FY2023 Interim Results Earnings Call

Attendees
MA Pak Wing Kevin, Chairman & Chief Executive Officer
WONG Kar Hang Patrick, Chief Financial Officer
LEUNG Maisie, Investor Relations/ Host

Host

Hello and welcome to the Hypebeast financial year 2023 interim results earnings call. This is Maisie from Hypebeast's IR team, and I'll be coordinating the call today.

I am joined by our founder and CEO, Kevin Ma, and our CFO, Patrick Wong. In our call today, our management will go over the financial year 2023 interim results, and explore key strategies going forward across our business 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 at once during the end of the presentation.

Before we begin, I want 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. As such no reliance should be placed on the fairness, accuracy, completeness or correctness of the information presented today. Any statements included simply 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 - CEO

Good morning and evening, everyone, and thank you for joining us today to discuss our interim results. Broad economic trends in the first half of the year have required us to be more agile and I would like to thank the Hypebeast team for their efforts. We are adapting to changing customer demands and tackling challenging dynamics while positioning our future.

In terms of our business, we recorded total revenue of HK$450 million in the first half of the year. The media segment amounted to HK$302 million, while the e-commerce segment reached HK$148 million. Overall gross margins decreased by 7 percentage points to 52% as compared to the same period in financial year 2022.

North America and EMEA generated robust growth in signed contract value over the first half of the year, however, the notable performance was offset by the softening in demand and weaker recovery in the APAC region. Downside pressures are more pronounced in APAC. Our e-commerce and retail segment recorded higher sales, reaching HK$148 million and contributing approximately one third of our overall revenue. We will continue the trajectory of conversion and focus on cost management while expanding our e-commerce segment.

Taking a look at our user and viewership metrics in the first half, our community continues to grow. We are seeing growth in readership, with average monthly unique visitors reaching 17.4 million over the first half and social media followers reaching 33.2 million as of September 30, up 12% and 18% respectively year on year.

Looking into the second half of the year, we are actually anticipating more activity around Media campaign deliveries as well as e-commerce compared to the first half. That said, it's not clear that the economy has stabilized yet so we are cautiously optimistic and are planning our budget conservatively. We are increasing scrutiny on all areas of expenses and investments, focusing our investments on only high priority growth areas that will bring us in position to capture growth and be stronger coming out of the near-term challenges facing our business.

And now, I would like to turn the call over to Patrick to give more details.

Patrick Wong – CFO

Thank you Kevin, and good morning or evening, everyone.

Let's begin with our consolidated results. Our overall revenue for the first half of the year amounted to HK$450 million, for a 2% increase from HK$441 million for the prior year.

Gross profit for the first half amounted to HK$234 million, representing a decrease of HK$24 million or 9%, also reflecting a decrease in gross profit margin from 59% to 52%. Increase in headcounts in the media segment and increase in cost of sales in the e-commerce segment impacted our profitability in the first half of the financial year compared to prior year.

We recorded adjusted **EBITDA** of HK$22 million, which excludes the effects of one-off professional fees related to the proposed merger, non-cash items such as impairment loss recognised on assets and gain on disposal of a joint venture. Adjusted EBITDA for the first half is down HK$82 million or 79% compared to prior year, translating to a decrease in adjusted EBITDA margins from 24% to 5%.

Diving into details on our operating expenses, selling and marketing expenses of the Group increased by 46% from HK$71 million to HK$104 million in 2023, and correspondingly as a percentage of revenue, increased from 16% to 23% in 1H2023. Such increase in selling and marketing expenses was largely driven by increase in advertising and social media marketing expenses to promote and raise awareness of our e-commerce platform and freight costs and additions to headcounts within the Group's sales and marketing teams. We expect the increase in selling and marketing expenses would boost customer and user spending and to further extend audience and consumer reach.

Administrative and operating expenses of the Group increased by 29% from HK$93 million in 1H2022 to HK$120 million in 1H2023 and correspondingly as a percentage of revenue, increased from 21% to 27%. The overall increase was mainly led by the expansion of our businesses in US and EMEA markets and investments in headcounts that would build a foundation for the longer term growth of our business.

Absent the one-off professional fees related to the proposed merger of HK$55 million, gain on disposal of JV of HK$18 million and impairment loss recognised on assets of HK$13 million, our adjusted ongoing operating expenses would have been HK$230 million, representing an increase of HK$60 million or 35% as compared to last year, while adjusted EBITDA would have been HK$22 million, down 79% as compared to prior year and adjusted loss for the period would have narrowed to HK$15 million.

We expect our pace of increase in operating expense to slow down in the second half, net loss to narrow and turnaround in the near future and we will take progressive steps to address cost savings in the remainder of the year. While operating expenses would also come down as a percent of revenue over the longer term.

Before diving into details on our business segments, I wish to quickly review some insights on our balance sheet – as of 30 September 2022, inventories of HK$92 million were HK$22 million or 32% higher than as at 31 March 2022 due to anticipation of peak season centered around global holidays and consumer activity in the second half of the fiscal year. Bank and cash balance was HK$192 million, 32% lower than as at the 31 March year end mainly due to upfront professional fees related to the proposed merger being paid out in the first half of the year.

Capital expenses decreased to HK$12 million during the first half and returned to normal levels. The robust capex growth in 1H2022 was mainly driven by the pre-opening of our New York flagship store and we did not have significant capital outlay in the first half of this fiscal year.

AR turnover for 1H2023 is approximately 83 days compared to 70 days in 1H2022, while inventory turnover increased from 154 days in 1H2022 to 181 days for 1H2023.

Diving into the Media Segment, Media Revenue amounted to HK$302 million in 1H2023, 7.8% less against a strong comparative of HK$327 million in the same period in last fiscal year.

In terms of regions, US, EMEA and APAC markets accounted for 48%, 27% and 25% of our total signed contract value in 1H2023 respectively. The US and EMEA markets are tracking towards growth and generated 20% and 19% increase in signed contract values in 1H2023 compared to the prior year respectively. Such increase however was offset by the softness seen in APAC markets due to the impact of continuing COVID-19 related lockdowns in Mainland China and slow emergence from lock-down precautions in other APAC markets.

Gross profit margin decreased from 63% in 1H2022 to 58% in 1H2023. The difference was mainly due to a decrease in campaign cost being offset by increase in staff headcounts in editorial and creative teams in key growth areas to support anticipated increase in campaign deliveries. We will increase scrutiny and continuously review campaign production strategies to ensure productions are streamlined and cost-optimised. We also expect the pace of increase in headcount related costs would slow down in the remainder of the year and headcounts as a percentage of revenues to reduce in the second half. In the APAC region, resources in slower growth regions will be redeployed to support regions of development to ensure the efficiency of our workforce is maintained.

Diving into our e-commerce and retail segment, our e-commerce and retail business grew by approximately 30% on the top line in 1H2023 primarily due to the streamlining of shopping experience and promotional activities implemented during the period.

Average order value remained stable at approximately HK$1,930. Average unit value, which is calculated by the total retail price of products sold divided by the number of products sold, decreased by 10% to approximately HK$940 in 1H2023, mainly due to a shift in merchandising strategy which led to increase in sales of streetwear, sports and contemporary items. We also see an increase of 24% in the total number of orders recorded in the 1H2023 as compared to prior year, reaching 70,480 orders.

Gross profit for the e-commerce segment increased to HK$58 million as compared to HK$51 million. Translating to gross profit margin of 39%, which represents a decrease of 6 percentage points. The decrease in gross profit margin is mainly due to a more proactive approach to adapt to new market conditions and shift in strategy to meet changing needs of our customers. In the first half of the year, we had more frequent promotional activities, such as free shipping and promotional codes. With a more balanced approach with respect to paid versus organic marketing channels, new season product arrivals and higher anticipated full price sale items versus discounted items, we are expecting overall gross profit to fall within average in the remainder of the year and we will closely scrutinize the segment's profitability over time. We are also reviewing our e-commerce subdivisions and teams to ensure a level of rightsizing against growth with respect to our headcounts.

Putting this all together, we remain committed to financial prudence as an organization and are cautiously optimistic regarding our growth trajectory despite a challenging macroeconomic environment. Moving forward, we will execute on our strategies to build a sustainable, profitable business and deliver shareholder value. We thank all of our investors for your continued confidence to support Hypebeast.

And now turn over to the Q&A session.

Host
Thank you Kevin and Patrick for your presentations.

Please send through all your questions using the on-screen messaging function if you would like to present a question to the management.

Thank you everyone for attending the financial year 2023 interim results earnings call. The call's recording and the presentation will be uploaded to our corporate site shortly. If you have any follow-up questions or requests, please feel free to send us an email at investors@hypebeast.com.

So the first question from our investor is about our merger deal. The investor would like to know if there is any update on the listing in the US through SPAC.

Patrick Wong – CFO

I can take that question. We continue to work in earnest with our partners and Iron Spark on different deal workstreams. As you understand, there are multiple work streams involved in a complicated transaction, including regulatory review and also various closing conditions.

We anticipate being able to provide further updates on the transaction over the next few weeks. Obviously the timing is a little bit delayed versus what was expected before, but we anticipate more updates over the next few weeks, and we'll keep all the investors abreast in terms of the transaction itself.

Host

And the second question is about our company's intangible assets. What is the investment and status, whether it's profit making or loss making on our investment in intangible assets? And what are the strategies towards our investment on intangible assets?

Patrick Wong – CFO

On a high level in terms of our intangible assets related to cryptocurrencies, in the first half of this fiscal we actually took a mark to market adjustment already in the valuation obviously reflecting broader downturn trends in terms of cryptocurrency valuations.

However, I think our focus is mainly on web3 technologies and how that would impact businesses and growth trajectory over time.

So whilst if you look at the general market experiencing a downturn, over time, I think we're still looking at opportunities to incorporate various aspects that are positive around the web 3 technologies into our business.

I think some of the more short term trajectories in terms of projects might have slowed down a little bit. And obviously we're more focused on our ongoing core business for the near term. But to the extent that we see opportunities in terms of developing web3 technologies that would enhance our business over time, we're still very positive and very open and receptive to changing the strategies moving forward depending on what those are.

Overall, from a capital financial investment point of view, the business would be more focused around the core business versus looking at more cryptocurrency or web3 related technologies over the next few months.

Host
If you have any further questions, please feel free to put it in the Q&A box.
There's another question about our selling expense, and what are the major reasons leading to the increase in selling and marketing expense and our admin and operating expense?

Patrick Wong – CFO

Sure, let's break down the increases by the two different segments; for the media space and the SG&A expenses in terms of the increases were more centered around headcount increases. This is to support growth in key regions. Like I said in terms of the USA and the EMEA regions, those two regions are still experiencing robust growth, particularly over the last few months in terms of business activities and campaign signings. The second half of the year is where a lot of the campaign activities are at. First half for us was really making sure we have the right teams and the right points of delivery into capabilities internally. So you're seeing obviously operating expenses being up a little in terms of the SG&A spending on head counts.

Like we said in the presentation, most of the headcounts have already been placed in terms of expanding the capacity, and we're confident that the headcount in terms of SG&A growth will slow down in the second half compared to the first half. And if you look at campaign deliveries and business activities overall, the second half looks to be much more robust than the first half. There's a bit of timing in terms of execution, particularly in the EMEA and the US markets. Where the softness is coming from the APAC region, again cautiously optimistic around developments in Mainland China. The year on year declines mostly came from that region. Our strategy is to take a very deep scrutiny in terms of resources in that region; a level of rightsizing will be done in terms of our headcount and our resources there compared to our growth opportunities, and we look to shift some of the APAC resources to higher growth regions in the second half to make sure that whilst headcount are maintained at a certain level by way of cost, we still maintain an efficient workforce to be able to deliver our media campaign activities.

On e-commerce, SG&A more so is centered around marketing costs used to promote some of the campaign activities and project activities we had in the first half of the year.

Looking at activities, one of the major presentations or major debuts was our New York store opened in June. So some of those omnichannel marketing costs in terms of teams related to building up the right teams in the US, which is a strong focus in terms of markets for us in the e-commerce business over the next few years. That led to some of the increases you're seeing in the SG&A cost, combined with more digital marketing spend in the first half, again to shore up some of the business developments we're seeing in key regions we hope to open, particularly in the US.

Again, along the same route as the media business, we're taking a very close scrutiny at different costs. SG&A certainly is one of them. The anticipation is headcounts for the second half in terms of growth wouldn't be as robust as the first half. We're looking to maintain the workforce at our current headcounts, if not reuse some of them in certain regions for the second half in terms of e-commerce. The activity in terms of sales campaigns and overall business activity for e-commerce in the second half looks to be much higher, anticipating the peak season. For the second half of the year, we're taking a close scrutiny of our costs and development, and will control costs over the second half to ensure that profitability is delivered across businesses overall.

Kevin Ma – CEO

If there's no more questions, thank you everyone for attending today's 2023 Interim Result Earnings Call. Again, if you have any follow up questions, feel free to send us an email at investors@hypeebeast.com.

Thank you.