HYPEBEAST

FY24 INTERIM RESULTS EARNINGS CALL

Attendees
Patrick Wong, Chief Financial Officer
Maisie Leung, Investor Relations and Host

Host
Hello and welcome to the Hypebeast fiscal year 2024 interim results earnings call. This is Maisie from the investor relations team and I'll be coordinating the call today. Joining me today to discuss our results is our CFO, Patrick Wong. In our call today, the management will go over the interim results and explore key strategies going forward across our business segments. The presentation will then be followed by a Q&A session and we 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. 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 Patrick.

Patrick Wong - CFO
Thank you, Maisie and good afternoon everyone.

Thank you for joining the call. On the business franchise, total revenue declined by a little bit over 2% versus prior year to HK$440 million for the first half of our fiscal year. Media segment revenue declined by 6% compared to the prior year at HK$283 million. Our key operating regions have encountered varying dynamics as we focus on different geographic areas. For North America and APAC regions, media executions were slower than expected in the first half with the majority of momentum expected in the second half. In the EMEA region, decreases in contract signings, particularly in the luxury segment, had an impact on the first half results. As for the e-commerce and retail segment, revenue increased by 6% to HK$157 million for the first half of the fiscal year.

We are making progress in pursuing our strategic opportunities and taking a much more vigilant approach in rearing our costs. We have implemented several measures to enhance efficiency and realign our business with these priorities. For example, we optimized our headcount to create a more cost-efficient, coordinated, and streamlined approach to our operations as we find more efficient ways of working. Headcounts decreased by 5% globally, on a year-on-year basis, to 523 as at September 30, 2023. The financial impact of such optimizations are reflected in the first half and expected to be continued in the second half.

Beyond our financial performance, our users and viewership portfolio continues to grow across our media platforms. In terms of readership, average monthly unique visitors reached over 19 million in the first half and the social media followers reached 35 million globally by September 30, 2023. These figures are up 10% and 5%, respectively, on a year-on-year basis.

Although, in general, the first half of 2024 was slower than anticipated in terms of revenue growth, management took the opportunity to pursue efficiency and the way we refine our business to make things better. We are setting the foundations for a more efficient business moving forward as we anticipate acceleration of media executions in the second half.

On an overall company basis, gross profits decreased by 12% from HK$234 million in the previous period to HK$207 million. This translates to a decrease of 5 percentage points and gross margins from 52% to 47%. The decrease is mainly driven by an increase in promotional and discount activities within the e-commerce and retail segments as we continue to right-size our inventory portfolio ahead of this spring summer 2024 season. On an overall basis, our net loss is narrow to HK$10 million compared to HK$65 million in the first half of last year. Aside from a one-time transaction cost in the previous year, the decrease is primarily driven by actions taken by the management to right-size the business and promote a low-cost and high-efficiency business model.

In terms of operating expenses, in general, this showcases a downward trend comparatively. Total operating expenses amounted to HK$214 million for the first half and represents a decrease of 7% versus the same period last year. This is mainly driven by decreases in selling and marketing expenses and optimizations in terms of admin and operating expenses. Selling and marketing expenses decreased by 12% compared to the last period due to reductions in marketing expenses overall and reprioritization of marketing activities. Primarily this was due to a shift in marketing strategy from higher cost paid channels to lower costs or no cost marketing channels within the Hypebeast ecosystem to drive customer acquisition and conversion within the e-commerce space; this created cost efficiencies that generated savings. In terms of admin and operating expenses, this increased 4% compared to the fiscal of previous year, from HK$120 million to HK$125 million. This is mainly driven by an increase in direct staff cost and depreciation of renovation costs for retail space within our 41 Division New York multi-use space. Management took steps to increase and improve operating leverage throughout this fiscal period and the realization of efficiencies from such savings would continue throughout the fiscal year. For example, the pace of hirings has slowed in the first half as we consolidated resources and realigned our team to leverage cross region capacity. This was consistent with our previously stated plans and we anticipate the effect of cost savings to reflect it in the second half and upcoming fiscal year. In general, we are taking steps to improve operating leverage, right-size our inventory portfolio and streamline our business units, and such strategies are expected to have a positive impact on margins moving forward.

Taking a deeper dive into our segment in terms of media revenue, this decreased by about 6% comparative to the same period last year. The pace of media executions as I have mentioned, APAC and U.S. are slower than expected for the first half, with the second half media executions gathering momentum. We see acceleration beginning to gather pace in terms of both media signings and campaign executions. Further, a shift to less cyclical non-endemic brands and industries, including alcohol and logistics, are insulating the business from near-term softness seen in endemic clients in the luxury footwear and fashion industries, which is a positive to the business. In the EMEA region, which is predominantly focused on endemic categories such as luxury, fashion and footwear, we are seeing a bit of softness in terms of macro conditions. However, this impact is expected to moderate over time. Executions and signings for this region are also gathering pace in the second half of the fiscal year. Media gross profits decreased compared to the same period in the prior year due to slowness and media executions in the first half, as well as higher year-on-year direct cost on a comparative basis. The expected acceleration activity in the second half combined with staffing and cost optimization are expected to bring improvements in media gross profits in the near term.

In terms of e-commerce and retail segment, revenue increased by 6% from HK$148 million to HK$157 million in the first half of fiscal 2024. This was due to an increase in sales and promotional activities that liquidated inventory as we continue to right-size our inventory portfolio ahead of the spring summer 2024 season. Such strategic action also led to a decrease in gross profit of 8%. The promotional activities we are undertaking to right-size our inventory are expected to diminish throughout the second half of the fiscal year as inventories reach an optimal level ahead of the spring summer 2024 season. Management continues to bring in the right inventory, optimizing product mix, building network efficiency, and focusing on gross and net margins within the segment. Shifting in strategies, including marketing, from reliance on paid channels to costless or low cost organic marketing channels will also bring about an improvement in OP overtime. In general, first half results are slower than usual for media although acceleration in media executions in all three key regions are anticipated for the second half. Inventory optimization strategies will drive revenue in the near term for e-commerce, but we expect some short term pressure on gross margins, which will decelerate towards the end of the fiscal as we complete the exercise of the spring summer 2024 season. Cost optimization strategies deployed earlier in the fiscal year already have a positive impact on margins in the first half, and we expect such impacts will continue into the second half.

Taking a look at our balance sheet position and focusing on our main categories, inventory as of September 30, 2023 was HK$96 million and accounted for approximately 16% of our total assets, representing 16% decrease compared to the year ended as of March 31. This credit to the improvement we are making to inventory management processes as we continue to right-size our inventory for dull as we are ahead of the spring summer season. Inventory turnover increased from 181 days to approximately 200 days in the first half of the fiscal year. Cash and cash equivalent as at September 30 of 2023 was HK$140 million and this represented 24% of our total assets. The bank balance decreased by about HK$26 million compared to the year-end balance as at March 31. This was due to an increase in working capital from optimization of inventories and improvement in AR collection efforts offset by cash outflows relating to the financing of office, retail, and warehouse space and a reduction in bank borrowings. Cash position, however, is anticipated to grow over the second half of the fiscal year as peak season for media activations and related incomes flow back into our treasury. Further, inventory optimization is expected to reduce stock related working capital investments and increase cash. Accounts receivable turnover is stable at 83 days compared to the first half fiscal year due to continued improvements in our AR collection processes. This concludes the presentation part of the fiscal interim presentation and with that we will turn over to the Q&A session.

Host
Thank you for your presentations. Please send through all your questions using the on-screen messaging function if you would like to present a question to Patrick.

The first question from an investor is about the future growth drivers of our company. What are the major growth drivers?

Patrick Wong - CFO
As we look into the second half and beyond, some of the growth drivers we are looking at by regions are again, 360 activations. Going into the U.S. region, it continues the trend that we have been experiencing over the last few years in terms of expanding contract sizes, larger clients and larger activations overall in that region. Another pivot for us is event-related and physical related IPs. Along the lines of what we did for Hypefest China, I think it is associated with what we put on for media activations, that is another strong point in terms of products that we are pushing out. Hypefest China in particular was one of the many resurges in terms of some of the content IPs that would be developed in the past, usually associated with those revenue streams would be sponsorship revenue. Associated media revenue which continue to obviously benefit the business over time. I think China is probably one of the first destinations we are looking to reopen and time we will look to accelerate on those content IPs throughout our global regions. If we look at industry and the macroeconomic environment, we are looking at a little bit of pressure in terms of some of our endemic brand categories and clients. However, I think that the diversity in terms of our portfolio is proving to be a point of resilience for the company and a lot of the turnaround points for us would be newer industries and clients who are willing to work with us. They see that value proposition again in terms of the way we can reach the audience and there are a lot of commitments coming in from industries like alcohol, gaming and technology. Brands that obviously might not be associated historically with Hypebeast but looking to generate new and positive marketing channels. Those are strong pivots in terms of individual industry expansion plans over time. Broadly, we are looking to put on more kinds of content IPs and event related IPs as we look to continue to expand our momentum in terms of bringing in new clients, those are stronger new term pivots for the business.

Host
Is there a path to overall profitability for the business on a fiscal year basis? Do you think that historical levels of margins and profitability are still feasible?

Patrick Wong - CFO
If you look at the first half, obviously a lot of different aspects were impacted, and there was a bit of slowness in terms of execution than expected. But if you look internally and this is something management looked at in terms of sales pipeline, the momentum looks to be focused on the second half of the year. Overall, with the optimizations we have looked at in the first half and with the momentum accelerating in the second half, I think there is a feasible path back to a profitable basis

over time. I do not think anything fundamental within the business has changed; the first half was really an exercise for management to right-size the business and obviously coming off from several kinds of different accelerations in the last fiscal, it was a period for us to reconsider and reach our goals. I think operating leverage improvements will continue over time and like I said, the sales channel, maybe the first signal in terms of acceleration on sign revenue, is proving to accelerate in the second half. So yes, I think there is a path to stabilizing in terms of margins and acceleration in the profitably over time.

I see your second question, Manuel, around Hypefest China. I think there was another question around that as well. The revenue size and scope for that activation is about US$3 million to US$4 million overall. It was a profitable venture for the business. The way we looked at products for something like that is that there is that content and sponsorship that was generated associated with the event itself, and there's also after sales media attachments and add-ons in terms of sponsorships related to the event itself. Overall the event itself was slightly positive in terms of profits, but with the media activations coming on strong in terms of China and broadly for the APAC region, overall in terms of sponsorships, that would be a positive margin overall for that event. For us, looking at content IPs, event IPs and any other franchise IPs, over time we are looking at and we are expecting basically margin to improve; so obviously looking at the ways we execute such events, there are several different revenue channels that we are continuously exploring in terms of sponsorship avenue for these events; commercial partnership is a strong one; continuing that momentum and expanding the scope in terms of the partnership, title sponsorships and various other activations that we can bring to light in the association with brands, but also working with maybe, institutions, governments or other broader kind of franchises or opportunities that might be interested in collaborating with us. For us, we look forward to bringing these activations to life, as those are strong revenue and sponsorship channels for us, and we continue to explore ways to improve upon the profitability of these events. That is a strong motive for us putting these events forward.

Host
Does the merger that happened in the last fiscal year have any impact on our company?

Patrick Wong - CFO
I would answer no from an operational basis. Throughout the history of our company, mostly we focus on generating profits and operating a strong business, that has not changed throughout the transaction or just the various kinds of evolutions in terms of what happened. For us, it has always been focusing on profitable business, focusing on growth and focusing on generating the right opportunities. We looked at our internal financial resources, our treasury remains strong and it is capable of financing our aspirations and our expectations for growth. Historically we have been in a strong position in terms of cash flow positivity, and although there were obviously variances along the way, we continue to generate positive cash flow and we expect to do so in the future. From an internal support and internal financing perspective, we are not affected by the variations in terms of the transaction. Over time, the narrative in terms of reaching the right investors and communicating the right things and focusing on the business continues to be what the business wants to focus on. The U.S. market continues to be the right market for us in terms of our products. If you look at our platform, you look at culturally where we are aligned and you look at our customer base, the U.S. continues to be a center of gravity. Over time, we are working on various ways of reaching our investors and communicating the right things, and also focusing on the business to deliver the results to our shareholders, but also looking for a path to return some of the shareholders' support over time. The treasury strongly supports that direction. Over time we will look at sharing that with our investors. I think that maybe answers Manuel's question as well, like I said, the treasury position continues to remain strong. If you look at the business overall, it is cash flow positive and it is expected to be so over the future and again, we are looking at various ways of sharing and returning those returns to the shareholders over time.

Host
Can you explain the increase in admin and operating expenses in this fiscal year?

CFO, Patrick

A lot of the increase is related to capacity building in terms of both expansions in e-commerce and our media segments, and are primarily associated with the expansion we had in North America. This year is really a year where we are focusing on streamlining and consolidating. Right now, we have placed the right resources in terms of payroll or headcount acquisitions, we have the right teams in terms of being able to execute our strategies moving forward. The first fiscal was really where management took a strong look at the way we were doing things and looking at opportunities on how to streamline. Consolidating regional capacity, for example, aligning our production, creative and other channels in the backend between North America and EMEA, and generating savings and efficiencies there, that was maybe one of the stronger pivots we took in terms of the first half and also looking at the way we land in terms of resources. Focusing on the competencies and the right capabilities and maybe leaning down or just obviously kinda shutting down things that we do not need, were really what the momentum was for the first half. Over time, we will continue that trend of being prudent in terms of our cost spending. The actions we have taken in the first half in terms of improvements to operating leverage, we expect that to continue throughout the second half, so that there will be a positive in terms of operating leverage as we look into the second half of the fiscal year and this is expected to continue as we look at the next fiscal as well. Structurally, I think we are being much more efficient in the way we are delivering and we are exploring growth with the same or maybe just a more muted kind of increase in capacity, which I think is the right thing to do, just making things more efficient.

Host
Please feel free to use the on-screen Q&A messaging function if you have more questions to present to Patrick.

If there are no further questions for us, we will end here today. Thank you. The recording of the call and presentation will be uploaded onto 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. Thank you.