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Haypp Group AB (HAYPP.SE)

Q1 2023 Earnings Call

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Niklas Ekman

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MANAGEMENT DISCUSSION SECTION

Operator: Welcome to the Haypp Group Q1 Presentation for 2023. For the first part of the conference call, the participants will be in listen-only mode. [Operator Instructions] Now, I will hand the conference over to CEO, Gavin O'Dowd; and CFO, Svante Andersson. Please go ahead.

Gavin O'Dowd

Chief Executive Officer, Haypp Group AB

Good morning, everybody, and welcome to Haypp Group's presentation of the interim report for the first quarter of 2023. Today, we will briefly walk you through an overview of our business and comment on the operational and financial performance for the first year. The interim report and the results presentation is available at the Investor Relations section of our corporate website. Presenting today, in addition to myself is Svante Andersson, our CFO.

Moving to slide 3 in our results presentation. Here, we state at our higher purpose of inspiring healthier enjoyments to millions, which is predominantly moving people from cigarettes to safer alternatives that, traditionally, were snus; and in more recent years, nicotine patches.

On slide 4, we have a chart presenting the spectrum of nicotine products and their relative level of harm versus cigarettes. Haypp Group's primary focus on the nicotine patches and snus lies in the lower end of the spectrum. The scientific body of research around modern – reduction alternatives to cigarettes has come a long way in recent years. In addition to nicotine patches and snus, products such as In addition to nicotine pouches and snus products such as tobacco heating devices and vape are widely accepted as carrying a significantly lower level of harm than traditional cigarettes and other tobacco smoking products. On slide 5. We can see that smoking rates for smoking rates are likely across a range of European countries.

Sweden, with a strong tradition of oral nicotine and robust harm reduction strategy is below one-third of European average of smoking rates and is on track to become the first smoke free country in Norway, where oral nicotine products were introduced some 20 years ago. Smoking rates are at similarly low levels to Sweden.

On the right-hand side, we can see how these smoking rates collapsed between 2005 and 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 pouches 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 that we laid out in 2021 in connection with our IPO, which we believe is equally as valid today. We see a global market size for nicotine pouches and snus, which will increase from SEK 27 billion in 2020 to SEK 60 billion in 2025. All of this growth is going to be driven by nicotine pouches, which will increase from the share of 30% in 2020 to 80% in 2025.

Since the market outlook was prepared, nicotine pouches has been tracking in line with expected cover of 41% per annum. It is also worth noting that hype has been growing at a significantly faster pace. The primary driver behind the growth of the category is strong consumer demand for less harmful products, which is supported by regulators in general adopting a principle of harm reduction in their legislative approach to nicotine products.

This, in turn, has led to significant investment in the category from industry players, both large tobacco companies and many credible new entrants driving innovation. Furthermore, the category is very well suited for online and we see online penetration rates increase in every quarter that goes by and we continue to expect online to increase at healthy levels.

Moving along to slide 7, you will see an overview of our logistics infrastructure. Convenience remains one of our key USPs and the ability to offer consumers across all markets fast and reliable delivery sets us apart. We completed the first phase of our warehouse expansion plan in Q2 of last year, and we are now operating six warehouses across our core and growth markets.

We have managed this expansion while continuing to maintain a healthy inventory turnover of 15 times for 2022. Furthermore, the warehouse expansion has led to further improve customer retention rates as the convenience levels have increased.

Having successfully completed the first phase during Q2 of last year, we have progressed to another phase where we are enhancing our infrastructure and back end. In addition to supporting scalable future growth in our current markets, it will also enable us to efficiently move into new markets and adjacent categories.

Moving along to the operational highlights for Q1 on slide 9 and starting with our performance in nicotine patches. The growth in consumer demand for significantly less harmful products remained strong in Q1. Effectively, all growth for the combined nicotine pouch and snus category is coming from nicotine pouches in snus category is coming from nicotine pouches.

With this in mind, nicotine pouch volume is our primary measure of growth. In addition to the general nicotine pouch category growth, Haypp continues to grow market share across all of our markets. Our nicotine pouch volume increased 41% year-on-year and is just over 100% over on a 24-month basis for the group, driven by solid growth across all of our geographies.

Nicotine pouches now account for 45% of the group volume as compared to 37% for the first quarter of last year. We continue to play a pivotal role in launching products into the nicotine pouch category, which in turn accelerates the migration from cigarettes. During Q1, 22% – sorry. During Q1, 22% of our nicotine pouch volume related to products which were launched in the past year.

As I briefly mentioned earlier, our investment in the logistics infrastructure in the first half of 2022 have resulted in material improvements in customer satisfaction and retention rates. In a difficult macroeconomic environment for consumers, we are particularly pleased to note that we are growing our active consumer base by 21%, indicating that our value proposition remains highly relevant, even in challenging economic times.

On slide 10, we are highlighting key regulatory developments. In general, we continue to see governments adopting the principle of harm reduction as a core pillar of the regulatory strategy. In Sweden, for example, new legislation came into effect from the 1st of August of last year, which clearly reflects this perspective. In Europe, we are also noting growing governmental interest for harm reduction, and we remain positive that the EU – that EU will introduce positive regulation for nicotine pouches in TPD3.

that EU will introduce positive regulation for nicotine patches in [indiscernible] 00:07:52.

In a world first initiative in the UK, 1 million smokers would be encouraged to switch from cigarettes to vaping through a swap-to-stop scheme. This effort aims to improve public health and reduce smoking rates. As part of the scheme, nearly one in five smokers will receive a vape starter kit, along with the behavioral support to help them quit smoking. This measure is one of several aimed to helping the UK government achieve its goal of becoming smoke free by 2030, which would mean reducing smoking rates to 5% or less.

In Q4 of last year, California imposed a ban on flavored nicotine products sold in physical retail locations, which prohibits brick-and-mortar retailers and vending machines from selling flavored products. While we, as an online retailer, have benefited greatly from this, it is our opinion that the law, to some extent, is a step back in terms of harm reduction as it does not distinguish between harm reduced and more harmful nicotine products. Moreover, we do not expect this regulation has any material impact on the overall category growth in California as we have seen other examples of flavor bans, none of which have had any material impact on consumption, neither do we expect this type of regulation to spread to other states.

In March, the Norwegian government presented a new public health strategy which expresses the government's desire to ensure better control over the sales of vapes and tobacco products. The government health strategy includes measures within most of the priority focus areas in the Norwegian health policy and is renewed every four years. The proposed measures should be seen as a gross list of efforts based on previous input from different health organizations. The publicized measure is not a legislative proposal, but a formulation of strategy with the aim to prevent minors from gaining access to tobacco products.

Based on previous public health strategies, it is clear that far from all desired measures are going to be realized. We share the Norwegian government's view on the issues addressed in the public health strategy. However, we do not see a ban on e-commerce as part of the solution. On the contrary, e-commerce players in Norway, including ourselves, have far more robust procedures in place for preventing minors from getting access to tobacco products. From here, it's a relatively long process with significant unknowns. We do not know if online sales will be prioritized by the government, and if so, what the exact definition of online sales will be. With that, I'll pass the word to Svante for comments on our financial performance.

Svante Andersson

Chief Financial Officer, Haypp Group AB

Thank you. With that, let's flip to page 11 and the financial overview for the group. We reported a net sales increase of 22% for the group in the first quarter. In constant currency, net sales increased by 21%. And effectively all of the growth is attributable to our progress with the nicotine pouches. And we're recording solid growth rate for nicotine pouches across all markets, while tobacco based volume is only growing low-single digit.

The gross margin improved year-on-year by a 0.3 percentage points to 12%. We continue to further strengthen our position in the value chain within the category, which along with scale benefits in our operations will continue to drive our gross margin performance over time.

Adjusted EBIT for the quarter grew by 29% versus last year and amounted to SEK 18 million, which corresponds to an adjusted EBIT margin of 2.3%, which is up by 0.1 percentage points versus last year.

And the drivers behind the EBIT margin uplift is the higher volume and gross margin, partially offset by a higher adjusted OpEx from the investments that we've done in the organization to support further growth. The cash flow from operating activities during the period amounted to SEK 92 million.

And, turning to page 12 and our core markets, the reported net sales for the core markets segment grew by 14% during the quarter and amounted to SEK 616 million. In constant currency, the net sales increased by 15%.

Sweden continued to perform well with an above 20% year on year growth rate, predominantly driven by nicotine pouches. In Norway, we are very pleased to note that the net sales continues to increase at healthy levels sequentially and, on a year on year basis, we recorded a low-single-digit growth despite the inflated comparables in Norway from Q1 of last year driven by the final COVID lockdown. Our nicotine pouch volume in the core markets grew at a healthy 32%, with both Sweden and Norway showing a strong performance, while our snus volumes were flat.

In terms of the profitability for our core markets, it remained strong and continues to increase. On an LTM basis, we have now generated SEK 184 million of EBITDA in our core markets. In the first quarter, the EBITDA margin increased to 8.2%, up by 0.6 percentage points against last year, and the margin uplift in the quarter is mainly attributable to a higher gross margin, partially offset by OpEx investments.

Moving on to our growth markets on page 13, here, we reported net sales here – sorry. Here, net – reported net sales increased by 67% to SEK 166 million for the first quarter. And in constant currency, net sales increased by 55%. We had strong performance mainly in the US and the UK. And as Gavin mentioned earlier, we have benefited from the flavor ban in California, which limits the flavor assortment in physical retail and have led to a strong online migration across the consumer base in the state.

In Europe, we're seeing continued strong demand for harm reduced products, and the UK, in particular, is showing strong growth, albeit from a low base. Our nicotine pouch volume in the growth markets increased by 60% in the quarter. The EBITDA amounted to negative SEK 20 million versus negative SEK 18 million during the same period of last year as a result of a continued commercial investments for growth.

On page 14, we have our selected KPIs, and I would like to focus here on the balance sheet in particular. Our financial position remains very strong. We closed the quarter with a net working capital position of SEK 178 million, which our inventory accounted for SEK 194 million. The excess inventory we built up ahead of the excise tax increase in Sweden was successfully sold out during the quarter.

At the same time, we took advantage of inbound price increases in Norway effective from February and built up excess inventory of which part was built to be cleared out after the end of this quarter. And the fast moving nature of our products naturally implies high inventory turnover rate, and we will continue to see opportunities for inventory loading as they arise going forward.

and we will continue to seize opportunities for inventory loading as they arise going forward. The net debt decreased to SEK 140 million versus year-end, corresponding to a net debt-to-adjusted EBITDA ratio of 1.3, which we expect to continue to decrease.

And, with that, I will hand the word back to Gavin.

Gavin O'Dowd

Chief Executive Officer, Haypp Group AB

Thank you, Svante. Moving along to slide 16, we reiterate our long-term targets of SEK 5 billion 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. And as you will have seen from Svante's material, we are rapidly closing on this target in our core markets. Due to the growth potential in the category, the board does not intend to issue any dividends for the foreseeable future and instead utilize our strong cash generation and our robust balance sheet to accelerate growth.

On slide 17, 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 positions in all of our key markets.

Moving along to slide 18 and our current trading. The market trends for harm-reduced products remains favorable, and we continue the transition of our business into mainly a 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 noncyclical characteristics of the category, we remain confident that any additional inflationary pressure can be passed on.

Looking ahead, we continue to see solid performance in our nicotine patch growth. The successful turnaround in Norway see solid performance in our nicotine pouch growth. The successful turn around in Norway creates a solid platform for profitable growth in core markets. The strong momentum we have in our growth markets is sustained and we continue to gain share of the total market since the beginning of the year. We have launched a test pilot for vape products in the UK on our existing UK storefronts.

Initial feedback from the launch has been very positive, and we are currently evaluating next steps. Our capabilities to attract new customers and retain them. We are offering hinge 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 in our back end enabling further growth opportunities both in terms of new geographies and new categories.

In addition to releasing benefits of scale. Lastly, we are very well-positioned for the current difficult economic environment for consumers with a strong balance sheet and 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 19.

There is over 1 billion 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 an undisputed global online market leader and we're over 10 times the size of our nearest competitor. We have a symbiotic relationship with our suppliers whereby, in addition to being a partner of choice for new launches, we are also the largest provider of 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 in the nicotine industry and e-commerce.

I would like to remind everybody on some of the key takeaways from today's presentation. Our nicotine pouch volume has grown by 41%. Our revenue has grown by 21% at constant currency or 22% outright, and our EBIT has grown by 29%. We are very proud of the results that we have for Q1, and I would like to take this opportunity to thank the team for an outstanding performance during the quarter.

With that, operator, I will pass over for any questions.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] The next question comes from Niklas Ekman from Carnegie. Please go ahead.

Niklas Ekman

Analyst, Carnegie Investment Bank AB

Q

Thank you. A couple of questions from my end. Firstly, the strong sequential acceleration you've shown here in the growth markets. You've had growth rates that are 40% to 50% in recent quarters, now almost 70%. Can you say something about how much of this you believe is related to the California ban? Is that the main driver here behind accelerated growth or is there anything else? That's my first question.

A

Well, I think, first of all, Niklas, I guess, there is a bit of an FX tailwind that we're benefiting from here, although we have benefited from it a little bit in prior quarters as well. And what we are seeing is that we are showing generally very strong growth across the US. And if I take a look at California itself, I think it's probably worth noting that we had a disproportionately low share in California going into this environment. If we were to revert back to the early stages of 2022, both of our warehouses at that stage in the US were hinged on the East Coast, and hence our convenience in California was a little bit – it had room for improvement at the time.

Seeing this regulation coming in the latter part of 2022, we chose to launch a West Coast warehouse based on Colorado to be able to handle this dynamic going in to California. And so, we were seeing an improvement in California prior to the ban, and we have seen an uptick within that. But the vast majority of the uptick that we are seeing from that 50% to 70% in local currency terms is not coming from California. I think California is accounting for maybe a high-single digit element of that.

Q

So that's very clear. Thank you so much. You mentioned in the report you talk about pressure on the product margin in Sweden due to campaigns in the start of the year. Is this something that was temporary? Have you seen this easing gradually in the quarter?

A

We had, yes. So this was something which was in the same way as we ourselves had loaded some stock to have competitive advantage going into the quarter because of the excise increase. It was something which was – which also had a little bit of an impact on the overall market dynamics during the quarter. So we did see a slightly more competitive first half of the quarter, and we see it as a quarter which has again returned to normal from a – from the middle of the quarter on.

Q

Thank you. That's very helpful. You talk about vaping here in the UK and you say you've had a very satisfactory initial evidence here and you're still evaluating and what are you evaluating? What can you elaborate a little bit on what could be your potential next steps? Are you going to – I assume you mean investing more in the category? Do you also consider expanding to other markets?

A

Yes. So I think both. So this is our first time to move into a category which is not product sold in a can. And there was a – we needed to launch, this as a pilot in order to get the learnings as with regards to where we needed to adapt different parts of our infrastructure in different parts of our model. I think we have the majority of the learnings got at this point in time and we're quite happy with the progress that we've been making so far within the UK. Now, I think we're evaluating exactly how to adapt and tweak a few things in order to accelerate that both within the UK, but also to prepare for expansion across other geographies also.

Q

Very clear. Any views on what geographies could be relevant? Can you elaborate on that or is it too early?

A

I think we'll be back in further quarters with a little bit more detail on that space.

Q

Super clear. Regulatory risks in Norway, can you tell us a little bit about – can you elaborate a little bit what you think would be the likely timeline here for regulation? And obviously being aware that regulatory processes tend to take a very long time. But can you say something on what you think is the likely outcome here over the next few quarters or years?

A

Yeah. Well, I think, firstly, this needs to be taken into account as with regards to the strategic paper, which is being – which is a process which generally relates to the next four years and can occasionally extend a little bit

further. And it's not unusual for these papers to come through. I believe this is potentially the fourth one, I think, which has come in this four year window at this stage. Not everything within this space tends to come into regulation. It's more of a bucket list of an extended sort of range of our wishes coming true. There's quite a broad spectrum of dynamics And it's more of a bucket list of an extended sort of range of our wishes coming through. And there is quite a broad spectrum of dynamics within that strategy paper across multiple nicotine and tobacco categories, and including the [indiscernible] 00:25:48 of them.

Now, we feel very confident that the piece around the online is being taking somewhat out of context and that digital, in general, is being bucketed together as opposed to digital marketing and online. And we feel very confident that, you know, common sense will play out when it comes to an online ban here because, not only are we, as I kind of alluded to, through the presentation, not only is online the channel, which has gotten the strongest age-gating and age-verification of any channel in Norway, but online is also a space with not only prohibition of under 18s, but it's also a space with a disproportionately low share of the 18-year-old to 25-year-old market because, in general, people with a lower disposable income, such as students or people which just started a career, tend not to go out and pre-purchase their snus for the next month. So, we tend to have a disproportionately low share of under 25s, not to mention the solid age verification that we have for everybody, which is – would attempt to buy, which would be under 18 years old.

So, we feel very confident that the regulation, that this strategy paper simply contains a bucket list of old and that it is highly unlikely to come in in this space, and we also believe that many aspects within the overall strategy paper will take many years to come in and may overrun into a – the next parliamentary session within Norway after an election.

Q

Thanks for that answer. And then, obviously being very hypothetical here, but if you were to see an online ban in Norway, is there any – I mean, what – do you have any clear plan B? Is there any option to your current setup? Is there any way you could continue to sell into Norway or would you have to cease operations in Norway entirely? Again, this is a hypothetical question, but just curious what you're thinking.

A

Yeah. No, it's extremely difficult to answer on the basis of we're dealing with effectively a paragraph around this at this point in time in the strategy paper. So, it's very, very difficult to determine what this could actually look like over the next three to five years. I think we would need more clarification before we'd understand what potential impact it might have on the business.

Q

Fair enough. Fair enough. Thank you so much for taking my questions.

A

Thank you, Niklas.

Operator: [Operator Instructions] There are no more questions at this time, so I hand the conference back to the speakers for any closing comments.

Kestutis Sasnauskas

Thank you very much for taking the time to join in and we look forward to updating you in three months' time regarding our Q2 performance.

Unverified Participant

Thank you.

Kestutis Sasnauskas

Have a wonderful day. Bye-bye.

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