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

Company Participants

Gemma Bakx - Head, Investor Relations

Yongchen Lu - Chief Executive Officer and Director

Albert Li - Chief Financial Officer

Conference Call Participants

Steve Silver - Argus Research Corporation

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. I'm 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'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.

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 and open kitchens. 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 plum-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 IT team launched bagel products with fewer than 400 calories, limiting all green bagels and smile bagels to fewer than 300 calories, and promising five zeros in all our beverage product offerings. That is zero non-dairy creamer, zero coffee whitener, zero hydrogenated vegetable oil, zero trans fats and zero instant tea powder.

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 only from RMB14.9. That's about \$2. Our lunch combos start at RMB21.9. That's about, no, only \$3. In addition, we have launched Chibaobao Cards, which our guests pay RMB6.6 to get 4 times, right, to buy drink -- one drink and one, no, one fruit item each time 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 purchase a card demonstrate 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, Shijiazhuang, Yancheng, Dongying, Heze, and Huangshi, leveraged 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 enthusiastic welcome and support. 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 nine new food items. We have been integrating more healthy ingredients into newly launched products. Alongside our principle of freshly handmade, 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 Bagels and Five Black Multi-Grain Bagels during the annual Tims Bagel Festival in September. These products merge Tims' Signature Green Bagel concept with the principles of traditional Chinese herbs.

In recognition of our guests' focus on 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 Reddit alone contribute 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-franchising 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 continue to streamline our operations by optimizing unit economics. This led to a year-over-year reduction in labor costs and others to 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 health 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 bottomline profitability.

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

Yongchen Lu

Thank you, Albert. Now, 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 pursue capital-efficient growth, most particularly via deployment of our proven small format stores and further growth of our sub-franchisee 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] Thank you. 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

Yeah. I mean, the -- you mean the operating cost leverage, right, Steve?

Steve Silver

Yes. As a percentage of sales. Yes.

Yongchen Lu

Yes. I mean, definitely. I mean, as you know, our major cost items include the front paper and rent and labor, and then, okay, the office G&A. So, I mean, 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 over 60 percentage points. And for labor, almost half are fixed. And for rent, the majority is fixed. And 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 the margin improvement when we increase our revenues, Steve.

Steve Silver

That's helpful. Thank you. So 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, I guess, granted status and then on to operating status?

Yongchen Lu

Yeah. I mean, there are some timelines, but most importantly, we are extremely careful in choosing the right partners and choosing the right locations. Because the right partners and right locations are critical factors to be successful in opening franchise stores. So, I mean, although we receive more than 5,000 applications, we are very strict in vetting process. We are using third-party to conduct background checks. We interview the applicants very carefully, checking their experience and willingness to see whether they fit us. And also, we use the networking planning team and our real estate team to vet their locations, whether the locations are right to open stores. So, I mean, the progress is strong so far. As we mentioned, we opened 43 already and signed an additional 94. So, we'll see much faster progress in the fourth quarter and the next year.

Steve Silver

Great. And one last one for 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. I mean, the loyalty members tend to have much more purchase frequency than non-members. That's why the member program is powerful. And especially, as we just discussed about the BaoBao -- Chibaobao Card. I mean, the members purchase the Chibaobao Card multiple times a ride for RMB6.6. I mean, in the third quarter alone, the purchase frequency is 4.6 times more than the average members. So I mean, we'll use various effective tools to drive the frequency among our members, which we can do a lot of work 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 to ask, 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's the bundling combination, meal strategy, how's that going?

Yongchen Lu

Yeah. I mean, the price competition is still ongoing, much longer than I expected. But I mean, for Tims, again, we really differentiate ourselves using Coffee Plus Fresh and Prepared Warm Food at affordable price. 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 competitive lies especially with our combos. Now, as I mentioned earlier, our breakfast combos, one cup of coffee and one fresh prepared food start from RMB14.9, about \$2 and our lunch combos start from RMB21.9, about \$3.

And again, we use Chibaobao Card the multiple rice cup, so our guests can enjoy one cup of coffee plus one food at 40% discount. So that's why we see much more purchase frequency for those people who buy the card. So I mean, we use the combos, we use, okay, the benefits of 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

Yeah. I mean, it's 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 drink at affordable price will really differentiate Tims from our peers and help Tims expand into more day parts, for example, into lunch day part and even dinner day part. 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 lightweight to fund the sub-franchise and include the payback?

Albert Li

Yeah. Okay. Sure. So, I will take these questions, right? So, yeah, currently our CapEx for a typical store is around RMB, like, RMB450,000 to RMB500,000. So, it's basically around US\$70,000 and with a payback period of actually between two years to three years. So, actually, we believe it is a very attractive unit economics, and actually, we will continue to use this, actually, store model to attract, like, a large number of franchisees and audiences. Yeah, so, actually, we think the payback period of two years 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 all. 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 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.

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