

May 4, 2022

# Haypp Group

Q1 2022



## Prepared Remarks

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Welcome to the Hype Group Audiocast Teleconference Q1 2022. Today, I am pleased to present CEO, Gavin O'Dowd and CFO, Svane Andersen. Please begin your call.



Good morning, everybody. Welcome to our Q1 interim report. Today, I'm going to do a quick recap of some of the underlying slides within our underlying messages within our business and then I'm going to move on in a little bit more detail into the Q1 performance. If I start off, first of all, with Slide 3 in the accompanying deck, I would like to remind everybody on what our higher purpose is, why we exist. So our role is to inspire healthier enjoyment to millions.



A few years ago, this was about moving people from cigarettes to snus. But in recent years, there has been much more about moving people to nicotine pouches, which has been very successful at reducing smoking rates across many markets. If I move along to Slide 4, you can see the spectrum which we operate within, where we are only prepared to operate with products which are sub-five percent the harm of a pack of cigarettes. And we are the only sizable retailer who sells nicotine products in Scandinavia, which operates in this category alone. Moving along to Slide 5 regarding the impact which this category can have across markets.



The slide on the left shows where smoking rates are within Sweden and Norway relative to the rest of the European markets. And I think we're happy to continue to say that smoking rates continue to decline quite rapidly in both of these markets and it's particularly positive to see the impact that nicotine pouches is having across the region. Moving along from Slide 5 to Slide 6, I would like to do a quick recap on our overall market potential here. So between 2020 and 2025, we envisage that the global market for nicotine pouches and snus will lift from 27,000,000,000 to 60,000,000,000. All of this growth is expected to manifest in the form of incremental growth in nicotine patches, which we expect to grow by more than 30% per annum.



You will see later on how our performance in nicotine pouches is going, but we're happy to say that we are currently growing by more than 50% per annum in this space. Moving along, we believe that given the nature of this category and the harm reduced elements within it because of the low question. Taxes around the products, the profit pool is quite significant relative to that of any other nicotine category. So there is a substantial profit to be shared here between both the manufacturers and the retailers. Moving along now to Slide 7, Taking a look at what is the key driving factors for this category, the most fundamental aspect for this is very much the consumer demand for harm reduced and we see this continuing to expand across new geographies and continuing to get traction within the existing geographies that we operate within.



We continue to see strong positive legislation from regulators around this category where the principle of harm reduction is anchoring much of the legislation which is coming through. And we continue to see strong investment from all of the large tobacco players, global players and also from many small emerging players around this category, which is further accelerating innovation and driving the category forward. The chart to the right here on Slide 7 shows our estimates for what the market will look like between now and 2025 between nicotine pouches and snus. Performance is very much driven by nicotine pouches and this is part of the reason why we are dedicating a lot of our KPIs towards our performance within nicotine patches throughout the rest of our messaging. Moving along to Slide 8. This is a quick snapshot at our competitor landscape online.



Nothing much has changed here in recent years. So this is relatively consistent over the last number of years. I'm moving along quickly to Slide 9. This looks at our share of both the total market and our share of the online space. Again, there hasn't been significant change here in the last couple of years.



Probably the one space where we think there may be a bit of an update versus here is where we probably have a significantly larger share of the nicotine pouch market in Europe as we've been performing there quite well over the last 6 to 12 months. And lastly, when it comes to our logistics space here on Slide 10, You will see an overview of our warehouse infrastructure. And in addition to opening our new warehouse in Oslo in Q4, which is more than meeting our expectations regarding lead times across Norway, We've also opened a 3PL center in Denver, Colorado. This warehouse has already significantly reduced lead times in the Western states of the USA. You will also see here that our inventory is turned over circa 18 times per annum, which is an important element in our strong cash conversion, which question which Svante will touch upon later.



Moving along to the operational highlights for Q1 on Slide 12. 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 will come from nicotine pouches. With this in mind, nicotine pouches nicotine consumers nicotine pouch consumers and nicotine pouch volume are the primary measures of growth. And as you can see in the chart below, we have experienced robust growth in nicotine pouch sales for many years.



And during Q1, we grew more than 50% year on year. This brings nicotine patches to almost 40% of our global volumes. You can also see that while we did experience the lift in sales in Q2 2020 Due to 2019, it is insignificant compared to the overall growth, which is driven by consumer demand for healthier products. Moving along to Slide 13. During Q1, we adapted our organization to reflect that each of our 4 geographic business units Are now at critical mass and we have given the local teams clear mandates to manage the market in ways which reflect its specific level of consumer understanding around the category for that market.



We continue to underpin this with an exceptionally strong central organization, which develops the global technical infrastructure and the data management creating strong synergies across the markets. We continue to develop our warehouse footprint to meet the current and future demands. And in addition to our new warehouses in Oslo and Colorado, which I touched upon earlier, we have successfully increased the size of our Stockholm warehouse to provide the capacity to meet our forecasts for Sweden and the growth markets in Europe. We intend to announce further expansions on our warehouse footprint through the year with an emphasis on growth markets. Regarding regulation, we continue to see governments adapt harm reduction as a core pillar of their strategy.



Within Sweden, the new law comes in line with the principle of harm reduction and a principle which has been upheld in numerous parliamentary votes in the past. While this regulation is not expected to be finalized prior to the summer, our initial indications suggest that new legislation We'll be directionally similar to the regulations on snus, albeit slightly more liberal. It will restrict the out of store marketing, But obviously, since we are a store, we will continue to have the ability to communicate and launch products and brands. Our ability to communicate with consumers would be largely unaltered as we don't engage with social media marketing at the moment. In addition, the legislation paves the way for product standards and nicotine caps.



This is another area where we have self regulated for a number of years as we currently send all of our products away for independent testing before we offer them to our consumers. But I think what's probably most important about the proposed legislation is the precedent that it will set for EU For the EU with the TPD 3 legislation, which we expect in 2024. We need to bear in mind That Sweden is still the largest nicotine pouch market in Europe and hence it has a significant influence on EU wide regulation. Moving along to the financials, and I will pass over to Svernte.



Thank you, Gavin. Right. Starting off on Page 14 and the financial overview for the group. I'd like to start off here by stating that the underlying growth across all our segments With the exception of Norway, remained strong during the Q1. We are reporting a net sales increase of 16% to SEK640 1,000,000 for the Q1.



And And organically, when we exclude the acquisitions in Sweden and exclude the markets in Europe and the rest of the world that we exited, our sales growth was 6%. However, if we also exclude Norway, the organic growth rate for the remaining segments is 32% combined. Looking at our gross margin. The gross margin for the quarter amounted to 11.7%, which is marginally lower than the same period of last year, But a continued improvement sequentially quarter on quarter. The sequential improvement is driven by a stronger gross margin in our core markets.



Adjusted EBIT for the quarter increased to SEK14.1 million corresponding to an adjusted EBIT margin of 2.2%, which is up from 1.9% in the Q1 of last year. The key driver behind the margin uplift is higher volume and efficiency from leverage on our operating expenses. We recognized a smaller restructuring charge of SEK3.6 million during the quarter related to the decision to adopt our operational structure as Kjerund described earlier. Now turning to Page 15 and our core markets. Here, net sales increased by 11% and amounted to SEK 541,000,000 for the Q1.



Our nicotine pouch volume grew substantially more at 43%, Coupled with acquisitions of Nestor Torbjorn and Nestor that contributed with SEK58 1,000,000 to net sales. And in Norway, the year on year growth was still negative during the quarter at negative 21% as we faced challenging comparable figures from the Q1 However, during the Q1 of 2022, we did see a return to sequential quarter on quarter growth in Norway. In terms of profitability for our core markets, we're pleased to see that the profitability is strong and already close to levels where we're expecting the overall group to be in the medium to long term. Our EBITDA for the business unit amounted to SEK41 1,000,000 versus SEK27 1,000,000 in the same period of last year. The EBITDA margin increased by 2 percentage points to 7.6%, mainly attributable to the higher gross margin and leverage on operating expenses from higher sales volume.



Turning to Page 16 now and the core markets. We recorded a net sales increase here of 55%. Net sales amounted to SEK 99,000,000 for the Q1 on the back of Strong performance across both the U. S. And Europe with Germany standing out in particular.



Nicotine pouches grew even more at 78% in volume during the quarter. Our comparable net sales, so when we adjust for the markets that were exited in the Q1 of 2021 was 62% for the segment. In terms of profitability, we continue to invest behind the growth. Our EBITDA amounted to negative SEK 18,000,000 versus negative SEK 11,000,000 during the same period of last year as a result of continued investment And on my final page here, Page 17, we're presenting a selection of our KPIs. And We're noting that our number of customers continue to increase by circa 25% year on year during the quarter, and our average order value increased marginally.



When it comes to our balance sheet and our financial position, it remains strong. We had a net working capital of SEK 30,000,000 As per end of the quarter, down from SEK70 1,000,000 at year end. And the Q1 of the year is normally a strong quarter for cash Generation as we're settling certain supplier compensations for prior year and to a certain extent get prepaid for current year agreements. The inventory levels that we noted at year end remained in line with levels at the end of the quarter. As we during the quarter, continues to see its opportunity to load certain products at favorable commercial terms to generate benefits that we ultimately can pass on to our customers.



As per the end of the quarter, we recorded a net cash position of SEK 19,000,000 on the back of strong cash generation. With that, I'll hand the word back to Gavin.



Thank you. Moving along to Slide 19 regarding our financial targets. We reiterate our long term targets of €5,000,000,000 in revenue by 2025 predominantly through organic growth. We also reiterate our profit target of high single digit adjusted EBIT over the medium term. And as you've heard from Svante's material, we are rapidly closing on this target in our core markets already.



Due to the growth potential of the category, the Board does not intend to issue any dividend for the foreseeable future and instead utilize our strong cash generation and robust balance sheet to accelerate growth. In slide 20, we highlight the potential that we see for the overall category growth and also the potential for online to take a larger share of the category, given how suitable the characteristics of this category is for online. We also reiterate our market leading position in all of our key markets. Moving along to Slide 21. Touching upon our current trading, we continue to see growth in nicotine pouches driven by consumer demand and regulatory support.



We continue to see intense competition from all of the global manufacturers and many credible small manufacturers due to the potential of the category. And this has led to the launches of new and exciting brands and strong consumer relevant innovations. So far, we have no direct or indirect exposure



to the war in the Ukraine.



However, we do see ourselves as very well positioned for uncertain times. In previous cycles of contraction in consumer spending, nicotine consumption has remained resilient. However, consumers have been known to down trade to less expensive nicotine categories. And nicotine pouches are well positioned for this Because due to the harm reduced nature of this category, there is little or no punitive taxes on the category, which means that they are sold to the consumer at a fraction of the price of a packet of cigarettes. We also believe that in the event of a contraction consumer spending sorry, of a contraction in consumer spending, consumers We become more aware of the price advantages of buying nicotine pouches online.



Regarding inflation, So far, we have not seen any abnormal price increases from our product suppliers. This may be due to a combination of The nature of the component costs going into the products not being that subject to inflation, but also the relatively high product margins which are available to the manufacturers. However, we have seen an increase in some of our fulfillment costs, particularly within shipping, but these costs relate to Significantly less than 10% of our overall revenue and any extra costs that we experience will be passed on to consumers. We continue to see strong performance in our nicotine pouch growth in Sweden sorry, in nicotine pouch growth. In Sweden, our share of nicotine pouches continues to grow.



In Norway, the activities which we initiated in the latter part of 2021 are gaining traction, and we see strong consistent growth in the U. S, Germany and the U. K. We will continue with our existing proposition to consumers hinged around a broad assortment, convenient delivery and good prices. Our platforms continue to play a pivotal role in the launch of new brands With almost onethree of our current sales of nicotine patches coming from products which were not on the market 1 year ago.



We will continue to enhance our digital infrastructure, including our storefronts, our age verification, consumer insights and machine learning. This not only enables us to grow, but it also sorry, this not only enables us to sustain our growth, but also to further release benefits of scale. As a wrap up, I would like to guide you to slide 22 And just to sort of recap on our overall business here. 1, there is over 1,000,000,000 smokers in the world, many of whom are looking for a safer alternative And nicotine pouches is the fastest growing category within this space. There are many dynamics around this category, which makes it perfect for online, including It being not particularly heavy or bulky, having a high repeat purchase pattern and extremely low return levels.



We are the undisputed global online market leader where we're roughly 10 times the size, maybe a little bit more of the 2nd largest player. Our symbiotic relationship with suppliers, in addition to being the partner for Choice for new launches, we are also the largest provider of consumer insights to them. We continue to welcome the proportionate regulation. And as we touched upon within Sweden, we often benefit from this regulation. Our Our unit economics continue to improve as we scale, and this is already evident within our core markets.



And we have a highly engaged management team with core competencies across both the nicotine industry and e commerce. Question. So with that, I would like to pass back over to the operator for any questions.



Our first question comes from Niklas Ekman from Carnegie. Please go ahead. Your line is now open.



Thank you. Yes, I have a couple of questions. Firstly, on Norway, are you seeing any signs of price competition easing in that market? And you mentioned here that you have Couple of initiatives here that I started to show, but are you expecting headwinds throughout 2022? And I'm thinking particularly here about the borders having reopen.

## Q&A

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Do you see any chance of growth being restored sometime in 2022 in Norway?



Yes. Hi, Nicholas. Good morning. So regarding Norway, what we can see is that we've actually have returned to growth. So Q1 is showing Strong growth is showing growth versus Q4 and reasonable growth versus Q4 within Norway.



What we can The dynamics within Norway have altered radically within Q1, but as you say the border is reopening, but also The duty free from the airport starting to become a much larger share of the market returning back towards their previous trends, where it was a significant share of the market as well. We're really happy to have been able to grow Q1 versus Q4, bearing in mind that domestic sales within Norway Has contracted significantly during the quarter because of those two factors. So we consider ourselves to be quite well positioned within it. Regarding competitor pricing, we have seen a marginal easing of that, but it's very difficult to predict. It's still very much in its infancy.



It's very difficult to predict how the pricing landscape within Norway will manifest over the coming quarters. But we are very happy with having turned the corner During Q1 and seeing sequential growth coming through in, like I say, what has been a difficult environment for all question. Nicotine pouch and snus retailers in Norway, either brick and mortar or online.



Thank you. That's very clear. And the second question, you reversed to net cash in this quarter. Do you see this as a temporary fact Related to these working capital changes or do you see this as a permanent stage? And if so, What do you expect to use your balance sheet for?



You mentioned here no plans of dividends anytime soon. So what is the M and A agenda



question. Good morning, Inclest. This is Sande speaking. I mean, as I a little bit alluded to in my question. There is the Q1 of any year is normally a little bit stronger in terms of cash conversion.



And there's a little bit of a I mean, it's slightly I would say maybe slightly inflated for the Q1. And but we mean with that said, I think we I mean our balance sheet remains very strong with no sort of structural debt on there. And in terms of I think you're sort of what you self said here, I mean, we are planning to keep that sort of dry powder for any sort of M and A opportunities that we sort of come across out there.



Okay. And is there Significant M and A opportunity. And is that are you looking at the Nordics or are you looking mainly at new growth markets for M and A?



Yes. So when it comes to M and A, we have a history. I think we've done 4 M and As before where we've acquired businesses, Which are very similar to ourselves either in existing geographies or as an access point to new geographies. At this point in time, We are leaning much more towards new geographies, but again, looking for similar models as regards to seeing if there's anything of anything which we can bolt in. When it comes to significance, no, there's nothing significant on our radar.



I think it's going to be more incremental and an opportunity to create a base to grow in the future in those spaces rather than individual M and As, which will change the landscape.



That's very clear. Thank you. 3rd question here is regarding the margins here. They finally reversed now question. After 3 quarters of margin contraction, was this you would say due to temporary factors or do you Back to continued positive margin trend throughout 2022.



Yeah. I mean, I think this is very much driven by so if you take the gross margin, for instance, the gross margin uptick is very much driven by the fact that we are able to increase our share of nicotine pouches as a share of the total volume of the group that really we really have a stronger share of the value chain for that category, hence that drives margin for us. And I mean assuming that we continue to make progress there, I think you should expect sort of gradual margin uplift from here as well.



Very good. Thanks. And finally, just a question on the regulators here, question. Just an update. You mentioned a positive view on ARMOUR reduction.



Which market in particular, are you seeing amicable regulation and where are you seeing the most pushback on the regulatory front towards nicotine pouches.



I think from we caught up last, Nicholas, probably the space where we're seeing most clarity manifesting is actually in our home market here in Sweden, where we expect some regulation to be coming out in the coming months. And that regulation is going to be touching it's bringing the base principle of harm reduction to the core of the regulation. The regulation itself is going to touch on 3 specific areas. The first area is going to be the ability to market these products where the products are going to become because just bear in mind, we need to bear in mind here that nicotine patches in Sweden today are completely unregulated. So we will introduce a degree of marketing restrictions, not quite as tight as snus, we're quite similar to it.



So there will be much more restrictions regarding what people can do around social media, for example. We welcome this. We haven't used social media as a marketing tool in any way because we've always struggled with the ability to guarantee that it was always adults that we were reaching out to. So we welcome this in and we also recognize that this also has a strong economic benefit to us where the value of our marketing capabilities on our platforms becomes even more important in a market where there's less marketing opportunities in other channels. And the second piece to be coming through, which is really so much strong in Sweden as well is they're introducing strong age verification requirements.



Now we've always run with robust age verification irrespective of whether people were buying snus or nicotine patches. So this is something which we had implemented from the outset. And the last piece, which is coming on this regulation as well is that it paves the way for product standards and nicotine caps. And again, we have always introduced we've always sustained product standards and nicotine caps, particularly on nicotine patches from the outset and we send all of our products off to be independently tested before we will offer them to our consumers to ensure that they are safe. So again, this space is something which we've already self imposed.



So regulation like this is bringing the rest of the market up to our level. And I think what the big thing coming out of this one for Sweden, what's the real positive out of it is the precedent that it sets for TPD 3 in the EU. And I think Sweden being the largest nicotine pouch producer or the largest nicotine pouch consumer market so far in Europe, I think it creates very strong precedent at an EU level. And the industry, in general, are question. I'm extremely happy with this balanced approach that the regulators are taking and keeping that principle of harm reduction.



Thank you for a long and good answer. Those were all my questions. Thank you so much.



Thank you, Nicolas.



Thank you. Our next question comes from Anders Lindbergh from SEB. Please go ahead. Your line is open.



Thank you and good morning guys. Starting with your growth market I think you touched upon the investment more on the gross margin level versus the OpEx side. Could you maybe more give more color on that? Is it the pure price thing? Or what is it?



Good morning, Andreas. This is Hunter. I think you're right. We The gross margin was lower in our growth markets versus last year and that's pretty much various types of offers, Campaign investments that we do in order to acquire customers within these markets, I mean, we're still very much in a growth stage here, and we're trying out a lot of different things and pretty much prioritize growth here over profitability and hence why gross margin is down.



Is it more to rip In customers or attract completely new ones or?



So we invest in both. I mean, when it comes to sort of question. We do commercial offers to attract new customers. But then as I mean, as we also have Communicated here earlier, we're setting up new warehouses in order to improve on convenience, which tends to drive higher retention. So we're investing on Both sort of the retention space and the acquisition of new customers space.



And on Dagru and Andreas, The setting up of the new warehouses means that the economies of scale within the warehouses do reduce until we reach new levels of of volume. And I think that's one of the large investments you can see coming through here, and that's very much hinged around continuing to increase our retention rates.



All right. Thank you. And on your overall gross margin or group gross margin, I think you talked about higher share on equity in pouch as the key driver of the sequential improvement. Was that the case? Or



And then I talked about the improvement versus Q4. That's coming from our core markets. And I mean, what we're seeing is that Within nicotine pouches, we are we have generally higher margins and that's, of course, driven by The fact that manufacturers are more willing to invest and sponsor different types of initiatives around That category, so within over time with an increasing nicotine pouch share of volume, we expect gross margin



Thank you. And then on the Outlook or the more uncertain times you touched upon Gavin, will you do anything extra to support question. Your own selling, you said you will pass on potentially higher shipping costs. Is there a risk there if your current price of the vantages could disappear?



No. So actually to be clear on this one, it's more about setting a principle that If any costs come in, we will pass them on. However, we haven't seen any material costs so far. I talked about shipping, but of course shipping is a very small percentage of our total cost base. So I don't envisage actually that we're facing that we have that In the foreseeable future, we will struggle to keep our current price gaps and price positioning within the market.



I think that's going to be I think that's going to be very sustainable and we're seeing we've been seeing no challenges around that during Q1 nor do we see any challenges of it to date going into Q2 either or any indications of it.



Okay. Thank you. And last one, a follow-up on the cash flow or working capital. The difference versus last year, that's my question. You said that seasonally have some Positives in the Q1, what's the difference versus last year in Q1?



Thank you.



Yeah.



Question. It's actually sort of the period around year end, so around December, January and to a certain extent February perhaps, which are the periods when those sort of supplier Agreements and compensations are settled. And I think between years, there could be sort of Timing issues if some sort of settlement planned in December and others in January, February. So I think Last year, it was more or sorry if you go back to 2020, I think the cash flow was very strong in Q4 rather than in Q1 2021. So that was just a case of payment landing sort of on one side of the year end rather than the other.

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Okay, got it. Thank you so much.



Thank you, Andreas.



Thank you. There appear to be no further questions. I'll return the conference back to you, speakers.



Thank you all very much. I look forward to catching you all for our Q2 update during the summer.



Thank you. Thank you. Have a great day.

