

Company Announcement
ASX: HPC

DATE: 31/7/2023

Q2 FY23 Quarterly Report and Appendix 4C: Ongoing material reduction in cash burn alongside another consecutive quarter of revenue growth

KEY HIGHLIGHTS

- Net sales of US\$2.8m achieved in Q2 FY23 - 24% increase on prior corresponding period ('PCP') (Q2 FY2022: US\$2.2m) and a nearly 10% rise on last quarter (Q1 FY23: US\$2.5m)
- Record quarterly sales result consolidates momentum from a strong Q1 and marks the ninth straight quarter of sales growth on a trailing 12-month basis.
- Gross margin remains stable at 50% - up 3% on prior quarter
- Significantly reduced net cash burn of US\$1.5m down 44% from Q4 FY22 (US\$2.6m) and in line with Q1 FY23 (Q1 FY23: US\$1.5m)
- Marketing costs as a percentage of net revenue declined for the third straight quarter to 33% - a new record low since IPO date, down from 48% in Q1 FY23 and 78% in Q4 FY22
- Revenue growth underpinned by 37% rise in sales to major Canadian retail groups on PCP
- Amazon US YoY subscription growth up 36% from 3,072 same time last year to 4,189 subscribers at end of Q2 FY23
- Continued execution of stated strategy to reduce expenditure and extend cash reserves through significant reduction in marketing spend off the back of heavy brand investments in 2022

Hydration solutions company **The Hydration Pharmaceuticals Company Limited (ASX: HPC)** ("Hydralyte North America" or "the Company") is pleased to provide an update on its quarterly activities and Appendix 4C for the three-month period ended 30 June 2023 (the "quarter").

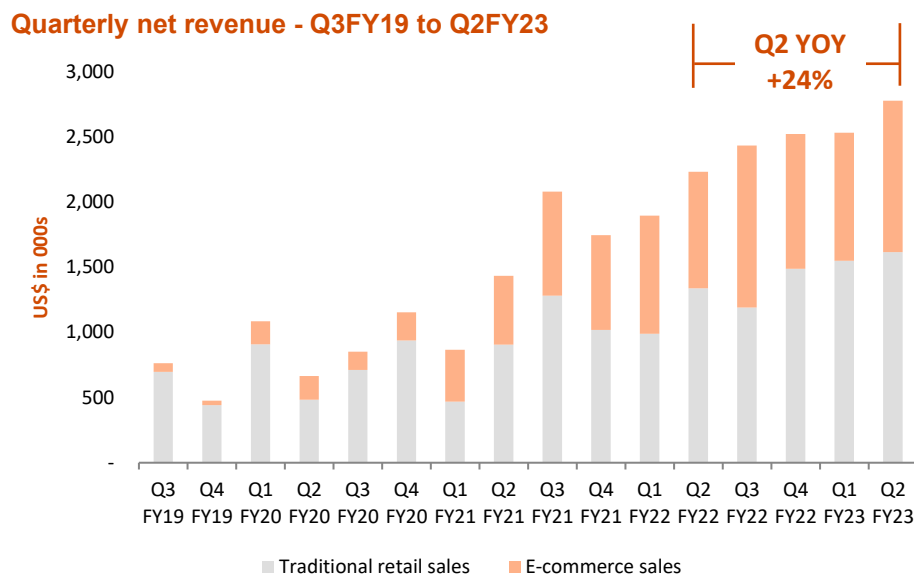
Financial overview:

Revenue for the quarter increased 24% on PCP (Q2 FY22: US\$2.2m) to US\$2.8m - highlighting another consecutive quarter of revenue growth and another record high. Q2 FY23 revenue also highlighted a 10% uplift on last quarter (Q1 FY23: US\$2.53m). Q2 FY23's strong result takes 12-month trailing revenue to US\$10.23m.

The increase in Q2 FY23 revenues was underpinned by continued strong growth through e-commerce channels, highlighted by Amazon Canada quarterly net sales increasing 102% on the PCP to CAD\$0.6m (Q2 FY22: CAD\$0.3m). The following chart displays the trailing 12 months net sales for the period ending Q2 FY23:



Set out below is the equally strong growth in YoY sales across e-commerce and traditional retail channels:

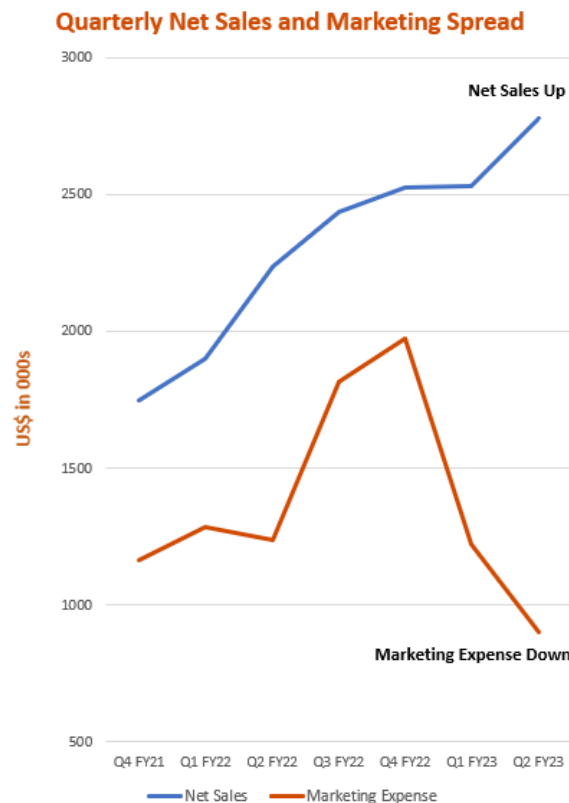


The following table summarises change in revenues and gross margins into Q2 FY2023:

	Q2 FY22	Q1 FY23	Q2 FY23	QoQ change	YoY change
Total net revenue	2,233	2,532	2,777	10%	24%
<i>E-commerce sales</i>	896	981	1,162	18%	30%
<i>Traditional retail sales</i>	1,338	1,551	1,615	4%	21%
Gross Margins	1,273	1,196	1,385	16%	9%
Gross Margin %	57%	47%	50%	3	-7

US\$0.7m was invested in marketing during the quarter, a 23% reduction or US\$0.2m decrease from the US\$0.9m used in marketing activities in Q1 FY23. Upon completion of the majority of some key marketing initiatives in FY22, the Company is focused on the execution of cost reduction strategies to decrease expenditure throughout FY23. Alongside the cash preservation initiative, HydraLyte has significantly improved the profit profile of Amazon while still achieving growth.

The following chart reflects the continued increase in net revenue and significant decrease in marketing spend:



Gross Profit dollars hit a record high of US\$1.4m. Gross margin as a percentage of net sales increased from the previous quarter by 3 percentage points (Q1 FY23: 47%) and decreased 7 percentage points on the PCP to 50% (Q2 FY22: 57%). The PCP decrease is attributable primarily to increased inventory reserves and write-downs which are expected to subside as the Company progresses through FY23. In the transition to prioritising cash preservation, the Company modified the product profile to eliminate the lowest performing products. The company is selling these low performing products off through discount channels to be left with our strongest selling inventory and was therefore left with temporarily repressed margin from

this clean-up process. Also contributing were write-downs of incompatible raw materials through the supply chain optimization projects, which will result in margin improvement. Although the percentage margin decreased from the PCP, the PCP gross profit dollars increased by 9%, with the increase in net revenues countering the decrease in gross margin percentage.

Commentary on cash flows:

In line with focus on cash preservation, net cash used in operating activities remained flat on the previous quarter to US\$1.5m (Q1 FY23: US\$1.5m). HydraLyte North America lowered marketing spend by US\$0.2m from US\$0.9m down to US\$0.7m. Product manufacturing and operating costs decreased by US\$0.2m. Staff costs decreased by US\$0.3m and Administration costs increased by US\$0.2m, while receivables rose US\$0.7m offsetting the US\$0.2m increase to net sales.

With many of the key marketing investments completed during FY22, the Company has increased focus on reducing operating expenditure to extend cash life through significantly reduction in marketing spend, while leveraging its market footprint to maintain record revenue growth. The significantly reduced net cash use in Q1 and Q2 FY23 is a direct result of this ongoing strategy.

Available funds and PURE arrangements:

As at 30 June 2023, HydraLyte North America had cash and cash equivalents of US\$1.7m. To increase financial flexibility, in FY22 the Company secured a A\$12m loan facility from existing substantial shareholder PURE Asset Management Pty Ltd (**PURE**) with availability in two tranches, with the first tranche (of \$6.5 million) drawn in November FY22. Further details of this debt are outlined in the Company's ASX release dated 17 October 2022.

The Company has gone into a trading halt on 31 July 2023, pending an announcement in relation to a proposed capital raising to be undertaken as a placement and entitlement offer. In conjunction with the capital raising, the Company and PURE have agreed that:

- (a) the availability period of the second tranche of debt (A\$5.5 million) will be extended from 14 October 2023 to 31 December 2024; and
- (b) the second tranche will only be made available if PURE consents (at its discretion) to make it available at the time that the Company seeks to draw it down.

The variation is conditional on completion of the capital raising.

At present, the second tranche of the PURE debt is available until 14 October 2023. In order for the Company to draw down the second tranche of debt certain conditions must be met, including that the Company must issue Warrants to PURE as described in the Company's Notice of Annual General Meeting for 2023. The Company's shareholders approved the issue of these Warrants to PURE on 5 May 2023. In accordance with the ASX Listing Rules, the Warrants must be issued on or before 5 August 2023, failing which the Company will not be permitted to issue the Warrants to the extent that it does not have the available capacity under ASX Listing Rule 7.1. The Company does not expect that it will have the available capacity to issue the Warrants after 5 August 2023 and therefore the second tranche of PURE debt may not be available after that date (on the basis that the Company will not be permitted by the ASX Listing Rules to issue the requisite Warrants to meet a condition of the draw-down).

PURE has committed to exercise ~7.5 million of the Warrants granted to it on completion of the capital raising at the 'adjusted price' (refer to the Notice of Annual General Meeting dated 4 April 2023 for further details). PURE has also agreed, subject to successful exercise of the Warrants and shareholder approval, that the exercise price of the Warrants will have a 'floor price' of the adjusted price after this capital raising (in circumstances where the exercise price of the Warrants could otherwise decrease in the future in the event of a subsequent dilutive capital raising in accordance with their terms of issue).

Along with inventory growth and ecommerce, the Company has also allocated additional funds for deployment in product development and manufacturing, as well as UK distribution and sales. These objectives will be undertaken in collaboration with stringent cost management initiatives across other aspects of the business with a strong focus on reduced cash burn through improved return on marketing.

Operational overview:

Streamlined Canadian manufacturing:

In Q2 FY23, the Company began manufacturing powder sticks at its new Canadian-based contract manufacturer for the Canadian market. This is viewed as a strategic priority and optimises HPC's manufacturing process from a North American facility, allowing the Company to capitalise on its existing North American distribution channels.

The manufacturing change is expected to lead to a reduction in costs of goods sold, cheaper freights and an increase gross margin on the powder stick range.

Activities post quarter-end

Post quarter-end, HydraLyte North America reported a strong start to Q3 ecommerce sales following the Amazon Prime Day promotion in July 2023.

Consolidated gross sales for US and Canadian Amazon Prime Day totalled over US\$120,000 (on a currency-adjusted basisⁱ) following the two-day sales promotion.

The Amazon Prime Day promotion resulted in approximately a more than a 5x daily jump in Canadian Amazon sales and a 3x daily jump in US Amazon sales (refer ASX Announcement July 19 2023).

Management commentary:

HydraLyte North America CEO Oliver Baker said: *"Our operational success in the June quarter is a direct by-product of the group's stated strategy to maintain a cap on costs while also generating consistent momentum in top-line revenues. Pleasingly, what stands out in these results is the consistency of that execution, where cost outflows remained in line with Q1 FY23 following a large decrease from Q4 FY22 alongside another quarter of record sales growth."*

"With these results, HydraLyte North America has demonstrated its ability to improve cashflows without impacting its key revenue milestones, and reflects the strong traction the brand has established in North American markets over an extended period of time. They also highlight the group's strong momentum heading into the peak northern summer months (July and August), and the Company's capacity to drive incremental sales growth from multiple channels

across e-commerce and traditional retail. In the wake of its recent momentum, the Company looks forward to providing more trading and operations updates during the September quarter.”

ENDS

This announcement was authorised for release by the Board of HydraLyte North America.

For further information:

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ⁱ Based on a CAD to USD FX rate of \$0.76

Appendix 4C

Quarterly cash flow report for entities subject to Listing Rule 4.7B

Name of entity

The Hydration Pharmaceuticals Company Limited

ABN

83 620 385 677

Quarter ended ("current quarter")

6/30/2023

Consolidated statement of cash flows	Current quarter \$US'000	Year to date (6 months) \$US'000
1. Cash flows from operating activities		
1.1 Receipts from customers	2,102	4,828
1.2 Payments for		
(a) research and development	-	-
(b) product manufacturing and operating costs	(682)	(1,568)
(c) advertising and marketing	(698)	(1,605)
(d) leased assets	-	-
(e) staff costs	(607)	(1,564)
(f) administration and corporate costs	(1,512)	(2,801)
1.3 Dividends received (see note 3)	-	-
1.4 Interest received	-	-
1.5 Interest and other costs of finance paid	(133)	(271)
1.6 Income taxes paid	-	-
1.7 Government grants and tax incentives	-	-
1.8 Other (provide details if material)	49	46
1.9 Net cash from / (used in) operating activities	(1,481)	(2,934)

2. Cash flows from investing activities		
2.1 Payments to acquire or for:		
(a) entities		
(b) businesses		
(c) property, plant and equipment		
(d) investments		
(e) intellectual property		
(f) other non-current assets		

Consolidated statement of cash flows		Current quarter \$US'000	Year to date (6 months) \$US'000
2.2	Proceeds from disposal of:		
	(a) entities		
	(b) businesses		
	(c) property, plant and equipment		
	(d) investments		
	(e) intellectual property		
	(f) other non-current assets		
2.3	Cash flows from loans to other entities		
2.4	Dividends received (see note 3)		
2.5	Other (provide details if material)		
2.6	Net cash from / (used in) investing activities		

3.	Cash flows from financing activities		
3.1	Proceeds from issues of equity securities (excluding convertible debt securities)		
3.2	Proceeds from issue of convertible debt securities		
3.3	Proceeds from exercise of options		
3.4	Transaction costs related to issues of equity securities or convertible debt securities		
3.5	Proceeds from borrowings		
3.6	Repayment of borrowings		
3.7	Transaction costs related to loans and borrowings		
3.8	Dividends paid		
3.9	Other (provide details if material)		
3.10	Net cash from / (used in) financing activities		

4.	Net increase / (decrease) in cash and cash equivalents for the period		
4.1	Cash and cash equivalents at beginning of period	3,171	4,688
4.2	Net cash from / (used in) operating activities (item 1.9 above)	(1,481)	(2,934)
4.3	Net cash from / (used in) investing activities (item 2.6 above)		

Consolidated statement of cash flows		Current quarter \$US'000	Year to date (6 months) \$US'000
4.4	Net cash from / (used in) financing activities (item 3.10 above)		
4.5	Effect of movement in exchange rates on cash held	50	(14)
4.6	Cash and cash equivalents at end of period	1,739	1,739

5.	Reconciliation of cash and cash equivalents at the end of the quarter (as shown in the consolidated statement of cash flows) to the related items in the accounts	Current quarter \$US'000	Previous quarter \$US'000
5.1	Bank balances	1,739	3,171
5.2	Call deposits		
5.3	Bank overdrafts		
5.4	Other (provide details)		
5.5	Cash and cash equivalents at end of quarter (should equal item 4.6 above)	1,739	3,171

6.	Payments to related parties of the entity and their associates	Current quarter \$US'000
6.1	Aggregate amount of payments to related parties and their associates included in item 1	
6.2	Aggregate amount of payments to related parties and their associates included in item 2	
<i>Note: if any amounts are shown in items 6.1 or 6.2, your quarterly activity report must include a description of, and an explanation for, such payments.</i>		

7.	Financing facilities <i>Note: the term "facility" includes all forms of financing arrangements available to the entity.</i> <i>Add notes as necessary for an understanding of the sources of finance available to the entity.</i>	Total facility amount at quarter end \$US'000	Amount drawn at quarter end \$US'000
7.1	Loan facilities	4,388	4,388
7.2	Credit standby arrangements	3,684	-
7.3	Other (please specify)	-	-
7.4	Total financing facilities	8,072	4,388
7.5	Unused financing facilities available at quarter end*		3,684**
7.6	Include in the box below a description of each facility above, including the lender, interest rate, maturity date and whether it is secured or unsecured. If any additional financing facilities have been entered into or are proposed to be entered into after quarter end, include a note providing details of those facilities as well.		
	** Refer to disclosures regarding the Company's arrangements with PURE Asset Management Pty Ltd in the Quarterly Activities Report dated 31 July 2023.		

8.	Estimated cash available for future operating activities	\$US'000
8.1	Net cash from / (used in) operating activities (item 1.9)	(1,481)
8.2	Cash and cash equivalents at quarter end (item 4.6)	1,739
8.3	Unused finance facilities available at quarter end (item 7.5)*	3,684
8.4	Total available funding (item 8.2 + item 8.3)	5,424
8.5	Estimated quarters of funding available (item 8.4 divided by item 8.1)	3.66
	<i>Note: if the entity has reported positive net operating cash flows in item 1.9, answer item 8.5 as "N/A". Otherwise, a figure for the estimated quarters of funding available must be included in item 8.5.</i>	
8.6	If item 8.5 is less than 2 quarters, please provide answers to the following questions:	
8.6.1	Does the entity expect that it will continue to have the current level of net operating cash flows for the time being and, if not, why not?	
	Answer:	
8.6.2	Has the entity taken any steps, or does it propose to take any steps, to raise further cash to fund its operations and, if so, what are those steps and how likely does it believe that they will be successful?	
	Answer:	
8.6.3	Does the entity expect to be able to continue its operations and to meet its business objectives and, if so, on what basis?	
	Answer:	
	<i>Note: where item 8.5 is less than 2 quarters, all of questions 8.6.1, 8.6.2 and 8.6.3 above must be answered.</i>	

Compliance statement

- 1 This statement has been prepared in accordance with accounting standards and policies which comply with Listing Rule 19.11A.
- 2 This statement gives a true and fair view of the matters disclosed.

Date: 31 July 2023

Authorised by: The Board
(Name of body or officer authorising release – see note 4)

Notes

1. This quarterly cash flow report and the accompanying activity report provide a basis for informing the market about the entity's activities for the past quarter, how they have been financed and the effect this has had on its cash position. An entity that wishes to disclose additional information over and above the minimum required under the Listing Rules is encouraged to do so.
2. If this quarterly cash flow report has been prepared in accordance with Australian Accounting Standards, the definitions in, and provisions of, *AASB 107: Statement of Cash Flows* apply to this report. If this quarterly cash flow report has been prepared in accordance with other accounting standards agreed by ASX pursuant to Listing Rule 19.11A, the corresponding equivalent standard applies to this report.
3. Dividends received may be classified either as cash flows from operating activities or cash flows from investing activities, depending on the accounting policy of the entity.
4. If this report has been authorised for release to the market by your board of directors, you can insert here: "By the board". If it has been authorised for release to the market by a committee of your board of directors, you can insert here: "By the [name of board committee – eg Audit and Risk Committee]". If it has been authorised for release to the market by a disclosure committee, you can insert here: "By the Disclosure Committee".
5. If this report has been authorised for release to the market by your board of directors and you wish to hold yourself out as complying with recommendation 4.2 of the ASX Corporate Governance Council's *Corporate Governance Principles and Recommendations*, the board should have received a declaration from its CEO and CFO that, in their opinion, the financial records of the entity have been properly maintained, that this report complies with the appropriate accounting standards and gives a true and fair view of the cash flows of the entity, and that their opinion has been formed on the basis of a sound system of risk management and internal control which is operating effectively.
- * The company has gone into a trading halt on 31 July 2023 to release the news of a capital raise. As part of the raise, The Hydration Pharmaceuticals Company has conditionally agreed with the debt provider, Pure Asset Management, to release the obligation of providing the second tranche of the debt facility as it is listed in this document with the intention that the capital raise will replace additional debt. The Hydration Pharmaceuticals Company Limited has the right under ASX rule 7.1 to access the second tranche, but the right to access will expire on August 5th without further shareholder approval.