

TH International Limited (NASDAQ:THCH) Q1 2024 Earnings Call Transcript June 5, 2024  
8:00 AM ET

#### Company Participants

Yongchen Lu - Chief Executive Officer and Director

Dong Li - Chief Financial Officer

Gemma Bakx – Head of Investor Relations

#### Operator

Ladies and gentlemen, welcome to Tims China's First Quarter 2024 Earnings Conference Call. All participants will be in a listen-only mode during management's prepared remarks and 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 Gemma Bakx, who heads Tims China's Investor Relations efforts, for prepared remarks and introductions. Please go ahead, Gemma.

#### Gemma Bakx

Thank you very much. Good morning and good evening, everyone, and thank you for joining us on today's call. My name is Gemma Bakx, Head of Investor Relations at TH International. We announced our first quarter financial results 2024 earlier today. The press release, as well as an accompanying presentation, which contains operational and financial highlights, are now available on the company's IR website at [ir.timschina.com](http://ir.timschina.com). Today, you will hear from Yongchen Lu, our CEO and Director and from Albert Li, our CFO.

After the company's prepared remarks, the management team will conduct a question-and-answer session. You can find the webcast of today's earnings call on our IR website.

Before we get started, I'd like to remind you that our earnings presentation and investor materials contain forward-looking statements, which are subject to future events and uncertainties. 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, and our

actual results may differ materially from those forward-looking statements. All forward-looking statements should be considered in conjunction with the cautionary statements in our earnings release and risk factors included in our filings with the SEC. This presentation also includes non-GAAP financial measures, which we believe can be helpful in evaluating our performance. However, those measures should not be considered substitutes for the comparable GAAP measures. The accompanying reconciliation information related to these non-GAAP and GAAP measures can be found in our earnings press release issued earlier today.

With all that said, I'd like now to turn it over to Yongchen Lu, our CEO and Director. Over to you, Yongchen.

Yongchen Lu

Thank you, Gemma. My name is Yongchen Lu, CEO and Director of Tims China. During the first quarter of 2024, which is historically the weakest quarter in terms of seasonality, we delivered 7.1% year-over-year growth in system sales and our seventh consecutive quarter of positive adjusted store EBITDA. We delivered these despite a challenging industrial landscape of intense price competition and significant macro headwinds.

This quarter, driving profitability and improving operating cash flow, remains a top priority for us, and will remain so going forward. Our team has been focusing on strategic initiatives that bolster our bottom line while supporting profitable growth. With a strong focus on operational efficiencies and targeted marketing efforts, we are confident that our dedication to enhancing profitability will yield positive results, with the goal of achieving our first quarterly adjusted corporate EBITDA breakeven this year. We persisted in strategically pruning underperforming stores in Q1 2024, aligning with our previously outlined strategic initiatives.

On March 31, 2024, we reached a significant milestone, surpassing 20 million registered loyalty club members, representing a 63.6% year-over-year growth. The average number of members per store exceeds 22,000, serving both as a catalyst for growth and a testament to our customers' support of Tims China's loyalty programs. The support from our customers has been an inspiration for our team, continually spurring us to elevate our commitment to deliver top-tier products and exceptional services.

We continued to deliver growth in a capital-efficient manner, and we remain committed to offer absolute convenience for our guests. Our strategic partnership with sub-franchisees is underpinning the expansion of our store network, increasing our density in existing cities

for quicker services and broadening our outreach into new cities to welcome new customers. New cities we entered during the first quarter include Huizhou and Huzhou.

Starting February 26, 2024, we launched a campaign nationwide to celebrate the significant milestones of our 5th anniversary in China and the 60th anniversary of the 'Tim Hortons' brand with a theme of '60 years of freshness and deliciousness.' As part of this campaign, we introduced a new series of core products called Tims China Double Double, which enhances the original Double Double brew coffee with richer milk and more flavors. Additionally, three flavors of donuts were reintroduced: chocolate, strawberry and rainbow. Throughout the campaign, over 160 media agencies covered the history and legacy of Tim Hortons, resulting in over 20 million media exposures. The hashtag #doubledouble reached over 14 million views on Douyin, while the live broadcast on Douyin attract over six million viewers during the campaign period.

Continuous product innovation remains a cornerstone of our strategic vision. We launched 14 new beverages and 18 new food products during the first quarter of 2024. New products, including Cherry Americano and Croissant series, have been a particular success. We sold over 1.7 million units between them. Recognizing the popularity of our Smile Bagels, we have expanded the platform with enticing new flavors this quarter, including Low Sugar Dark Chocolate and Rose Litchi, offering a taste of innovation while maintaining the quality and appeal that our customers cherish.

In Q1 2024, our collaborations with Tangle Angel and Dove Chocolate have also achieved significant success, reaching over 10 million media exposures on Douyin and Little Red Book during the campaign period.

As a leading international coffee brand renowned for delivering exceptional value-for-money, high-quality products, we focus on advancing our distinctive Coffee Plus strategy. During the first quarter of 2024, we initiated the Bagel Tuntun Card campaign. This promotional offer allowed customers to enjoy a delicious Tims bagel for just RMB9.9, a move designed to boost food orders and attract a fresh wave of patrons to experience our offerings. In the first quarter of 2024, the percentage of orders that included food rose to 52.7%, an increase of over eight percentage points from 44.2% in the same quarter of 2023.

Lastly, our Popeyes brand continues to grow. So far, we have launched 14 Popeyes restaurants in Shanghai and are actively fine-tuning our menu, including expanding our product offerings beyond our core fried chicken products. Our 14 restaurants will serve as a solid base for further growth in Shanghai and beyond.

At this time, I would like to turn it over to our CFO, Albert Li, to discuss our first quarter 2024 financial performance in more detail. Albert?

Dong Li

Thank you, Yongchen. During the first quarter of 2024, facing intense industry competition and macroeconomic headwinds, we remained steadfast in our commitment to deliver exceptional value-for-money, high-quality products to an expanding customer base and to enhancing our operational efficiency. In the first quarter of 2024, our system sales grew by 7.1% year-over-year to RMB363.5 million. The growth was primarily driven by an increase in the number of system-wide stores from 648 as of March 31, 2023, to 917 as of March 31, 2024. Overall, monthly average transacting customers were 2.8 million during the first quarter of 2024, representing an increase of 22.8% from 2.3 million in the same quarter of last year. Digital orders as a percentage of total orders increased from 79.1% in Q1 2023 to 85.4% in Q1 2024. We continue to strengthen our digital capabilities to meet the growing demand potential for delivery and takeaway services.

During the first quarter of 2024, we continued to enhance our operational efficiencies: as a result of refinements to our supply chain management and economy of scale, our food and packaging costs (as a percentage of revenues from company-owned and operated stores) have decreased by 1.0 percentage points year-over-year.

We continued to prune our underperforming stores and optimize our unit economics. These actions allowed us to further deliver year-over-year reduction in rental and labor costs (as a percentage of revenues from company-owned and operated stores) by 0.9 percentage points and 1.3 percentage points, respectively.

We also pared back costs at the headquarter level, helping to reduce our general and administrative expenses as a percentage of total revenues by 4.1 percentage points year-over-year.

Turning to liquidity: as of March 31, 2024, our total cash and cash equivalents and time deposits were RMB218.2 million, compared to RMB220.8 million as of December 31, 2023. The change was primarily attributable to cash disbursements on the back of the expansion of our business and store network nationwide, repayment of bank borrowings, offset by the US\$20 million junior promissory note financing provided by Cartesian Capital Group, our existing shareholder.

Moving forward, with driving profitable and capital-efficient growth being front and center of everything we do, we will continue to optimize our store unit economics, roll out our differentiated made-to-order fresh food preparation model to drive traffic, enhance our supply chain capabilities and efficiencies and facilitate our franchisees to manage the growth and profitability of their stores effectively.

Now I will turn the call over to Gemma for today's Q&A session.

## Question-and-Answer Session

Gemma Bakx

Is there anything, operator, you want to say introducing the Q&A or shall I go ahead with the first question?

Operator

[Operator Instructions]

Gemma Bakx

Thank you, Emberlin. Our first question comes from Steve Silver from Argus Research. Steve, go ahead with your question.

Steve Silver

Thank you and good morning and good evening everybody. My question is: if the competitive and the macroeconomic challenges that the company is seeing last for longer than is currently expected, I'm curious to hear management's thoughts on how the company plans to stay the course in terms of expanding its store-level EBITDA margins and then more broadly executing on its growth strategy?

Yongchen Lu

Thank you, Steve. The pricing competition has lasted longer than expected. But for us, we don't really compete head-to-head with our peer coffee brands since we not only sell coffee, but also provide fresh prepared food. As I mentioned earlier, more than 50% of our orders now come with food, which is much higher than the market average. And coffee plus food will continue to serve as our big differentiation point, which can increase our average check and also our sales at the store level. Our differentiated position has attracted thousands of sub-franchisee applications. We have received over 3,000 applications

already, and we will accelerate our sub-franchisee developments in the coming quarters and years to expand our network.

Steve Silver

Okay. Thank you so much.

Yongchen Lu

Thank you, Steve.

Operator

Gemma, over to you for the next question.

Gemma Bakx

We have a submitted question from an investor who's asking about margins, and Luckin's numbers. He is observing that Luckin's numbers were down significantly in the quarter, including same-store sales and margins as well. What do you think is the reason that Tim's margins are up, be it sequentially over the same quarter last year only? Anything that Tims is doing differently? What is your take on this?

Dong Li

Managing our cost structure effectively is very important to us and we target to achieve margin expansion at both store and corporate levels even with very challenging consumption sentiment, fierce industry competition and pressure on our same-store sales growth. So we want to expand our margins under these conditions. We continued to implement rigorous capital expenditure control and cost reduction measures, and we took decisive action to prune those underperforming company-owned and operated stores. We collaborated very closely with almost every supplier to strive for better pricing for our food and packaging items. And we invested in our warehousing and logistics to reduce overall freight and transportation costs. We also constantly reviewed the pricing of our core product offerings to ensure we can get optimal margins out of the products that we sell. We deployed AI and big-data technologies to enhance our technology platform so that we can

predict our daily sales more precisely and manage our labor scheduling and inventory more effectively.

We cut down the headcount of our personnel at the corporate level. And in the meantime, the expansion of our franchise store network will bring us more profitable growth along the road. So we are confident that our dedicated effort can help us improve our overall profitability at both the store and corporate levels.

Operator

Thank you. Over to Gemma for the next question.

Gemma Bakx

We have a question from Sunny Huang from Nordic Asia Investment Group. How do you view the extended price war? The question is: is it more about lagging industry demand or aggressive competitors given the increased number of coffee stores in China in 2023? The question is also about potential price hikes for certain Tims products. There were some in May. Could you speak to the sustainability of product price hikes and any further plans of price hikes going forward?

Yongchen Lu

Yes. As I just mentioned, the pricing competition has lasted longer than expected. I think that is because most coffee brands just compete on coffee products, and coffee products have become more common, with similar tastes, similar profiles. If companies want to capture market share, they have to compete on price. But for us, we not only sell coffee, we sell a lot of food. Food especially is a big differentiation point for us. Yes, we increased our bagel and bagel sandwich price early May, and we don't see much impact on our sales because that is a huge differentiation point for us.

We give discounts to attract our customers or to maintain our customer base and we plan to launch a series of value-for-money campaigns in the future to handle the price competition. For food, we are different. People love our bagels. They will come back for a repeat purchase. We don't see much impact there.

As for the combos, we sell those at a very competitive price. For example, our breakfast combo, one cup of coffee plus one bagel is priced only at RMB19.9, which is very competitive in the market. Our lunch menu, one cup of coffee plus one bagel sandwich, starts at RMB26.9, which is also very competitive in the market. So that is our view for Tims. We are quite different from the peer coffee brands in the market right now.

Operator

Thank you. Over to Gemma for the next question.

Gemma Bakx

We have another submitted question: how has your franchising strategy been evolving since you first announced it last September? And what parts of it have exceeded your expectations and what has lagged your expectations?

Yongchen Lu

Our individual franchising strategy has been evolving very well and has received over 3,000 applications already, as I just mentioned, which has exceeded our expectations. We don't really promote that much yet.

The vetting process of the partners and the sites is very time consuming as we want to make sure we select the right partners to work with for many years to come. Also, we want to open the right sites to ensure profitability and payback for our sub-franchisees. So the vetting process does take a lot more time than we expected. We are getting more personnel and we have streamlined the process so we can open our franchise stores faster in the future.

Operator

Thank you. Over to Gemma for the next question.

Gemma Bakx

We have a question about the supply chain. Given that you have a lot of products that are new and new flavors as well, could you provide color on what your supply chain looks like and how you optimize it?

Yongchen Lu

Over the past five years, we have built a robust supply chain infrastructure and capabilities. For example, we have leveraged our increasing scale to secure very competitive costs from our suppliers to achieve high gross margins for both company-owned stores and our franchisees. And we have at least two suppliers for almost all materials to make sure that we can supply all materials safely. Also, we have multiple distribution centers in China to cover the whole country. So we can open in many new cities if we want. And in addition, we have set up a flexible and nimble process so that we can launch new products every two weeks to adapt to the market and customer demand.

Operator

Thank you. Over to Gemma for the next question.

Gemma Bakx

We have another submitted question. It touches on the competition again. How have you seen that developing over the last year especially, but also what does it mean to Tims given the perceived weakness of the Chinese consumer?

Yongchen Lu

As we all know, Cotti has emerged from the market very quickly opening thousands of franchisee stores last year and initiating a price war for the whole coffee industry, which has affected all brands including ours in the market to some extent. The price war might continue for a while. Having said that, as I mentioned earlier, Tims don't really compete head-to-head with our coffee brand, given our coffee plus food differentiation strategy. So we will continue to focus on our differentiated product offerings and accelerate our sub-franchising development to expand our network.

Operator

Over to you, Gemma, for the next question.

Gemma Bakx

Our next registered question speaks to the food orders and the efforts Tims has made to boost them. How do you see those efforts relating to the competition?

Yongchen Lu

It works very well for us. As you can see, the percentage of our orders that include food rose to 52.7%, increased by over 8 percentage points from 44.2% in the same quarter of last year. With our differentiation strategy, we don't really need to compete head-to-head with our peer coffee brands. We don't need to compete just on price.

Operator

Thank you. Over to you, Gemma, for the next question.

Gemma Bakx

Our last submitted question is about Tim's loyalty customers program. How many of your loyalty customers are transacting on average is the question? And do transacting customers have a higher spend? Do you work a lot with coupons?

Dong Li

We just celebrated the core milestone of surpassing 20 million loyalty club members as of March 31, 2024. And our monthly average transacting customers were about three million during the first quarter this year. On average, our loyalty members purchased about two and a half to three times a month. On average, our loyalty members spent 80% more than a non-member customer.

On the discounts: we do offer many attractive promotional activities and discounts to attract new customers and also to encourage our existing customers to repurchase and to increase the customer frequency. However, I do not think we rely heavily on coupons. We

have creative marketing minds and many attractive products. We believe our overall product quality and services offerings are very attractive to our customers.

Operator

Thank you. Over to you, Gemma, for the next question.

Gemma Bakx

This completes the submitted questions, as far as I can see.

Operator

Thank you. We are coming to the end of the conference call. Gemma, over to you.

Gemma Bakx

Thank you, operator. Thank you very much, Yongchen and Albert. This concludes today's earnings conference call. We thank you so much for your participation, for dialing in and also for your interest in Tims. We look forward to reconnecting with you again in the very near future.

Yongchen Lu

Thank you. Thank you, all.

Dong Li

Thank you, all.

Operator

Thank you. This concludes our call today. You may disconnect.