



Luckin Coffee, Inc.
Q3 2022 Earnings Conference Call
Transcript

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PARTICIPANTS

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PRESENTATION

Operator

Ladies and gentlemen, welcome to Luckin Coffee's Third Quarter 2022 Earnings Conference Call. (Operator Instructions). There will be a question-and-answer session to follow. Today's conference is being recorded.

At this time, I would like to turn the call over to Mr. Bill Zima at ICR for opening remarks and introductions. Please go ahead, sir.

Bill Zima

ICR

Hello, everyone, and thank you for joining us on today's call. Luckin Coffee announced its third quarter 2022 financial results earlier today. A press release is now available on the Company's IR website at investor.lkcoffee.com.

Today, you will hear from Jinyi Guo, Chairman and CEO of Luckin Coffee; and Jing An, CFO of Luckin Coffee. After the Company's prepared remarks, the management team will conduct a question-and-answer session based on questions submitted via the Company's webcast. And this Q&A session will also be joined by Reinout Schakel, CSO of Luckin Coffee. As a reminder, investors can submit questions via the "Ask a Question" section on the bottom of the webcast during the call.

We will be referring to a slide presentation on today's call, which can be found via conference call webcast link as well as on the Company's IR website. Again, the IR website link is investor.lkcoffee.com.

During this call, the Company will be making some forward-looking statements regarding future events and results. Statements that are not historical facts, including, but not limited to, statements about the Company's beliefs and expectations are

forward-looking statements. Forward-looking statements involve inherent risks and uncertainties. Further information regarding these and other risks is included in the Company's filings with the SEC. With respect to any non-GAAP measures discussed during the call today, the accompanying reconciliation information related to those measures can be found in the earnings press release issued earlier.

During today's call, Dr. Guo will speak in Chinese and his comments will be translated into English.

Now, I would like to turn the call over to Dr. Jinyi Guo, Chairman and CEO of Luckin Coffee. Dr. Guo, please go ahead.

Jinyi Guo

Chairman and CEO, Luckin Coffee

(Translated). Hello, everyone, and welcome to today's conference call. Thank you for your continued support of Luckin Coffee.

I am Jinyi Guo, Chairman and CEO of Luckin Coffee, and it is my pleasure to be speaking with all of you again.

In the third quarter of 2022, despite the negative impact from COVID-19 pandemic-related restrictions nationwide, our performance continued its strong momentum which proved once again our solid and highly resilient business model, and that the Chinese coffee market space continues to expand. As I have always said, we firmly believe that China's coffee market is large with strong growth potential. We will continue to commit to our long-term strategy of focusing on our core business of coffee, as well as strengthening our customer insights. At the same time, in the face of increasingly fierce competition, we are confident that with our first-mover advantages in terms of branding, supply chain, digitalization and store presence, we can achieve healthy and sustainable growth, as well as increase our market share and strengthen our competitive advantages, all while ensuring reasonable profitability.

In terms of our performance, the third quarter of 2022 continued our strong growth momentum of the first half year of 2022. Total net revenue was RMB3.9 billion, representing a year-over-year increase of 65.7%. Our operating profit margin achieved double-digit for the first time in our history, reaching 15%. Self-operated stores profit margin was 29.2%, and same-store sales growth was 19.4%. The number of net new store openings was 651. Cumulative transacting customer reached 123 million as of the end of the third quarter of 2022, and the average number of monthly transacting customer reached 25.1 million in the third quarter, representing a year-over-year

increase of 71%. An Jing, our CFO, will share more details on our financial results later during the call.

This year, we launched our ESG related work and established a sustainable development governance structure, as well as began to formulate our sustainable development strategies. We recently released our corporate governance report, namely, Transformation and Reinvention Luckin Coffee 2020-2022 Corporate Governance Report, which provides a systematic review of Luckin Coffee's transformation over the past two years in terms of our corporate governance, as well as our cultural values and other important topics. And we would like to take this as a basis to establish a good example of building long-term corporate governance. Furthermore, we plan to officially launch our sustainable development strategies and objectives in the first half year of 2023. We will take sustainable development as an important basis to continue to create both customer value and social value, and lay a solid foundation for the long-term development of Luckin Coffee.

In the third quarter of 2022, our competitive advantages in branding, product R&D and store layout continued to play important roles in terms of the three pillars of “people, products and places.” From the perspective of “people”: Luckin Coffee remains popular among consumers, with average monthly transacting customers further increasing by 4 million compared to the second quarter, reaching 25.1 million for the third quarter. We also won the “Top 50 Emerging Chinese Consumption Brands with Strong Growth of the Year (2022)” by CBNDData, and the “Top Chinese Brand of 2022” from YiMagazine.

From the perspective of “products”: since the beginning of 2022, we have launched more than 100 new SKUs. We continue to strengthen our product strategy of “professionalism” and “good flavors”, insist on product innovation and continuously launch blockbuster products. Innovative products such as Prunes Flavored Velvet Latte and SOE GeSha series are all well-received by the market. Our coffee beans have recently been awarded the IIAC Gold Medal for the fifth consecutive year.

From the perspective of “places”: as of the end of the third quarter of 2022, we retained our leading position within the industry with 7,846 stores in total, and the number of net new store openings was 651 in the third quarter of 2022. We believe that China's coffee market has substantial upside potential with significant opportunities and we are full of confidence in our future expansion in cities at all tiers.

In terms of our supply chain, we continue to deepen our strategic cooperation with the world's leading coffee bean traders, and purchase high-quality coffee beans in large quantities in world-renowned origins such as Ethiopia, Colombia, and Brazil, among others. We have become one of the largest green coffee bean importers in China. In September 2022, we have reached an understanding for strategic cooperation with

XIAMEN C&D CORP. LTD., Mitsui&Co., and ECOM Agroindustrial Corp. Limited of Switzerland to purchase Brazilian coffee beans. With the support of the Brazilian Embassy, we will continue to carry out cooperation in the coffee industry in Brazil, share ideas and practical experiences, and promote the deepening of cooperation in the coffee industry.

IT is the core driving force of our business. While continuing to strengthen the construction of a comprehensive digital system, we also attach great importance to the protection of users' privacy information and data security. In May 2022, Luckin Coffee's APP has obtained the security certification from the China Cybersecurity Review Technology And Certification Center, which is a real milestone as it is the first batch of enterprise Apps in the new retail industry and catering industry to obtain this certification.

At this time, I would like to turn the call over to An Jing, our CFO, to discuss details related to our financial performance.

An Jing

CFO, Luckin Coffee

Thank you very much, Jinyi.

Good morning/ evening everyone. My name is An Jing, the CFO of Luckin Coffee. This is my first time to meet you all and it is my honor to be part of the Luckin management team.

Although I've joined Luckin for just over three months, I can already see that this is a unique Company with a very professional management team and a corporate culture that stands for innovation, transparency and a determination to succeed forged under the leadership of Jinyi. I also was able to witness the Company's consistent efforts to continuously launch new high-quality products that are suitable for the Chinese customer, optimize the customer experience by providing convenience and affordability and further enhancing the Luckin brand, which is already one of the most well-liked brands in China, particularly for younger consumers.

Furthermore, after having worked with the finance team as well as the various operational teams over the last few months, I believe that our teams are very professional, highly capable and well-integrated, and I am very excited to try and help bring our finance team and functions to the next level under my leadership. I would also like to thank Reinout, our former CFO and current CSO, for a very smooth transition and close cooperation and look forward to working with the broader team in achieving our

common goals and create long-term shareholder value. Lastly, I am very much looking forward to developing a dialogue with all of our investors and communicate more with all of you going forward.

Next, please allow me to share more color on our third quarter financial performance.

As Jinyi mentioned earlier, we continued to be impacted by pandemic-related store closures in various cities throughout China during the third quarter. Although the impact was less severe than in previous quarters, it still had a substantial impact on our operating results. As the winter season approached with bouts of COVID-19 cases in recent months, the Company experienced around 330 daily store closures on average in September and October 2022. As of the date of this earnings release, the number of daily store closures on average in November 2022 was about 500, and we believe this number may further increase.

The lack of visibility from this uncertain and unclear operating environment means we are not providing any forward-looking guidance at this time. We have however been able to deliver yet another quarter of outstanding financial and operational results.

Let me go through some of the quarterly highlights. We reported RMB3.9 billion of net revenues, an increase of 65.7% compared to the same period last year. Both of our store formats reported strong top-line growth. The net revenue of our self-operated stores reported over 50% year-over-year growth with SSSG for self-operated stores of close to 20%. Our partnership revenue grew by more than 110% in the third quarter and currently amounts to 23.1% of our total net revenues.

This was the result of continued progress in customer engagement, our continued store expansion and successful new product launches, demonstrated by 25 new freshly brewed SKUs this quarter including, for example, the Aomori Apple Velvet Latte. In terms of our customer engagement, we saw continued growth in transacting customers. We acquired another 4 million average monthly transacting customers in the quarter and reached a record high of 25 million, an increase of over 70% year-over-year.

And, perhaps most notably, as a result of our strong results and benefits of scale, we recorded an operating profit margin of 15% which is a further material improvement compared to last year and also last quarter. We are very pleased with our results as these clearly demonstrate our strong momentum and overall progress towards achieving our key strategic objectives.

In terms of store growth, we opened 651 net new stores, an acceleration compared to the second quarter, to meet the ever-growing demand for our products. The net new store growth is the strongest since 2020. We now have a nationwide footprint of close to

7,900 stores as of September 30, 2022 which provides us with significant benefit of scale. In terms of the store mix, we opened 405 net new self-operated stores this quarter. For our partnership stores, we opened 246 net new stores and entered into two new lower-tier cities. This is in line with our strategy of increasing store intensity in tier 1 and 2 cities while rapidly penetrate in lower-tier cities, to further improve store coverage and better meet consumer needs.

During the third quarter, we saw a further material improvement in our profitability profile. Specifically, our reported operating margin reached a record high of 15% as a result of our strong results, relentless focus on efficiency and cost control as well as benefits of scale. Store-level profit margin of self-operated stores continued to stay at a high level close to 30% and a notable improvement compared to the 25% achieved in same period last year. For our partnership stores, we do not disclose any metrics on profitability. However, as can be seen from our partnership store revenue breakdown in the earnings release filed earlier today, revenue contribution from profit sharing, one of the contributors of the partnership revenue and profit, almost doubled year-over-year to RMB145 million during the quarter.

We see our overhead expenses ratio continued to improve during the quarter. Our general and administrative expenses increased by RMB62 million year-over-year, which reflects our continued investments in our business. The G&A expense, as a percentage of revenue, decreased from 13.7% in Q3 last year to 9.8% this quarter, thanks to the benefit of scale. The sales and marketing expense ratio is relatively flattish at 4.1% compared with the same period last year and a slight increase compared to last quarter of 3.9%. Compare to last year, we spent more on advertising expenses as Company continued strategic investment in our branding through various channels.

The expenses as related to the fabricated transaction and the restructuring has decreased by RMB11 million compared with Q2 since the Provisional Liquidation of the Company in the Cayman Islands was completed in the first half of 2022. With the majority of the Company's historical issues being resolved, I believe the expense related to fabricated transaction will further decrease over time.

During the third quarter, we had a positive operating cash flow of RMB417 million, which included the settlement of payable to equity litigants of RMB385.2 million. If we exclude the payment to equity litigants, the operating cash flow increased to RMB802.1 million in the third quarter of 2022, compared to RMB8.3 million in the same quarter of 2021.

In terms of our balance sheet, as of the end of the third quarter, we had no interest-bearing debt since we have fully redeemed the Senior notes B for an amount of USD110.6 million on August 26. As of September 30, 2022, after payment of the equity litigant settlement and redemption of Notes B, our cash position remains very strong

with close to RMB4 billion of cash and cash equivalents. We have a healthy balance sheet and will continue to review our liquidity requirements on an ongoing basis to ensure that we can meet all of our business needs and continue to further optimize our capital structure.

I'll now turn it over to Jinyi for concluding remarks followed by Q&A.

Jinyi Guo

Chairman and CEO, Luckin Coffee

(Translated). Lastly, I would like to thank all of our stakeholders again for their long-term support of Luckin Coffee. Now, we would like to open the floor to questions.

QUESTIONS AND ANSWERS

Operator

Ladies and gentlemen, we will now begin the Q&A session. I will now turn the call over to Alicia Guo at Luckin Coffee who will moderate today's Q&A session.

Alicia Guo

Investor Relations Director, Luckin Coffee

Thank you. Now, we would like to open the floor to questions.

The first question: Luckin continues to expand its footprint rapidly in the third quarter. Could you let us know whether the store expansion is within your expectations? And can you provide us with any guidance on your store expansion plans for the next few years?

Jinyi Guo

Chairman and CEO, Luckin Coffee

(Translated). Thank you for your question. Based on publicly-available information, Luckin Coffee has become one of the largest coffee chain brands in China in terms of store counts. As of the end of the third quarter, we had 7,846 stores in total covering

over 230 cities with 651 stores newly opened during the third quarter. This growth is in line with our expectation. Our two store models are highly complementary to each other, with the newly opened 405 self-operated stores mainly operated in tier-1 and tier-2 cities, while the newly-opened 246 partnership stores mainly operated in lower-tier cities.

In the past two years, we have built an industry-leading digital site selection and store expansion management system. Based on our analysis, we believe there are still plenty of locations in both higher-tier and lower-tier cities that meet our site selection requirements and the market is far from being saturated. And we believe the China's coffee market size will further expand driven by the accelerated promotion of coffee consumption.

And we are confident of our future store expansion. The pace of store opening this year well demonstrated our ability to expand. And we will closely monitor the relevant developments in the market, maintain a strong and competitive expanding pace of store openings to further increase our presence and better meet consumer needs.

Regarding the partnership store model, we will reopen the recruiting channel for partners in lower-tier cities from this December. Please stay tuned for further official announcements.

Alicia Guo

Investor Relations Director, Luckin Coffee

Thank you, Dr. Guo. Let's move on to the next question.

In the second quarter of 2022, Luckin has announced the launching of the sustainability development strategy. And recently, the corporate governance report has been issued. Why Company decided to start to focus on the sustainability development at current time point? And what does this mean to the Company? Also, could you please share more color on the corporate governance report?

Jinyi Guo

Chairman and CEO, Luckin Coffee

(Translated). Thank you for your question. This year marks the fifth anniversary of Luckin Coffee. In July 2022 with the approval of our Board of Directors, The Sustainable Development Committee was formally established. This marks the official launch of our

sustainable development strategy and it also means that going forward, we'll pursue long-term value and will more proactively address social responsibility.

In the past four months, we have systematically constructed our sustainable development governance structure, forming the value orientation of high degree of synergy between business growth and sustainability. We're now gathering suggestions from all stakeholders, including consumers, suppliers, employees and partners, shareholders, regulators, and friends from industry and media by conducting a survey, which is estimated to be completed in the near future. We believe this will help us establish our sustainable development strategy in a more constructive and comprehensive way.

We chose to start with corporate governance because we believe a sound corporate governance is not only the precondition to building a sustainable business model, but a good starting point and solid foundation for carrying out environmental and social responsibility. Our corporate governance report consists of five parts based on our core values, namely, Integrity, Craftsmanship, Innovation, Ownership and Cooperation. This report gives a thoughtful review of our journey over the past two years to get back on track and the efforts we have made in taking responsibility, led by our new core values, by fully resolving the historical problem, reshaping our corporate culture and values, optimizing our governance structure, implementing a strategy of enhancing internal control and empowering technology continuously, enhancing talent development and incentive mechanism.

I hope this report can help all of you to better understand our positive changes. And we would like to take this as a new starting point to remain prudent and pragmatic to promote our sustainable development work in a transparent, virtuous, and scientific manner. This report is an important cornerstone for Luckin Coffee to enter a new stage of sustainable development and create broader value and lay a solid foundation for our continued high quality and sustainable development.

Alicia Guo

Investor Relations Director, Luckin Coffee

Thank you, Dr. Guo. The next question is what are the main factors driving your SSSG growth in the third quarter? How much of this is the result from the introduction of new products and is that sustainable? How should we think about your store capacity? Is there a limit to how far we can further increase item sold per store per day and how should we think about that?

An Jing*CFO, Luckin Coffee*

Thank you for the questions. We anticipated a further normalization of SSSG for self-operated store compared to the last 6 quarters, and I would expect that trends to continue going forward.

The key driver of the item sold per store per day included an incremental sales from the launch of new products and ongoing strong performance of our blockbuster products. In Q3, we have launched a series of new products such as Aomori Apple Velvet Latte, which have sold 2.2 million cups within the first week since launch. Our ongoing blockbuster products such as the Newer Latte, Coconut Milk Latte, Coconut Cloud Latte, etc., continue to rank in the top10 of the best-selling products and contribute substantially to sales. And enhance the branding power from increasing store presence and marketing initiatives. As coffee becomes essential to more and more Chinese customers, we gradually experienced the benefits of scale and the strengths of our brand as we open more stores nationwide.

And in terms of the ceiling of the item sold per store per day, it basically depends on the store efficiency and the traffic. Our overall goal is to satisfy all the needs from customers, the store efficiency and our IT facilities and systematization will help us to continually optimize and standardize the operation and increase the efficiency. The traffic, as our footprint covered more area -- and our brand awareness keeps strengthening, we will attract more customers in the future.

In terms of pricing strategy, our affordability proposition is an important differentiator. We are profitable at this price as demonstrated by our store-level margins during the third quarter, and do not anticipate any major changes in our pricing strategy.

Alicia Guo*Investor Relations Director, Luckin Coffee*

Thank you, Ms. An. The next question is the average monthly transacting customers reached over 25 million in the third quarter, a notable increase compared to last year and also last quarter. What are the key drivers behind this? And what is your strategy both for attracting new customers and retaining existing customers going forward?

An Jing*CFO, Luckin Coffee*

Thank you for the question. I believe this is due to our scale. This quarter, we newly opened 651 stores and entered into two new cities, which enabled us to reach to the new customers in the new markets out there and fulfill their needs.

The strength of our products, professional, and good taste. In Q3, we have launched a series of popular products and the GeSha SOE series, which is also the important driver of the new customers. At the same time, our ongoing blockbuster products continue perform well, which plays a critical role in helping us retain the customers. And actually, these popular products have already been filtered as the basic menu of the customer in long-term.

Our branding power. In Q3, we have launched some marketing initiatives along with the new products, and new packaging such as the “Chinese Valentine's Day” and “the first cup of coffee in autumn”. Those topics are popular among the young generation and attracted them to try our new product. Our tech-driven refined customer operation, which also played an important role in retaining the existing customer. Empowered by the technology, we could better understand the customer needs and have more efficient and accurate interactions and communication with customers without bothering them. In addition, our “RMB9.9 coffee” initiative in Shanghai also helped to reactivate the existing customers and drive the increase in the number of new customers.

In the long run, we will continue our marketing strategy with the idea of “Livin’ Young, Luckin On” using different marketing and the branding initiatives to build our brand as the representative of professional, youth, fashion and wellness. Combing the good quality coffee with creativity, the young customer favored, embracing the young generation and gradually building their brand loyalty.

Alicia Guo

Investor Relations Director, Luckin Coffee

Thank you, Ms. An. The last question is can you please give us an update on the overall status of the restructuring and the overall capital market strategy? Any further relevant developments? Also, notice that you early repaid the outstanding debt. Why did you decide to do that?

Reinout Schakel

CSO, Luckin Coffee

Thanks for your question, and I'm happy to take this opportunity today to address that to the extent I can. As mentioned in our Q2 earnings call, the provisional liquidation of the

Company in the Cayman Islands was completed in the first half of 2022. And we reported that we had made substantial progress in resolving the outstanding U.S. securities litigation, including receiving final approval of USD175 million settlements of the federal class action.

I am pleased to be able to share some additional information today regarding our progress on the remaining U.S. securities litigation. Firstly, on October 7, 2022, the New York State Court preliminary approved a USD7 million settlement with a class of investors who purchased our January 2020 convertible bonds, but were not included as creditors in our Cayman scheme. The settlement is still contingent upon final approval of the court, and we expect the court to hold a hearing on final approval in Q1 2023.

Secondly, there were three securities lawsuits filed by investors in our ADS, who opted out of the federal class settlement. We have reached agreements to resolve all three actions. One of the actions has already been dismissed, pursuant to the terms of the settlement; and we expect the other two to be dismissed upon the Company's satisfaction of the terms of those settlements, which should occur in Q4, 2022 and Q1 2023.

Finally, we currently expect that all lawsuits filed due to our historical accounting issues will be dismissed by the end of Q1 2023.

Let me turn to the repayment of our debt, the key rationale. On August 26, we announced a full redemption of our only outstanding offshore debt securities of USD109.9 million of 9% Series B senior secured notes due 2027. A key reason for the early redemption, first and foremost, to optimize our capital structure. We have a very healthy liquidity position, a business that is profitable and generates substantial free cash flow, while the debt was relatively expensive at 9% interest. From a corporate finance perspective, it was therefore a relatively easy decision for the Company.

Secondly, the early redemption means the Company has currently no offshore debt obligations, which provides us with additional operational flexibility. And lastly, it allowed us to return fully back to normal by terminating the role of the scheme supervisors as defined under the restructuring support agreement.

Now my answer to the capital market strategy question is consistent with my previous response. The priority for us is providing sustainable long-term value for our shareholders by executing on our business strategies, by delivering outstanding products and services to our customers, maintaining strong internal controls over our financial reporting, to ensure we operate with the highest level of integrity and expand our ESG efforts.

We remain committed to the U.S. capital markets and are closely monitoring all relevant developments, and take actions we believe are in the best interest of the Company and all our stakeholders. We will share further updates if and when appropriate.

Alicia Guo

Investor Relations Director, Luckin Coffee

Thank you, Dr. Guo, Ms. An and Reinout. This is all the time we have for today's earnings conference call. We thank you for your participation on today's call. We look forward to providing you with regular business updates and look forward to speaking with you again next quarter.

Operator

This concludes our call today. You may now disconnect.

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