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TH International Limited (THCH) Q2 2024 Earnings Call Transcript

Aug. 29, 2024 6:07 PM ET | TH International Limited (THCH) Stock

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TH International Limited (NASDAQ:[THCH](#)) Q2 2024 Earnings Call Transcript August 29, 2024 8:00 AM ET

Company Participants

Gemma Bakx - IR

Yongchen Lu - CEO and Director

Albert Li - CFO

Conference Call Participants

Steve Silver - Argus Research Corporation

Operator

Ladies and gentlemen, welcome to the Tims China's Second Quarter 2024 Earnings Conference Call. All participants will be in listen-only mode during management's prepared remarks and then will be 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 instructions. Please go ahead, Gemma.

Gemma Bakx

Thank you very much, Nadia. 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 Tims China. And we're announcing second quarter results earlier -- we announced it 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 site.

Now before we get started, I'd like to remind you that our earnings presentation and investor materials contain forward-looking statements, and they 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 these forward-looking statements. All forward-looking statements should be considered in conjunction with the cautionary statements in our earnings release with risk factors included in our filings with the 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 as 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 all 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. I'm Yongchen Lu, CEO and Director of Tims China. The second quarter of 2024 represents a significant milestone for our company as we achieved adjusted corporate EBITDA profitable for the first time in our corporate history. This result was driven by an intense focus on our core strength of delivering guests, great value for money products and our differentiated fresh food offering coupled with continuous improvements in operational efficiency. This important milestone comes as we deliver our highest-ever adjusted EBITDA margin of 10.3%.

Our focus on sustainable profitable growth has included greater emphasis on building our franchise network, collaborating closely with our sub-franchisees to deliver them compelling unit economics while providing our guests with our customer experience and driving our bottom line profit. Despite a 6.6% reduction in revenue from company-owned stores due to our strategic decision to prune underperforming stores since the fourth quarter of 2023, we have sustained to achieve 1.6% growth in system sales.

Our efforts are paying off, not just in our improving profitability, but in the strength of our sub-franchisees pipeline, which stands at over 3,600 applications as of the end of June. As of the June 30, 2024, our registered loyalty club members reached 21.4 million, reflecting remarkable 45.4% year-over-year growth. The average number of members per store has now surpassed 23,000 serving as a strong catalyst for our growth and clearly demonstrating our customers into the haptic support for Tims China loyalty programs. The ongoing support from our customers inspires our team to continue delivering the best value for quality products.

During the second quarter, we launched several impact for marketing campaigns, including collaborations with the Suzhou Museum and the [indiscernible] which collectively garnered a combined total exposure of over \$45 million across the region and the Little Red Book social platform. Continuous product innovation is central to our strategic vision. In Q2 2024, we introduced 25 new beverages and nine new food products. which contributed approximately 14% of our top line sales. Standard offerings such as the Floral Latte [Foreign Language], Buffalo milk latte [Foreign Language], and low fat Real Juice Fruits Americano series [Foreign Language] have resonated strongly with customers.

We are committed to delivering healthy food options for our guests. With our customers' preference for healthy products in mind, we have also advanced our distinct Coffee Plus strategy launching new bagel products like strawberry yogurt smile bagel [Foreign Language] and fig yogurt smile bagel [Foreign Language]. The total number of bagels sold increased from 4.8 million in Q2 last year to 6 million in Q2 2024, with the percentage of orders that include food rising to 51.9%.

To further enhance our strength and leadership in differentiated food product offerings and healthy food options, we completed make-to-order renovations for nearly 300 stores to date. With very limited capital expenditure investment, we have witnessed strong incremental revenue growth already. We are on track to roll out our renovations model to more stores by the end of the year to demonstrate to our customers that at Tims China, our food is freshly prepared on site.

Additionally, we secured up to \$50 million in financing in Q2 2024 from our founding shareholders, Cartesian Capital Group and RBI, which underscores the commitment of our founding shareholders to our dynamic business. This year is a pivotal one for us and fortifying our balance sheet is an important step forward towards ensuring our long-term success in a highly competitive market. This transaction enables us to drive growth in and intensify our focus on our core Tim Hortons brand.

Strengthening our core brand remains a key element of our strategy and in order to provide an even sharper focus on developing the Tims brand, we agreed with RBI to transfer the Popeyes China business back to them at the end of the second quarter. This transaction allowed us to streamline our operations and focus on our core business areas while providing us with \$15 million in capital, which will be instrumental in driving further business expansion and optimizing our balance sheet.

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

Albert Li

Thank you, Yongchen. In the second quarter of 2024, we achieved positive adjusted corporate EBITDA for the first time. We reached the significant improvement in our financial performance. by optimizing our store unit economics, cutting costs at headquarters and closing underperforming stores. We remain committed to delivering cost-effective, high-quality products to our growing customer base.

Our overall monthly average transacting customers reached to 3.1 million in the second quarter of 2024, a 12.1% increase from 2.8 million in the same quarter of 2023. Additionally, digital orders as a percentage of total orders rose from 80.6% in Q2 2023 to 86.5% in Q2 2024. We continue to enhance our digital capabilities to meet the growing demand for delivery and takeaway services. During the second quarter of 2024, we made more significant strides in enhancing our operational efficiency. Through refinements in our supply chain management and economies of scale, we reduced the food and packaging costs as a percentage of revenues from company-owned and operated stores by 3.1 percentage points year-over-year.

We continued to streamline our operations by pruning underperforming stores and optimizing unit economics. These actions led to a year-over-year reduction in rental expenses, labor costs and other store operating expenses as a percentage of revenue from company-owned and operated stores by 1.5 percentage points, 3.0 percentage points and 1.3 percentage points, respectively.

Benefiting from our cost optimization measures and increased brand recognition, our marketing expenses as a percentage of total revenues decreased by 2.6 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 revenue by 3.4 percentage points year-over-year.

Turning to liquidity. As of June 30, 2024, the company's total cash and cash equivalents, time deposits and amount due from related parties in relation to the financing from RBI were RMB253.2 million compared to RMB219.5 million as of December 31, 2023. The increase 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 bank borrowings.

Looking ahead, our focus remains on executing our strategy to drive profitable and capital-efficient growth. We will continue to strengthen our brand and expand our guest value -- great value for money, freshly prepared food offering. We will also work closely with our sub-franchisees to drive traffic and enhance our supply chain efficiencies, improving their store economics and in turn, driving our bottom line profitability.

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

Gemma Bakx

Thank you very much, Albert. Over to you, operator. Do we have questions for our Q&A?

Question-and-Answer Session

Operator

[Operator Instructions] There are no questions at this moment on audio lines.

Gemma Bakx

Okay. Thank you. I have a question here that came in, and it says, congratulations on achieving your first ever adjusted corporate EBITDA profitability. That's a significant milestone. Can you elaborate on how the company can maintain and achieve continuous profitability going forward?

Yongchen Lu

Okay. I'll take this one. So I mean, we successfully achieved adjusted corporate EBITDA profitability for the first time as I just mentioned amidst the macroeconomic challenges and intense competition in the Chinese coffee market. So this really inspires us to provide more exceptional value for money products for our guests going forward. So moving forward, we start first in prioritizing profitable growth as our core strategy. Firstly, we will be bolstering our revenue through our unique coffee plus freshly prepared food strategy complemented by our target precision marketing initiatives that resonated with our customer very well. Secondly, we have achieved significant benefits from improving operational efficiency reducing basically all cost elements year-over-year, as Albert just now mentioned in detail. This confirms to us that our relentless focus on optimizing unit economics is crucial for securing our long-term profitable growth and success. So given the significant brand recognition we have built in the market partnering with our franchisees make us well positioned to drive our profitable growth capital efficiently. Back to you, Gemma.

Gemma Bakx

Thank you.

Operator

Thank you so much. And now we're going to take the next question from Steve Silver from Argus Research Corporation. Just give us a moment, Steve, and your line is open now. Please ask your question.

Steve Silver

Okay. Thank you, operator. My questions are that in the past, Q4 has been the most active quarter for new store adds. And I'm just curious if there's any visibility emerging into the growth outlook for this year's Q4?

Yongchen Lu

Yeah. Thank you, Steve, for the question. Yes, no, we're expecting much more openings in Q3 and especially in Q4 as usual. So yeah, we are aware of that and we have done very well in the individual franchisees for the first half. We opened 20 already, and we have signed additional 52 at the end of June, and we are now getting the momentum on the individual franchisees. So we're expecting much more openings in the second half of this year.

Steve Silver

Okay. Thank you.

Operator

[Operator Instructions]

Gemma Bakx

Nadia, can I ask the next question that came in?

Operator

Yes, of course. Please do, Gemma.

Gemma Bakx

The next question that we received is, does your Q2 adjusted store EBITDA margin of 10.3% have room to grow further in the coming months, which are typically the busiest of the year, as Steve pointed out, I believe?

Yongchen Lu

Yeah. I mean we always keep our sharp eye as streaming line our operations of refining our supply chain and cutting costs wherever now appropriate. So I mean, we are happy with the margin we have achieved in Q2, and we'll always seek further improvements where we can find. And with -- back to you, Gemma.

Gemma Bakx

Nadia, are there any more questions? If not, then I will ask the next one that came in, which is, in the context of our competitors exhibiting signs of growth weakness recently, how does Tims analyze and interpret the competitive landscape in the Chinese coffee market as it stands today?

Yongchen Lu

Okay. I will take that one. So I mean, in the second quarter of 2024, the Chinese coffee market continues to face huge challenges with notable players like Luckin and Starbucks in China experiencing a decline in the same-store sales by 20% and 14%, respectively, as they released in the last quarter earnings and we believe our distinctive coffee plus freshly prepared food strategy sets us apart and does well amongst the intense competition as we have done. Even as China navigates the churn of reducing consumption and trading down, there continues to be a strong and enduring pursuit of convenient and healthy food options among consumers. So our great value for money coffee plus bagel combination is well positioned to cater to this change. And to accelerate this strategy, we have completed make-to-order renovations in near 300 stores to date, which has showed great growth in sales, and we are on track to further roll out these renovations model to most of our stores by the end of the year. And with a very limited capital expenditure investment, we anticipate the strategic enhancements will significantly drive incremental growth in our revenues. Back to you.

Gemma Bakx

Thank you very much. Nadia, is it okay if I ask the next one?

Operator

Yes, please follow.

Gemma Bakx

All right. Regarding the ongoing price war, as it's described, where do things stand with regards to that price war as it's ongoing? Are there any signs in your view? Is there anything that you're seeing that the battle is cooling off or losing steam?

Yongchen Lu

We have possibly being as devoted as the next person about how long some of our competitors have been going at it. I believe some can last longer, some cannot go on forever. That said, we cannot expect it to last this longer.

Gemma Bakx

And as a follow-up that I'm receiving here, where does Tims China position itself in the ongoing price war? Where does it see itself? Where do you see yourself?

Yongchen Lu

I mean, while obviously, it has an effect on us, right? But we do not really proactively participate in the pricing war. I mean, we are not in the premium category. Our brand is value for money. So rather than lowering our coffee price that we have been promoting our combos coffee plus bagel, coffee plus freshly prepared food at a very attractive price. So we'll continue doing that strategy and differentiate us from other coffee players. And also, we are launching value lines, both in coffee and food to adapt to the market by now.

Operator

Thank you, Gemma. And now we are going to take the question from audio lines. Just give us a moment. And the question comes from the line of Steve Silver from Argus Research Corporation. Your line is open. Please ask your question.

Steve Silver

Thanks for taking this follow-up. With the recent capital infusions and the achievement of corporate EBITDA positivity in this quarter, just curious what the company sees as its primary need for capital moving forward given that the sub-franchise model is capital-light by nature.

Albert Li

Okay. I will take this one. Thank you, Steve. Okay. So as Yongchen has mentioned, to further like strengthen our leadership in the corporate plus strategy, so we will be making additional investments in terms of to like implement the made-to-order renovations. So the MTO renovation will enable our customers actually to see the fresh food ingredients and also our freshly food preparation process to be more visualized to them. So we believe this will offer expanded like revenue opportunities for us. And with this MTO renovation, we can also ensure that all of -- like most of our stores can offer actually standard menu among our store formats. And we also believe that like the return on such MTO stores will be very good. And secondly, we also plan to enlarge our spending like more actually marketing initiatives or efforts to actually to address like new markets from multiple channels. So we will definitely invest certainly in marketing. And we will also invest like in R&D to offer more attractive and also good value for managing products like more value line products to our customers. And lastly, I want to mention like in terms of how we want to use the capital more efficiently is that we do also have plans to open like certain like new company owned and operated stores. Like on the -- I want to mention that actually, on the back of the reusage of certain coffee machines, future equipment and furniture from those like store closures, we think actually the additional incremental CapEx will be quite limited. So to address your question, I think that would be the plan for us, like how we want to deploy the recent capital injections from our shareholders. Thank you, Steve.

Steve Silver

Thank you for the detailed color. Appreciate it.

Operator

Thank you. Speakers, there are no further questions from audio lines.

Gemma Bakx

All right. I have one more here, if I may. And the question is, do you expect the store count to go up this year? Or will you continue to focus also on pruning more underperforming store and also on store renovations? The second part of the question is, do you foresee now that you've demonstrated success in expanding your capital efficient sub-franchise model, do you foresee any further changes in store concepts for Tims?

Yongchen Lu

Yes, we do expect the store count to go up in the second half. No, I mean, especially in Q4, as I just mentioned to these questions. As our individual franchisees are ramping up quickly. I mean for the first half of this year, we focused more on pruning underperforming stores. And right now, we have achieved the positive corporate EBITDA. And also, we have opened very successfully in individual franchising. So we are ramping up to open more in the second half. Back to you, Gemma.

Operator

Dear participants, thank you for all your questions for today. There were no further questions. And I would like now to hand over the conference to Gemma for any closing remarks.

Gemma Bakx

Thank you all very much. I have no further questions here either. Thank you very much for sharing our good news with us today, and we look forward to speaking with you very, very soon. Thank you very much.

Yongchen Lu

Thank you, everyone.

Operator

This concludes today's conference call. Thank you for participating. You may now all disconnect. Have a nice day.

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