross margin expectations while you're maintaining it.

So last quarter, you had said more equitable for the remainder of the year. Obviously, decelerated quite a bit in Q2. So can you talk about some of the offsetting moves to drive the expansion in the second half?

You just talked about promo having a net flattish impact on your targets. So did you make any other modifications to how you're thinking about investments given your view on consumer spending? Anything else that creates an offsetting impact despite the incremental cost pressures appreciated appreciate it.

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

Yes -- no, we've been very pleased with our margin profile. Strong margins over 51%. And we see that holding. We continue to believe our gross margins on a full year basis will be 40 to 60 basis points higher than last year and certainly to be able to hold that in the back half. Again, our pricing actions have resonated. We, like we said, are getting good results out of that. We've been able to offset the increases that we've seen through the supply chain as well as the increases in freight. And so -- and then we've also contemplated the mix shift that's happening with Sally and the international markets coming back from their reopenings versus where they were last year. So I feel pretty good about that margin profile and the ability to be able to hold that in the back half .

Operator

Next, we go to the line of Oliver Chen with Cowen.

Oliver Chen - *Cowen and Company, LLC, Research Division - MD & Senior Equity Research Analyst*

On the topic of inflation and your details on frequency, what do you see ahead in terms of that being stable and/or why, and how might that really relate to the marketing mix and the marketing engine? As we look back many years, the approach to marketing has been an opportunity, and clearly now in a digital world, there's opportunities to think about, performance marketing and return on that spend and algorithms.

And then related to inflation, just what's happening with your own average unit retails and your view there as you have that fewer, deeper, more simple strategy in place previously.

Lastly, just on the in-stock topic, you gave a lot of great detail. What's -- which parts of the portfolio are you most concerned about? I feel like supply chain is an ongoing topic where there's still a high degree of uncertainty within the nature of many aspects of the supply chain.

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

Okay. Oliver, you certainly packed a lot into that one-line question. Let me piece it a part, and if we don't hit all the points, please let us know that there's something that we missed.

I think the first part of your question was really around the nature of what are we seeing with inflation and has it stabilized in terms of how we believe it's impacting frequency, and then what marketing things might be in play that could help move that around. Very simply, I think we have seen it stabilize. We can't predict to the future and what else might happen as we all watch macro events, economic activity, et cetera. But I think as I mentioned earlier, April is performing as we anticipated it performing. And that customer seems to be pretty consistent in her behaviors now that they had made the shift, give or take, 6 weeks ago or 6 weeks at the end of second quarter.

In terms of marketing, you're spot on. And we talked a little bit in the script about marketing mix modeling, we're doing a lot more in getting smarter about how we're leveraging our performance marketing dollars be reaching the right customer in the right way and combining that with personalization, and to really work to get the relevant references for add-on products, reengaging her when the care options that go along with her color treatment she might have just done. And we are, as I've said before, at the relatively early stages on the personalization front. You will finish this year really the first wave of personalization and the foundational tools to be able to take us further next year and be able to move faster. That's part of what we're standing up now.

And the performance marketing has been a really exciting thing to evaluate with the marketing mix model. We've gotten notably smarter about where to lean in a little more and out a little less. And that's what we're really going to be leveraging as we go through the second half. And it's a bit of what we've included some benefit of in the way we think about our second half performance.

And overall, from AUR perspective, I think was the second part of your question. AURs, as you would expect, are up modestly. There is inflation coming through. It is dependent upon the specific category. So there's no one generic answer as to how much that is moving or not. But in general, AURs are heading up. As I mentioned and how that's impacting a customer's basket, basket was actually up from Q1 to Q2 on the Sally side of the business and -- but it was down versus last year, where last year had the stimulus effect that really did have people spending in those higher cost categories.

And then in terms of the portfolio, overall, across both businesses, I think we feel great about hair color and hair care. On the BSG side, our biggest opportunity is with some of our core vendors and really partnering with to help them on their journey to get back fully in stock. There's just some great brands that, in particular in color, our customers rely on quite a bit on the professional side that have just been a bit in short supply.

The categories, I think, that we're all working on a little bit more, and I think more so on the Sally side or some of the secondary categories where just getting those things fully back in stock the way we would like to see them, whether that's styling tools and some of the cosmetics businesses or skin care businesses, we see that opportunity being part of the second half of the year.

I think a real point of strength is that we're going to with our nail category reset in both BSG and Sally as we progress out of Q3 and into Q4. So much sharper presentation for the customer, much easier to shop. And importantly, it's going to bring new brands at good price points into both businesses in addition to capitalizing on gels and dips more so than few lacquers. So a reinvention for there -- for us that we're also very excited about as part of the overall portfolio.

Operator

Next, we go to the line of Steph Wissink with Jefferies.

Stephanie Marie Schiller Wissink - *Jefferies LLC, Research Division - Equity Analyst and MD*

I wanted to just ask another question on your feedback that you're getting from your customer, but maybe talk more about the stylist community versus the individual customer. Any sense of how that community is feeling about their book of business, their bookings trends? Any change in consumer attitude around or approach around booking frequency?

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

Yes. Happy to answer that. Overall, our solids are feeling reasonably confident they're seeing a good book of business come through, and I think that they believe that, that's going to persist. The change from Q1 into Q2, I think in Q1, they were very worried about product availability as we were still all rebounding from COVID last year, and they likely stocked up in some of their shops a bit. What we're hearing from them now is they're back to buying a bit more just in time for what they think they need. Now that falls a little short when occasionally we might be short of product, we fully acknowledge that. But they are using that as a way to manage their own cash flow as they have their own impacts of inflation hitting them personally and things like that.

And for the most part, we're seeing our stylists take price increases along with price increases that are being passed along to them. It's a little harder choice for them, they do feel a nervousness and asking their customers to pay more. But in the grand scheme of the nature of a price increase they're taking versus the price of an overall service, which is hair color service could run close to $200. And they are making a few of those shifts as well. So overall, stylists are feeling pretty good. I think they're appropriately cautious as they're watching things around them as well. But they have not seen their book of business decline.

Stephanie Marie Schiller Wissink - *Jefferies LLC, Research Division - Equity Analyst and MD*

Okay. That's helpful. And my follow-up question is just on the competitive environment. Have there been any changes either from your direct competitors that maybe look like you in style? Or are there competitive threats from some of your brands going direct to the stylist community or to the consumer? Is that changing the competitive dynamic?

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

Sure. We haven't seen anything material in way of movement that we would talk about. I think the one that we would say on our side that we've really had a win on is really celebrating the success of another 2,500 Regis storefronts converting over to being serviced by our BSG division, which is clearly a win for us versus competitors and bringing that business in-house. And we certainly continue to see that there are some brands who go direct to stylists, but we haven't seen that increase.

And in particular, what we generally see is when brands are tied with both color and care, that continues to be very much of a distributor CosmoProf type shop because they really are focused on their color and the care after that for the stylist community. So on the professional side, we haven't seen any increased movement or change in behavior from that dynamic. And I don't think -- I think we'd say on the retail side, no material shift.

Operator

Next, we go to the line of William Reuter with Bank of America.

William Michael Reuter - *BofA Securities, Research Division - MD & Research Analyst*

When you were discussing a little bit of the weakness in higher ticket items, do you think that this was just that there were a lot of these appliances that were sold during the pandemic and now they don't need another one of these? Or do you think it's more trading down within categories to lower-priced items generally?

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

I think the second -- the simple answer to that question is likely a number of factors are driving it. We clearly do know that last year in the second quarter and into the third quarter, those higher ticket items through COVID, where people were a little flush with extra cash with the stimulus, as well as we're spending a little bit more time at home, doing different things like that, those tools really were bought in a little higher rate than we would have seen even in prior years. So last year was a big year to lap.

You could also say that even for folks shopping now, if your blow dryer works, right, you're probably not as focused on looking for the new blow dryer. If you fit into a category where folks might be feeling more frugal. And so we think that is more of a sense that people are looking for if they need it, they're going to come buy it. But they're unlikely to be more spontaneously deciding to buy a new styling tool or that type of thing.

Now the category is healthy overall. The piece that we can't say of how healthy it really is, is that we knew we had some of our own supply chain issues that likely dampened that demand a little more than we would have liked to see as components for some of those pieces of equipment were harder to get and so our manufacturing was really backed up to be able to supply us there. So I think we see the trend shift. We, at this point, believe it has more -- a little bit more to do with last year than this year, but certainly still believe that frugality is a real trend.

William Michael Reuter - *BofA Securities, Research Division - MD & Research Analyst*

Okay. And then just a quick follow-up. You announced the redemption of your bonds. You don't have a leverage target at this point. Previously, there was going to be a refinancing. Is this a change in strategy where you expect to run the business with less debt in general? Or is this just the market and you will reserve the right to potentially issue debt in the future when credit markets are a little more stable?

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

Yes. I would say it's definitely not a change in the strategy. All along our capital allocation plan has contemplated potential debt pay down. And so I'll just kind of go back to our strategy, we are a very strong cash flow model. We've made a ton of progress on our balance sheet over the last couple of years. And we're just in a great position to be able to deploy cash. We ended Q2 with $227 million of cash on the balance sheet. That's more than $150 million more than our historical cash levels that we would typically carry on the balance sheet. So our net debt leverage ratio at near 2 is in a great place as well.

So it gives us the opportunity to continue to prioritize our investments to grow the business. We've restarted our share repurchase program. And now we have the opportunity to pay off some expensive debt that we put on during the outset of COVID. We put that on as an insurance policy at 8.75%, it finally became callable in April. So we are taking that opportunity to remove that debt off the balance sheet. From a leverage ratio point of view, we're basically swapping cash for debt. So we'll stay in that kind of range.

William Michael Reuter - *BofA Securities, Research Division - MD & Research Analyst*

Okay. So it sounds like there shouldn't be additional debt that's issued in-- okay.

Operator

Our next question comes from the line of Carla Casella with JPMorgan.

Carla Casella - *JPMorgan Chase & Co, Research Division - MD & Senior Analyst*

A couple of follow-ups. So on the Regis, can you give us a sense for the magnitude of that, the opportunity there? And will that make Regis your largest kind of partner in that? And is that margin accretive or dilutive for BSG?

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

And so I guess we'll step back and say, we're excited to have gained the Regis business overall. And it's a long list of salons, big component large customer profile. We haven't talked exactly about how much the 2,500 additional stores are going to contribute. I think we'll give you guys that information a little bit as we go into next quarter. But it's a meaningful growth of the business for next year that we're excited about. It will start in Q4 and ramp its way through.

Regis is certainly one of our biggest chain accounts, which has been really nice to see them grow with us and see the benefit that what they understand is how cumbersome the distribution process can be, right, and how hard it is to manage that yourself or to manage it through smaller companies. Our ability to effectively step in and disintermediate that for them to make it a much easier business is something that we should think is a positive trend that these larger salon chains are really looking to take advantage of to take one more complication out of their business.

Carla Casella - *JPMorgan Chase & Co, Research Division - MD & Senior Analyst*

Have you disclosed how much of that BSG is large chain versus the smaller customers at Regis?

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

I don't believe that we have. I don't believe that we have. It's a healthy mix of the business. But if you remember, one of the largest portions of our business, which comes primarily from our stores is the independent stylist in the booth renter, which would still be the more predominant portion of our business.

Carla Casella - *JPMorgan Chase & Co, Research Division - MD & Senior Analyst*

Okay. So -- but are there larger changes that -- is it typically margin dilutive then? Or no because you don't have the store overhead?

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

Yes. There's always going to be slightly margin dilutive. But I think what it adds up for in dollars, it's not a substantial margin impact because as you said, we don't have the overhead that goes servicing those. But it is a distributor -- a little bit different distributor relationship, but the dollars will make up for what would be a small margin impact.

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

Maybe just to follow back on the top line. We talked about the first chunk of Regis business that we received some time ago, and it was about a 1% lift on to the BSG segment. So think about this as taking the remaining part of that distribution will certainly double and slightly more than that as we go forward.

Carla Casella - *JPMorgan Chase & Co, Research Division - MD & Senior Analyst*

Okay. Great. And then I had another follow-up margin question more for the Sally side. It seems like the Sally gross margins, they're running 300 basis points or thereabouts above prepandemic levels. And I'm wondering, is that -- what are the biggest drivers of that? And is it sustainable? Is it the change that you've made in distribution and e-com? Or is some of that inflated due kind of full price selling over the recent past?

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

I would say it's twofold. You kind of got to go back about 1.5 years, probably maybe more than that. As we started into the pandemic, we took a different approach on our promo strategy, that fewer, deeper. And that really is what catapults us over into the solid 50-plus margins.

We've held on to that ever since those promotions and approaching promotions in a different way, you've heard Denise talk about several that we're approaching that we've been using over time and really driving great purchasing behavior and keeping that margin profile strong. On top of that, you have pricing that has been going on over the last several quarters as well. So the combination of those 2 is really what's driving the margin profile for Sally.

Operator

There are no remaining questions in the queue. Please continue.

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

Great. Well, I'd just like to thank everyone for taking the time to join us on the call this morning. And hopefully, it was a good illustration of what we're doing to really move the business forward for the longer term, but while we're working through some shorter-term dynamics. I also want to take a moment to thank all of our team members across the globe. They are what makes it possible for us to serve our customers, and we appreciate what they do every day. So with that, I'll thank you guys for joining, and we'll talk to you soon.

Operator

Ladies and gentlemen, that does conclude our conference for today. We thank you for your participation and for using AT&T conferencing service. You may now disconnect.