

May 3, 2024

Haypp Group

Q1 2024



Speakers



Gavin O'Dowd
CEO | Haypp Group



Niklas Ekman
Senior Equity Research Analyst | Carnegie



Operator



Peter Deli
CFO | Haypp Group

Prepared Remarks



Operator

Welcome to the Haypp Group Q1 2024. For the first part of the conference call, the participants will be in listen-only mode. During the questions-and-answers session, participants are able to ask questions by dialing pound key five on their telephone keypad. Now I will hand the conference over to the speakers, CEO Gavin O'Dowd and CFO Peter Deli. Please go ahead.



Gavin O'Dowd

CEO | Haypp Group

Good morning everybody, and welcome to our Q1 2024 interim results. Starting with the operational highlights, I would like to begin with our nicotine pouch first quarter volume growth of 40%, which remains robust despite Easter falling in the first quarter. If we run our NP volume performance out to year-to-date, end of April, i.e., reflecting the Easter effect in both years, you can see that our NP performance accelerated to 42% over that four months. NP accounted for 58% of our total volumes for the year, up 12 percentage points vs the first quarter of 2023, and the trend continues, and our NP share was over 60% in March. We're particularly happy with the continued strong performance for NP in our growth division, which has also moved into profitability for the first time.



Gavin O'Dowd

CEO | Haypp Group

This snus category moved into overall decline, overall market decline during 2023, and this is expected to continue for the foreseeable future. These changing dynamics have reduced the brand owners' appetite to invest in either new Snus launches or Snus promotions. Our consumers greatly value our ability to display new products and our competitive prices. The absence of both has resulted in a decline in our Snus sales slightly faster than that of the overall market. While Snus is not a strategically important long-term category for us, we have taken some actions to bring our decline back in line with the market. The increase in our EBIT margin from 2.3% to 3.5% reflects the benefits of scale throughout our business, particularly in our growth markets. This 3.5 percentage points includes an additional 0.8 percentage points, which has been reinvested into emerging opportunities.



Gavin O'Dowd

CEO | Haypp Group

Our infrastructure transformation continues on track and will be key to our effective continued expansion. Moving to the next slide and taking a look at our emerging market segment. As we touched upon in the Capital Markets Day, while nicotine pouches, our primary category is the fastest growing of the three risk-reduced product categories globally, and our existing markets currently account for the vast majority of total NP global volume, we also recognize that only 4 million of the existing 100 million users of risk-reduced products are in our current target. This is why we plan to expand into adjacent RRP categories and new countries over the country. We have first expanded into Vape in some of our existing European markets, which covers an additional 6 million risk-reduced product consumers.



Gavin O'Dowd

CEO | Haypp Group

While our existing infrastructure and skill set gives us a material boost, our granular understanding of the Vape category and establishing organic search positions will require persistence over the coming years. We also appreciate the strong relationship between nicotine pouches and Vape, with many NP consumers either previously been vapers or even still been dual users. Finally, we recognize that a wave of regulation regarding disposables is potentially on the horizon in Europe and may alter the landscape for the Vape category. In general, we view this disruption as a long-term opportunity and shall dedicate our resources towards this opportunity with a clear appetite to have an economically sustainable slice of the market over the longer term. Moving along to our infrastructure improvements.



Gavin O'Dowd
CEO | Haypp Group

We are building our total company infrastructure with the principles of sustaining growth in our current markets and ensuring efficient expansion into both adjacent categories and new geographies. We continue to make strong progress in this transformation. During Q1, we replaced our ERP and middleware in Sweden and Growth Europe, bringing all of our European operations onto the destination architecture. This facilitates the migration of our e-commerce stores to V3, our upgraded system. In addition to the new launch of VapeGlobe, the Vape Globe store in Germany in late 2023, we have also successfully migrated our first Norwegian store in recent weeks with minimal disruption. Moving on to our warehouse structure, we plan to automate our Texas warehouse in the latter part of 2024. This will harmonize our warehouse equipment and software, which is working efficiently in our European warehouses.



Gavin O'Dowd
CEO | Haypp Group

In summary, the team are executing in line with our plans. Moving along to regulation. The new national regulatory initiatives in Sweden reinforce the principle of tobacco harm reduction. In addition, we support potential initiatives which could deter youth access, including restrictions on private persons reselling products and reinforcing product standards which we at Haypp Group have self-imposed many years ago. In Norway, there has been minimal movement on regulation, and we remain confident that Haypp Group will not be negatively impacted by the potential regulation. In the U.S., the regulatory framework remains very stable despite some recent concerns from a prominent senator. Youth consumption remains extremely low for nicotine pouches. While the upcoming legislation is somewhat later than we initially expected, we generally welcome the legislation and believe that Haypp Group is well positioned to benefit from it.



Gavin O'Dowd
CEO | Haypp Group

At an EU level, TPD3 appears to be even further delayed. This has encouraged more member states to start to regulate NPs themselves. This continues to add even more weight towards appropriate category regulation at an EU level. With that, I will hand over to Peter for more depth on our commercial performance.



Peter Deli
CFO | Haypp Group

Good morning everyone. Thank you, Gavin. Let me start with the financial overview on a group level, and let me start with sales. So overall, we reported a 12% sales growth on a group level and achieved SEK 888 million sales. If we exclude the unfavorable currency impact, the growth would have been 13%. But there are three key elements which I would like to call out to give a bit of a color behind our sales performance. Gavin already mentioned Easter. So during holiday seasons, it's very typical for us to see a lower order intake. We experience this every time in the Christmas period every year. That's a usual thing. And this year, because in 2023 Easter was in April, and now this year in March, we have to better look on year-to-date April performance.



Peter Deli
CFO | Haypp Group

We already do have the preliminary sales numbers available, and looking at those year-to-date April sales performance is already at 17%, so we can see the correction in the April months. Then a second important element to highlight here is the contribution, the sustained contribution of our growth markets. We can see that those segments are contributing solidly to our overall growth. However, this quarter, the core market's contribution was lower than historically. And here comes the third part which Gavin already mentioned, the decline in the Snus segment. If we look at our sales drivers, net sales drivers, then the nicotine pouch remains solid. However, the Snus decline bites heavily into our overall growth. With this, let me move to the profitability, because here I think we achieved the major step towards our long-term commitment of the targets we set down in our Capital Markets Day.



Peter Deli
CFO | Haypp Group

So our gross margin for the quarter increased by 2.4%. This increase is predominantly driven by the annual commercial renegotiations, and typically such change happens only from Q4 to Q1, and throughout the year it's relatively stable. The margin improvement was partly reinvested into overheads, into new capabilities and capacity, particularly behind the new emerging market segment. And overall, this resulted in an adjusted EBIT of 3.5%, an increase of 1.2% from 2.3% in Q1 2023. Important to highlight here that the core and growth markets EBITDA was at 6.1%, 0.8% out of which was invested into the emerging markets. So the total group EBITDA was at 5.6%, with the depreciation resulting in 3.5% adjusted EBIT. I would like to also highlight the cash flow performance from operating activities because we achieved SEK 122 million positive cash flow.

**Peter Deli**
CFO | Haypp Group

This is a combination of lower inventory levels after year end, but also mainly driven by improved trading terms with our suppliers for the payables. We reported some exceptional costs in this quarter, and these are connected to the impairment of the retired equipment for the Stockholm warehouse, where, in the previous year, we overhauled the entire infrastructure to improve capacity. Moving to the core markets. Here, the net sales increased by 2% in Q1. In constant currency, the increase was 3%. Again, year-to-date April is an important figure here to bear in mind because that increase is already at an 8% level. We are happy with our nicotine pouch sales performance, which remained strong and grew 32% in the quarter and 34% year-to-date April. Based on our understanding, this growth is ahead of the market growth, so indicates that we are gaining share.

**Peter Deli**
CFO | Haypp Group

The Snus performance, which was on the weak end in Q1, has to be seen also from a long-term perspective. We do not see the category as part of our long-term strategy. There are not enough innovations, products coming through from the suppliers, and there is a very low level of appetite to invest into the category by the brand owners, whose focus is clearly shifted towards nicotine pouches. However, we recognize that the Snus category is not going to disappear completely, so we took actions to mitigate this decline, as Gavin already indicated. The adjusted EBITDA grew 6.5% to almost SEK 54 million and reaching 8.6%, up by 0.4% vs last year. This is mainly attributable to a favorable mix impact between the categories. Moving to the growth markets. Let me start with the sales, which increased by 46%.

**Peter Deli**
CFO | Haypp Group

Here, we saw strong performance across all markets, but especially in the U.S., where nicotine pouches grew by 59%. In the U.S., I would like to highlight California and the impact of California because, as we talked about a year ago when we announced our Q1 report, we highlighted that due to the flavor ban, Haypp Group also benefited greatly from the increased consumer demand for products which were legally available by online retailers. However, we see that since then many consumers reverted back using flavor-free nicotine pouches, which created a temporary headwind for Q1 for us. And this is what we evidently see in our sales in California. However, outside of California, we achieved 70% growth overall. EBITDA is another important element and a great milestone what we reached in the core markets this quarter.

**Peter Deli**
CFO | Haypp Group

From being a clear profit drag for the group, this quarter we resulted around the break-even result, a very slight positive adjusted EBITDA, which is clearly driven by the economies of scale, very partly offset by commercial investment. Obviously, there is a key role here for the annual commercial negotiations, which had our overall margin performance in this market segment. Last but not least, emerging markets. Here, financially speaking, there is not too much to say. These categories are in their infancy. So as you can see, we achieved SEK 8 million sales, and in overall, we invested SEK 7 million on EBITDA level. This SEK 7 million investment mainly went into capacity and capability in specific parts of the organization, mainly in commercial search optimization and category management.

**Peter Deli**
CFO | Haypp Group

At this stage, I believe that the success of this category is not to be seen through the financial KPIs, but more how we can build our sales positioning and progress in terms of customer acquisition within this segment. Let me move to the selected KPIs. I already told you about strong cash flow performance and strong EBITDA, what we had. The combination of these two is resulting in a nice decrease in our net debt to adjusted EBITDA ratio, which is down to 0.8%. As I look ahead, I believe that our business model will allow us to maintain the capital light structure and maintain our healthy balance sheet, so we are ready for the next phase of growth. With that, I give it back to you, Gavin. Thank you.

**Gavin O'Dowd**
CEO | Haypp Group

Thank you. Moving to our financial targets. We target SEK 5 billion in revenue for 2025 from our core and growth markets. While we recognize that our Q1 overall revenue growth was well below what's required, we would also like to guide you to our overall nicotine pouch growth of over 40% despite some one-off impacts, and that nicotine pouches now account for over 60% of our sales. Continued strong performance in NP will continue to lift the overall revenue growth. Regarding profitability, we guide investors towards an adjusted EBIT for core and growth segments in the range of 5%-7% in 2025. During Q1, our adjusted EBIT for these segments was 4.3%, an increase of 2 percentage points vs Q1 2023. We would like to remind you that our operating model tends to reflect the benefits of scale as we transition from one calendar year into the next.



Gavin O'Dowd
CEO | Haypp Group

As such, I expect early 2025 to be the next time when we experience a material uptick in our EBIT margin. Moving to our final slide, I would like to reflect the dynamics underpinning our continued performance. Our operating model is a substantial moat for our business, which in turn is built on robust processes and systems. However, our overall progress is a result of an excellent team and culture that they have fostered and their connection to our higher purpose of inspiring healthier enjoyment to millions. I would like to take this opportunity to thank the team for their commitment, dedication, and overall performance. And with that, I will hand over to the operator for questions.

Q&A



Operator

If you wish to ask a question, please dial pound key five on your telephone keypad to enter the queue. If you wish to withdraw your question, please dial pound key six on your telephone keypad. The next question comes from Niklas Ekman from Carnegie. Please go ahead.



Niklas Ekman

Senior Equity Research Analyst | Carnegie

Thank you. Just a couple of questions from my end. Firstly, if I could start maybe with the growth target here of SEK 5 billion by 2025. Given the slowdown you're seeing here, how confident are you? Because I think this requires a sales CAGR of 28% over the next seven quarters. How confident are you that you can see that level of acceleration and that the slowdown you saw here in Q1 was really very temporary?



Gavin O'Dowd

CEO | Haypp Group

Good morning, Niklas. Yeah, so I think there's a couple of dynamics in this one. I think the first dynamic running through this, I think we very much have to view it towards probably three different layers sitting within it. The way I would lay the layers out would be at the bottom level is Snus, what level of decline we'll be manifesting through that. At the next level, nicotine pouches within our core markets, and then at the top level, nicotine pouches within our growth markets. What we can see is that now roughly one-third of our sales is coming in each of those segments. We call it simplistically 1/3 of our sales coming in each of those segments.



Gavin O'Dowd

CEO | Haypp Group

What we can see is accelerating growth in that top layer of nicotine pouches in our growth markets, continued robust growth operating well above that 25%-28% level that you're referring to for nicotine pouches in our core markets. Of course, we have been experiencing that headwind on snus. Now, regarding snus, we always expected that there was going to be a decline. I think what has been sort of interesting to us over the last maybe five or six quarters is realizing that it's not constant. It does come in ebbs and flows a little bit as it comes through here. We still remain confident for the overall numbers, but we recognize that we are going to have to navigate what the snus dynamic within it will be.



Gavin O'Dowd

CEO | Haypp Group

But we also recognize, Niklas, on this one that we're maintaining our primary focus on nicotine pouches because that is where not just the growth is coming from, but it's also where all of our margin comes from. I think, as Peter alluded to in some of his slides, part of the reason why we've been seeing the margin expansion in our core markets has been the mix change away from nicotine pouches towards snus. So we remain confident for those sort of key factors going through it.



Niklas Ekman

Senior Equity Research Analyst | Carnegie

Thank you. That's very clear. A second question. If you can elaborate a bit on the margin development here, is it right to understand that because of renegotiated contracts, we can now expect basically a plus 1 percentage point margin improvement throughout 2024, and you believe this could accelerate even more to more than 1 percentage point margin expansion in 2025? Is that the right way to understand this?



Gavin O'Dowd

CEO | Haypp Group

Directionally, absolutely. So at the calendar, as you sort of alluded to, the negotiations are done on an annual basis, and we've taken more than 2 percentage points out of core and growth with the uptick in it. And this was why we felt that as we knew this was coming, as we went through 2023, we thought it was an opportunity to be able to utilize some of that to invest into our emerging opportunities. Hence where, you can see the 80 basis points of margin reinvested into there. So we do expect that to continue during the year. Like I said, I don't expect to see that level of uptick that we've seen from Q4 to Q1 occurring in other quarters during 2024. But again, I would expect that that type of step change would be anticipated again in early 2025.



Gavin O'Dowd
CEO | Haypp Group

That wouldn't come across as a great surprise.



Niklas Ekman
Senior Equity Research Analyst | Carnegie

Excellent. And can you elaborate a bit on the pricing environment as well? Your ability to keep these benefits, do you think that you will be able to absorb these cost efficiencies fully, or do you see any price competition in the market or anything else? Or do you have an ability to raise prices in the market?



Gavin O'Dowd
CEO | Haypp Group

Yeah, no, we're planning our model is that we will generate a bottom line without closing the pricing gaps on any competition. We quite like the pricing gaps where they are. We believe they're a good reason for people to maintain or accelerate the migration from offline to online. So we're not particularly interested in closing the price gaps bearing in mind how competitive or how rapidly growing the category already is. We're very keen to continue to take share within it. So we see that we can maintain the price gaps and that what you're getting coming through in the form of increased margin is predominantly falling out from both the economies of scale, both directly within our operations, and of course, with support from our business partners.



Niklas Ekman
Senior Equity Research Analyst | Carnegie

Very clear. Thank you. Final question. If you could just help me define what you characterize as emerging markets. You say here that it's your vaping operations in the U.K., Sweden, and Germany, but you also talk about new markets. Are you then referring to expansion of vape into new markets, or would you also classify a new nicotine pouch market? Would that also be included in emerging markets as you define it?



Gavin O'Dowd
CEO | Haypp Group

Exactly. So when we laid this out as regards to the position of the Capital Markets Day, we wanted to cover the next couple of years, bringing us up to the end of 2025. So we're grouping things together here, all of which will be manifesting between now and the end of 2025. The first one being, as you said, the expansion into adjacent categories in our existing geographies. And then as we get further along through that time frame, we will expand into new geographies, both with vape and with nicotine pouches. So it's a segment which catches both over that two year window.



Niklas Ekman
Senior Equity Research Analyst | Carnegie

Very, very clear. Just to follow up there, can you tell us a little bit about your development here in new markets? What new markets have you launched nicotine pouches in, say, the past 12 months, and how do you see that progressing over the next 12, 18 months? Do you have a long list of markets where you wish to enter, or is this a very slow, gradual process?



Gavin O'Dowd
CEO | Haypp Group

Okay. Apologies if my last point was perhaps unclear on this one, Niklas. So I view it between now and late 2025, whereby we will first expand into vape in existing geographies, so hence the Sweden, Norway, and the U.K. And as we get towards traction in that, at some point during that two-year window, we will expand into new geographies with both vape and nicotine pouches. At this point in time, we have not expanded into new geographies with the category at this stage. And this is partly because we feel we can get more initial return on our energy by entering into markets where we already have the warehouse infrastructure and the store infrastructure is up and running.



Gavin O'Dowd
CEO | Haypp Group

Also with the new infrastructure that we've been rolling out for both our ERPs and middleware, and that we're now starting to roll out for our storefronts, that makes it substantially easier for us to roll out new geographies and new stores in new geographies in the future. Hence why we're taking it in this order. To paraphrase, we are in no new markets in the last few years. We are solely expanding first into vape in some of our existing markets. As we get into the latter part of this year and early next year, we will start moving out towards new geographies at that stage.

Haypp Group

Q1 2024 | May 3, 2024 07:00



Niklas Ekman

Senior Equity Research Analyst | Carnegie

Super. That's very clear. Thank you so much for taking my questions.



Gavin O'Dowd

CEO | Haypp Group

Thank you, Niklas.



Peter Deli

CFO | Haypp Group

Thank you, Niklas.



Operator

As a reminder, if you wish to ask a question, please dial pound key five on your telephone keypad. There are no more questions at this time, so I hand the conference back to the speakers for any closing comments.



Gavin O'Dowd

CEO | Haypp Group

Thank you all very much for your time. I greatly appreciate it this morning, and I look forward to catching up with you in three months' time for our Q2 performance. Thank you. Goodbye.



Peter Deli

CFO | Haypp Group

Thank you. Goodbye.