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Haypp Group AB (HAYPP.SE)

Q3 2023 Earnings Call

CORPORATE PARTICIPANTS

Gavin O'Dowd

Chief Executive Officer, Haypp Group AB

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Chief Executive Officer, Haypp Group AB

Peter Deli

Chief Financial Officer, Haypp Group AB

OTHER PARTICIPANTS

Niklas Ekman

Analyst, Carnegie Investment Bank AB

MANAGEMENT DISCUSSION SECTION

Gavin O'Dowd

Chief Executive Officer, Haypp Group AB

Thank you. Good morning, everybody, and welcome to Haypp Group's Presentation of the Interim Report for the Third 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 third quarter. The interim report and the results presentation is available in the Investor Relations section of our corporate website. Presenting today, in addition to myself, is Peter Deli, our CFO.

Peter Deli

Chief Financial Officer, Haypp Group AB

Good morning, everyone. Welcome on our Q3 call.

Gavin O'Dowd

Chief Executive Officer, Haypp Group AB

Moving along to slide 5. We have – sorry, moving to slide 4 in our results presentation. Here, we state the higher purpose of inspiring healthier enjoyment to millions, which is predominantly moving people from cigarettes to safer alternatives. This is traditionally with snus, but in more recent years, this has been nicotine pouches.

And moving along to slide 5, we have a chart presenting the spectrum of nicotine products and the relative level of harm versus cigarettes. Haypp Group's [ph] primary focus (01:07) on nicotine pouches and snus lies at the lower end of the spectrum. The scientific body of research around modern harm-reduced alternatives [ph] to (01:15) cigarettes, has come a long way in recent years. In addition to nicotine pouches and snus products, products such as tobacco-heating devices and vapor are widely accepted as carrying significantly lower levels of harm than traditional cigarettes and other tobacco smoking products, which is part of the reason why we have extended our portfolio slightly up this spectrum towards the vaping products during the last year.

On slide 6, you can see what smoking rates are like across a range of European countries. Sweden, with its 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 the world. 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 smoking rates have collapsed between 2005 and 2020 in Norway, especially among the younger part of the population.

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 7, we can see the outlook for the market that 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 pouches and snus, which is in the process of increasing from SEK 27 billion in 2020 to SEK 60 billion in 2025. All of this growth has been driven by nicotine pouches, which will increase from a share of market of 30% in 2020 to circa 80% in 2025.

Since the market outlook was prepared, nicotine pouches have been tracking in line with the expected CAGR of 41% per annum. The category is now growing faster than initially expected, particularly in the USA. And Haypp Group is growing significantly faster than the category in each market.

The primary driver behind the growth of the category is strong consumer demand for less harmful products, which is greatly supported by regulatory – sorry, the primary driver behind the growth in this category is strong consumer demand for less harmful products, which is greatly supported by regulators in general, adopting the principle of harm reduction in [ph] legislative (03:41) approach to nicotine products. This in turn has led to significant investments in the category from industry players, both large tobacco companies and many credible new entrants who are driving innovation.

Furthermore, the category is well-suited for online and we see online penetration rates increase, and we continue to expect online to increase at healthy levels going forward.

Moving to slide [ph] 8 (04:08), you will see an overview of our logistics infrastructure. Convenience remains one of our key USPs, and the ability to offer customers across all our markets fast and reliable deliveries at an efficient cost sets us apart. We completed the second phase of our warehouse expansion in Q2 of last year and we're now operating six warehouse locations across our Core and Growth Markets. We have managed this expansion while continuing to maintain healthy inventory turnover of around 15 times per annum.

Developing our underlying systems and processes combined with the local warehouses is pivotal to not just manage significant growth in our existing markets, but it is also an excellent base to expand our offerings into both adjacent categories and new geographies. During Q3, we opened our own warehouse in Milton Keynes, just north of London, and we also reequipped our Stockholm warehouse to facilitate future growth and cost efficiency.

In addition to this, we also went live with our fully integrated backend in Norway, integrating the warehouse administration system with our new ERP. This transition was not only the smoothest which I've experienced in my career, but also the benefits and efficiency were immediately realized. While there is a substantial part of this journey to go, including migrating all of our frontends onto more effective platforms, the progress so far, combined with the acceleration of the opportunity which I referred to earlier, assures us that we haven't taken this journey one moment too soon.

Moving along to the operational highlights for the third quarter on slide 10 (sic) [9] (05:44), and starting with our performance in nicotine pouches. The growth in consumer demand for significantly less harmful products remained strong in Q3. All growth for the combined nicotine pouch and 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 Group continues to grow market share across all our markets.

Our nicotine pouch volume accelerated from last quarter to 37% year-on-year [ph] for the group (06:19), driven by solid growth across all of our geographies. We continue to play a pivotal role in launching products in the nicotine pouch category, which in turn accelerates the migration from cigarettes. [ph] During (06:32) Q3, over 20% of our nicotine pouch volume related to products which were launched in the past year.

As I briefly mentioned earlier, our investment in logistics infrastructure in the second half of 2022 have resulted in material improvements in consumer satisfaction and retention rates. In a difficult macroeconomic environment for consumers, we are particularly pleased to note that we are growing our active customer base by 15%, indicating that our value proposition remains highly relevant, even in challenging economic times.

Moving along to the next slide, I would provide a slightly longer perspective on our nicotine pouch performance. The chart on the left shows the historical NP volumes sold by quarter. You will notice that Q3 was the first-ever quarter where the year-on-year growth was over 3 million cans. The chart on the right shows the share of volume which are nicotine pouches. As you will notice, maintaining high growth rates in an increasing base has led to a mix change to accelerate in recent quarters, despite continuing revenue growth within snus.

On the next slide, I would like to provide an update on regulation since our last call. After the summer, the Swedish government proposed a change to tobacco taxes in Sweden, whereby taxes will increase significantly for cigarettes and reduce significantly for snus. While the economic implications of the proposal are not significant, since snus taxes are already a fraction of cigarette taxes in Sweden, this is still an extremely important, as it reaffirms Sweden's support for the principle of harm reduction and will be closely considered by many other governments, especially when Sweden becomes the first country to meet WHO threshold for going smoke-free.

In addition, there have been some stories around the EU's work on the future of nicotine. Just to create some context for this. In 2020, the EU Commission published its mid-term evaluation of the Tobacco Product (sic) [Products] (08:43) Directive variance 2, in which the Commission considered if nicotine pouches should be considered to circumvent the snus ban within the EU.

During the year, the Commission carried out a public consultation to get the views of member states, organizations, companies, and EU citizens on the EU's regulation of tobacco and nicotine. Haypp Group follows this development closely and continuously informs relevant parties about how smoking-related mortality in the EU can be significantly reduced by more quick – more quickly with the support of Haypp Group and the products which we sell.

A number of decisions in recent years and even in recent weeks have gone in the direction of nicotine pouches and it will be appropriately regulated by the EU. Given the benefits of the category and the support which many regulators across a multitude of countries are providing to the category, we remain confident that the category will be appropriately regulated.

With that, I will pass the word to Peter for comments on our financial performance.

Peter Deli

Chief Financial Officer, Haypp Group AB

Thank you, Gavin. Let's flip to slide 12 and the financial overview for the group. In general, I would like to say that we are pretty much tracking in line with our previous performance in Q2, which is a great news because we felt that the momentum what we gained in the backend of last year, we are capable to maintain.

We reported a net sales increase of 22% for the group in the third quarter. And in constant currency, that was also 22%. Effectively, all of our growth is attributable to our progress within the nicotine pouches, and we are recording solid sales growth rate for nicotine pouches across all markets, while tobacco-based sales revenue is only growing low single-digit.

The gross margin improved year-over-year by 0.2 percentage points to 12.6%. 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.

Moving down in the P&L to the adjusted EBIT. For the quarter, it grew by 34% versus last year and amounted to SEK 18.3 million, which correspond to an adjusted EBIT margin of 2.4%, up by 0.2 percentage points versus last year. The drivers behind the EBIT margin uplift is the higher volume and gross margin, partially offset by higher adjusted OpEx from investments in the organization to support [ph] or (11:17) further growth.

Cash flow from operating activities during the period amounted to SEK 128 million.

Moving on to the next page, page 13, which is about the Core Markets performance. Here, our reported net sales for the segment grew by 12% during the quarter and amounted to SEK 574 million. In constant currency, net sales increased also by 12%. The key driver of the growth is the Swedish nicotine pouch, which continued to perform well, while the market decline in snus consumption, which is more or less in line with what we see on the market, had some negative impact on our sales performance.

I would like to call out also Norway, where we are very pleased that the net sales continues to increase at healthy levels sequentially and on a quarter-over-quarter basis as well. And we recorded very solid double-digit growth, mainly driven by the nicotine pouches. However, the snus performance on the Norwegian market [ph] remained (12:23) solid as well.

Our nicotine pouch volume in the Core Markets grew by 29%, with both Sweden and Norway showing strong performance. The profitability of our Core Markets [ph] remained (12:36) strong. On a last 12-month basis, we have generated SEK 189 million of EBITDA in our Core Markets. The EBITDA margin was 8% in the third quarter, 0.2 percentage points down versus last year. The margin reduction in the quarter is mainly attributable to some negative exchange rate impacts.

Let me move to slide 14 and the Growth Market performance. Reported net sales here increased by 68% to SEK 195 million for the third quarter. And in constant currency, the growth was 65%. We had strong performance in all markets. I would like to call out particularly US and UK. However, the DACH region is also showing some very healthy growth.

Our nicotine pouch volume in the Growth Markets increased by 53% in the quarter. EBITDA amounted to a negative SEK 13 million versus a negative SEK 17 million during the same period of last year. The improvement is driven by volume growth, which is obviously unlocking [ph] economies (13:43) of scale across the different lines of the P&L.

I would like to stop a little bit here on the next page, page 15, and illustrate the contribution of our Growth Markets to the group sales performance. We call them Growth Markets for a reason. They continue to rapidly grow, and this growth is increasing their weight in our total sales rapidly. Year-to-date Q3, what you see on the left side for the current year and the previous two years, you can see that the contribution of the Growth Markets increased from 12% to 23% in the total group. In the discrete Q3, this contribution was 25%, as you can see it in our quarterly report.

Importantly, this sales growth is almost fully driven by the nicotine pouches, which is nicely fitting with our strategic direction. We are confident, in line with other industry players, that the underlying consumption patterns will remain and allow us to maintain an exceptional growth trajectory despite the sales base is increasing. I think it's important to note that this should support the acceleration of our total group sales as we go ahead.

Moving to slide 15 (sic) [16] (15:03), it's about our selected KPIs. Here, I would like to draw your attention to the balance sheet, which remained healthy. We closed the quarter with a net working capital position of SEK 183 million, out of which our inventory accounted for SEK 175 million. The increase versus the same quarter last year is predominantly driven by the increase in our current assets driven by the volume growth, what we saw both on the inventory and on accounts receivable line as well.

On the liabilities side, in accounts payables, we saw a reduction driven by the weekly pattern of the payment rounds what we are performing.

On the inventory, I would like to highlight that we keep taking the opportunity to temporarily increase the inventory of particular brands where we expect an increase on inbound prices.

Net debt was SEK 131 million corresponding to a net debt to adjusted EBITDA ratio for the last 12 months of 1 time versus 1.8 times in the full year of 2022.

With that, I would like to hand back the word to Gavin.

Gavin O'Dowd

Chief Executive Officer, Haypp Group AB

Thank you. On slide 18, we reiterate our long-term targets of SEK 5 billion in net sales by 2025. And we also reiterate our profit target of high single-digit adjusted EBIT over the medium to long-term. As you would have seen from Peter's material, we're already rapidly closing on this target in our Core Markets. And as you have also seen, Growth Markets rapidly moving to profitability and we expect them to be net contributors from the start of 2024.

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 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 this category, given how suitable the characteristics of the category are for online. We also reiterate our market-leading position in all of our markets.

Moving along to slide 20 on our current trading. Market trend for harm-reduced products remains favorable, and we continue to transition our business into mainly nicotine – into mainly the nicotine pouch category. On top of that, the online channel continues to grow relevance within the category.

In terms of inflationary pressure and inbound costs, we reiterated our previous guidance that inflationary pressure on our cost base remains limited and can be passed on should they occur.

We recognize the recent acceleration of nicotine pouch total market sales growth in both the USA and the UK. We continue to develop our business to be able to benefit from these accelerating growth rates.

Our pilots into vape at the start of the year in the UK and at the end of Q2 in Sweden have shown strong performance and provided a depth of understanding. This has enabled us not only to improve the performance, but to embed the specific learnings of the category into our new infrastructure.

Our capabilities to attract new customers and retain them, with our 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 our backend, 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 complex environment for consumers. With a strong balance sheet, a noncyclical product, a capital-light business, we are able to remain flexible and strengthen our market position. As I wrap up, I would like to guide you to slide 21. There is over 1 billion smokers in the world looking for healthier alternatives, and already, over 100 million of them have chosen so. Nicotine pouches remains the fastest growing category in this space.

The category is perfect for online, and we are an undisputed global online market leader. We have a symbiotic relationship with our suppliers, and in addition to being the partner of choice for new launches, we are also the largest provider of consumer insights. We continue to welcome [ph] proportionate (19:31) regulation and we often benefit from it. Our unit economics continue to improve as we scale, and we have a highly engaged team with core competencies across both the nicotine industry and e-commerce.

Before I hand over to the operator, I would like to take the opportunity to invite you to our Capital Markets Day on the 28th of November in Stockholm. Operator, I would now like to open the line for questions, please.

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. Just a couple of questions from my end. Firstly, you talk about the regulatory development, and you mentioned here that there have been a number of news towards regulation rather than a ban. And you talk about the recent weeks here. Can you give us a few examples of this?

Gavin O'Dowd

Chief Executive Officer, Haypp Group AB

A

Good morning, Niklas. So I guess you have seen some proposals coming through or just some leakages coming through from the EU. And then we saw a substantial number of countries take a very strong position against that. A broad range of countries, many of which don't actually have nicotine pouches as a primary part of their geography, as a primary part of their assortments as of yet.

But in addition to this, we also see some very strong support from a number of EU countries where the category has been very well-supported by local regulation in recent years and where the category is being quite successful in getting people off cigarettes. So some of these countries include, for example, Austria, Slovenia, the Czech Republic. And then of course, you also have strong support around the Scandinavian markets, not just of Sweden, Denmark, Finland.

So you have a very strong position starting to emerge now as the discussion is opening up and becoming more public. So, I think on the basis of that, we feel as though the sort of unified position from a substantial number of EU members is greatly supporting not just the category to continue, but also greatly supporting that appropriate regulation is brought in and that the market is going to face similar dynamics as what it faces currently in Sweden or has faced over the recent years in Sweden.

Niklas Ekman

Analyst, Carnegie Investment Bank AB

Q

Very good. Thank you. And can you also update us on Norway? [ph] I think (22:10) there's no news here, but one of the discussion's been among the political parties on the topic of a potential ban on online sales.

Gavin O'Dowd

Chief Executive Officer, Haypp Group AB

A

Yes. I think the position on this in Norway remains in line with what we'd said at the end of our Q2 results. So, we remain confident that any online ban for Norway is going to relate to cross-border sales only, and it's predominantly focused on the cross-border sales of vape, which are illegal in Norway. So, we remain confident equally, if not even more confident than we did, when we'd said the last time that online sales of snus and nicotine pouches, we believe is going to – we strongly believe is going to remain in Norway. So we don't see any change in that space.

Niklas Ekman

Analyst, Carnegie Investment Bank AB

Q

Very good. And on the topic of vape, you are now present in the UK and Sweden. Is that correct? And can you tell us about some initial learnings of this, of your experience here, and also maybe a little bit on what you see in terms of rollout? Are you looking at multiple new markets over the next few quarters or more like one market at a time?

Gavin O'Dowd

Chief Executive Officer, Haypp Group AB

A

So if I take the first question there first, regarding what our experience has been so far. I think we've gotten a much deeper understanding of the category, the products within it, and how the consumers are interacting with the category. Also, how the consumers are interacting with the combination of that category and nicotine pouches. So, we've developed a lot of learnings and we have been making very good progress across our search engine optimization. And we've also been making very good progress around how to navigate our assortment to be able to guide the consumer in the direction for the category.

We're currently, as you say, present in UK from the start of the year and in Sweden from the middle of the year. And when it comes to our further rollout expansion, we will take the opportunity on the 28th of November to expand more fundamentally on that for the Capital Markets Day.

Niklas Ekman

Analyst, Carnegie Investment Bank AB

Q

Very good. Thanks. And I also noticed there your comment about Growth Market being net contributors to profitability from 2024. Does that include your investments into the vaping category?

Gavin O'Dowd

Chief Executive Officer, Haypp Group AB

A

We will go into a little bit more depth as regards to how we cut this piece on the Capital Markets Day. What we can say at this point in time is that our existing geographies will be, and we gave this guidance at the end of Q2 as well. At that stage, we said in the next few quarters, I think we can give a little bit clearer guidance now as [ph] regards to in (24:47) quarter one of 2024 we expect our current geographies for our overall products in the Growth Markets to be EBITDA positive.

Niklas Ekman

Analyst, Carnegie Investment Bank AB

Q

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

Gavin O'Dowd

Chief Executive Officer, Haypp Group AB

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.

Gavin O'Dowd

Chief Executive Officer, Haypp Group AB

Thank you very much for taking the time to listen to our Q3 results. And I would like to take this opportunity to thank the entire team for delivering another exceptionally strong quarter. In addition, I'd like to reiterate, our Capital Markets Day is on the 28th of November, and everybody is in Stockholm and everybody is very welcome to attend, and we will be releasing our full-year results in February. Thank you very much.

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