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Beauty Health Co (SKIN) Q4 2022 Earnings Call Transcript

Feb. 28, 2023 2:43 PM ET | **The Beauty Health Company (SKIN) Stock****SA Transcripts**

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Q4: 2023-02-28 Earnings Summary

EPS of \$0.05 **beats by \$0.01** | Revenue of \$98.13M (25.99% Y/Y) **beats by \$3.23M**

Beauty Health Co (**SKIN**) Q4 2022 Earnings Conference Call February 28, 2023 8:30 AM ET

Company Participants

Eduardo Rodriguez - Senior Director, M&A and IR

Andrew Stanleick - President, CEO & Director

Liyuan Woo - CFO

Conference Call Participants

Bruce Jackson - The Benchmark Company

Jonathan Block - Stifel, Nicolaus & Company

Olivia Tong - Raymond James & Associates

Linda Bolton-Weiser - D.A. Davidson & Co.

Korinne Wolfmeyer - Piper Sandler & Co.

Allen Gong - JPMorgan Chase & Co.

Kyle Rose - Canaccord Genuity

Navann Ty - BNP Paribas Exane

Margaret Kaczor - William Blair & Company

Operator

Good morning, and welcome to The Beauty Health Company's Fourth Quarter and Fiscal Year 2022 Earnings Conference Call. [Operator Instructions].

I would now like to turn the conference over to Eduardo Rodriguez, Senior Director of M&A and Investor Relations. Please go ahead.

Eduardo Rodriguez

Thank you, operator, and good morning, everyone. Thank you for joining The Beauty Health Company's conference call to discuss the company's fourth quarter and full year 2022 financial results, which were released this morning and can be found on our website at beautyhealth.com. Also available on our website is an investor presentation that will be referenced during this call.

With me on the call today are Beauty Health's President and Chief Executive Officer, Andrew Stanleick; and Chief Financial Officer, Liyuan Woo.

Before we get started, I would like to remind you of the company's safe harbor language. Management may make forward-looking statements, including guidance and underlying assumptions. Forward-looking statements are based on expectations that involve risks and uncertainties that could cause actual results to differ materially. For a further discussion of risks related to our business, see our filings with the SEC.

This call will present non-GAAP financial measures such as adjusted gross margin and adjusted EBITDA. Reconciliation of these non-GAAP measures to the most comparable GAAP measures are included in the earnings release furnished to the SEC and available on our website.

I will now turn the call over to Andrew.

Andrew Stanleick

Thank you, Eduardo. Good morning, everyone, and thank you for joining Beauty Health's Fourth Quarter and Full Year 2022 Earnings Call. To begin, I will discuss our performance and accomplishments for the year, my first serving as CEO of this incredible category-creating company. I am extremely proud of the progress of our team in these past 12 months, and I am pleased to share the results with you today. I will also discuss our outlook for 2023 before Liyuan provides more detail on the numbers. We will then be happy to take your questions.

As always, I want to start by thanking our incredible Beauty Health one team. Our teams around the world worked tirelessly over the past 12 months to execute our strategy and deliver incredible growth and momentum amid uncertainty in the operating environment. Despite the macro backdrop, we delivered a year of record revenue. We launched the biggest product innovation in our company's history with Syndeo, our next-generation Hydrafacial delivery system. We continue to build the world's premier skincare booster portfolio, partnering with the best in the industry from Murad to JLO Beauty. We open more doors than any year before with exciting retail partnerships and expansive growth in the booming MedSpa channel, not to mention continued solid growth in our core medical channel.

Our loyal provider community and consumer fan base remains highly engaged and is growing around the world. The planned investments we have made to scale our business over the last 2 years are driving strong top line growth and position us for margin expansion in 2023 and beyond.

Let's now look at the results on Slide 5. In Q4 2022, we reported net sales of \$98.1 million, our eighth consecutive quarter of delivering mid-double-digit top line year-on-year growth and of beating expectations. For the full year, our planned strategic investments, paired with continued consumer and provider demand, drove strong sales growth of 41% year-over-year to \$365.9 million. This growth represents the resiliency of our business and the increasing demand for Hydrafacial despite the challenging macro backdrop.

In particular, foreign exchange headwinds in Europe were significantly impactful, and China's zero COVID policy delayed return on our planned investment in our China infrastructure buildup. Notwithstanding these challenges, we delivered adjusted EBITDA of \$47.7 million for the full year, up 46% year-over-year. I'm also pleased to report that we achieved double-digit growth in all 3 of our operating regions in 2022. Year-over-year, the Americas grew 44%; APAC increased 24%; and EMEA was up 46%. These strong growth numbers are in reported currency. On a local or constant currency basis, the results are even stronger.

Our strong growth is nothing new. We have averaged 48% growth per year since 2018 when excluding 2020 for COVID. Our period of planned heavy investment is now behind us. As a new public company, our global infrastructure build is largely complete and ready to scale. Our business model remains agile, and we have strong fundamentals in place to capture the large profitable growth opportunities ahead of us.

As a result of our momentum, we have full conviction in our long-range plan to deliver \$600 million to \$700 million net sales and adjusted EBITDA margin in the range of 25% to 30% by 2025, targets we first shared at our Beauty Health Investor Day last fall.

If 2022 is about establishing a new foundation, the focus of 2023 and beyond is about accelerating profitable growth. We will launch Syndeo internationally in the second quarter of 2023. We have taken lessons learned from our highly successful U.S. launch last year and look forward to growing Syndeo's soon-to-be global footprint.

We will build our portfolio of products to sell to Hydrafacial providers, adding strategic and [indiscernible] to our portfolio of personalized treatment options as well as through strategic M&A. We will expand our business in China as zero COVID policies ease and consumer activities returns, and we remain optimistic on the outlook and our long-term opportunity in the strategic market.

As you would expect, we will remain nimble and are able to quickly pull levers to protect our margin should on-the-ground conditions in China deteriorate. In totality, I am confident in our ability to generate net sales of \$450 million to \$470 million and to deliver an adjusted EBITDA margin in the range of 18% to 20% for 2023.

Turning to Slide 7. We continue to make strong progress against our five point master plan, which you are all familiar with. Our strategy to expand our footprint and increase provider and consumer access to Hydrafacial is working. In fact, we have continued to expand our position as the market leader, with some research estimating our market share to be around 85%. It is hard to displace the go-to brand, and Hydrafacial has become an eponym for the category it created.

In 2022, we delivered a record 8,492 Hydrafacial systems globally, which includes 1,793 trade-up units to Syndeo. This represents a 37% increase from 2021, highlighting consumer and provide resiliency and increasing demand globally for our products.

Across distribution channels, we continue to see provide a preference for the Hydrafacial treatment and device. In fact, just last week, we received 2 Aestheticians' Choice Awards from DERMASCOPE Magazine, the best hydradermabrasion machine for Syndeo and favorite signature treatment for Hydrafacial. The validation of our aesthetician community is more meaningful than anything else, and we wear this badge with great pride.

I am thrilled with the expansion we saw in 2022. And more importantly, we continue to have a massive, underpenetrated growth runway in front of us to capture. We believe all of our providers should be on Syndeo. And as you saw in 2022, we employed a strategy to push our provider network to upgrade to Syndeo, and you can expect us to continue this approach in 2023. Syndeo is our next-generation connected system, provides us with rich data insights into trends and consumer preferences that we have never had before, once again pushing the category forward.

Ultimately, we envision that Beauty Health can become one of the largest sources of skin health data on the planet, and that is a powerful and compelling proposition.

Turning to Slide 9. We are driving consumable sales and recruiting new consumers into our brand with a steady pipeline of innovation, delivering regular upgrades to our booster portfolio and treatment protocols.

With our portfolio of approximately 20 skincare boosters and a wide range of treatment tips, including a wide head body tip and our patented wet diamond abrasion tip, Hydrafacial has never been more customizable for the consumer, with each treatment delivered by our patented Magic Wand hand piece. We view this as a key competitive advantage. Our aestheticians are trained to tailor every treatment to a client's personal skincare needs, a differentiator that builds affinity for our brand. No other device in our category delivers a level of customization and personalization to the consumer, and this is the feature of skin health.

Each booster is developed with careful attention paid to ingredients, and our products are validated with clinical studies and overseen by our Chief Medical Officer. We lead with this science-backed approach for our own Hydrafacial boosters and also for those that we co-create with, with other world-leading skincare experts. This allows us to accelerate our R&D, capitalizing on the combined strength of our [indiscernible] together with our partners. The Hydrafacial ecosystem that we have created with the partner brands and providers is a unique model in the industry.

What's more, our partnerships with notable brands are key recruitment tools that bring new consumers into the Hydrafacial brand. We saw the success of this approach with JLO Beauty, our biggest ever booster launch in the U.S. last fall, and we are preparing to expand JLO to EMEA and APAC during the first half of this year.

Last week, we announced our latest booster and protocol with prestige skincare brand Omorovicza, which speaks to a most discerning consumer. And finally, we are bolstering our treatment innovation pipeline with HydraBody treatments, new protocols and tips that give providers the ability to use their delivery systems on other parts of the body beyond the face.

Importantly, these treatments represent a promising source of consumables growth for us, covering larger treatment areas as well as offering providers new revenue streams from their existing Hydrafacial systems, and this is yet another win-win experience for our providers and us.

Hydrafacial is among the world's top educators of aestheticians, and we continue to invest in our providers as a key pillar of our 5-point master plan. Investments in our growing and loyal community, what we call the Hydrafacial Nation, continue to drive brand awareness, earned media value and, ultimately, sales growth.

In addition to our renowned HFX trainings, we also regularly engage with our providers at high-profile trade shows. Here on Slide 10, you can see our impressive presence at January's IMCAS trade show in Paris, an event which brings together the top doctors, aestheticians and skin health leaders from across the globe.

Across the globe, we see the love for our brand growing exponentially. On Slide 11, you can see 2 metrics we follow as indicators of brand awareness among providers and consumers, earned media value and Google search trends. In 2022, we grew earned media by 85% year-over-year driven by an exponential jump in influencer and press activity. In 2022, we were the fastest-growing brand in terms of EMV of any aesthetics brand measured by Tribe Dynamics. Additionally, our worldwide Google search activity has continued to trend meaningfully upward over the last 4 years. Indeed, in 2022, we established a new higher baseline for performance.

In all of our storytelling, we remain anchored in science, which is our touchstone and represents the core of our brand DNA. It is from science where Hydrafacial created the hydradermabrasion category and is where we continue to lead the industry and remains unrivaled by competitors.

A new clinical study published in the peer-reviewed Journal of Clinical and Aesthetic Dermatology found that Hydrafacial clarifying treatments improve acne concerns for 100% of study participants. It is a secret our aestheticians have long known and are further validated with clinical results.

The study results generated widespread interest from providers and consumers alike, with media coverage across beauty titles and broadcast, chatter on social and a spike in orders for our clarifying boosters.

Interest in Hydrafacial science and story doesn't stop with providers. Consumers are increasingly interested, too, as they look to step beyond the wellness trends of past years and seek our position or scientific endorsement of their beauty and aesthetic choices. It is a trend we call a medicalization of beauty, a long-term shift in consumer mindset that Beauty Health and Hydrafacial are intrinsically poised to capture. Indeed, we see an embrace of this idea by the earliest adopters and tastemakers in beauty and aesthetics, influencers and celebrities. To this end, we are partnering with a diverse range of influencers and celebrities to rapidly scale the Hydrafacial message.

Among the recent fans to profess their love for Hydrafacial, Lilly Collins, aka Emily in Paris, shared the secret of Hydrafacial in Vogue France. , a social media megastar with more than 13 million followers, showed her treatment in progress on her channels. Luis de Javier, an up-and-coming designer, prepped all 38 of his models with a Hydrafacial before they walk the runway at New York Fashion Week. And of course, JLo remains a most vocal supporter.

Moving to Slide 13. We continue to innovate our partnership model. Just yesterday, we announced a new partnership with the iconic Dior Beauty. Together, we have developed a Dior powered by Hydrafacial experience, which includes a custom protocol and co-branded booster that will be available exclusively in our Dior spas around the world later in 2023. Partnership incorporates the best of Dior's skincare with Hydrafacial technology and promises to resonate with a sophisticated beauty consumer. We are yet again setting our brand apart and extending our competitive moat with this prestige beauty powerhouse.

Turning to Slide 14. The acceleration that we are seeing in our business is thanks to the planned investment we made in infrastructure and capabilities during the past 2 years. Since joining the company last year, I made several additions to fortify our executive leadership team, and I'm confident that we now have the right team in place to drive our strategy forward and deliver profitable growth.

We opened key training and education centers in New York, London, Paris and Singapore and made planned investments in our provider community to drive loyalty and awareness. We also invested in foundational operational initiatives and infrastructure builds that we expect will deliver future leverage. These included progress on in-region production in China, setting up a 3PL partner in Europe and rolling out global ERP and CRM platforms.

Moving to M&A on Slide 15. As we progress into 2023, we remain committed to creating value for shareholders through disciplined capital allocation. M&A remains a priority, and we maintain a strong cash position to pursue opportunities to accelerate the platform.

We continue to evaluate options specifically those opportunities or brands that provide a differentiated product or service with a high Net Promoter Score, are complementary to our existing platform and community, leveraging decision core point and are financially accretive with compelling revenue growth and additive to our profitability.

Today, I'm excited to announce a key strategic acquisition that will immediately build our product portfolio for providers while providing Beauty Health with a future second profitable growth revenue stream in a large and growing market. Beauty Health has signed an agreement to acquire SkinStylus, an FDA-cleared microneedling device. Including all potential royalties and milestones, the transaction is valued at approximately \$15 million. Microneedling is a rapidly growing nonsurgical procedure performed by qualified providers, including dermatologists, plastic surgeons and aestheticians. The treatment uses an array of tiny needles to create micropunctures in the skin to stimulate the body's natural wound response, which is associated with the creation of new collagen and smoother therma even-toned skin.

Today, the microneedling market size is around \$540 million in the U.S. alone. Industry estimates put the growth rate at a high single-digit CAGR to reach an expected \$1 billion by 2030. Microneedling is one of the top co-treatments for Hydrafacial, making a perfect fit to sell alongside Hydrafacial.

Many of our dermatologists, plastic surgeons and aestheticians recommend Hydrafacial as a pretreatment to ensure the skin is clean and in its optimal state before microneedling. Indeed, when I'm in the field with our providers, it is one of the most requested tools our aestheticians ask us to bring to market.

Consequently, microneedling represents a significant growth opportunity for Beauty Health given the complementarity of the service to Hydrafacial in our existing distribution core point. What's more, SkinStylus also seamlessly fits into our existing razor blade commercial infrastructure. The SkinStylus business model consists of the SkinStylus device, along with single-use cartridges containing the needle arrays to operate the device as a recurring revenue stream.

We have been actively looking in this space for over a year. And after extensive research and analysis, we are highly confident that in the SkinStylus device, we have found the best-in-class technology to add to our portfolio and to create sustained long-term shareholder value. Having carefully studied the category, we believe skin SkinStylus offers providers an innovation that is new, better and different to anything else on the market.

Specifically, SkinStylus is the only device with multiple arrays of needles at differing heights to achieve optimal outcomes. Additionally, it offers a superior user experience to the provider with a patented design to prevent cross contamination and the flexibility to operate it with or without a cord for maximum provider flexibility.

Looking forward, we intend to make modest investments to seek key regulatory approvals to expand the use of SkinStylus for additional indications and to markets outside of the U.S. As SkinStylus is an emerging technology at the beginning of its journey, the revenue will be limited in 2023. However, we expect upside from this acquisition in 2024 and beyond as we seek to leverage the Beauty Health infrastructure and sales and marketing capabilities to capture share in this large and growing market.

We could not be more excited for the opportunity to bundle Hydrafacial together with the SkinStylus device. It's a clear step towards realizing our vision to become the world's leading beauty, health and wellness platform fueled by a community of engaged providers, aestheticians and consumers. We will share more about our plans as we work towards completing a successful integration of SkinStylus into the Beauty Health portfolio.

And finally, before I turn it over to Liyuan, I want to again thank our teams around the world and reiterate how proud I am of what we accomplished in 2022. We drove strong top line and profitability growth, launched a groundbreaking technological innovation in Syndeo and now marquee booster partnerships continue to expand our global retail footprint and grew consumer and provider interest in demand around the world. With our planned investment phase largely behind us, we can now as intended turn to driving profitable growth in 2023 and beyond. And we will continue to lead the way in this booming category beauty, aesthetics, wellness and health. I couldn't be more excited about the future of Beauty Health.

And with that, I will now turn the call to Liyuan.

Liyuan Woo

Thank you, Andrew, and thank you, everyone, for joining the call. I would also like to take a moment to thank our teams and partners around the world. We exceeded top line expectations for the eighth consecutive quarter, and we continue to see momentum building across the business despite macroeconomic uncertainty. Today, I will walk you through our fourth quarter and full year results, cost and balance sheet highlights, and finally, our outlook for 2023.

Turning to net sales on Slide 18. We delivered net sales of \$98.1 million in the fourth quarter, up 26% year-over-year. This was driven by continued strong global demand for both delivery systems and consumables. As you can see, despite the negative impact of China's shutdown and foreign exchange headwinds, we have seen sequential net sales growth throughout the year when excluding the significant trade-up sales from the Syndeo launch during the second quarter.

For the full year, we achieved net sales of \$365.9 million, up 41% year-over-year or up 32% year-over-year when excluding the Q2 trade-up sales from Syndeo's U.S. launch.

On Slide 19, you will see we drove strong double-digit growth across all 3 of our regions in '22.

Looking at the fourth quarter. In the Americas, we continued our expansion, growing 29% year-over-year, driven by the continued success of both new Syndeo placements and trade-ups. In APAC, we grew 33% year-over-year, highlighting once again our team's resourcefulness in China while operating the business in a difficult environment.

In the fourth quarter, there was a surge of COVID infections shortly after reopening, resulting in China effectively shutting down again. Post-Chinese New Year, with China reopening and the infected population largely recovered, we're starting to see increasing demand with our providers.

In EMEA, fourth quarter net sales grew 12% year-over-year. The growth would have been even stronger if not for an approximately \$2 million constant currency foreign exchange headwind during the quarter.

Sentiment to start the year is strong, and we expect this to continue throughout the region in 2023. Given the promising trend, we're seeing in APAC and EMEA. We look forward to launching Syndeo internationally in the second quarter 2023.

Briefly touching on our KPIs on Slide 20. We ended the year with a net installed base of 25,336 delivery systems, an increase of 24% year-over-year. We shipped 2,067 delivery systems in the fourth quarter. Nearly 10% of those system sales were trade-ups, which is an increase compared to the third quarter due to testing slightly deeper promotions in Q4 versus Q3.

As Andrew mentioned, we believe all our providers should be using Syndeo. With Syndeo set to be global this year, we expect to continue promoting Syndeo adoption amongst our existing provider base with trade-up efforts in 2023.

We have experienced no issue with our pricing power across delivery systems and consumables. The average selling price or ASP of our delivery system for the quarter was 24,408. The blended ASP for 2022 was 23,832, representing an 8% year-over-year increase versus 2021, in line with our high single-digit expectation. Lastly, delivery systems revenue for the quarter was \$50.7 million, resulting in 19% year-over-year growth. And consumables revenue came in at \$47.4 million, growing 35% year-over-year.

I want to take a moment on Slide 21 to discuss how we evaluate the performance of our consumables. As you can see from the chart on the left, we have demonstrated a sustained upward trajectory in consumables revenue quarter after quarter. On the right of the slide, you can see why. There is a high correlation between execution in expanding our footprint and pull-through of the consumable revenue.

Things will continue to be in the high-growth phase of rapidly expanding and selling new systems. We view total consumables net sales growth as a better measurement than a per system utilization metric for our business. As a reminder, we include one quarter's worth of consumables in the form of training kits for both new and trade-up Syndeo. Additionally, we have previously mentioned the longer run and, therefore longer tail of provider consumables consumption.

To feel an increase in that lifetime value, we're confidently introducing innovative new boosters and other product line extensions to stay nimble and increase the value delivered to consumers at each visit.

Moving to Slide 22. For the fourth quarter, we reported a GAAP gross margin of 66.4% or 72.3% on an adjusted basis. For the full year, GAAP gross margin was 68.4% or 73% on an adjusted basis. These margins declined year-over-year on a GAAP and adjusted basis driven by trade-up mix, costs associated with Syndeo's U.S. launch and international launch readiness, including trade-up volumes and premiums paid on accelerated manufacturing and shipping, global supply chain challenges, inflationary pressures and foreign exchange headwinds.

Most first-generation IoT products require continuous improvement based upon user experience. From our Syndeo launch, we gained valuable insights through provider feedback. Because our providers are always our #1 priority, we implemented a program to replace all systems regardless of issue until October 2022. As a result of this onetime program, we incurred \$2.4 million in nonrecurring logistics and servicing costs in 2022. Through the program, we have also optimized the deal in preparation for our international launch in the second quarter of 2023.

As we have mentioned previously, we have been value engineering and optimizing Syndeo for its international launch. As part of this optimization process, we increased our raw material inventory write-offs and warranty reserves for the fourth quarter, which negatively impacted the quarter's gross margin by approximately 2%.

As we mentioned previously, we expect to drive gross margin expansion in 2023 as part of our journey towards an 18% to 20% 2023 EBITDA margin. Even the similar dynamic at play with Syndeo international launch, we expect the gross margin for the first 2 quarters of 2023 to be similar to their respective quarters in 2022, with expansion occurring sequentially in the second half of 2023 post international Syndeo launch.

Moving to the bottom right. We delivered adjusted EBITDA of \$16.3 million for the fourth quarter and \$47.7 million for the full year. As Andrew mentioned, our profitability was impacted by FX headwinds and zero COVID policy in China in 2022. To help contextualize our China headwind, we invested \$17 million into our APAC operations in 2022, much of which was not productive due to the shutdown. The advantage is that we now have the team and the infrastructure in place ready to seize the opportunity of the reopening.

We also incurred onetime expenses of around \$3.8 million in patent litigation expenses and approximately \$3.6 million in reorganization expenses for the year.

I want to spend a few moments on Slide 23 to remind you of the seasonality in our business. On the left, you see our sequential net sales growth pattern. The year typically starts with a Q1 that is lower than the previous year's Q4, and results in Q1 being the lowest dollar revenue quarter of the year.

The second quarter gained momentum from the marketing activities conducted in the first quarter, which typically results in a heavy sequential increase in revenue from Q1 to Q2. In 2022, the second quarter benefited from Syndeo U.S. launch and the trade-up program. We anticipate a similar tailwind this year when we launched Syndeo in our international regions in the second quarter 2023.

The third quarter sees growth a bit at a more moderated level relative to Q2 due to the seasonal summer slowdown experienced across the beauty sector, especially in EMEA.

Lastly, the fourth quarter is typically our highest dollar revenue quarter of the year as holiday promotions, seasonally peak consumer consumption and the desire to exhaust CapEx budgets drive higher demand. Importantly, we made planned strategic investments in marketing early in the year to boost our productivity and support the stronger sales and margins seen in the second half. On the right-hand slide, you can see how this translates to a quarterly cadence of our adjusted EBITDA generation.

The seasonality we just walked through naturally makes us a back half-weighted business, and we expect the quarterly EBITDA contribution in 2023 to be similarly weighted as it was in 2022.

I will now turn to Slide 24 to walk through our cost details. Selling and marketing expenses for the fourth quarter were \$39 million compared to \$37.1 million in the fourth quarter last year. The increase is primarily due to sales commissions associated with higher revenue. Importantly, selling and marketing expenses as a percentage of revenue decreased 781 basis points year-over-year, demonstrating increased cost efficiency via operating leverage from higher revenue.

Fourth quarter G&A expenses of \$28.5 million were \$3.4 million higher year-over-year, primarily as a result of increased stock-based compensation, personnel-related expenses as we scale and professional fees relating to our SOX implementation, partially offset by fixed cost leverage. Lastly, R&D costs of \$1.4 million decreased approximately \$0.4 million from Q4 2021 to Q4 2022 as we lapped Syndeo development cost partially offset by planned investments in our data infrastructure.

I will now move to our balance sheet highlights on Slide 25. We ended the year with roughly \$568.2 million in cash and cash equivalents. Our first of \$200 million accelerated share repurchase programs launched in September was completed during the quarter and retired a total of 9.3 million shares. Our [indiscernible] million accelerated share repurchase program announced in November is expected to be completed by the end of the second quarter of this year.

We remain well capitalized to execute on our growth initiatives while keeping strategic M&A opportunities actionable. To that end, we are excited by our M&A announcement today with SkinStylus and continuing to build on the promise of a connected portfolio of BeautyHealth brands to serve our customers and consumers while keeping the majority of our dry powder for future growth.

To prepare for our international Syndeo launch, we invested significant working capital in anticipation of strong trade-up demand, similar to what we experienced at the on-site of the U.S. Syndeo launch. We anticipate lower working capital levels in the second half of 2023.

We continue to carry \$750 million of 1.25% convertible notes due 2026 on the balance sheet, which we opportunistically raised for M&A, among other uses. Our \$50 million revolving credit facility remains undrawn. Finally, our current shares outstanding are approximately 132.2 million.

Turning to Slide 26. Following two years of planned elevated investments to achieve scale, our goal and strategic focus now shifts to generating operating leverage and accelerating growth in China. We are proud of how fast we scale the business while simultaneously achieving strong net sales and profitability growth in 2022 despite the macro headwinds.

With continued momentum in delivery system sales, the international launch of Syndeo in the second quarter and resilient consumer demand around the world, we estimate to deliver net sales of \$450 million to \$470 million for 2023 or 23% to 28% growth versus 2022. With our foundation set, we're confident in our ability to deliver an adjusted EBITDA margin of 18% to 20% for 2023.

The chart on the right-hand side of Slide 26 demonstrates how we expect to realize this margin expansion. As you can see, we expect to leverage our fixed operating cost base to generate margin expansion, which you already started to see in the 2022 fourth quarter results.

Moving to gross margin expansion. As mentioned during our Investor's Day, we believe we have substantial gross margin expansion opportunity to capture through value engineering efforts. However, similar to what we saw in the first half of 2022, we expect the impact of trade-ups and Syndeo launch-related promotions to create a temporary headwind to our first half 2023 gross margins. Despite this, we expect our continued value engineering progress in 2023 were shown in the results in the second half of the year and result in full year gross margin expansion versus 2022.

We continue to remain disciplined, cautious and measured on performance in China. And should the region accelerate faster than currently anticipated, we're cautiously optimistic about achieving a 2023 adjusted EBITDA margin towards the higher end of our guided range.

While 2022 was a year of great achievement, it was made more remarkable by the fact that we overcame macroeconomic headwinds beyond our control. Our business overall continued to grow, and our consumers around the world showcased their resilience.

I'm very proud of what we accomplished in 2022, and we look forward to continuing to execute on our strategy to drive profitable growth in 2023 and beyond.

Andrew and I will now gladly take your questions. Operator?

Question-and-Answer Session

Operator

[Operator Instructions]. The first question is from Oliver Chen of Cowen.

Unidentified Analyst

[Indiscernible] on for Oliver. Congratulations on the acquisition. Just wanted to get more color on the potential synergies you expect from the new acquisition. And also in terms of China, I know you're giving a range in terms of EBITDA. But in your model, how are you thinking about sort of the recovery trend in China?

Andrew Stanleick

Thank you. Thanks for the question. I will kick off. First of all, we're very excited, of course, to announce this morning the acquisition of SkinStylus, an FDA-cleared microneedling device. And as I said in my prepared remarks, with our customer base, microneedling is the most complementary service towards Hydrafacial.

In fact, many of our providers actively recommend or prescribe Hydrafacial to prepare consumers for microneedling to make sure their skin is clean in its optimal state. So for us, it's an absolutely complementary and perfect fit for the company because it really leverages our existing call points. So immediately, we can have leverage to our sales team as they can put this product, SkinStylus, in the bundle with Hydrafacial.

So whilst -- as we've just announced the deal, we'll be working on integration. Revenue in 2023 will be limited, but we expect upside in 2024 and beyond. I couldn't be more excited.

And Liyuan, I'll hand over to you for the second part of the question regarding how we see China and that 18% to 20%.

Liyuan Woo

Absolutely. Thanks. Yes. So we're actually quite excited about some of the trends we're looking at right now from a consumer demand opening point of view. But for model assumptions, we assumed a very gradual opening. And part of the emphasis we're putting out there is if it does come back stronger, that's where you see potential upside. Otherwise, we model it based on gradual.

Operator

The next question is from Bruce Jackson of The Benchmark Company.

Bruce Jackson

On the last conference call, you were discussing about moving some of your manufacturing, and developing a more global supply chain. Just I wondered if we could get a quick update.

Andrew Stanleick

Bruce, thank you very much for the question. Yes, as we spoke before in previous calls, 2021 and 2022, really, as we're a new public company, were those years of elevated investment when we were setting out systems and infrastructure, a new EPL in Europe. As well as during Q4, we completed the in-market manufacturing in China for the APAC region, which we're very excited about. As we look to enhance our margin from this year and the coming years ahead, that will be an important component. So we completed that during Q4, Bruce.

Operator

The next question is from Jon Block of Stifel.

Jonathan Block

Liyuan, the systems delivered in the quarter was 2,067, essentially is right in line with our estimate, but I believe the ending installed base was below. I think the trade-ups were a bit higher based on your commentary, but maybe if you can just detail for us, did the retirements pick up a bit to get to that ending installed base?

And sort of a tack on to that question would just be, can you discuss the fourth quarter system ASP? I believe that was down sequentially. So I'm not talking about year-over-year FX, just again to be clear. That was down Q-over-Q. But I also think per the comments last quarter, you took price recently on the system. So please provide just color on the 3Q to 4Q ASP move, and I'll stop there.

Liyuan Woo

Absolutely. In terms of the net installed base, Jon, as you know, we do calculate the churn based on purchase patterns. And given the shutdown period for China specifically and some of the other APAC region countries, that negatively impacted the net installed base. That's one of the biggest factors, obviously, we continue to look at across the globe as well as we measure the churn.

Secondly, I think your second question -- sorry. Remind me again, the second question was on...

Jonathan Block

Just the ASP 4Q '22 versus 3Q '22 was down sequentially in light of what I think it was recent price increases. Maybe if you can just reconcile that for us.

Liyuan Woo

Absolutely, Bruce. So the ASP, as we mentioned, they actually did go hand in hand with the gross margin trend as well. As we test and learn on the promotion for trade-up, right -- remember, we talked about we went aggressive with trade-up when we launched, and then we went very shallow in terms of the promotion in Q3. As we test more in Q4, giving a slightly deeper discount, we saw it does move the needle. But obviously, that negatively impact the ASP as well as gross margin.

There's also partially -- as you recall, we're also marketing these refurbished leads, the last generation system, to different regions. So between distributor sales, given the shutdown in China and some of these refurbished resell in addition to the trade-up, those were the drivers actually move the needle when it comes to ASP for Q4.

Operator

The next question is Olivia Tong of Raymond James.

Olivia Tong

Can you talk about the launch of Syndeo internationally? Maybe compare and contrast your plans relative to the U.S. launch because obviously, it's a very different environment now versus last year when you launch in the U.S. And then just your thoughts on the contribution from U.S. in year two of Syndeo.

Andrew Stanleick

Thank you for your question. Yes, we're excited to launch Syndeo in Q2 of 2023. I think the benefit of us waiting a year is that we've got all the benefits from the learning and the optimizations we've made to our playbook from the U.S. So we're excited to launch it out sequentially globally from Q2 onwards, a rolling launch focused on key markets, first of all. So we're excited about that. And for the second part of the question, Liyuan?

Liyuan Woo

The second part of the question in terms of the...

Andrew Stanleick

U.S. contribution.

Liyuan Woo

Yes. So Olivia, as we model out the year, U.S. growth continue to be top of mind for us. And we kind of emphasize the fact that everybody is shooting on Syndeo. This is precisely the reason why we've been testing trade-up program.

As we're launching globally, the fact that we are value engineering, we're optimizing, we actually learned a lot with this IoT product, we continue to believe U.S. play a very significant part. As we emphasize a lot of the upside actually really truly depends on the APAC region, how strongly it comes back. So that's where really the potential upside will lay for the year.

Operator

The next question is from Margaret Kaczor of William Blair.

Margaret Kaczor

I thought I would start maybe with the gross or operating margins. Just kind of doubling down, I guess, on the cadence during the year. Should we assume kind of adjusted EBITDA maybe is below the range in the first half? And would it be anywhere near as much below kind of the 2022 numbers and then above the range in the second half? All of that leading to this question of, could you reach, I guess, even the mid-20s to finish the year this year?

Liyuan Woo

To answer that question, we really wanted to be clear in terms of the seasonality. When you look at Q1 being the lowest quarter of the year and the fact that we're launching globally Syndeo in Q2, I think -- and with all the investment we're going to be making on marketing to support the growth, all of which will speak to the higher investment for the first half of the year. And that also goes hand in hand with margin -- gross margin, right?

The fact that we're going to push trade-up, we emphasized this whole year last year. As you add trade-up, it's incrementally have a positive flow through. But from a gross margin percent point of view, it will give you a temporary negative impact. So with that in mind, absolutely to confirm your comment, it's going to be very much [indiscernible] heavy for 2023.

Operator

The next question is from Allen Gong of JPMorgan.

Allen Gong

I just wanted to follow up on a question that was asked earlier on the call just in terms of, I guess, the mix of new systems and churn in the quarter. You highlighted that China was one of the challenges there. So when I think about the trends you're seeing from China so far in the first quarter, it sounds like -- is it appropriate to think that we're seeing that more gradual improvement that you're assuming near the bottom end of your guidance?

And then also when I think broadly about your assumptions for the year, when I think about that \$450 million to \$470 million, how should we think about that when it comes to the mix of growth you're seeing between systems and consumables?

Andrew Stanleick

Thanks for your question. I'll start with China and then hand off to Liyuan. I think, look, what we're seeing is, obviously, we're in constant contact with our team on the ground in China. I think what we're hearing is that after an initial surge in COVID infections after reopening, as we get into late February, the market now is pretty much fully open.

And in fact, during the last two or three weeks, you've seen traffic gradually pick up. And our team estimates it's about 80% free COVID levels at this stage. So with that, we've taken a measured approach factoring in a limited contribution from China in the earlier part of the year, but we remain cautiously optimistic about Q2 and beyond. And of course, we're excited to launch Syndeo in that market during Q2.

And of course, if the rebound in China is more accelerated than originally anticipated in the second half of the year, as Liyuan stated earlier, that's when we'd be looking at more of the 20% higher range of our adjusted EBITDA guidance for 2023. Moreover, should the market deteriorate, we'll quickly take steps to adjust levers of investments to protect the bottom line.

Liyuan Woo

Yes. Allen, I think that's well summarized. I think the motto just confirms that, right? Q1 is almost over the fact that nothing really happens to after Chinese New Year kind of give you the sense of why we emphasize the gradual reopening. And you have to keep in mind, even the providers are very much focused on hiring, engaging their consumers and utilizing whatever the inventory they have at hand. So we took that into consideration. Hence, both of the revenue upside and EBITDA upside tie pretty closely to how robust the reopening will be.

Operator

The next question is from Korinne Wolfmeyer of Piper Sandler.

Korinne Wolfmeyer

Congrats on the quarter. So first, I'd like to touch on you -- spend a lot of time overseas the past year, really understanding the market and preparing them for Syndeo. Can you just talk about what visibility you have into system placements in these international markets once you do launch in the second quarter? And I assume some of the partnerships you've developed will help here, but any color there would be helpful.

And then secondly, just on marketing, can you just expand a bit on your ability to flex on marketing dollars that we do head into a tougher downturn or China goes back into lockdown? Can you just talk about your ability to be flexible with that marketing spend to maintain the margins?

Andrew Stanleick

Thanks for the question. Great to speak to you. So once again, I will kick off and then hand over to Liyuan for the second part of the question. I mean, clearly, despite the economic backdrop of last year, we're extremely pleased with the way our international markets perform, particularly our direct markets. If you consider EMEA, plus 46% up for the year despite the war, despite the FX headwinds would have even more if we are factoring constant currency. APAC, despite China with zero COVID policy, we grew 24%. So clearly, we're extremely excited to bring that Syndeo innovation during Q2.

I think all the work we've done in the last two years, in '21 and '22, investing in that planned infrastructure build of teams, people, training, education center systems [indiscernible] the manufacturing in China, I must say we're really excited and cautiously optimistic about the year overseas. And despite that, if we -- we obviously expect a strong year in the U.S. where we have a booming medical spa channel. So it's -- we're very cautiously optimistic about the year.

Liyuan, why don't you talk about the leads, which can flex if this doesn't plan out?

Liyuan Woo

Yes. Absolutely. And then just to add on to even Andrew mentioned, I think there were a bit more of the recession's peak when they come to the end of the year. But it's just lessening to the team around the world, it seems that it turned to be a bit more positive. But again, we're being cautious, and we're going to continue to observe.

Precisely as we shared before, Korinne, we're sort of 50-50 split when it comes to fixed and variable. And even on the fixed side of the equation, it's a lot of people cost. So to Andrew's point, if the market shut down, that's a lever you can't still pull. When it comes to variable, it's very much under our control. There are certain [indiscernible] locked in terms of investment, but we can pull that lever quite flexible around the globe.

Operator

The next question is from Ashley Helgans of Jefferies.

Unidentified Analyst

It's Blake on for Ashley. I might have missed it, but I was wondering if you could provide any commentary on your revenue contribution from Syndeo for new placements versus trade-ups throughout fiscal year 2023. Just was wondering how to think about that. If we could get any kind of commentary there. And then also just wondering if we could get an update on what are you seeing in terms of the health of your end consumer here in the U.S., and how that trended throughout the quarter.

Andrew Stanleick

Thank you, Blake. I'll kick off with the second part of the question and then Liyuan handle the first part. I must say, while no business is totally recession or economic uncertain proof, we found that our consumer and our provider has been extremely resilient. And we've seen -- as you've seen in our results, no slowdown in the demand for Hydrafacial. And as a proof point, you see that in our results.

And I think there's obviously a few factors behind that. I think, first of all, if you consider our channels, our products are extremely democratic place when compared to other aesthetic services in many of our customers. So we're really active that gateway product for entering aesthetics. And we do a little bit, I think, of trade down from higher-priced products into Hydrafacial. I think consumers are maybe cutting back in other areas, but certainly not willing to cut back in that monthly Hydrafacial. It's an investment in their self-care, their confidence.

So to date, we've seen no slowdown. I think we're benefiting really from the zoom boom and other broader shifts something I talked on the call about this medicalization of beauty where consumers are increasingly interested to step beyond perhaps the wellness trends of the past, the years and seek out a position and scientific endorsed products such as Hydrafacial. And we're really well captured to -- really well positioned to capture that shift.

I think the final piece for the U.S., the med spa channel is booming. It's a key channel for us. AMSTAR recently published that between 2018 and 2022, the med spa channel in the U.S. grew , significant growth, and we're -- it's a big part of our business, and we're on that journey with all of our providers growing as they grow. Liyuan?

Liyuan Woo

Yes. In terms of trade-up, we actually called out the dollar pretty specifically for the second quarter. It's over \$20 million, and that's the biggest quarter that we had the trade-up impact. When you sit back and just think about how many systems we sold in terms of a percentage, it's roughly about 20% for the year of 2022.

Operator

The next question is from Kyle Rose of Canaccord.

Kyle Rose

I wanted to just touch on two things. One, the acquisition. I wonder if you could give us just an expectation for how we should think about the revenue contribution over the near to medium term as it folds in.

And then secondarily, you really impressive leverage in the Q4. Obviously, it's seasonally strong with the revenue number there. But just was impressed by sales and marketing leverage given all of the initiatives you have going on. So it would just be helpful to understand how we should think about some of those incremental spend as we move through 2023.

Andrew Stanleick

Thanks for your question. I will kick off in terms of SkinStylus. So clearly, we've just announced it. We're very excited about it. We absolutely convinced that this microneedling device is new, better, different than anything else in the market, but it's an early emerging stage technology.

So I think what you'll find is that we'll have, in 2023, limited revenue upside, but we have obviously significant plans for this ahead for 2024 and beyond. And I think in the coming months during later calls, I'll update you on the successful integration and what more you can expect from SkinStylus. But it's the perfect fit for our business. It's so complementary to Hydrafacial, our sales team, our BDM team. It's a really great fit for us. Liyuan?

Liyuan Woo

So when it comes to marketing, last year, we've been emphasizing our own seasonality. We always invest heavier in the beginning of the year, and we anticipate the leverage to pay out in the second half. And you've sort of seen that during the fourth quarter.

When it comes to 2023, clearly, there's committed events that we invest upfront. You can see [indiscernible] as Andrew was sharing. Especially with the second quarter of launch, there's a lot of preplanned events around the globe at play. But when you look at the second half, there's a lot of leverage we can pull and lever we can pull as we double down and getting more at least in order to convert, but then we can really decide on how big or small we can go when it comes to trade shows and other more physical activation.

Operator

The next question is from Navann Ty of BNP Paribas.

Navann Ty

Just a question on China. There's a comment on the related return on investment. So shall we see further investment in China? And if yes, what's the timing of investments?

In the U.S., my second question is, have you seen -- or do you expect a change in competitive pressure? And just a final quick one. Do you plan similar acquisitions in the low double-digit range in 2023?

Andrew Stanleick

Thank you. Thanks for your question. There's a lot in there. So let me start, first of all, with China. If you're relatively newer to our story, we've said that '21 and '22 as a new public company were our years of elevated investment where we set up globally our infrastructure systems and local manufacturing, training, education and teams, which we did in '21 and '22 and especially in 2022 in China. So the -- predominantly, the bulk of our investment is done in China, and that's where we're so well positioned now to capture the opening growth as this market starts to open, especially as we launched Syndeo in Q2 across the region.

Liyuan Woo

Yes. I think the other question that you had in terms of acquisition, we've always looked through those three criteria that Andrew has mentioned. It has to be accretive to the bottom line and need not to be a fad, and they need to have a common call point. And we continue to be very mindful and thoughtful in terms of our execution.

Andrew Stanleick

And then the final question I'll take. You asked about the guidance for the year. Yes, I want to reiterate, we absolutely confident to deliver between the 18% and 20% adjusted EBITDA guidance we gave for 2023. The upper limit, as we discussed earlier, will be really dependent on China and also just reaffirming our long-term 2025 guidance, which we gave during Investor Day. Thank you.

Operator

The next question is from Linda Bolton-Weiser of D.A. Davidson.

Linda Bolton-Weiser

Sorry if I missed this, but can you give an operating cash flow number for 2022? And then I know you kind of mentioned some investment in working capital. Is there some kind of a rough outlook that you have for operating cash flow in 2023?

And then my second question is, what are you seeing or learning so far regarding the connectivity and the data and analytics you're able to have now with the connectivity of that new Syndeo device? What are you seeing or learning so far with that?

Liyuan Woo

I'll address the free cash flow question first. We had spoken about we invested in working capital heavily in 2022 as we're getting ready to launch Syndeo globally. As we learned, if you recall, when we launched in the U.S., we run out of inventory. We were very quickly trying to speed up and really shift the units out. So we're in a really good position as you can observe our inventory balance.

Obviously, if you look at us, we pay about \$10 million in terms of interest. We pay about \$20 million CapEx, if you assume the EBITDA margin will be guaranteeing for 2023. That by definition should be in a cash flow positive position. So then they all boil down to working capital.

So once we launch globally in the second quarter, Linda, our expectations really managing that working capital closely, and you should see more of a beneficial trend coming through the second half of 2023. We feel positive about cash flow generation starting at the end of 2023.

Andrew Stanleick

Thanks, Linda. And in terms of what we're learning, coming up for nearly a year since we launched Syndeo in the U.S., we're learning a lot. I think we're learning, adjusting. It's giving us a number of insights, firstly, on the consumer and the number of sort of more depth of knowledge on the consumer. It's helping us develop new products and protocols such as body, which is obviously going to be a key strategically for us this year.

Also, we're learning how to improve the system and the software. And we're always iterating and learning and improving the system based on provider feedback, based on what we're learning of that data. And that's why, again, I think it's another advantage why we waited for a year before launching internationally. We're able to take all of those learnings and optimize that for that launch in Q2 overseas. And I think in coming quarters, we'll share more insights with you on what we're learning.

Operator

This concludes our question-and-answer session. I would like to turn the conference back over to Andrew Stanleick for closing remarks.

Andrew Stanleick

Well, thank you, everyone, for your questions. Just to close, I'll reiterate our confidence in the path forward. I think with our investments now already complete, we have the infrastructure in place to deliver on our profitable growth strategy. I think we have an exciting year ahead with Syndeo's Q2 international launch, differentiated partnerships to drive consumable sales and recruit new consumers to the brand, China's reopening and the integration of SkinStylus.

So we look forward to continue to execute and further our category leadership in 2023 and beyond. The team will be available today for any additional questions you have. Once again, thank you, and have a great day ahead.

Operator

The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.

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