

TH International Limited (THCH) Q3 2024 Earnings Call Transcript

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Play Earnings Call

TH International Limited (NASDAQ:[THCH](#)) Q3 2024 Earnings Conference Call November 12, 2024 8:00 AM ET

Company Participants

Yongchen Lu - Chief Executive Officer and Director

Albert Li - Chief Financial Officer

Gemma Bakx - Head, Investor Relations

Operator

Ladies and gentlemen, welcome to Tims China Third Quarter 2024 Earnings Conference Call. All participants will be in 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, Sarah. 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. Tims China announced its third quarter 2024 financial results 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.

Today, you will hear from Yongchen Lu, our CEO and Director, and 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 as well.

Before we get started, I would 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.

These 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 SEC.

This presentation also includes certain 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 those non-GAAP and GAAP measures can be found in our earnings press release issued earlier today.

With that said, I'd like now to turn it over to Yongchen Lu, our CEO and Director. Please go ahead, Yongchen.

Yongchen Lu

Thank you, Gemma. Good morning, and good evening, everyone. In the third quarter of 2024, we maintained adjusted corporate EBITDA profitability despite the ongoing price competition in the Chinese coffee market after achieving, our first-ever adjusted corporate EBITDA profitability in the second quarter of 2024. We are committed to focusing on product differentiation and product -- providing great value for our customers.

We achieved our highest-ever quarterly company-owned and operated store contribution margin of 13.3%, previously disclosed as adjusted store EBITDA margin, and a year-over-year margin expansion of 5.8 percentage points, demonstrating our continuous efforts towards delivering further improvements in operational efficiencies and supply chain capabilities.

In alignment with our differentiated strategy of “Coffee Plus Warm Food”, we prioritize delivering freshly prepared, healthy and high-quality products at affordable prices to our customers.

On freshly prepared food: we have completed the “made-to-order” renovation of 539 new and existing stores by the end of October, adding working stations designed for efficient, fresh and handmade food preparation (现点现制手作台) and “open kitchens” (开放式厨房). With this investment, our guests can watch our staff craft fresh meals from start to finish.

On healthy and high-quality product offerings, we launched low-sugar, high-fiber and plant-based options, with a particular emphasis on freshness and preservation of nutrition and flavor of our high-quality ingredients. We also provide transparent nutrition and categorized

information on our menu so that our guests can evaluate the health benefits of our products and make decisions easily.

In order to make our healthy coffee plus bagels and bagel sandwiches options accessible to broader audiences, our R&D team launched bagel products with fewer than 400 calories, limiting multi grain bagels and smile bagels to fewer than 300 calories, and promising “Five Zeros” in all our beverage product offerings, i.e. zero non-dairy creamer, zero coffee whitener, zero hydrogenated vegetable oil, zero trans fats and zero instant tea powder (0 植脂末、0 奶精、0 氢化植物油、0 反式脂肪酸、0 速溶茶粉).

On providing great value, we price our products competitively, especially our combos. Our breakfast combos, one cup of coffee and one warm fruit item, start at RMB14.9. That’s about \$2. Our lunch combos start at RMB21.9. That’s about \$3. In addition, we have launched Chibaobao Cards (吃饱饱套餐卡), for which our guests pay RMB6.6 to get four-time rights to buy one drink and one warm food item, all four times at a 40% discount. Our guests can get much more than RMB6.6 savings even for one-time usage. The cards have been a resounding success with our guests. We sold over 120,000 cards in Q3. They have been a very effective tool to drive purchase frequency: those who purchased a card demonstrated a 4.6 times increase in purchase frequency, compared to those who did not purchase a card. Moreover, our efforts have driven sales, contributing to a total of RMB7.6 million in revenue during Q3 this year.

We continue to deliver capital-efficient growth, and we remain committed to offering absolute convenience for our guests. Our strategic partnership with sub-franchises 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 guests. We have generated strong momentum on individual franchising. Since we launched the program late last year, we have received over 5,000 applications, opened 43 already and signed additional 94 as of the end of September.

New cities we entered during the third quarter of 2024, including Haerbin (“哈尔滨”), Shijiazhuang (“石家庄”), Yancheng (“盐城”), Dongying (“东营”), Heze (“菏泽”), and Huangshi (“黄石”). Leveraging our brand influence and the high-quality products and services we provide, every time we open a new store in a new city, we are met with an enthusiastic welcome and support from guests. For instance, our inaugural store in Haerbin achieved over RMB100,000 in sales during its first three business days, garnering considerable media attention.

By September 30, 2024, our registered Loyalty Club Members had reached 22.8 million, reflecting a remarkable 35.3% year-over-year growth. The average number of members per

store has now surpassed 24,000, serving as a strong catalyst for our future growth and clearly demonstrating our customers' consistent support for Tims China Loyalty Programs. The ongoing support from our customers inspires our team to continue to deliver the best value-for-quality products.

In Q3 2024, we introduced 10 new beverages and 9 new food products. We have been integrating more healthy ingredients into newly launched products, alongside our principle of "freshly handmade" (新鲜手作). Our successful products not only resonate with current health-driven trends but also cater to the increasing self-care demands of our Chinese consumers. A prime example is the introduction of our Five Red Multi-grain Bagel (五红贝果) and Five Black Multi-Grain Bagels (五黑贝果) during the annual Tims Bagel Festival in September. These products merged Tims' signature grain Bagel concept with the principles of traditional Chinese herbs.

In recognition of our guests' focus on a healthy lifestyle, we collaborated with Menglan, the panda. Menglan, a hugely popular panda star with its healthy green diet, quickly proved to be an excellent mascot for us. Thanks to the innovative products and our eye-catching furry mascot, the 2024 Tims Bagel Festival garnered over 63 million media exposures, KOL seedings on RED alone contributed 7 million exposures and sparked a 160% surge in user-generated content compared to August. Searches for Tims Bagel nearly doubled in September, boosting Tims brand ranking within the coffee industry by one position.

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

Albert Li

Thank you, Yongchen. In the third quarter of 2024, we delivered adjusted corporate EBITDA profitability again. We remain dedicated to enhancing our financial performance by refining our store unit economics and driving efficiencies at the corporate level. Concurrently, our rapidly growing sub-franchise business continues to generate a steady stream of cash flows and profitability, bolstering our margins. We remain committed to delivering cost-effective, high-quality products to our growing customer base.

Our overall monthly average transacting customers reached 3.3 million in Q4 2024, a 2.4% increase from 3.2 million in the same quarter of 2023. Additionally, digital orders as a percentage of total orders rose from 82.6% in Q3 2023 to 86.6% in Q3 2024. We continue to enhance our digital capabilities to meet the growing demand for delivery and takeaway services.

During the third quarter of 2024, we made more significant strides in enhancing our operational efficiency:

Through refinement in our supply chain management and economy of scale, we reduced the food and packaging costs as a percentage of revenues from company-owned and operated stores by 6.1 percentage points year-over-year.

We continued to streamline our operations by optimizing unit economics. This led to a year-over-year reduction in labor costs and other operating expenses as a percentage of revenues from company-owned and operated stores by 3.0 percentage points and 1.1 percentage points, respectively.

Benefiting from our cost optimization measures and increased brand recognition, our marketing expenses as a percentage of total revenues decreased by 2.3 percentage points year-over-year. Additionally, we streamlined our headquarter costs resulting in a significant reduction in adjusted general and administrative expenses as a percentage of total revenues by 2.7 percentage points year-over-year. As a result, we achieved our highest ever quarterly company-owned and operated store contribution margin of 13.3% and consecutively quarterly adjusted corporate EBITDA profitability after the second quarter of 2024.

Turning to liquidity: as of September 30, 2024, the company's total cash and cash equivalents and term deposits were RMB203.7 million, US\$29.1 million, compared to RMB219.5 million as of December 31, 2023. The change was primarily attributable to the financing from our funding shareholders, partially offset by cash disbursements on the back of the expansion of our business and store network nationwide and the repayment of certain bank borrowings.

Moving forward, our strategic focus remains firmly on delivering profitable, capital-efficient growth. We are committed to bolstering our brand and broadening our appeal by offering great value for money with our fresh and healthy food selections. Additionally, we are collaborating closely with our sub-franchisees to boost customer traffic and optimize our supply chain efficiency, thereby enhancing overall store economics and our bottom-line profitability.

I will now turn it over to Yongchen for concluding remarks, followed by Q&A.

Yongchen Lu

Thank you, Albert. Before we turn to Q&A, I would like to highlight the two core messages to take away today.

First, Tims China is committed to continuing to distinguish itself by delivering great value and differentiating our products to our guests, avoiding direct participation in the ongoing price war.

Secondly, we are equally committed to pursuing capital-efficient growth, most particularly via deployment of our proven small-format stores and further growth of our sub-franchise network.

Together, these two initiatives help us continue to drive improving profitability.

I would like to take this opportunity to express our heartfelt gratitude to the diligent work of every Tims China employee, the love of our guests, the support and encouragement from our partners and the trust of our investors and stakeholders.

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

Gemma Bakx

Thank you, Albert, and thank you, Yongchen. Let's begin with the first question. Go ahead, Sarah.

Question-and-Answer Session

Operator

Thank you. [Operator Instructions] We will now take our first question. This is from the line of Steve Silver from Argus Research Corporation. Please go ahead.

Steve Silver

Thank you, Operator, and thanks for taking my questions. It's great to see that the costs are being contained as the revenue growth navigates the industry-wide challenges. I'm curious as to how much room do you see for continuing expense leverage moving forward?

Yongchen Lu

You mean the operating cost leverage, right, Steve?

Steve Silver

Yes. As a percentage of sales.

Yongchen Lu

Yes. As you know, our major cost items include the food and packaging, rent and labor, and then, the office G&A. So as we can see, F&P is variable, but we are still able to reduce F&P cost materially year-over-year. As Albert mentioned, we have reduced them by over 60

percentage points. And for labor, almost half are fixed. For rent, the majority is fixed. For office G&A, the majority are not fixed. So when we increase our revenue, these fixed costs will be allocated. That's why we'll continue to see margin improvement when we increase our revenues, Steve.

Steve Silver

That's helpful. Thank you. In the prepared remarks, you mentioned that there were 5,000 sub-franchise applications received to date. Is there a timeline for converting many of these to granted status and then on to operating status?

Yongchen Lu

Yes, there are some timelines, but most importantly, we are extremely careful in choosing the right partners and choosing the right locations. Both are critical factors in being successful in opening franchise stores. So although we receive more than 5,000 applications, we are very strict in our vetting process. We are using a third-party to conduct background checks. We interview the applicants very carefully, checking their experience and willingness to see whether they are a good fit. Also, we use the networking planning team and our real estate team to vet their locations, whether the locations are the right ones to open stores. The progress has been strong. As we mentioned, we opened 43 already and signed on an additional 94. We'll see much faster progress in the fourth quarter and into the next year.

Steve Silver

Great. One last question from me. You mentioned the 22.8 million loyalty members growing at a very healthy rate. Do you have any data that shows the impact of the loyalty program on repeat customers and perhaps any differences in transaction size among the loyalty members?

Yongchen Lu

Yes. We do. The loyalty members tend to have much more purchase frequency than non-members. That's why the loyalty program is powerful. And especially, as we just discussed, around the Chibaobao Cards. The members purchased the cards multiple times a ride for RMB6.6. I mean, in the third quarter alone, the purchase frequency was 4.6 times more than the average member. We will use various effective tools drive the frequency among our members, which we can do a lot of work on over the days or months to come.

Steve Silver

Great. Thank you so much for taking the questions.

Yongchen Lu

Thank you, Steve.

Operator

[Operator Instructions] Whilst we wait for any more telephone questions, I think, Gemma, do you have a question?

Gemma Bakx

There's a question that reached us, and it is please give an update on the status of the franchising, the number of units, what the outlook is, anything qualitative about the types of applications you have. You touched on it already, Yongchen. And the other question is, if you could please give an update about the pricing competition in coffee, how is the bundling combination, meal strategy, how is that going?

Yongchen Lu

The price competition is still ongoing, much longer than I expected. But for Tims, again, we really differentiate ourselves using Coffee Plus Fresh and Prepared Warm Food at affordable prices. The strategy really differentiates Tims from our peers, so we don't need to compete head-to-head.

And we price our products competitively. Now, for example, our coffee starts from RMB16 and our price competitiveness lies especially with our combos. As I mentioned earlier, our breakfast combos, one cup of coffee and one fresh prepared food item starts at RMB14.9, at around US\$2 and our lunch combos start from RMB21.9, at around US\$3.

And again, we use the Chibaobao Card so our guests can enjoy one cup of coffee plus one food item at a 40% discount. That is why we see much more purchase frequency for those guests who buy the card. We use the combos, the benefits for our members to price our products more competitively in the market. Back to you, Gemma.

Gemma Bakx

Thank you so much, Yongchen. Sarah, are there any other questions? If not, I have one.

Operator

Not yet. [Operator Instructions] Thank you.

Gemma Bakx

Another question that came in, Yongchen or Albert, is: how important are the renovated open kitchens for Tims franchises and why?

Yongchen Lu

They are very important. As I just mentioned, fresh prepared food is the big differentiating point for Tims compared with other coffee brands in China. An open kitchen will allow our guests to watch our staff craft fresh meals from start to finish. And freshly prepared food coupled with a cup of coffee or other drink at affordable prices will really differentiate Tims from our peers and help us expand into more day parts. For example, into the lunch day part and even dinner. That will help continue to drive sales growth over time. Back to you.

Gemma Bakx

Thank you. Sarah, are there any other questions in your queue? Otherwise, I have one more that came in.

Operator

None on the phone currently. [Operator Instructions]

Gemma Bakx

One question that reached us is whether you can speak to the capital required for the company-owned stores versus the capital-light ones to fund the sub-franchise. Could you address the payback too?

Albert Li

I will take this. Currently our CapEx for a typical store is around RMB450,000 to RMB500,000. That is around US\$70,000 and with a payback period of between two to three years. We believe these are very attractive unit economics, and we will continue to use this store model to attract a large number of franchisees and audiences. We think the payback period of two to three years is very attractive and it is a proven track record.

Gemma Bakx

Thank you. Sarah?

Operator

No questions on the phone lines.

Gemma Bakx

All right. Then I think we might be through.

Yongchen Lu

Great. Thank you. Thank you for your time.

Gemma Bakx

Thank you all for dialing in and we look forward to connecting in the coming days and weeks. Of course, if you have any further questions for us, please let us know. Thank you very, very much and see you soon.

Yongchen Lu

See you soon. Thank you. Bye.

Operator

Thank you. This concludes today's conference call. Thank you for participating and you may now disconnect.