REFINITIV STREETEVENTS

EDITED TRANSCRIPT

SBH.N - Q3 2022 Sally Beauty Holdings Inc Earnings Call

EVENT DATE/TIME: AUGUST 04, 2022 / 12:30PM GMT

CORPORATE PARTICIPANTS

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

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

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

CONFERENCE CALL PARTICIPANTS

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

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

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

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

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

PRESENTATION

Operator

Welcome to the Sally Beauty Holdings Conference Call to discuss the company's fiscal 2022 third 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 today. With me on the call 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 would also like to remind you that management's remarks today on this call may contain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Actual results may differ materially from those indicated by these forward-looking statements as a result of various important factors, including those discussed in the Risk Factors section of our most recent annual report on Form 10-K and other filings with the SEC.

Any forward-looking statements made on this call represent our views only as of today, and we undertake no obligation 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. Looking at our fiscal third quarter performance, our teams executed the plan as they remained focused on delighting and engaging our core Sally customers and BSG stylists.

Net sales came in at $961 million, representing a decline of 6% on 149 fewer stores, while comparable sales declined 3.6%. Our top line results reflect the continued impact of a challenging macro environment, most notably, the inflationary pressures and supply chain disruptions we discussed on our Q2 earnings call as well as a difficult comparison to last year, when the easing of COVID restrictions drove a net sales increase of 45%.

Against this backdrop, we maintained healthy gross margins and delivered adjusted operating margin of 10.5%. Importantly, we further strengthened our balance sheet during the quarter with the full repayment of our $300 million senior secured notes. In under 2 years' time, we've paid down approximately $1 billion in debt, leaving the business well-positioned to adjust rest for growth and return value to shareholders in the coming quarters and over the long term. As we navigate current macro complexities, we're leaning into our core strength in color and care and leveraging the operational investments we've been making in recent years.

In the third quarter, trends remained relatively consistent in our 2 largest businesses, Sally U.S. and Canada and BSG. At Sally U.S. and Canada, while transactions were up sequentially versus last quarter, they remained lower than last year as our core customers stretched the time between coloring and focused their purchasing mainly on the core categories of color and care. Basket adds like higher-priced electricals and styling tools remained under pressure, reflecting a combination of cost-conscious behavior and supply chain challenges that continued to impact our in-stock levels. Enhanced lead times are beginning to show improvement in these categories, and we expect further progress in the upcoming quarters on our in-stock.

The bottom line is that our customer does not want to sacrifice quality and remains loyal to Sally, but there is a portion of our customer base that's coloring less frequently and modestly lowering their overall spend during this inflationary period. Importantly, our Sally stores consistently receive positive feedback on service, friendliness and knowledge. We believe the level of engagement and education we provide truly sets us apart and has proven to be a key factor in our ability to navigate challenging economic environment.

Turning now to our BSG segment. Overall demand remained stable in the quarter. From a category perspective, bonding and express coloring continue to trend well. As we anticipated, raw material shortages for some of our vendors persisted during the third quarter and continued to impact stock levels on some of our top-performing SKUs. We're starting it back in stock on certain products and expect to regain further rent and expect to regain further ground in fiscal 2023. We also began servicing over 300 new Regis salons in June and expect to be fully ramped up on all 2,500 salons by fiscal year-end under our expanded distribution partnership.

In addition, we recently launched a dedicated web portal to streamline the ordering process, which we'll be leveraging for other large chain accounts such as forklifts. As we approach the final months of fiscal 2022, the shift in purchasing behavior among both our Sally customers and BSG solid is persisting. At Sally, our customer is continuing to stretch the time between coloring and reducing some of their basket adds.

At BSG, we're continuing to work through supply chain challenges, and while salons are so busy, our stylists are beginning to purchase closer to need. Balancing these trends, the negative impact of FX rates on sales and the positive momentum we have from our initiatives around innovation, marketing and personalization, we are moderating our full year outlook for sales and operating margins.

While we're operating in a difficult macro environment, we have confidence in our operating models and the infrastructure we've established in recent years. Underpinning our outlook is the continued loyalty of our core color and care customer as seen in our Net Promoter Scores, our strong competitive positioning as the leading provider of professional color and care and the depth of our teams who are continuing to execute against our 4 strategic growth pillars that I'll discuss today.

These pillars include leveraging our digital platform, driving loyalty and personalization, delivering product innovation and advancing our supply chain. Let's start with digital. Our omnichannel model is serving us well, and we'll continue to lean into and invest in digital going forward. E-commerce sales penetration was 8.4% of sales in the third quarter. During the quarter, our Sally U.S. and Canada stores fulfilled 48% of e-commerce sales with 2-hour delivery representing 22%, BOPIS comprising 19% and ship from store accounting for 7%. Notably, we saw a strong uptake of 2-hour delivery in both the Sally and BSG segments.

At Sally, we continue to receive positive customer response and feedback on our new virtual color experts. Net Promoter Scores are 7 points higher in our virtual color expert stores versus our control stores. Additionally, our virtual color expert stores are delivering an average ticket that is about 30% higher versus control stores. This virtual experience is now being piloted in 45 locations with another 25 coming online in early fiscal 2023 with more expansion planned for '23 that will include our website and app customers. This is a great example of our relentless focus on customer experience, the importance of education and our ability to leverage our digital investments to drive engagement and strengthen our competitive positioning.

Moving to our second growth pillar, loyalty and personalization. In the third quarter, approximately 77% of our sales at Sally U.S. and Canada came from our loyalty program, and active member count remained steady at 17 million.

On the BSG side, we have data on 100% of our BSG customers, and 9% of our sales came from the rewards credit card in the third quarter. At the end of the third quarter, we have launched 5 different personalization journeys for e-mail and web for Sally, and we expect to launch the first personalization journey for BSG by the end of the year.

The implementation of our new marketing mix modeling tools that we talked about last quarter is progressing well. We're in the early innings of gathering, analyzing data, and we're excited about the opportunity to sharpen decision-making and increased efficiency by utilizing this tool that will ultimately help us optimize future spend.

Turning now to our third growth pillar, product innovation. We continue to be enthusiastic about the robust innovation pipeline we have ahead of us within both the Sally and BSG segments. In Q3, we had successful launches at Sally across hair care, lashes and skin care, including our new Strawberry Leopard hair care line, we're particularly pleased by the strong response to the Strawberry Leopard brand and Regis is a great launching pad for our strategy to drive owned brand penetration over the long term.

For Q4, we recently launched the same color called Vivid Color line and total results Haircare Line from Matrix. Additionally, in Q4, we have new product launches planned in nails and the Sally tool categories. On the BSG side, we saw positive response to our Q3 product launches across color, hair and tools including Olaplex No. 9 and continued momentum of Wella's new shineinfinity line. In the fourth quarter, we have new products launching in both color and care, including more innovation from Olaplex with their new 4C clarifying shampoo.

Our initiatives in the nail category are well underway at both Sally and BSG. This includes new fixturing, more prominent in-store placement and new product launches. The first phase of the expansion was completed in Q3. Early results are positive and additional product rollouts are planned for the fourth quarter as we focus on continuing to bring excitement to the category.

Now on to the fourth and final pillar, supply chain. We recognized the importance of being in stock in our core categories of color and care every time. We exited Q3 in a better position despite some lingering supply chain disruptions impacting our top vendors. Our teams are continuing the work of transforming our transportation network to full distribution, which is expected to increase our speed to market, improve reliability and served as a partial offset to the higher cost environment.

In closing, I want to recognize the hard work and dedication of our team who have demonstrated remarkable resiliency and commitment to serving our customers. As we move forward, we remain steadfast in building value for all of our shareholders and stakeholders over the long term. In this uncertain macro environment, this includes staying focused on what we can control, including utilizing aggressive cost controls and expense planning as we transition into fiscal 2023. Now I will turn the call over to Marlo to discuss the financials before opening the call to questions.

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

Thank you, Denise, and good morning, everyone. Third quarter net sales decreased 6% to $961 million, and comparable sales declined 3.6%. As we anticipated, macro factors including inflationary pressures and supply chain disruptions continued to impact both Sally and BSG divisions. Additionally, we were operating 149 fewer stores at the end of the quarter compared to the prior year, and foreign currency translation had an unfavorable impact of 130 basis points on consolidated net sales for the quarter.

Global e-commerce sales increased 16% to $81 million, representing 8.4% 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. Third quarter gross margin expanded by 70 basis points to 51% as pricing leveraged drag an improvement in both the Sally and BSG segments. These benefits were partially offset by higher distribution and freight costs.

Moving to operating expense. Adjusted SG&A totaled $390 million, essentially flat to last year. Higher year-over-year labor costs were mostly offset by lower variable and accrued bonus expenses as well as lower advertising costs. Additionally, we are continuing to optimize our store base, which will serve to partially offset wage inflation as we move into fiscal 2023.

Turning now to earnings. Amidst the tough macro environment that is pressuring our top line, we maintained our consistent healthy gross margin profile and delivered good cost control. Third quarter adjusted operating income totaled $101 million. Adjusted EBITDA came in at $128 million, and adjusted diluted EPS was $0.55.

Looking at segment results. Sally Beauty's net sales declined 8.5% primarily reflecting inflationary pressures that impacted our lower-income Sally customer and the lapping of last year's strong reopening demand. In addition, foreign currency translation had an unfavorable impact of 200 basis points on net sales, and we operated 143 fewer stores versus a year ago.

Comparable sales were down 5% and similar to last quarter. The sales decline was concentrated in the U.S. and Canada, which had a negative comp of 6.3% and accounted for 79% of segment net sales in Q3. Performance in Europe was pressured by the macro environment, while Latin America remained quite strong.

For the global Sally segment, color was down 4%, while care was down 3%. At Sally U.S. and Canada, color was slightly positive on a comp store basis. Additionally, vivid performed in line with the overall color category and made up 29% of the color category sales. While total transactions and units per transaction were down at Sally U.S. and Canada, average unit retail increased nicely, reflecting our pricing actions, which resulted in a slight increase in the average ticket. As Denise talked about, the Sally customer continues to rely on us as their resource for color and care. They are stretching visits and minimizing basket adds.

Gross margin at Sally expanded 60 basis points to 58.5% compared to the prior year as we continue to generate solid product margins driven primarily by pricing leverage partially offset by higher distribution and freight costs. Segment operating margin came in at 16.1%.

In the BSG segment, net sales declined 2.4%, while comparable sales declined 1.6% primarily reflecting the impact of supply chain disruptions among key vendors, which led to lower stock levels of some of our top-performing SKUs as well as lapping the last -- lapping of last year's strong reopening demand. We estimate that the sales loss from raw material shortages was approximately $15 million or 350 basis points of impact on net sales growth. The raw material shortages got worse in April and May before improving in June, and we expect further improvement in Q4, but not fully back to normal until fiscal 2023.

The color category was down 7% in the quarter driven mainly by the raw material shortages, while hair care increased 5% compared to the prior year. Salon demand has remained consistent. The sales were more conservative on inventory, buying just in time. Gross margin at BSG strengthened by 150 basis points to 40.9% primarily driven by improved product margins as a result of pricing leverage, partially offset by higher distribution and freight costs. Segment operating margin came in at 13.7%.

Moving to the balance sheet and cash flow. We ended the third quarter in strong financial condition with $101 million of cash and cash equivalents and $167 million outstanding under our asset-based revolving line of credit. At the end of May, when our senior notes due 2025 became callable, we made the strategic decision to retire the outstanding $300 million to further strengthen the balance sheet and optimize our capital structure. The repayment was funded through a combination of excess cash and our ABL facility. At the close of the third quarter, our net debt leverage ratio stood at 2.2x.

At quarter end, inventories were up 8.5% to just over $1 billion. The year-over-year increase is in line with our expectations and can primarily be traced to 3 key factors: vendor price increases; the ramping of inventory in support of our expanded Regis partnerships; and lastly, the pull forward of inventory in the face of supply chain disruptions. Third quarter cash flow from operations was $52 million, and capital expenditures in the quarter totaled $23 million.

Moving on to guidance. We are updating our full year outlook to reflect the customer dynamics Denise discussed as well as intensifying foreign currency headwinds. With approximately 8 weeks remaining in our fiscal year, for fiscal year 2022, we now expect the following: Net sales are expected to decline by approximately 2% compared to the prior year. This includes an unfavorable impact from foreign currency exchange rates of approximately 70 basis points on full year guidance and reflects the incremental impact in the third quarter anticipated impact in the fourth quarter compared to the prior net sales guidance.

Net store count to decrease by approximately 90 stores driven primarily by Sally U.S. stores as we continue to optimize our portfolio. GAAP gross margin expansion of approximately 70 basis points, adjusted gross margin expansion of approximately 50 basis points, GAAP operating margin to be approximately 10.3% and adjusted operating margins to be approximately 10.5%.

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.

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

So I just wanted to go back to BSG. So as you guys look at the salon industry, I know there's been some chatter about a July slowdown in salon visits. Just any perspective in what you're seeing right now on the salon side on industry trends?

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

Yes. Rakesh, it's Denise. Let me comment on there. First, let's talk a little bit about the BSG stylists and the trends they're seeing, and then we'll talk a little bit about our business. In general, what we're seeing on the BSG side, salons are still busy, but their behavior is a little bit more cautious, right? They're buying a little bit closer to need. When we talk with them, what they're talking about is that the customer sitting in their chairs are talking about how they're stretching their dollar and making things a little bit more frugal in some of the choices they're making.

And we're seeing it when we come to how people purchase with us. Our stylists actually have a really strong response when we've done our customer appreciation events. The one that we did this past quarter was actually the strongest in our history. So you definitely see the sensitivity to pricing out there with the stylists in the business in which we're operating. The good news for us, though, is in the core care and color segment, we actually remained quite healthy in our business. Our care business with our stylists was up about 5%. And while color in absolute was down about 7%, if we adjust for the vendor out-of-stock issues, it ran slightly positive. So in the core categories in which we're competing, we feel pretty darn good about that.

We're also really focused as we're thinking about growing our share, the things that we can do to better help our stylists. So we're focused on express products that let them get their chair turn faster and have more business coming through them; the integration of all of our Regis business with 2,500 accounts that will come online, 300 already on, but many more to go; and then most importantly, working with our vendors where we do have out-of-stocks on key items to get those back in stock.

We saw good progress at the very end of the third quarter. We saw more pressure in May in the first 2 months of the quarter and then better in the third month of the quarter. We expect that to continue in Q4, although a little bit will probably persist into 2023. So overall, while there's some pressure out there, the underlying stability of the business, we feel quite good about.

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

Okay. Great. And then maybe just one follow-up question. Just given the supply chain challenges, I think you quantified $15 million headwind this quarter. So as you get the supply back, do you expect to recover these customers? Presumably, these customers are going somewhere else. So just curious if you actually think as we look to next year as you get the product, you actually be able to recover those.

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

Yes. We've generally seen that our customer is very sticky. They are coming into our store. They might need to go somewhere else if they need to fill in something. But where we're short is mostly on our exclusive brands. And it's what our customers really believe in. It's what they have in their core assortment. And when they talk to us, they're very anxious to know when those brands will be back in stock and how we'll be able to service them come forward.

So as an example, we have a list of people who are waiting for certain SKUs to come back in stock. When our BD advisers and our stores call up those customers, they're quick to come in to buy what has come in and what's available. So I can't predict the future, but I have every reason to believe that our stylists remain quite loyal to some of the brands they've come to love, and they are exhibiting some patients and just making some trade-offs in the short term while they're waiting for that stock to come back.

Operator

Our next question will come from the line of Steph Wissink with Jefferies.

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

I have a follow-up question to Rupesh's question around supply chain. Have you gotten any feedback from your vendors on what steps they're taking to ensure that your overall inventory position can improve in some of these areas? And maybe just give us a sense of how the vendors are stepping up to support you. Are they providing you with alternative supply on anything to just help bridge that gap?

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

Seth, this is Denise. The way that I would think about it is what we've been able to do over the last 2 quarters with our vendors is get much more specific with them on where we see backlogs, where we see customer demand where they have shortfalls. And so a lot of it is really planning to give them what we can give them as the most accurate amount of demand and need that we see over the coming weeks, months, quarters.

What we see them doing with that is then going back up their supply chain and trying to work hard to say, I'm going to have all my raw materials. I'm going to be able to build to those numbers. I think we have had a little concern that is equally responsible on our part and the vendor part to be sure that, that clarity of the pent-up demand was getting through into the demand signal. And so we're focused on that.

All of our vendors want these sales as much as our customers want the product. So they are clearly trying to work hard, whether it's a bottle or a lid or a raw material ingredient itself, to be pushing those things back through. And I think we're seeing those results. We did talk about at the end of the third quarter things are getting better. We're expecting that to continue as we're going through the fourth quarter as we're starting to see our receipts come in.

So I think that piece is going to hang around and wrap to 2023. As expected, is going to be smaller. So I think they're stepping up to the plate. We're certainly doing our best to share with them all the information we've got. And they're wanting that business as much as our customers want the product.

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

All right. That's helpful. And then my follow-up question is on pricing. Can you just share with us a little bit about how much price you have seen come through? How much you've passed along? Any sense on what more to come, there could be? And I think you mentioned in your prepared remarks, both on the professional side and on your core consumer side, some resistance or some slowing in the pace of consumption. Just want to understand a little bit how you're thinking about price elasticity and the amount of price you're having to pass through.

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

Sure. I'll jump in there, and then if Marlo wants to add any color as well, she can certainly do so. When we think about pricing, the pricing that we've taken this past year has really come in 2 forms. And early in the year, we were very focused on strategic pricing, leveraging our new pricing tools and capabilities. We talked about that being one of the investments through our transformation period of some new technologies and have gotten a lot smarter about what those elasticities were and went ahead and took some pricing there.

And then as the year has progressed, we have done pass-through pricing in response to vendor prices increases. We haven't seen some elasticity, as expected. And generally, the elasticity has been within a range that we feel good about, right? We do the same math that everyone would do there and feel like there's the right balance of units versus sales and margin that we're seeing come through.

When we think about how the customer is adjusting, what we're not seeing them do is choose to not buy a tube of color or a bottle of shampoo or thinking what they're really doing and saying, "I've got this overall amount of money that I'm going to spend. And I'm just being a little bit more frugal with that total amount of money I have." So it's where we see people more outside the core categories saying compared to last year, which was the boom year of the COVID reopening, and people are saying, "I don't know that I need another styling tool unless mine's actually broken." Or maybe that add-on purchase, if it's going to take my basket size, those are the amount I feel good about, maybe I'll hold off. Maybe I won't do that quite as frequently.

So that's really what we're seeing on that front. Overall, in pricing, we'll continue to watch the market move as we can move over time and what we're seeing in the modeling that we do. But if we step back one, the other adjustment that we've really made for our customers is to put ourselves in their shoes and be able to think about what it means as they're seeing price increases come through as they're doing decision-making. And specifically by that, we've really turned a lot of our customer communications to be focused on value.

And when we think about value, that comes in a lot of different forms. First, it's reinforcing the core message of who we are. And at Sally, we're using a new tagline about pro quality for less and reminding the customer that, that's out there and that's real.

We're also stepping up communication on gray coverage. It's been very interesting to see that, in the last 4 weeks, we've seen a notable uptick of customers looking for advice on gray coverage. It became the #1 trending question with our virtual color experts. It has not been the #1 question up until about 4 weeks ago. We're also seeing our beauty advisers in store getting a lot more frequent questions on that gray coverage.

So when we can provide pro product at a value, make sure the customer knows we have it, make sure we have the expertise in place and are delivering that expertise to our customers about how to use the product, that starts to really fuel the value equation more so than just the focus on what we're doing on a list price of the product.

Operator

Our next question comes from the line of Oliver Chen with Cowen.

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

Regarding the frugal consumer and all the cross currents we're seeing in the consumer, are you more concerned about traffic or UPTs? And what's -- will this get worse before it gets better? I was curious on your sense of volatility and the trends you see and how that interplays with guidance. And as we think about next year, it's just very dynamic situation with inflation happening and accelerating in the minds of the consumer.

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

I'll start off. And I think the way that we think we see it right now is that we're seeing a little bit bigger pressure point on traffic than we are on UPT. So when our customer comes into the store, they're getting what they want, they're selling their basket, they're doing things within that frugal mindset but coming in and spending as we would expect them to spend.

The traffic piece is a little bit trickier. And when somebody doesn't have something and they're waiting and waiting and waiting, getting that choice to come to the store and know that you're going to be spending when things are a bit more cost constrained in your mind is the harder piece of things, and we're really working around ways around that. So as I mentioned, a lot of what we're doing in talking about just the value equation of the product we offer and how that can resonate with someone about why it's worth coming in to spend when we spend.

We're also trying some different promotional tactics. So we're not increasing our promotion overall, but we're tweaking to what the current environment might be able to address. So we just recently launched a buy 4, get 20% off color promotion that just started here in August. We had tested it earlier in the year. And I think we're -- there could be a concern that you might be pull forward sales.

But we actually saw the customer do when the sale was out there, as they came in, they shopped. And we think about it this way that we are hoping they're going to increase their units but not have -- that would really mitigate a frequency decline that they could see. The customers who came in, they took advantage of the promotions, they didn't change their purchases over the subsequent months, which was fascinating because what they really said is I'm going to actually send net positive with you over this 3- to 4-month period versus pantry loading.

And when you get under it, we really think there's a psychology to it, that if it's in your medicine cabinet, you're going to use it. If you need to go out to the store and spend again to buy it, maybe you're going to hesitate and wait a little bit longer. So these nuances of where we spend our promotional dollars to be getting units up the frequency is going to be down. And then the value messaging to remind people why we are a great place to come and make that extra soft and extra trip to get the pro quality product. There are 2 things we're really focused on.

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

Okay. And on the supply chain front, you've given us a lot of great details. What's the magnitude of the percentage of assortment or inventory that's impacted? And what should we know about timing as we think about our models and how this may evolve?

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

Yes. So I think the way we characterized it more it was about $15 million worth of sales in the third quarter that were missed. The absolute SKU count changes as vendors come in or out of supply in a given SKU, but it was about $15 million. We think that there's still pressure in Q4. Pressure should be going down. And then as we wrap into 2023, it will go down even further. I would certainly hope as we push meaningfully into our fiscal 2023 that we won't be talking about this anymore. But that's a bit dependent upon the macro world around us.

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

Okay. Last question. We've seen some lesser marketing efficiency on the digital sides of businesses across the retail industry. Have you been seeing that? How do you feel about your traffic and conversion online relative to your physical stores?

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

Yes. Interestingly, we feel great about our conversion online. It has been ticking up throughout the year as we've continued to sharpen both the way the customer gets to the site and what they land on in the site and then the ease of shopping. On the site itself, we've seen nice traffic and we've seen nice conversion increases. Our traffic numbers haven't changed materially in terms of what we've seen in terms of click-through rates.

And certainly very sensitive to one reason why this might be true for us is we spent a good amount of effort this year on developing a marketing mix model, where we are able to read kind of quarter-over-quarter what vehicles and where we're spending our money are going to get us our base paying for our buck, and we do regularly pivot. So we step back every month, every quarter and be sure the way we're deploying those dollars seems to be what's relevant to the customer as real time as we can get it. That's a new tool, a new capability for us, and I think we're starting to see the benefit of that come through.

Operator

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

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

I wanted to get a little bit under the sales outlook for the full year. We've obviously discussed the weaker consumer, but then you also talked about AUR going up. So just -- and Q3 was a little bit better than we had anticipated. So can you guys just talk a little bit about your view on the consumer? If things are weakening, why is AUR going the opposite way? And then what's sort of embedded within your expectation for sales to come in a little bit lighter from the full year perspective outside of currency?

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

Maybe I'll start with the second question and then Denise can talk more about consumer trends. In terms of guidance and kind of how we're thinking about that relative to where we left off last quarter, we're seeing a lot of the same trends continue with a little bit more intensity on the inflation side. But really, probably the biggest move that I see on a mathematical exercise is the move in the currency. We had 130 basis points impact on Q4 -- or in Q3. We see a similar impact in Q4. When you look at that, it's a pretty significant impact to the full year.

So that's a good magnitude of what we moved the guidance down to the lower end of the range and a little bit more pressure on the inflationary front and really seeing that in Europe as well. So those 2 things combined moved us towards the lower end of the range.

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

Yes. And I think the only piece that I would build on that is besides the FX, which I think was a dominant piece of the change to the guidance, when we just look at the consumer and what's happening, we do see real positives against some of the initiatives that we're looking on. So we will bring in more Regis business as we stand up more customers as we go through Q4. We just reset our nail business in both our BSG and Sally stores. We're working a lot of personalization journeys, and we see those as really offset to what we're seeing of just the customer being a bit more frugal.

You specifically asked about AUR going up. The core of our business is color and care. We have taken pricing, and so that's the more natural movement of AUR. And that makes a bigger difference to us than where we might have lost just truly high AUR items such as a blow dryer or straightening iron out of the basket compared to where we were last year. So just seeing that more in pricing coming through as we would have anticipated.

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

Got it. And then I wanted to get your view in terms of the consumer interest in color. And I don't mean from the covering grays perspective, but vivid was obviously huge for some time, particularly in the last few years. Just general view in terms of color trends outside of gray coverage, that would be great.

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

So overall, hair, hair expression, personalization, we are not seeing any meaningful change in behavior in customers from what we've seen over the last 12 to 18 months. Vivid is still quite strong. It represents 29% of our business, and I think that's pretty flat in Sally. It's pretty flat to what we've seen over the last few quarters in terms of penetration. So really no drop-off in interest of people experimenting there. And I think a really fun business because you do a lot more with semi-permanent or short-term types of color where people can get a pop of color and then step away from it if they choose do that.

And then core color remains also generally on trend. As we talked about the overall statistics, we were a little lighter in Sally this year than we were last year. I think that's more about the fuel of the reopening that actually happened last year with the consumer as COVID really -- vaccines were there, people reemerged, business really kind of took a different turn.

And on the BSG side, color trend, color demand remained quite strong. The only thing that we feel held us back for some of the vendor out-of-stock issues, as we talked about, we think we would have posted a slightly positive comp in our color business in BSG excluding the vendor out-of-stock.

So still feel good the hair color, hair trend is real overall. And I think we, personally, for our business, are optimistic that as people think more about that gray coverage and maybe different ways to achieve that could be an interesting trend as we watch further into Q4 and the new year.

Operator

We will next go to the line of Simeon Gutman with Morgan Stanley.

Unidentified Analyst

This is actually Justin on behalf of Simeon. Earlier, you guys mentioned that for the BSG segment, you mentioned you're seeing good progress toward the end, and you expect it to improve going into Q4. I was wondering if you could talk maybe just a little bit of color on volume and price that you saw a little more detail towards the end of the quarter and then if you guys think you're taking share from your key competitors.

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

Yes. I think, overall, if we just talked about the BSG business, specifically of our improvement towards the end of the quarter, that was in regard to the in-stock. So that's where we saw ourselves get back better in stock in some of the key SKUs that were out with some of our vendors and saw that kind of positive trend convert over into customers in terms of basket and traffic. And it also coincided with what we do every quarter of a customer appreciation sale. And the value that got provided there, we see more and more with folks looking for that value, just a good time to shop. So we were happy to have that inventory back in stock and what we were seeing. And then I think your other question, which I'm -- forgive me, I'm forgetting right now.

Unidentified Analyst

It was if you think you're taking share in the BSG segment.

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

Yes. I think in our general, in our view of everything we can see in the numbers, we are currently holding share in care and color in BSG. The one gap to color that we know we have is a little bit of slowdown because of the vendor out-of-stocks but working hard to get those back into stock. But with care growing about 5%, that feels like a good healthy growth rate in the business. And I think the thing that gives us a great conviction that our customers are still actively coming in, the customer counts remain stable. So we feel really good about that.

And as I mentioned earlier, we're also working hard to be looking at how we're going to grow share rather than just maintain share with our customers. The ability that we have that we're now adding on a lot of new Regis business, those 2,500 accounts coming online, and it's going to be a great build to our business as we look to Q4. But even more importantly, 2023, we'll get our product back in stock with our vendors. We just reset our nail walls within BSG. It gives us access to a whole bit of a different customer base. So clearly, our stylists buy and participate in that for their independent businesses, but we also believe there's more leverage there to get people back into our stores as they understand the new assortment for their nail tech businesses.

And then we're really focused on the products that make a difference to our stylists right now, a big one of that being express. So the more efficient she can be in running her chair, turning over her client base in a difficult time, being able to do color in a 10-, 15-minute process instead of a much longer process. it's pretty important. So we're working with all of our vendors for that express piece to come through as well, so that we can convert as our vendors are back in stock to growing share in color as well.

Unidentified Analyst

Got it. And just a quick follow-up on that. Before you mentioned, I know the care business being up 5% color. I think you mentioned about down 7% due to out of stock. Would you say that's kind of the biggest divergence you guys are seeing in category? Or any insight you can provide in other categories or maybe how the new nail walls are performing thus far?

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

Yes. So care and color are, by far, the largest businesses within BSG. So that really represents a huge base of the store. And the nail wall for reset in the third quarter, they'll be more fully kind of full quarter as we go into Q4 and more products coming in behind them. Early on, we've seen very positive response. So with 3 or 4 weeks of the sets kind of under our belt, people are figuring out that it's there. There is new. We're getting messaging out about it. So I would call it so far positive.

Operator

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

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

And when it comes on the e-com side, is that business accretive or dilutive to margins at this point?

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

Sorry, your e-com margins? Was that the question?

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

Yes. Are the e-com margins better or worse than in-store?

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

Yes. So we've been on quite a journey with e-comm versus just standing it up throughout the journey we were on with COVID and bringing on all of our digital capabilities. I mean we now have a full suite in our platform in both banners. And so still building a bit more into that in terms of bringing CRM and personalization in as well. To further enhance that, I would say, early on, it was all about speed and getting the capabilities stood up. Since that time, we have made a tremendous amount of improvements in our profitability.

We're now at a point where we have a good part of the business being fulfilled out of the store, which is more profitable than doing that from a DC in through that, too, as well as our operational improvements, cancellation splits, just improving the overall customer experience. You've talked -- you've heard us talk about better conversion. So we just have a much more efficient operation as well.

And so since that time, I would say we are now starting to approach -- I mean BSG has always been the stronger banner in terms of profitability. Sally has now caught up to BSG, and we are now starting to approach store profitability at this point. We don't expect ever to be a perfect parity, but we are getting closer.

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

That's great. And then on the -- just given the consumer environment and kind of supply chain, any change to how you're looking or sorting for holiday? Or just even given the business shift because you've spent so much time lately putting -- growing that color and hair and nail categories? Are we going to see a shift in the stores as a holiday time frame?

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

Yes. When I think about that, we aren't a seasonal business. So I think for one, we don't typically have a much different buy-in for the holiday time period. We do see more customers coming into our stores a bit more on the gifting front than maybe you'd see through the rest of the year. In our preparation for holiday, we're thinking more about how you think about stocking stuffers and things that become affordable luxuries that you can get in the store, complementing what we always do, which is have styling tools and other things that make good gifts under the tree.

So I'm clearly taking in mind where the customer's head is. But I think the most important part to us is our assortment that we buy at holiday isn't any different than our day in, day out assortment, right? So when we say we're going to stock up on something because that will be stocking stuffers, it's core go-forward product. We're just bringing in, knowing that seasonality might be there a little differently for those products.

So certainly hope that we see a nice gifting season. I think we all quickly forget that last December was a bit hampered by the joys of Omicron and all the things that it did impacting store labor and just general activity. So we're hopeful that, that customer does want to get back out and think about their holidays in a more positive light, but also, I think, just for us realizing that we're not a huge seasonal business.

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

Okay. Great. And then any thoughts in terms of the timing of the debt paydown or kind of a target there given the revolver borrowing?

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

Yes. We don't have a specific target date. But I would say our overall capital structure being in a strong position. We're going to continue to assess the best uses of our cash generation across business investments, returning value to shareholders and optimizing our debt.

Operator

And with that, we have no further questions. So please go ahead with any closing remarks.

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

I'll just take a minute to say thank you for all the interest in Sally Beauty Holdings. We're excited about the business. We're excited about where we're headed to go forward and how that we can serve our customers. So we do appreciate that interest. And as always, a big thank you to our associates across the globe. They work hard every day to bring color and care and happiness to our customers, and we appreciate all they do. So thanks for that, and we'll talk to you again next quarter.

Operator

Thank you. And ladies and gentlemen, that does conclude your conference call for today. Thank you for your participation and for using AT&T Executive Teleconference Service. You may now disconnect.
