Corrected Transcript

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Haypp Group AB (HAYPP.SE)

Q2 2024 Earnings Call

CORPORATE PARTICIPANTS

Gavin O'Dowd
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

Operator: Welcome to the Haypp Group Q2 Report 2024. 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, Peter Deli. Please go ahead.

Gavin O'Dowd

Chief Executive Officer, Haypp Group AB

Good morning, everybody. And welcome to our Q2 2024 interim results. Our CFO, Peter Deli; and I, Gavin O'Dowd, will talk you through our results. This quarter, I would not only like to reiterate the higher purpose of inspiring healthier enjoyment for millions, but I would like to call out that in the past 12 months, we served over 1 million consumers. While we have many more millions to reach, this in itself is a material milestone. Moving along to our operational highlights, I would like to begin with our nicotine pouch Q2 volume year-over-year growth of 43% and 93% across a two-year period.

Nicotine pouches now account for 61% of our total volume for the quarter, up 11 percentage points versus Q2 2023. And the robust trend continues. We are particularly happy with the continued strong nicotine pouch performance in our growth divisions, which grew 65% year-on-year after moving into profitability in Q1 and has continued expansion in margin in Q2. The increase in EBIT margin from 2.7% to 3.7% reflects the benefits of scale to our business, particularly in our growth markets. And the investment of 90 basis points in our Emerging segment is already delivering robust growth rates. Our infrastructure transformation continues on track and now all of our Norwegian stores are migrated to [ph] V3 (02:16). We will further add functionality to our [ph] store front (02:20) platform and then migrate to remaining European stores.

Moving along to slide 6. The quarter was more turbulent in the US than usual. Higher than expected overall consumer demand for the category during 2023 and early 2024 has created a well-documented market shortage for ZYN, the market leading brand. This generated an increased consumer awareness of the online channel, which resulted in the need to ration consumers by introducing a monthly ZYN cap for consumer. However, our broad assortment and skills in offering trial enable consumers to choose alternative brands, which increase the overall growth rate to 70% for the quarter. Moving along to regulation. In the US, the FDA issued marketing granted orders for some flavored vaping products. While processing the backlog of risk reduced products already on the market and new products awaiting the launch will undoubtedly take some time, this is a positive step forward. In the EU, while there had been better communication around TPD3, the outcome of European parliamentary elections is likely to further increase the support for risk reduction as a health strategy. In the UK, the July election delayed the proposed legislation on vaping. However, we expect the new Labour government to continue with the proposed legislation, albeit with some modifications and clarifications. In Sweden, while we have not seen any specific legislation changes, the principle of harm reduction as a strategy continues to be reinforced.

With that, I will hand over to Peter for more depth on our commercial performance.

Peter Deli

Chief Financial Officer, Haypp Group AB

Good morning. Let me start the financial review with our sales development on slide 8. In Q2, the group achieved 23% sales growth versus the same period last year. Excluding 1% favorable currency effect, the growth was 22%. As I mentioned in our Q1 report, 2024 March and April are not comparable with the previous year due to the timing [indiscernible] (04:48). So if you look at the period from March to June, the growth is 19%, which is a fairly comparable number. This shows the strong improving trend versus the slow start of the year. All business units contributed to the growth. However, the key driver was the growth segment, which accounted for 54% of [indiscernible] (05:10) growth. Important also to look not only at the geography but the product category split as well. The improvement since our Q1 results is mainly driven by the contribution of the nicotine pouch segment. But also this category contributed 24% to the overall sales growth, compensating for the 3% negative impact from the snus segment. The negative impact of snus is down to 3% versus 4% in Q1. The rapid growth in the nicotine pouch segment is a cornerstone for future strategy as well.

With this, moving to slide 9 and the profitability. Q2 was a strong quarter not only in term of sales but gross margin and adjusted EBIT as well. Gross margins are up by 1.4 percentage point versus same period last year, of 14.3%, which is in line with our Q1 results and reflects the benefits of scaling and favorable product mix through increased share of nicotine pouches. Adjusted EBIT for the group in the quarter is 3.7% or SEK 34.4 million. This is 68% higher than the 2023 Q1 and in line with the Q1 performance. The key driver for the improvement in the margin is margin performance, with 1.6% positive impact on our adjusted EBIT margin. Part of this was invested into organizational capabilities and capacity meaning to support the Emerging segment.

Looking at the bottom right part of the slide, you can see the core and growth – that the core and growth segments reached 4.5% adjusted EBIT margin in the quarter. We see this as a major step towards the 5% to 7% range for 2025 we guided during our Capital Markets Day. This quarter, we invested 0.9% of our sales into our Emerging segment. Moving to slide 10 which is showing the performance of our core markets. In our core segments, the net sales increased by 11%. The growth was driven by the nicotine pouch segment with 33% volume growth. EBITDA margin was 8.6%, driven by the improved gross margin performance. We see strong nicotine pouch performance both in Sweden and Norway showing the sustained high level of consumer interest for this category. With that, I'm moving to slide 11 and our growth markets. In our growth markets, net sales increased by 52%, excluding the favorable exchange impacted up by 50%. The segment reached 30% share of total group sales from 24% in Q2 2023. The growth was driven by nicotine pouches, which segment shows strong growth rates across all four markets. Profitability further improved since the previous quarter. The EBITDA margin was 1.3% in Q2 2024. This shows a major turnaround versus Q2 2023 where the group invested SEK 12 million into this category.

On the next slide, you can see the performance of our Emerging markets. This is slide 12. Here, the sales grew to SEK 12.8 million in the quarter, which is 58% higher than it was in Q1 2024. Investments remained comparable through the previous quarter. We are happy to see that this strong momentum continued into July as well, which is giving us opening for the future. Moving to slide 13, and our selected KPIs. On this slide, I would like to highlight two key lines. First, as Gavin mentioned before, we crossed the important milestone of the 1 million active customer over the last 12 months. We acknowledge that we have a long way to go to inspire millions but we got the first million. From the balance sheet, I would like to highlight our net debt to adjusted EBITDA ratio, which is 0.5, showing the strong balance sheet we are maintaining. In the quarter, we generated SEK 67.5 million cash flow from operating activities.

With that, I hand over to Gavin who is going to talk about financial targets and strategy.

Gavin O'Dowd

Chief Executive Officer, Haypp Group AB

Thank you, Peter. Moving to our financial targets, we continue to target SEK 5 billion in revenue for 2025. I will touch on this a little more in our next slide. Regarding profitability, our target is an adjusted EBIT for core and growth segments in the range of 5% to 7% in 2025. As Peter already highlighted, during Q2, our adjusted EBIT for these segments was 4.5%, an increase of 1.9 percentage points versus Q2 2023. We would like to remind investors that our operating model tends to reflect the benefits of scale as we transition from one calendar year to the next. As such, I expect early 2025 to be the next time we experience a material uptick in our EBIT margin.

Moving to the next slide. On the back of questions during our Q1 results, I would like to provide more context on our SEK 5 billion revenue target. In the right hand side, you can see the chart we provided during our Capital Markets Day in late 2023. I would like to provide a different touch on these assumptions on the right hand side. While snus, which is a substantially less profitable category for us and has been declining faster and we see very strong performance in our nicotine pouch category. It is also worth noting that the NP growth rates for our growth division is currently 65% and accounting for 42% of our nicotine pouch volume during Q2. This strong development would, if it continues, positively impact our overall growth rates.

Moving to the next slide. I would like to reiterate the overall growth rates, which are projected for our category. The potential for significant increases in overall [indiscernible] (11:48) penetration remembering that the online share in Sweden is now over 30%. And this, combined with our leading positions across all of our markets, leaves us particularly well positioned for robust growth for many years to come. Moving to our final slide. I would like to reflect the dynamics underpinning our continued performance. Haypp has a substantial competitive advantages in its business model, which in turn are built in robust processes and systems. However, our overall processes is a result of an excellent team and culture that has fostered and their connections to our higher purpose of inspiring, healthier enjoyment for millions. I would like to take this opportunity to thank the team for their commitment, dedication and overall performance.

With that, I will hand over to the operator for 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, it may be a theoretical question. This severe shortage of ZYN that you've seen in the US market, is it possible to quantify? And I'm trying to grasp whether this has been positive or negative for you because you mentioned here that it's driven more online sales. So that's just been positive or negative, any way to quantify the impact? Thank you. That's my first question.

Gavin O'Dowd
Chief Executive Officer, Haypp Group AB

A

Good morning, Niklas. Firstly, I think when it comes to referencing severe shortage, I don't think it's so much that there's a severe shortage. I think there's been very consistent supply and perhaps increasing supply in the category. I think it's more a case of there's just been – have as much more demand than was initially anticipated. And then when it comes to the implications that it has for us and potentially for others as well in this space and we wanted to – we took a principle going into this dynamic to be quite conservative regarding how we managed our business through this sort of turbulent period, particularly for the first month to six weeks within us.

And I think we've adapted our business accordingly. We've seen some strong performance on the back of it, and I think we're very well positioned for where it goes forward from here. And I think net-net, it has been perhaps marginally positive for us, but in the short to medium term. But I think where the real benefit for us comes out on this is that it creates an awareness for our channel where people are being encouraged to look for alternatives that perhaps was not existing beforehand. So I believe the awareness of online within the consumer base is increasing materially on the back of this. So I think we will see as we look back on this in quarters to come, exactly what the implications were. But I think there would probably be some long-term benefits for us. However, the way we've managed it so far, we wish to be conservative and it hasn't had a material impact on our performance so far.

Niklas Ekman
Analyst, Carnegie Investment Bank AB

Q

Okay. Super. That's very clear. Thank you. Second question, the Chevron Act. Can you elaborate a little bit on what you think that this could do in terms of FDA regulation and how long before we actually see an impact? Is this something that could have a significant long-term impact, but maybe not so much short-term or how do you view this as a potential for more relaxed regulation on the sale of nicotine pouches in the US market?

Gavin O'Dowd
Chief Executive Officer, Haypp Group AB

A

Yeah. So maybe just to create context on the Chevron Act for people here and the Chevron case was a case that came through in the early 1980s and it created a degree of precedent for the last few decades as regards to the absence of clarity, that there was a little bit more power sitting with government agencies to interpret what legislation actually meant. And the reversal of that act changes that dynamic a little bit within the overall regulatory space within the US. Then when it comes back to this category and the implications it will have, personally, I believe it's a little bit too early to put any guidance on what we think this will look like for the future. So I would like to and I'd like to give a couple more quarters for it. I know there are some people who view it, that this could be a basis for creating an opportunity for new products to enter into the category quicker than would have otherwise been the case. And I think it's quite a complex environment over there, and I personally like to sort of remain on the fence on this one until we see how it manifests over the next three to six quarters.

Niklas Ekman
Analyst, Carnegie Investment Bank AB

Q

Fair. Fair enough. Thank you. And I recognize that this is a complex question, of course. And a third question, you mentioned here in terms of your margins, your margins have reached to now a little more than 100 basis points year-to-date, both in Q1 and in Q2. And you mentioned that you expect the next significant uptick in profitability from early 2025. Can you say anything about what kind of magnitude? Are you looking at a similar uptick as we've seen now in H1? Or will it be less or more? It's possible, would be keen to hear your thoughts there.

Gavin O'Dowd
Chief Executive Officer, Haypp Group AB

A

I think when we come to giving guidance, even more detailed guidance for 2025, I think we'd probably wait until slightly further on in the year for that. But just to create a bit of context on this one. Yes, we do see generally material upticks as we go from Q4 to Q1 each year as it goes through, partly driven by that being the cycle that we do our annual negotiations with many of our suppliers, not least of which is our in – our industry suppliers. And when it comes to the scale and spectrum of that, I think there's still a range of variables out there. We do expect it to be material in Q1 and we'll come back nearer the time to give you a little bit more guidance on what range of material it would look like.

Niklas Ekman
Analyst, Carnegie Investment Bank AB

Q

Very good. Thank you. And also a technical questionnaire and maybe [ph] anything with you (18:29). But net financials, there was a significant negative impact here in Q2. And in general, when I look at your net financials over the last couple of quarters, they've been quite volatile, shifting from negative to positive. Can you tell us a little bit about the background on this and also kind of what we should expect for the coming quarters in terms of net financials and maybe net financials for the full year?

Peter Deli
Chief Financial Officer, Haypp Group AB

A

Absolutely, Nicholas. Good morning. So when you are looking at the net financials, in Q2 2024, the impact what you see is coming from three reasons for the underlying event. First, this is where we are recognizing the interest expense on the lease contract. What we had [ph] for all of our outside treatment (19:18), this is where you see materializing the interest rate on the credit facility we are using. And lastly, this is where we see the realized exchange impact. In the previous quarters, that the fourth component, which was the revaluation of the intercompany loans, however, we revisit those contracts and change the structure in a way that the revaluation in Q2 already went directly into that other comprehensive income. So there is no more impact expected from this fourth component going forward. Then you look ahead in terms of the interest cost and the realized exchange, the interest cost, which is a bit more than half in this quarter. The net financials what you see is expected to remain stable. However, when it comes to the realized exchange, I think it's very difficult. Here, I know to quantify. It depends on how the working capital is going to move into different group entities. However, I think, if you take the current quarter as a base assumption [indiscernible] (20:27).

Niklas Ekman
Analyst, Carnegie Investment Bank AB
Q

Okay. And in terms of underlying net financials, we're talking about a roughly SEK 1 million negative per quarter, that's the current run rate in your underlying interest rate, right?

Peter Deli
Chief Financial Officer, Haypp Group AB
A

It's more than that, right? It's roughly the amount you mentioned for the lease. But also, we have the credit facility. That's the generally our cash flow that might go down. But again, there is a volatility on this one depending on the inventory movements we will see in the coming quarters.

Niklas Ekman
Analyst, Carnegie Investment Bank AB
Q

Okay. Okay. Fair enough. Thank you. I also – just a final question. You mentioned in your report here, you talk about [ph] media insights (21:13) being a significant contributor to your earnings improvement. Can you quantify this? How big of an impact does this actually have to your profitability?

Gavin O'Dowd
Chief Executive Officer, Haypp Group AB
A

So I think what you can see here, Niklas, is that – and much of the uptake in our overall group profitability has come from an improvement in our growth division. And our growth division has now started to reach sufficient critical mass as we guide to our share within those markets and the importance of those markets, both for the industry and for us and that much of our media and insights capabilities are starting to be utilized by a broader range of industry players. So it is starting to create a material uptake. And hence, it's one of the key drivers you can see when it comes to the uptake between Q4 and Q1 on this space. So I think that probably creates a bit of an indicator on the spectrum that we're dealing with here.

Niklas Ekman
Analyst, Carnegie Investment Bank AB
Q

Okay. Very good. Thank you so much for taking my questions. Thank you.

Peter Deli
Chief Financial Officer, Haypp Group AB
A

Thank you.

Gavin O'Dowd
Chief Executive Officer, Haypp Group AB
A

Thank you very much, Niklas.

Peter Deli
Chief Financial Officer, Haypp Group AB
A

Hi. We got some questions from [ph] Danielle (22:22). In the presentation, maybe we start going from the bottom. First question was about the putting in the number of shares, which in case is around 4% year-on-year. And there has also been a new issue warrants for the management. Can you please give us an idea of the annual average growth in fully diluted shares in issue we can expect over the next few years?

Gavin O'Dowd
Chief Executive Officer, Haypp Group AB

A

Perfect. And so I don't think I'm quite sort of on the same page when it comes to the 4% that we've seen year-on-year coming through on this one. But when it comes to looking forward, what we generally do is we issue roughly 3% of warrants for the management each year as it goes forward. And as you can see the details of in our AGM, these warrants are generally issued 30% out of the money and at the time of maturity, three years later, they will generally result in being converted into an equivalent value of shares subject to [ph] earnings (23:26). So if I was to simplify this, I'd give some examples of what this could look like. So in the scenario where the share price grows roughly 30% over those three years, there would be zero dilution. In a scenario where the share price grows by roughly 100% over those three years, it would be roughly 1% dilution per annum coming through on this piece. So I hope that gives some sort of a context as regards to, let's say, relatively linear equation from there as regards to what the driving factor is, which is the underlying share price itself and what the spectrum of implication of that could be.

Peter Deli
Chief Financial Officer, Haypp Group AB

A

Then the next question was around the balance sheet. The balance sheet is [ph] beginning (24:11) quickly. Do you expect this [indiscernible] (24:13) to continue? And if so, what do you plan to do with the business balance sheet, which should be net cash relatively soon?

Gavin O'Dowd
Chief Executive Officer, Haypp Group AB

A

Yes. So we touched on this a little bit when we were doing our Capital Markets Day in late 2023. And we recognized over the last couple of years that as we started moving into profitability with our growth markets and hence our overall group profitability started to uptick. Given our strong cash conversion, our balance sheet would start to move in a robust position. And we remained – we maintained the position that we did in 2023 of that we will not be redistributing any capital during 2024 or 2025 within the business and the set of principles that we laid out then as regards to how we would allocate capital, remain valid within this space. So bearing in mind the robust growth potential that we see within the category, we will prioritize growth within our organic business so long as we can see a sufficiently robust return on capital employed in that space and if the capital generated gets to a level where we don't believe we can efficiently put that work, put that capital to work and generate a healthy return on it, we will then be prepared for alternatives when it comes to and returning that capital to the shareholders. But again, to reiterate, I do not expect any returns and the capital to be returned to shareholders during the remainder of 2024 or 2025.

Peter Deli
Chief Financial Officer, Haypp Group AB

A

Next question was around emerging market and [ph] vape (25:49) ambition. I see emerging market includes your vape ambition and exclude it from your growth target. Can you give us some idea of early consumer responses to your online vape offering?

Gavin O'Dowd
Chief Executive Officer, Haypp Group AB

A

Yes. So as you can see within Peter's material, we are seeing robust quarter-on-quarter growth within our vape offering. And many of the principles around this are very – and the operating model within this are very similar to that of our nicotine pouches. So we understand how to do this part of the business quite well. And so far, the performance has been in line with expectation, perhaps a little bit ahead of us. And I think we would like to give this a few more quarters before we give a little bit more depth on what the future will lead to in this space.

Peter Deli
Chief Financial Officer, Haypp Group AB

A

And last question. We have eased around the development of ZYN supplies. Has there been any development in the ZYN supply in the recent weeks? It seems that [indiscernible] (26:49) most the customer has been significantly increased.

Gavin O'Dowd
Chief Executive Officer, Haypp Group AB

A

Yes. So as I alluded to earlier in the presentation, it was a somewhat turbulent quarter, Q2 within the space. And we aired on the levels of conservatism as we were going through that. I believe whilst in a somewhat turbulent environment, it is a slightly more stable than it was at the beginning and hence we are in adapting in order to reflect that and hence you can see an uptick in the volumes that we're allowing consumers to buy from us on a monthly basis at this stage. So we feel as though while still a little bit choppy, it is – there's a little bit more clarity to the environment than there was in the earlier part of the quarter.

Peter Deli
Chief Financial Officer, Haypp Group AB

And I think that was the last question what we got.

Gavin O'Dowd
Chief Executive Officer, Haypp Group AB

Excellent. Thank you very much for – thank you very much for your participation. And we look forward to reaching back to you again with our Q3 results in the autumn. Thank you.

Peter Deli
Chief Financial Officer, Haypp Group AB

Thank you. Bye.