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Haypp Group

Q4 2022



Prepared Remarks

Morning, and welcome to the Q4 2022 Earnings Conference Call. All participants are in listen only mode. After today's presentation, there will be an opportunity to ask Please note this event is being recorded. I would now like to turn the conference over to Gavin O'Dowd, CEO. Please go ahead, sir.

Thank you very much. Good morning, and welcome, everybody, to Hyatt Group's presentation of the Interim Report for the Q4 of 2022. Today, we will walk you through a brief overview of our business and comments on the operational and financial performance for the Q4. The interim results and results presentation is available at the Investor Relations section of our corporate website. Presenting today, in addition to myself, is Shans Anderson, our CFO.

Moving to Slide 3 in our results presentation. Here, we see it our higher purpose of inspiring healthier enjoyment to millions, which is predominantly moving people from cigarettes to safer alternatives There traditionally was snus and in more recent years nicotine patches. Moving to Slide 4. We have a chart presenting the spectrum of nicotine products and their relative harm versus cigarettes. Hype Group's current focus on nicotine pouches and sluice Lies in the lower end of the spectrum.

The scientific body of research around modern harm reduction alternatives to cigarettes Has come a long way in recent years. In addition to nicotine pouches and snus, products such as tobacco heating devices and paper are widely Accepted as carrying a significantly lower level of harm than traditional cigarettes and other smoking products. On Slide 5, we can see the smoking rates across a range of European countries sorry, In Slide 5, we can see what smoking rates are like across a range of European countries. Sweden, with a strong tradition of oral nicotine, It's below 1 third of the European average of smoking rates. In Norway, where oral nicotine products were introduced some 20 years ago, Smoking rates are on similarly low level to Sweden.

On the right hand side, we can see how smoking rates collapsed Between 2005 2020 in Norway, especially among the younger part of the population. And there is an almost perfect correlation between that And the uptake of nicotine patches and snus among the same age groups. It is this impact on public health, which we wish to bring to other countries. Turning to Slide 6. We can see the outlook for the market we laid out in 2021 in connection with our IPO, and we believe it is equally as valid today.

We see a global market size for nicotine patches and snus, which will increase from SEK 27,000,000,000 in 2020 To €60,000,000,000 in 2025. All of this growth is going to be delivered by nicotine pouches, which will increase from share From 30% again in 2020 to 80% in 2025. Since the market outlook was nicotine pouches has been tracking in line with our expected CAGR of 41% per annum. And it is also worth noting that hype has been growing significantly faster. Due to the harm reduced nature of this category, it carries lower excise taxes Hence, there is quite a significant profit pool to be divided between manufacturers and retailers from SEK 48,000,000,000.

Furthermore, the category is very well suited for online and we see online penetration increasing for every quarter that goes by and we expect online to increase at healthy levels. Moving along to Slide 7. We laid out the key factors behind the growth in nicotine patches. The primary driver is strong consumer demand for less harmful products, which is greatly supported by regulators In general, which are adopting a principle of harm reduction in their legislative approach to nicotine patches. This in turn has led to significant investment from the category in the category from the industry players, both large tobacco companies and many credible new entries Our driving Innovation.

These are the drivers for the growth which we see on the right hand side. On Slide 8, We have a picture of the competitive landscape for online in our category. While there is a significant number of players, many of whom come and go over time, They never reached the scale that we are at, and we are currently about 10 times the size of our largest competitor online. On Slide 9, starting off with Sweden, we are continuing to grow market share within nicotine pouches. And as nicotine pouches continues to grow its share in the total market, our share of the Swedish market has lifted from 10 percentage points that we stated in 2020 Up to the early to mid teens.

As discussed in previous earnings calls, we have struggled in Norway since the border and the duty free channels reopened post COVID And contracted the domestic market. However, we turned around the development in the Q4. And in the Q4, we saw Strong growth in the nicotine pouch volume, which brought our total volume growth in Norway into positive low single digits. We estimate that our market share within the domestic market has been holding strong throughout 2022 and accelerated in the 4th quarter, especially within nicotine patches. In our growth markets in Europe and the U.



S, we have invested to grow market share, both within the online channel and within the total market during 2022, and we continue to do so in the Q4. Moving along to Slide 10, You will see an overview of our logistics infrastructure. Convenience remains one of our key USPs and the ability to offer our customers across the markets Fast and reliable delivery sets us apart. We completed the first phase of our warehouse expansion plan in Q2, And we are now operating 6 warehouse locations across our core and growth markets. We have managed this expansion while continuing to maintain healthy inventory turnover 15 times in the past 12 months.



Furthermore, the warehouse expansion has led to improved consumer retention rates, which I will come back to in a moment. Having successfully completed the first phase during Q2, we have progressed to another phase where we are enhancing our infrastructure and back In addition to supporting scalable future growth in our current markets, it will also enable us to efficiently move into new markets. Moving along to the operational highlights of Q4 on Slide 12 And starting with our performance in nicotine patches. The growth in consumer demand for significantly less harmful nicotine products remains unabated And continues to gain support from regulators. As I touched upon in the earlier slides, effectively all growth for the combined nicotine pouch and snus category is coming from nicotine pouches.



With this in mind, the nicotine pouch volume is our primary measure of growth. In addition to the overall nicotine pouch Category growth, Hype continues to grow market share across all of our markets. Our nicotine pouch volume increased 42% year on year For the group, driven by solid growth across all geographies. Our stellar performance in the category in recent years It's the result of relentless efforts and focus from our team, who I would like to take the opportunity to thank. Despite a turbulent environment with firstly COVID-nineteen and secondly the terrible invasion in Ukraine and the effects of the macroeconomic environment, We have grown our nicotine pouch volume by 5 74% since the Q4 of 2019.



Nicotine pouches now accounts for 44% of the group volume, and this compares to 36% in the Q4 of last year. We continue to play a pivotal role in launching products in the nicotine pouch category, which in turn accelerates the migration from cigarettes. During Q4, 20 percent of our nicotine pouch volume relates to products which were launched in the past year. As I briefly mentioned earlier, our investment in 3 local fulfillment centers in the U. S.



And the UK in the first half of twenty twenty two Have resulted in a material improvement in customer satisfaction and retention rates. While the relatively low volume in these warehouses initially means lower margins, The increase in volume is rapidly releasing benefits of scale and will support our EBITDA over time. With that, I'll pass the word over to Svernte for comments on our financial performance.



Thank you, Gavin. With that, let's flip to Page 13 and the financial overview for the group. So we reported a net sales increase of 19% for the group in the 4th quarter. In constant currency, the net sales increased by 15%. Effectively, all of the growth is attributable to our progress within nicotine pouches, And we're recording solid growth rates for nicotine pouches across all markets, including Norway.



The underlying trend of gradually increasing gross margin that we've seen throughout 2022 is driven by our performance within nicotine pouches and the strength of our value Our volume performance in the 4th quarter further amplified this trend, and we increased the gross margin by 3.1 percentage Point to higher than normal 13.9 percent gross margin. Adjusted EBIT for the quarter grew by 36% versus last year and amounted to SEK 16,000,000 corresponding to an adjusted EBIT margin of 2.3%, up by 0.3 percentage points versus last year. The drivers behind the EBIT margin uplift is higher volume and gross margin, partially offset by higher adjusted OpEx from investments in the organization to support further growth. Our cash flow from operating activities during the period was negative SEK 32,000,000 due to the planned Temporary inventory buildup in Sweden ahead of the excise tax increase on the 1st January. Adjusting for the inventory buildup, Underlying cash generation remains strong.



Now turning to Page 14 and zooming in on our core markets. Reported net sales for the segment grew by 12% during the quarter and amounted to SEK565,000,000. Arniketian pouch volume grew substantially more at 41%, with both Sweden and Norway showing strong performance. In Sweden, net sales for the quarter increased by 19%, driven by continued strong performance in the nicotine pouch category. In Norway, we saw results from our efforts to turn around the previous negative trend and net sales increased by 1% versus last year.



On a sequential basis versus Q3, net sales increased by 20% in Norway after having seen declines sequentially in earlier quarters of 2022. The profitability for our core markets continues to increase. And on a full year basis, we generated SEK 174,000,000 of EBITDA in the core market. The EBITDA margin increased in the 4th quarter to 8.4%, up by 1.2 percentage points against last year. This is showing the scalability in our business model and evidencing our ability to reach our long term financial targets.



The EBITDA margin increase in the quarter is mainly attributable to a higher gross margin partially offset by OpEx investments. Now moving on to our Group Markets on Page 15. Net sales increased here by 56% to SEK 136,000,000. For the quarter on the back of strong performance across both the U. S. And Europe, EBITDA amounted to negative SEK 18,000,000 versus negative SEK 15,000,000 during the same period of last year as a result of continued commercial investments for growth.



And we continue to invest substantial resources into building strong market positions in these very significant consumer markets, And we have been gaining market shares throughout 2022. We remain confident that with our current trajectory and market share gains, we will over time be able to. Lastly, here on Page 16, we have the selected KPIs, and I would like to focus on the balance sheet in particular. In this uncertain macroeconomic environment, we are particularly pleased that our financial position continues to remain strong. We closed the year with a net working capital position of SEK 230,000,000 of which our inventory accounted for SEK 223,000,000. As we built up stock before the anticipated excise tax increase in Sweden. The fast moving nature of our products naturally implies High inventory turnover rates, and we are already well on the way to have cleared out most of this excess inventory.



On the back of inventory build, net debt increased at year end to SEK 185,000,000 corresponding to a net debt to adjusted EBITDA ratio of 1 point. Which we expect to revert down as the inventory is cleared during Q1. And with that, I'll hand the word back to Gerben.



Thank you, Sandeep. Moving on to Slide 18. We reiterate our long term targets of SEK 5,000,000,000 in net sales by 2025, Predominantly through organic growth. We also reiterate our profit target of high single digit adjusted EBIT over the medium to long term. As you have seen from Stellantis material, we are already rapidly closing on this target in our core markets.



Due to the growth potential of the category, the Board does not intend to issue any dividend in the foreseeable future and instead utilize Our strong cash generation and robust balance sheet to accelerate growth. On Slide 19, we highlight the potential which we see for the overall category growth and also the potential for online to take a larger share of that category, given how suitable the characteristics of the category are for online. We also reiterate Our market leading position in all of our key markets. Moving along to Slide 20 and our current trading. Overall, market trends for the oral nicotine category remains favorable, and we continue the transition of our business into a nicotine patch into the nicotine pouch category.



On top of that, the online channel continues to grow relevance within the category. In terms of inflationary pressure on inbound costs, we reiterate our previous guidance that inflationary pressure on our cost base remains limited. Given the non cyclical characteristics of the category, we remain confident that any additional inflationary pressure can be passed on. Looking ahead, we continue to see a solid performance in our nicotine pouch growth. The successful turnaround in Norway creates a solid platform for profitable growth. In core markets, performance has remained strong despite challenging comparables. From the final COVID lockdown during the 1st weeks of 2022.



The strong momentum we have in our growth markets. It's sustained as we continue to gain share in the total market. Following the flavor ban in California, we have seen an initial uplift in our performance, But we remain conscious that it is still early days and consumers are still settling into the new environment. Given the continued strong performance of both the category and the channel, we have further strengthened our capabilities in key strategic areas. We believe this is broad based efficient to achieve our medium term growth ambitions. Our capabilities to attract new customers and retain them. We are also hinged around convenience, assortment and price continues to perform well in the current macroeconomic environment.



We are on track with our plans to enhance our digital infrastructure, including our back end, enabling further growth opportunities and releasing benefits of scale. Lastly, we are very well positioned for the current complex environment for consumers. With a strong balance sheet, A non cyclical product and a capital light business model, we are able to remain flexible and strengthen our market position. As I wrap up, I would like to guide you to Slide 21. In summary, there is over 1,000,000,000 smokers in the world, The majority of whom are looking for healthier alternatives and nicotine pouches is the fastest growing category.



The category is perfect for online And we are the undisputed global online market leader, where we're over 10 times the size of our nearest competitor. We have a symbiotic relationship with our suppliers, We are in addition to being a partner of choice for new launches. We are also one of the largest providers for consumer insights. We continue To welcome proportionate regulation, and we often benefit from it. Our unit economics continue to improve as we scale, And this is already evident in our core markets.



And we have a highly engaged team with core competencies across both the Canadian industry and e commerce. With that, operator, I would now like to open up the line for questions.

Q&A



We will now begin the question and answer session. At this time, we will pause momentarily for assemble our roster. The first question comes from Niklas Ekman from Carnegie. Please go ahead.



Thank you. Yes, I have a couple of questions. Firstly, if you can elaborate a bit on this excise tax hike. You talk about a significant Stock build, is that something that's also had a positive impact to your sales in Q4? Or is it mainly that you built inventory That you're using to boost your profitability?



That's my first question.



Good morning, Ikhlas. This is Svantho speaking. Yes, you're correct. We did build a lot of inventory as we talked about. We have not seen that much hoarding effect on our sales From the tax increase, I think there was a bit of that in the last couple of days of the year.



So it obviously has a very limited impact On the quarterly figures here, but I'd say the big effect from the excise increases that you as we have highlighted here that we build inventories, but limited on the sales side.



Okay. Super. And are you using this inventory here to boost your profitability or to gain market share by having Lower prices than your store based competitors? Yes.



So I think we I mean, we built this inventory with the aim Have the flexibility. I think we are a little bit as we are sort of in the middle of the Q1 now, we won't come into detail At this point, I think we'll have to see the exact results. And we released our Q1 reports, right? The pricing always It kind of depends on competitive activity as well and so on. So we won't say too much about that at this point.



Okay. Fair enough. Secondly, on Norway, this is a business where you've had a Fairly sharp decline in the past four quarters. Now it's flat. And this is still a quarter where I think that you are Still negatively impacted year over year by the shift back to border trade.



So is there any way to kind of Pickup, what is the underlying growth in Norway? Do you have any estimate of what the underlying growth is when you kind of adjust for this the COVID impact Then what is done to border trade?



Maybe just to give a little bit of context around this one, Nicolas. So when COVID we had a robustly growing business quarter on quarter up until COVID hit. When COVID hit, we came close to tripling our business in Norway quite rapidly. And then we saw the unwind of that As we go in through the early stages of 2022, what we can see now is that our business in Norway has shown robust quarter on quarter growth During Q3 and continued robust quarter on quarter growth during Q4 and particularly driven by nicotine patches where we are seeing material year on year growth During quite substantial year on year growth during Q4. So



I'm bearing in



mind that for Q4 in 2021, There was a lockdown in Norway for the last, I think, 5, 6 weeks of the year. So we did face some high comparables for that period in Norway as we are facing For the 1st 4 weeks in January 2023, we also had a lockdown in Norway for that period. And we are showing We continue to show strong performance within Norway. So we view it very much as though not only have we turned the corner in Norway, but we are Showing material growth, and we are doing it now for a couple of quarters consistently.



And would that in your best estimates, is the growth in Norway, is that stronger than what you're delivering in Sweden or even the growth market, is that the kind of magnitude you're looking at? Or what kind of underlying growth are we talking about?



No. So it's not at the magnitude of it's not at the quarter on quarter growth here is not at the magnitude of what we're seeing in growth markets For the reasons of it's already a core market, we have a material market share already within Norway. So it is a much Our base to be working from, but we are dealing with quite healthy and robust quarter on quarter, strong And mid single digits sort of quarter on quarter growth rates within Norway, if that gives you some sort of guidance, some sort of Construct around the growth rates that we're experiencing there at the moment.



Yes, yes. Sure, sure. Thank you. Thirdly, just on your margin progression. Your and I'm talking EBIT margins now up 40 basis points now in 2022.



Do you have any best guess for what we can expect in 2023? And then Particularly considering your margin your medium term margin targets are for mid- to high single digit operating margin. So that would Acquire an acceleration from what we've seen in 2022, is it reasonable to assume that this margin expansion will accelerate in 20 3, and then particularly now with Norway maybe coming back to good growth.



Yes. I think I mean, on that one, our guidance Hasn't changed very much, Niklas. I mean, we I think, first of all, we see 2023 as quite a good year as well to Continue to really grow market share and advance our market positions in the current economic environment. And I mean, we have been sort of guiding, I guess, that our if you look at our margin in relation to the financial targets, it will be somewhat And I don't think we should expect any sort of material uplifting digit margin throughout 2023, but More sort of continued focus on well, advancing our positions within the markets we are in.



Okay. Thanks. And you talk about in the press release, you talk about a Favorable regulatory development. Are you referring to any specific recent events? Or is that more a general Reflection of the year that has



passed? I think it's a general reflection of the year. And I know in some of the prior calls, we talked a little bit about what had happened During some of the earlier quarters in 2022, particularly the positive output that we were getting from Germany around this space. So I think it's more of a general sentiment rather than any specific events which has occurred within Q4.



Okay. Fair enough. And the final question, just you mentioned here that your warehouse expansion enables expansion to new markets. Can you elaborate a little bit on what kind of markets you're looking at for future expansion?



Yes. So maybe just to give a little



bit more context around that one, Nicolas, what we talked about was the warehouse expansion was the first phase, which we've wrapped up by the middle of last year. We now recognize that in order to be able to utilize our capabilities across New markets and new opportunities as they emerge. We're going to be dedicating a little bit. We are currently in the process of dedicating a lot more of our energy towards building Other aspects of our back end infrastructure around both warehouse management systems, transport administration, ERP, etcetera, In order to prepare us to launch across more markets, our intent is that these markets are likely to Remain within Europe and North America. We don't envisage that there will be much outside of that.



Okay. But are you looking at several markets several new markets in Europe in the next 1 or 2 years? Or is it further down the line?



Yes. No, I think it's we're looking at a range of new markets and that is the timeline that we're considering as well.



Okay. Super. Thank you so much for taking my questions.



Thank you, Nicholas. Thank you. Thank you.



The next question comes from Yan Guarey from Barclays. Please go ahead.



Hi, good morning, Gavin. Good morning, Swante. So a few questions from me. First is around this e cigarette launch, which has happened in U. K.



Last month. Can you just tell us what are the initial sort of feedback from the market? And also, we had this issue with ELF BART in the UK last week. So how do you ensure that something like that doesn't come on your platform?



Absolutely. So maybe just to stand back and give some context So on this, we have been standing back. Of course, we've often said over the last number of years that our objective here is to inspire healthy enjoyment to millions and that we are in the harm reduced space around nicotine. What we've seen happen a lot in the last couple of years is that There's been a lot more progress around the product standards within the e cigarette space, and there's also been a lot more epidemiology Around e cigarettes, so we can see that it now meets our threshold of sub-five percent harm of cigarettes. We also recognize that As we look across broader markets, not every consumer is prepared to move away from cigarettes towards an eating pouch.



And hence, we decided that we would launch a test within the U. K. Where we're respectively just dipping our toe in very gently To get a sense of what the consumer behavior is in this category and how it interacts with the consumer behavior around our own category, so we can take learnings. So our primary objective within the UK is very much around learnings at this We don't expect this going to be a material share of our sales for the foreseeable future. This very much needs to be viewed as a Test concept in a test market.



And then regarding the specifics of products itself, of course, as you may be aware, Within nicotine pouches, where the product standards are not regulated by the governments, we test all of our products Independently and unless the products meet our product standards, we refuse to offer them to our consumers. Within the UK, Products themselves within the vaping space are regulated by the government. And as such, every product in the government gets a permit as it goes I think there is a certain degree of noise going through there at the moment regarding some of the products such as the ones you've mentioned. And we want to see how this plays out as the market stabilizes a little bit more in the coming weeks.



Sure. Thank you. So when I look at your growth in the core markets and growth markets, it's I mean, yes, core markets are growing mid teens, growth markets are growing mid-twenty, But it's not as much of a difference as one would think. So will that gap widen next year and going forward that growth markets are growing Twice or thrice the rate of core markets? Or will it still be fairly in a narrow band, the growth rates that we see in core markets and growth



Yes. Absolutely, Gara. Without being too specific here, but I guess, I mean, the growth markets Grew at the rate of 56% in Q4. And I mean, we as we mentioned here in the current trading section, we're continuing to See solid performance in the growth markets as to where we are today. I think In terms of the core markets, I mean, we mentioned today that we've seen a bit of a turnaround in Norway, where we're now Growing by 1%.



So I guess, we can call that sort of flattish rates. I think what we need to bear in mind as well regarding Norway is that there was The final COVID lockdown kind of extended a couple of weeks into 2022 as well. So the comparables We're meeting now for Norway are still somewhat inflated, I should say. But I mean, In general, I would say that the trends that we are seeing now in Q4 are kind of continuing in the same manner



Okay, sure. And the final question on this 2025 target, which requires a 25% sales CAGR from here. How confident are you that you will hit that number? Or do you need to bring it down a bit?



We remain committed to our €5,000,000,000 We definitely remain committed to that. And we see, of course, that You can take a look at a few aspects in this. One is that nicotine pouches in itself is growing by 42% At this point in time and our base of nicotine patches and how that has adapted over recent years, it's now 44% of our sales. So we I think the best way perhaps to understand the way that we view this is not necessarily viewing it on a total group growth level, but viewing it on a growth level per category. And I think as we view it on the growth level per category and map it out, we understand it's going to require a strong degree of focus and commitment, But we remain committed to this.



Sure. Thank you.



Perfect. Thank



you. The next question comes from Fred Yuan from FED. Please go ahead.



Hi, good morning. Just a few follow ups from me. Starting off with your core markets And the excise increase there. Could you give us some color on how you've acted on the Swedish market in light of this And your pricing of the stock from last year?



Hi, good morning. Yes, I think we We're a little bit reluctant to comment too much around our pricing. That's kind of day to day business that we cannot discuss too much publicly. I think What the inventory build ahead of the year and gave us was flexibility to obviously either Invest that benefit into customer into the customer or keep it for ourselves. And I think the exact trade offs there where we don't Sort of want to publicly discuss too much given that it's quite commercially sensitive.



But I think more of a general statement, as I said earlier on in question, we're seeing we're continuing to see strong performance in our core markets So far into Q1 and then sort of broadly in line with earlier trend here.



Okay. Fair enough. Turning to Growth Markets then. We saw a relative improvement in margins, But an increase or increased loss in absolute terms. Going forward, do you expect EBIT to improve in absolute terms as well?



And I guess, and if that's the case, how far away is the reversal there, do you think?



Yes. So I think we will it's fair to assume that we will continue to invest behind these growth markets. I mean, these are I mean, we have to keep in mind that it's Quite large consumer market. It takes a degree of investment to really get to the scale we want to get that. And I think it's just, as I said, we can assume that we will continue to do that for the foreseeable future.



And then you can sort of overlay that with our Financial targets here, we are we have been quite clear about the margin kind of expansion from here will be somewhat a close



Perfect. Makes sense. Speaking about your growth initiatives, do you have any Concrete growth initiatives for 2023 and what will be the financial implications of those?



We have there's nothing at this point in time that we're prepared to share around our growth initiatives for 2023. Apart from that, what I kind of responded a little bit on earlier, over the longer term, we do expect to have a broader geographic pace and we're preparing ourselves for that Across a range of markets, but there is nothing that we're ready to comment on Right



now. Fair enough. Fair enough. Have you seen any impact from PMI's acquisition of SwitchMatch On your operations?



No, not I'd have been no material impact on that one. We Spirit of Morris didn't necessarily have a huge position within the oral nicotine business beforehand, so it doesn't really alter the dynamic category very much. However, I do hope to see that it will accelerate the growth of harm reduced products and Orin Nickelodeon in particular across new geographies in the foreseeable future. I have a strong hope for that.



Yes. Fair enough. That's all for me. Thank you so much for taking the time.



Great. Thank you. Thank you.



This concludes our question and answer session. I would now like to turn the conference back over to the management for any closing remarks.



Thanks for listening everybody and we'll catch you again in May when we release our Q1 results. Thank you. Thank you. Bye bye.



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