FY2022 Annual Results Earnings Call
June 29, 2022 10PM - 11PM HKT

Attendees:
MA Pak Wing Kevin, Chairman & Chief Executive Officer
WONG Kar Hang Patrick, Chief Financial Officer
HUI Christopher, Investor Relations

Host
Hello and welcome to the Hypebeast financial year ended March 31st, 2022 earnings call. This is Chris from the Hypebeast's IR team and I'll be coordinating the call today.

I am joined today by Hypebeast's Founder and Chief Executive Officer, Mr. Kevin Ma and our Chief Financial Officer, Mr. Patrick Wong. In our call today, management will go over the FY2022 annual financial results and explore key strategies going forward across our operating segments.

The presentation will then be followed by a Q&A session during which management will be addressing the questions from investors.

Please feel free to submit any questions you may have using the on screen Q&A function throughout the presentation, and we will be addressing all the questions at once during the end of the presentation.

Before we begin, I just wanted to remind you that today's discussions contain forward-looking statements, including statements related to future strategy, products and overall long-term growth prospects of the company. These statements are subject to risks and uncertainties and do not intend to be a complete and comprehensive analysis or overview of Hypebeast. All matters, explanations, financials and any information set out in this presentation is subject to change at any time or notice. Such no reliance should be placed on the fairness, accuracy, completeness or correctness of the information presented today. Any statements included simple aims to provide an outline and covers the basic information of Hypebeast for informative purposes only.

With that said, I will now turn the call over to Kevin.

Kevin Ma

Thank you Chris for the introduction.
Good morning or evening, everyone, and thank you for joining us today.

The 2022 financial year has been a pretty remarkable one for the Group. We ended the financial year with a pretty strong revenue growth and reported another all-time high in revenues and profitability. Revenues achieved 33% year-on-year growth to HK$896 million and gross margins of 61%, that's a significant 11 percentage points increase compared to the previous year.

Before summing up the year, I would like to first of all thank the Hypebeast team for their efforts. Not only do they have an eye for uncovering the next big thing, they also demonstrated agility and made strategic decisions both before and during the unprecedented COVID-19 situation, which contributed greatly to the strength and growth of our business. The quality of the 2022 financial year result is the best demonstration of this.

For many years, we have built a powerful connection with our global audience who want to discover the most authentic aspect of culture. We will continue to expand our universe of content, commerce, and experiences in a way that strengthens our business and community.

Our editorial and media has remained as a powerful driving force as we continued to be at the forefront of discovering the undiscovered. Quick glance at our user and viewership metrics this year, we're seeing growth in both monthly unique visitors and Social Media following this year. We have also broadened our reach to attract a wider community by expanding into new interest areas, such as the launch of Hypemoon which focuses on all things web 3, as well as Hypegolf, a platform that bridges the community to discover the game of golf through a cultural lens. We will continue to capture such business opportunities as they contribute to generating new revenue streams and readership potential.

I am also very excited that we have unveiled, finally unveiled our Hypebeast multi-faceted building in the U.S. two weeks ago in June 2022. The building spans seven floors and houses all facets of Hypebeast, which includes the HBX New York flagship store, a Hypebeans café, an innovative space for event activations, as well as our North American Headquarters. The space will be a strong accelerator for our Media and Agency business growth in North America, and serve as a core point of marketing for the E-Commerce and Retail Segment. To put that into perspective, the US market currently accounts for approximately one third of our total revenues in the current year. So it really makes sense to have a building dedicated towards the U.S.

For the coming financial year, I remain ambitious and confident despite today's macroeconomic uncertainties. We have plenty of room and opportunities to grow, and we will remain focused on building and strengthening the interconnected Hypebeast ecosystem.

With that, I would like to pass on to Patrick for a deeper dive into our financials.

Patrick

Thank you Kevin. Good morning and evening everyone.

We are pleased to present our financials for the 2021/2022 annual financial results, which reflects a strong resurgence out of COVID, and highlights our brand's appeal, cultural leadership and strength from our community's and our brand partner's point of view.

As Kevin touched on earlier, our revenue for the fiscal year reached a record HK$896 million, for a 33% increase from HK$674 million for the prior year.

Our profitability improved markedly compared to the prior year due to improvements in efficiency in campaign delivery, especially in the U.S. where campaign costs were lower than expected. Gross profit for the year amounted to HK$549 million, representing an increase of HK$215 million, or 64%, and gross profit margin increased from 50% to 61%.

Selling and marketing expenses for the Group increased by 42%, HK$113 million in 2021 to HK$160 million in 2022 for the Group, and correspondingly as a percentage revenue increased slightly from 17% to 18%. The increase in selling and marketing expenses, which is largely driven by variable commissions paid to our sales representatives in light of the rise in revenues as well as additions to headcount within the Group's sales and marketing team to drive current and future revenue and business growth.

Administrative and operating expenses of the group increased by 62% from HK$125 million in 2021 to HK$203 million 2022, and correspondingly as a percentage of revenue increased from 19% to 23%. The overall increase was mainly led by additional staff costs in support of headquarter additions, and weaker comparatives in 2021 due to one-time COVID related government subsidies received and other management-led cost saving measures employed in the prior year.

EBITDA was HK$174 million represented corresponding EBITDA margin of 19%. Adjusted EBITDA calculated as excluding one off professional fees relating to the proposed merger, amounted to HK$204 million in 2022, representing an increase of HK$82 million, or 67% as compared to 2021, resulting in an increase in adjusted EBITDA margin from 18% to 23% and improvement of 5 percentage points.

Net profit increased from HK$71 million to HK$100 million compared to last year, representing an increase of HK$30 million, or 42%.

Notably, net profit figures include a one-time professional fees relating to the proposed merger, excluding this HK$30 million cost, adjusted net profit is HK$130 million, reflecting adjusted net profit margins of 15%.

Before diving into details on our Media & Agency and Ecommerce business, I wish to quickly review some insights on our balance sheet and particularly our Treasury – the Company continues to improve its liquidity and treasury position as our cash position reached HK$284 million as at March 31, 2022.

Account receivables and inventory turnover both improved from the prior year – account receivables turnover for FY2022 is approximately 59 days compared to 111 days for the last year, and Inventory turnover improved from 160 days to 158 days for FY2022.

Our healthy, operations-generated treasury position allows us to invest profitably in organic growth in both our Media and Ecommerce businesses.

Taking a deeper dive into our Media Segment. Our Media Segment showed robust acceleration out of COVID and continued strength throughout the year - recording a double digit percentage increase in revenue of 46% to HK$654 million.

This is mainly driven by increases in the number of media contracts signed with brand partners as well as significant increases in media deal sizes – both metrics increased by 32% respectively from the prior year.

Gross profit of the Media Segment soared in FY2022 and reached a record high of HK$451 million, representing an increase of HK$206 million, or 84%. The Group effectively adjusted its production strategies to adapt to the COVID-19 pandemic environment. Campaign productions were more streamlined and cost-optimized during the period. As a result, campaign costs during the period impacted by COVID-19 were lower than expected, resulting in adjustments in the provision of campaign costs during the period. The Group recorded a notable improvement in gross profit margin, an increase of approximately 14 percentage points from 55% in FY2021 to 69% in FY2022.

Increases in revenue were robust in both the EMEA and U.S. regions – as a snapshot, revenues from the U.S., UK and Italy increased by 95%, 85% and 102% respectively copmared to the prior year.

Our robust revenue growth reflects successes in our instinct to drive culture forward across broader lifestyle categories, thereby creating opportunities to attracting a wider and more diversified base of clients across a broader range of industries - non-endemic clients, which we define as clients from industries outside of the fashion, apparel and luxury categories, represented 48% of our total signed contracts by category, compared to 52% representing endemic categories.

Moving onto the Ecommerce Segment. The Ecommerce and Retail business grew steadily in revenue, recording HK$242 million compared to HK$227 million in the prior year, representing an increase of 7% .

Gross margins for the Ecommerce and Retail business improved from HK$89million to HK$98 million, representing an increase of over 10%.

Gross profit margin of the E-commerce and Retail improved from 39% in FY2021 to 41% in FY2022 due to an increased % of full price sales items in the year, where 71% of our sales were sold at a full price, compared to 63% in prior year.

The past year provided opportunities for the business to make improvements to its curation of products and optimize its mix of inventories to a more balanced portfolio.

The impact of improved product curation is reflected in increases in both average order value and average unit value, with increases of about 3% for both metrics compared to the prior year. Both indicators reflect increased captured opportunities for sales at full retail value and broader product diversity across higher priced and broadening categories such as home goods and luxury accessories.

Generally, trends in the market and brand sentiment reflect increased appetite from brands to engage in physical activations, as Kevin alluded to our New York flagship physical office and store opened just 2 weeks ago, and embodies a physical representation of Hypebeast – merging cultural, community, media and retail elements, into a single destination for our employees, fans, and brand partners.

Overall, we are very pleased with our results this year, which demonstrates the continued appeal of our brand, the success of our one-stop shop agency-editorial-ecommerce value proposition virtuous cycle, as well as our continued focus on profitable growth. And looking forward, we remain confident in our ability to deliver sustained revenue, earnings and shareholder value.

And now turn over to the Q&A session.

Host
Thank you Kevin and Patrick for your presentation.
I would like to remind everyone that if you have any questions, please send through using the on screen messaging function if you would like to present a question to the management.

I think we have a first question from an investor. I would like to see if there will be another Hypefest or another similar event in the future?

Kevin
I can take that one. I'm glad that you are excited about Hypefest as we are. That's not out of the possibilities. We just have to obviously figure out the location or where to do it, or operationally how to do it well, because it's a massive undertaking. We'll see, but I'm glad that you guys are interested in an upcoming Hypefest.

Host
Thanks Kevin. Another question is more about revenue and revenue growth in the second half. So revenue growth in the second half seems slower versus the first half and previous second half historical financials. Did you notice a deceleration in demand (in the second half) and has this trend continued into the coming year?

Patrick
I can take that question. If you look at the breakdown of this first half of the year relative to the 2021 period, first of all, that was impacted by comparatively weaker comparative during the COVID period. I think if you look at the first half of our fiscal, for example, during the first half

last year, which during that time our business was more heavily affected by COVID. The increase was about 85% percent versus average over the year we're arriving at an increase of about 30% overall broadly for the business. I would say from the media campaigns side of the equation, we haven't seen any particular slowdowns. Obviously accelerating outside or out of the COVID situation, but cadence in terms of campaign production and campaign deliverables is a lot smoother. I think over the last two years, the fiscal revenue recognition obviously, and timing of the campaign delivery was largely impacted across the different regions because of COVID impact and we're seeing a little bit of a smoother cadence in terms of production time frame and just revenue product delivery in the current fiscal year. So I think it's a bit of a normalization in terms of just a more consistent flow throughout the year versus I think the last two years production has been a bit of an up and down.

In terms of seeing kind of trends across revenues overall, the media side we just touched on, really our internal metric is looking at signed contracts and signed contract values. Both are showing quite robust increases relative to the base value from last year, as we mentioned 30% plus.

I think on the Ecommerce section, you're seeing a resumption of growth patterns. So obviously from the prior year would pick back up in terms of our purchases of inventories, we've made all the adjustments like we mentioned before on inventory product selection, and the way we're looking at full price sales relative to our pricing adjustment strategies.

So overall, I think Ecommerce is at a much healthier phase, presuming that both cadence starting with obviously 7% this year. But we’re accelerating, for example, into the biggest opportunities such as converting our Hypebeast ecosystem which we touched on this strategy before. And we look into continuously accelerating that growth momentum moving forward.

Host
Thanks Patrick.

Following on about the Media Revenues, we have another question about the receivable days. So this is apparently one of the lowest levels of AR turnover days of the company. Could you elaborate a little bit more about why this has been in the current year?

Patrick
Yes definitely. This is obviously good work of the team. There are several key mechanisms by way we're managing basically our account receivables. First of all, obviously most of our accounts receivables are from our media campaign executions. For larger 360 based activations which involve production, which I think you're going to follow along with where we are heading, just the agency services, a lot of our larger contracts involve a level of production. Those contracts we usually work with the client on prepayment or deposit ahead of our production expenses. So obviously up to 30% to 50% we're looking for in terms of prepayments on individual IOs and contract values. So immediately, obviously that mitigates some of the cash flow balances in terms having to look at the treasury position movement and hedges the treasury position in a big way.

Second is, actively following up on longer outstandings. Most of our terms have been tightened to about 30 to 60 days depending on the client, and we're actively enforcing these terms on the clients. A lot of our clients obviously there's a longstanding relationship, so we're working closely with the AP (accounts payables) teams or their creative teams of their sales teams in order to accelerate that pace of collections throughout our campaign period and beyond. I think those two key strategies and key optimizations developed within the team have helped drive AR and AR turnover to record low levels.

Host
We have a few questions about the e-commerce segment now. What is the general plan for the company to increase the e-commerce order conversion ratio in the coming years?

Kevin
I will answer a little bit and then pass it onto Patrick. We're investing into building a better connection through technology, obviously we have a massive user base. Number one, we need to get more products, we have been pretty conservative on the inventory since during the pandemic. So now that we're coming out and we see growth, better inventory will need to be bought in order for us to convert more. Secondly, building that bridge and connection between the media side and also the HBX side. Better editorial as well. I think it's a lot of content that we have to produce. We are investing into our content and branding teams in order for people to know about the products that we have. A lot of times we have great products at our store, but even on Hypebeast, people don't know about it. So I think building better content, creating better content that's important. And also building that technology as well. For example, can you do a one-stop-shop buy button on our media platforms so people can easily check-out? So again, investing resources into technology will help the conversion rate. If Patrick wants to add anything.

Patrick
Yes, I think additively there's multiple approaches we're taking. One is like Kevin said, developing more product assortment and really developing and connecting that with the Hypebeast ecosystem. Because I think a lot of the thesis and traction is around fundamentally the experience for the brand. You look at what we do on the Hypebeast side, you know we're known as a platform that is introducing ever-expanding product categories, something new and different and a curation really stands in contrast and in kind of isolation as a distinction as a special piece of the experience for our platform. Echoing those sentiments, a lot of the users that are coming in already have that intent to purchase. And it's about offering fundamentally those products before access, through brand storytelling, and also really through the custom experience, both digitally and also in real life, which is why there's a strong and big reason that a lot of thinking around investments would be looking at upgrading our app ecosystem and digital site ecosystem to first of all unite the two together of editorial and ecommerce, but also enhance the user journey by developing new and interesting ways of showcasing our products and brands as a point of curation for our audience. And this is done in the same way for in real life experiences, so 41 Division in New York really is a showpiece for us in terms of guiding our customer experience and really connecting in real life a physical way to our offline or online touch points. I think there's a heavy kind of correlation in terms of brand storytelling that acts in parallel with what we're doing online as well. Customer experience in the physical shop, fundamentally, they're getting to touch and feel part of the Hypebeast ecosystem, and that has attracted engagement and also driving back to that brand awareness and brand correlation for the brand overall.

Host
Thank you Patrick. Another question is from another investor about the Hypebeast headquarters in New York City. What kind of targeted revenue do you have in mind to derive from the new store in the U.S. in the current year and maybe in the future years?

Patrick
Without disclosing projections, let's maybe take a deeper dive into the revenue streams that are available for the physical store on 41 Division. As you mentioned, this is a multi-faceted space; I think there's all the core elements of Hypebeast in this physical, tangible form. So the bottom two floors - the ground floor and 2nd floor are the retail experience, we're operating a full scope retail shop, basically under the HBX brand name. Obviously correlating with the Hypebeast experience of the ecosystem, driving showcased brands, brand exhibitions and storytelling in the physical method in that space. That space is also flexible, the ideation around 41 Division is about being able to really showcase whether it be from a brand perspective or Hypebeast perspective, an element of storytelling and an element of community building as well as engagement for our audience. So the ground floor and the second floor actually can be quickly converted into media or brand venue space. From a revenue stream perspective, a lot of the brands we work with are very much interested in showcasing either a physical event or having some product tie-in of some sort in our space as part of the 360 media campaigns. So as we mentioned, the progression in terms of our capabilities and our one-stop-shop proposition for the media agency has always been really focusing on driving different experiences in one cohesive single media campaign for our clients. 41 Division is really that initial kind of crown jewel for New York in terms of showcasing some of our core brands and key brands in that space, and obviously the revenue perspective from the brand and creative agency revenue perspective, that is a revenue stream for us for 41 Division. I think overall you know the space itself, retail revenue stream is one kind of key driver in terms of just momentum from just from a revenue standpoint, and also correlated to enhanced kind of brand experience and brand campaign experience for our media partners. So it really is a combination of both sides.

Kevin
Just to jump in and add a little bit. Can't disclose numbers, but we've recently opened a Hypegolf pop-up shop in Soho on Mercer Street. So if you're in Soho, please check it out. It's still there. I think we started in May, it's going to last for three months. We're doing sales numbers there, and we're also doing events almost every week. We have a sponsored event there, so we see the demand for IRL experiences where brands are actually contracting us to work together to do these physical experiences. I think the new home of 41 Division and HBX space will be another way for us to do more brand activations not only to sell great products, but to do a lot more than that.

Host
Following on the e-commerce business, we have another question about can the company comment on the negative contribution from e-commerce this year?

Patrick
I can take that question. A lot of it I guess that the momentum for us for Ecommerce is scaling the business obviously, and coming out of COVID obviously we've made a lot of adjustments and enhancements to the way we operate. For example, the way we look at our inventory procurement and curation, the way we look at full price sales versus price adjustment strategies, and overall that has fundamentally a lot of improvements since the COVID period. You recognize that gross margins have increased by about 10% over the period. Now we're looking at investing in the business scale in terms of fundamentally driving that user base, driving up the conversion and necessarily there are some headcount improvements and structural investments that need to be made to scale up that business. So in terms of contribution wise, a lot of it fundamentally is really hiring and scaling the business for future growth. I think the long term for

us is obviously balanced growth. I think for us conversion of that Hypebeast ecosystem, it's fundamentally what you're after and there's a lot of tremendous revenue growth. And I think even internally in terms of what we're thinking about building structurally, there obviously needs to be some enhancements of our capabilities in order to really capture that. It's really a lot of interest in the negative contribution just driving and growing our scale and capabilities moving forward. And obviously you mentioned that as part of Hypebeast 2.0 kind of thinking, right? A lot of our thinking is building frameworks such as data, such as IT, building a great customer experience, and infrastructures to make that possible. Another part of the negative contribution obviously is the pre-operating cost for 41 Division. As you realize, we've been building up quite heavily towards opening this fiscal year. We just opened about two weeks ago, some costs were migrated in terms of the pre-operating costs for 41 Division. Obviously, we do have revenue streams in terms of looking at 41 Division store from the media side and e-commerce side, because we were not in operations and should see the impact from the revenue streams from the 41 Division space starting this current fiscal year.

Host
Thanks Patrick, e-commerce is definitely a very exciting growth spot for the company. Another question from another investor is about the financials. There's a HK$24 million financial asset on the balance sheet, could management elaborate a bit more about what it is and what is your cost base?

Patrick
These are actually minority investments related to what we consider strong strategic alliance companies. Looking at just from our relationships and networks we've developed in the space overall, oftentimes, they come on opportunities to be part of brands or different companies that you see actually has an impact from the strategic and operational perspective, and correlates in terms of developments that we want to do as a business. So as an example, technology companies in the earlier disclosed called Nothing, that's a good example of what categories of companies that we see a lot of traction and kind of fundamentally opportunities not only from an investment perspective, but also just from a strategic partnership perspective down the line, and working closely together with a lot of these brands.

The investments are obviously quite minor, and quite minority, oftentimes, less than maybe 5% in terms of the ownership overall. It's just a way for us to get involved in terms of correlating and that being involved in brands that show a lot of promise overall.

Host
Thanks Patrick, lastly, we have a question on the merger with Iron Spark, if management could provide some updates, the status and what the situation is.

Patrick
Yes, I can take that one as well. We're still obviously going through the process of our submissions with the SEC. We filed our F-4 earlier in May, and we've received the first round of comments from the SEC. We're actively working on the responses to be sent probably in the next few weeks. Obviously from a timing perspective, the long and probably the SEC review process, from our perspective, we don't see any kind of challenges, it's more of the diligence perspective from legal standards and regulatory questions to go through. On the other side is we will be actively looking at options in terms of financing for the transaction itself overall. As at the point of the announcement, we've had about 13 million funds raised from the PIPE. We're continuing strong and active conversations with strategic partners from a PIPE perspective,

looking obviously in correlation with our sponsors from Iron Spark towards at least the minimum cash amount. So I think from a timing perspective, obviously contingent on SEC review, we're still confident that the transaction will be able to close before the end of 2022.

Host
Thank you Patrick and Kevin, I think we cleared all the questions today. So if there are no further questions, we can wrap up. Thank you everyone for attending the earnings call this year. The call’s recording and presentation will be uploaded onto our corporate site shortly after this, so if you have any further questions or requests, feel free to send us an e-mail and investors@hypebeast.com. So thanks everyone for participating, and thank you Kevin and Patrick for your time.