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Nayuki 2024 Interim Results Conference Transcript

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Lu Cheng: Hello and welcome to the 2024 interim results presentation of Nayuki Holdings Limited, I am Lu Cheng, Head of Investor Relations of the Company. Present at today's presentation are Mr. Zhao Lin, Chairman and Chief Executive Officer, Ms. Peng Xin, Executive Director and General Manager, and Mr. Shen Hao, CFO of the Company. The agenda of today's presentation is as follows. Mr. Shen will first give you a brief overview of the Company's results, and then we will open the floor for questions. Please welcome Mr. Shen.

(The following is the introductory section of the presentation deck. Please go to page 4 for the Q&A section)

Shen Hao: Good morning, everyone—old friends and new. Welcome to Nayuki Holdings Limited's 2024 interim results presentation. Investors can view our presentation slides on our Investor Relations website at ir.naixue.com.

Before we begin, please take a moment to review our disclaimer.

Today, my presentation is divided into three main parts.

Firstly, I will provide a brief overview of our overall business performance in the first half of the year.

This year, demand-side pressures have remained significant. Compared to previous years, we have controlled the addition of new company-owned stores, closed some underperforming locations, and steadily advanced our franchise operations. In the first half, we added only 23 net new company-owned stores; we expect to close several more stores in the third quarter. There will not be a noticeable net increase in store count for the full year.

We observed that both revenue and profit performance at our stores declined year-over-year. Due to the presence of operating leverage, the decline in revenue had a significant impact on our margins. For example, among the six major cities, Shenzhen and Xi'an achieved daily average sales per store above 10,000 RMB, with operating profit margins of 16% and 19%, respectively—relatively high but still falling short of the 20% mark. Looking at different city tiers, first-tier cities saw a daily average sales per store of 8,600 RMB and an operating profit margin of around 10% in the first half, which was still higher than other tiers but showed a considerable decline compared to last year.

Thanks to our new product launches in the first half of the year and the expansion through our franchise operations, we reached more consumers, leading to growth in both our membership base and member activity. By the end of June, our registered members reached 92.3 million, with monthly active users hitting 5 million in the first half, an increase of 700,000 year-over-year. Our repurchase rate also rose to 23.8%, up by 0.8 percentage points.

Next, I will give you a brief overview of our financial performance in the first half of the year, and you can refer to the detailed figures in the earnings report that has already been disclosed.

As I mentioned earlier, insufficient demand and pressure on revenues are the primary challenges we face at this stage. Over the past few years, we have made significant efforts to reduce store costs and improve flexibility; however, the continuous decline in revenue inevitably impacts profitability through operating leverage. In the first half of the year, group revenue stood at 2.54 billion RMB, essentially flat compared to 2.59 billion RMB last year. Within this, company-owned store revenue declined by 250 million RMB, but the growth in our franchise and RTD (Ready-to-Drink) businesses offset part of this decline. The store operating profit margin dropped significantly from 20.1% last year to 7.8% in the first half of this year, a decrease of 12.3 percentage points.

Affected by these factors, the group recorded an adjusted net loss of 440 million RMB in the first half of the year, of which approximately 160 million RMB was related to store closures, including losses incurred from past closures and impairment provisions for stores expected to close this year. Group operating cash flow decreased by 73% compared to the same period last year. The operating cash flow for the first half of the year was 103 million RMB net.

From a business line perspective, as the franchise business grows, the proportion of tea drinks and baked goods has relatively decreased. In the first half of this year, tea drinks accounted for 68%, baked goods for 11%, RTD products for 7%, and the remainder included coffee, retail tea sales, and franchise business income.

In terms of revenue channels, the share of delivery orders remained stable at around 40% in the first half, with the corresponding delivery fees rate for stores staying steady at around 8%. Of course, we will delve into the store model in more detail later.

Regarding cost structure, we can see again that the decline in revenue through operating leverage has had a clear impact on profitability, particularly with a significant rise in the ratio of store labor costs. At the same time, most of the one-time impairment losses related to store closures were recorded under other expenses. The raw material cost ratio includes the franchise business, which is why it has increased, while the raw material cost ratio for our company-owned stores remains at the same level as previous years.

In addition, we have increased our marketing efforts, leading to a rise in the marketing cost ratio. In the first half of this year, advertising and promotional expenses amounted to 110 million RMB, accounting for 4.4% of total revenue.

Now, I would like to provide an update on the company's outlook for the coming period.

As previously mentioned, weak demand and declining revenue are the most pressing issues we face currently. Cost optimization at our stores has largely been achieved in the short term, and given the current level of revenue, there is limited scope for significant improvement in store profitability. In the first half of the year, labor costs accounted for 24.6% of revenue, rent for 17.1%, delivery fees for 8.1%, and raw materials, utilities, and other depreciation and amortization expenses totaled 42.4%. This left us with a store operating profit margin of 7.8%, which is a considerable distance from our usual target of 20%.

Therefore, we need to continue addressing the issue from the demand side:

1. We must remain steadfast in our strategic positioning, staying true to our mission of serving customers with high-quality products and maintaining our premium brand image.
2. We will continue to pursue high-quality development, closing underperforming stores and avoiding blind expansion into lower-tier markets.
3. We will appropriately increase our marketing efforts to enhance our brand presence.
4. We will also continue to develop our franchise and overseas operations. Recently, our flagship store at CentralWorld in Thailand opened, achieving a single-day sales record of nearly 350,000 Thai baht, equivalent to about 70,000 RMB, setting a new high for our overseas stores and boosting our confidence

in international expansion.

Additionally, the group will use its cash reserves prudently, waiting for opportunities for industry recovery and consolidation.

As we have repeatedly mentioned, over the past few years, the company has made significant progress in reducing costs at our stores. If store revenue can recover, the operating leverage will amplify the improvement in profitability.

The following table outlines our simulation analysis, demonstrating the significant effectiveness of our cost reduction measures over recent years. If market demand rebounds and overall conditions improve, we believe it will have a positive impact on the group. Using the average monthly customer spending and transaction volume from all stores during the first half of this year and the same period last year, along with the disclosed store model, we can see that if monthly store revenue returns or approaches the level of approximately 3.5 million RMB seen last year, we could achieve our target store operating profit margin of 20%. Furthermore, with the absolute increase in revenue, there will be a significant increase in profit potential. Assuming 1,600 stores, the store operating profit margin is expected to increase by at least 86 million RMB annually. Considering the optimization work done over the past year, we anticipate lower increases in labor and rent costs, which should result in a monthly increase in store operating profit of over 100 million RMB. As you can see, we remain optimistic about the future and are working systematically to address the primary issue of revenue. We look forward to a recovery that will bring better profitability to our stores.

That concludes my presentation. Thank you.

Lu Cheng: Thank you, Mr. Shen. Now, we will move on to the Q&A session. Please state your institution and name when asking questions, and limit yourself to no more than two questions per investor.

Question: Good morning, leadership team. I'm an analyst from Kaiyuan Securities, and I have two main questions for management.

First question, regarding the domestic market, overall, in the first half of the year, apart from the food service sector, other consumer sectors have also performed rather moderately. The food service sector hasn't shown particularly strong performance either, and the company has issued timely profit warnings, suggesting that the market had some expectations, but the actual loss might still be quite significant. At this point, I would like to ask how the company views the future development of the industry and what strategies we plan to implement to turn things around?

Peng Xin: Thank you very much for your question. From a broader perspective, the food service industry is not necessarily a shrinking market; it is currently in a mature market environment. For our own brand, it's important to clarify our positioning and provide products and experiences that meet the needs of our consumers. We've recently launched new test store formats and new products, which have validated our approach. The latest store format has returned to the "one tea, one pastry" product combination that Nayuki is known for. The recently introduced kale kiwi product has also resonated with the impression of Nayuki's products in the past, where the fruit content is abundant and health elements are incorporated. This product is currently selling very well, and this is something we will continue to do.

Question: Another question, regarding our overseas strategy. We've seen great success with the opening of our flagship store in Thailand. Could you share a bit about our overseas strategy and future plans?

Peng Xin: Our overseas expansion is still in its early stages. What we've found so far is that the overseas market is one where the offline market is relatively thriving, while the online market is just beginning to develop. Our overseas development strategy continues to emphasize the Nayuki brand and the experience we've provided in our stores. Both of our initial stores in Thailand are located in their top shopping malls. Our second store, which opened last week, is located in the atrium on the first floor of CentralWorld, Thailand's premier mall, where we have been allocated 200 square meters. We're using a combination of tea drinks and baked goods, offering a high-quality impression and a space with a strong sense of sophistication to build our brand. This store has been well received by local consumers, so we will continue to focus on building a strong brand and quality impression, and strategically position ourselves in top-tier shopping centers. We aim to develop our overseas presence in a relatively steady manner, focusing on brand building first, followed by steady growth.

Question: Good morning, management team. I'm an analyst from CITIC Securities. We know that the tea beverage industry is still highly competitive, and we can observe that the growth rates of the industry, as well as the pace of new store openings for other leading companies, have slowed down. From a competitive perspective, how do you assess the intensity of competition and the duration of such intensity? Additionally, regarding our single-store performance, if we break it down into volume and price, do you anticipate any further price erosion in the future? How does the company forecast this?

Peng Xin: The tea beverage industry is one of the most franchised sectors within the food service industry. We can see that there are many brands with over a thousand stores, including some that may not be widely recognized yet. For us, at this stage of the industry, it's crucial for each brand to clearly define its identity and focus on high-quality development. The key lies in this clarity and commitment to quality.

Question: For the second question regarding volume and pricing, could you provide some insights or projections?

Peng Xin: Currently, consumers expect high-quality products from brands. Drinking tea beverages is a source of joy for customers, and even in the current economic environment, they still seek affordable prices. However, for a brand like Nayuki, it's essential to maintain a balance between providing affordable prices and ensuring high-quality tea and baked goods. While we strive to offer value to our customers, we won't compromise on quality or engage in a race to the bottom in terms of pricing. That's not the direction Nayuki intends to take.

Question: I'm an analyst from CICC, and I have two questions: Firstly, regarding the new store format that focuses on "one tea, one pastry," we previously introduced the Pro store format to improve store operational efficiency. Now, we're returning to a more traditional format. How do we plan to improve store efficiency in this context?

Secondly, financially, we incurred over 160 million RMB in impairment losses related to store closures in the first half of the year. How do you foresee the impairment situation for the second half of the year?

Peng Xin: When it comes to tea beverages, we always put the consumer first. We discovered that consumers really enjoy Nayuki's baked goods. Previously, when we introduced the Pro store format, we aimed to address the complexity of our first-generation stores, where baking involved starting from scratch with flour, requiring a kitchen similar to a restaurant with high complexity and demanding ventilation and engineering requirements. This complexity hindered the brand's growth and made training difficult, leading to a higher likelihood of mistakes in-store. With the Pro store format, we leveraged our improved research and development and supply chain capabilities. The third-generation store format combines the provision of high-quality freshly baked goods with a simplified kitchen, eliminating the need for flour mixing and improving efficiency without compromising on the quality of the baked goods.

Shen Hao: Regarding the second question, the 160 million RMB in store closure-related impairment losses in the first half of the year, a small portion was due to actual losses from closed stores. During the first half, we conducted a comprehensive review of our stores. Last year, when the market was recovering in January and February, we adjusted our store expansion plans based on the positive market conditions, increasing our target number of new stores from 300 to 600. However, due to the current market environment, the stores we opened did not perform as expected. Therefore, we conducted a thorough review in the first half of this year, primarily looking at the net cash outflow over the past 12 months for each store and set a standard to guide store closures. The majority of the 160 million RMB is an impairment provision for potential store closures in the second half of the year. Since we have reviewed all stores, for the second half of the year, we do not expect to incur significant additional store closure-related expenses, as most of the impairment provisions have already been taken in the first half of the year.

Question: Thank you for the opportunity to ask a question. Good morning, management team. I'm an analyst from Guotai Junan Securities. I have a question regarding the franchise aspect. Given the current pressures in the industry, what is the payback period for franchisees right now? And what is the level of interest and readiness among potential franchisees? What are your expectations for franchise growth and how do you plan to attract more franchisees to join Nayuki?

Zhao Lin: Actually, since the second half of last year, after the pandemic restrictions were lifted, there was a significant increase in consumption. All brands, including ours, raised their expectations for opening new stores. We also increased the number of company-owned stores we planned to open and started preparing for franchising, with ambitious expansion plans. However, after operating for a while, we realized that Nayuki's positioning is focused on high-quality, premium products, and we understood that we couldn't blindly expand through franchising. Opening a successful store and growing steadily is our goal. This year, we have adopted a rational approach to franchising. We have adjusted our criteria for selecting franchisees, focusing on their maturity and management capabilities. When we open a franchise store, we want it to be exactly like our existing ones, delivering a high-quality experience to customers. We don't simply approve every franchisee who wants to join. We try to avoid risks, and whether it's a franchise store or a company-owned store, we are proceeding with caution.

Indeed, the rapid expansion of all brands in the second half of last year placed significant pressure on the market. I think this pressure will persist for a while until the market returns to a more rational state. We will then prepare for faster growth. Regardless of whether we have franchisees or not, we will continue to develop franchise and company-owned stores in a very rational, cautious, and gradual manner.

Question: For the second question, regarding headquarters expenses, is there any room for further optimization?

Zhao Lin: There is room for optimization, but we haven't pursued it yet because we are focused on steady development. If we find that certain departments are more mature, we might consider making some adjustments. But currently, we have not implemented any optimizations.

Question: Good morning, management team. I'm a researcher from Huaxin Securities, and I have two questions. Firstly, regarding the RTD business, we've seen the introduction of many new flavors and products. Could you share the long-term plan for the next two to three years?

Secondly, for the franchise stores, what is the long-term plan and expectation in terms of quantity and quality, as well as the contribution of individual stores?

Peng Xin: Regarding our RTD business, although we have launched numerous products, we mainly focus on low-sugar fruit teas and sugar-free pure teas. Our new product launches are based on the popular flavors from our in-store tea beverages. We also collaborate with large retail brands, such as our partnership with Sam's Club and Walmart this year, which has been successful in their stores. For our ready-to-drink teas, we will continue to focus on creating blockbuster products that resonate with consumers.

Zhao Lin: For the second question, I'll answer. Regarding franchise stores, I've already touched on this topic. Our approach to opening new stores, whether franchise or company-owned, will be rational, and we won't pursue overzealous expansion. Even when there's a clear increase in the industry, we will remain rational in our approach to franchise stores and won't prioritize the number of franchises. Instead, we will focus on stability.

Question: Good morning, management team. I'm from Guosheng Securities, and I have two questions. Firstly, regarding overseas expansion, Ms. Peng mentioned that our first two stores have secured good locations and have performed well. Have we observed how our competitors fare in similar regions, and do they receive similar conditions? Is this a result of the high demand for Chinese food service companies to expand overseas this year, or is it due to our brand influence compared to other companies?

Secondly, regarding franchising, Mr. Shen and others have discussed this topic. My understanding is that there will be some store closures for company-owned stores in the second half of the year, and the expansion plan has slowed down compared to last year. At the same time, we had mentioned plans for franchising last year. I would like to confirm with management if these plans will be slowed down as well. Also, I would like to confirm a detail that I'm not sure if we've discussed with the market before: what is the general profile of our franchisees, i.e., what kind of people choose to franchise our business? These are my main questions.

Peng Xin: Indeed, we can see a very positive trend this year, with the global expansion of tea beverage brands being quite lively, and the market response has generally been favorable. From our perspective, each brand chooses its own direction when expanding overseas. For us, we hope to first establish a strong brand impression abroad. When we initially explored overseas markets and spoke with property owners, we found that the general perception of the tea beverage industry was that of small street-side shops. Many property owners we spoke with, especially in places like CentralWorld in Thailand, had a lot of tea beverage brands, but they were mostly located on the sixth floor in the food court area, typically in small 20-square-meter shops. We learned that even though these shops were small and not in prime locations, the rent percentages were very high. In the eyes of property owners, these shops did not represent fashion or quality and did not attract significant foot traffic or generate buzz.

Why didn't we immediately go for franchising? Instead, we chose to lead the charge and open stores that create a good impression. We wanted to change the perception of commercial directors and consumers abroad that the tea beverage industry has entered a new era, not the small-shop, student-focused market of ten years ago in China. After some effort, we opened our two stores in Thailand.

Even though we opened on the ground floor, surrounded by major retail brands, our rent is actually lower than that of the tea beverage shops on the sixth floor. We believe this represents a significant step forward for tea beverage brands expanding overseas. Once a strong brand impression is established, with high-quality, fashionable, and buzzworthy products, it can secure better rents and prime locations.

Zhao Lin: Regarding franchising, our numbers will definitely not be as high as originally anticipated. Initially, we expected a strong market response and planned to expand our market share through franchising. However, we realized that our brand positioning is different from other brands, and we prioritize high-quality products and impressions. This is more important to us. In the process of selecting franchisees, it's crucial to ensure they are mature and share our brand values. During periods of rapid industry growth, each franchisee hopes for a quick return on investment, which is understandable. However, we've found that many potential franchisees lack the necessary management experience and skills. We believe it's more important to carefully select franchisees who are mature and share our brand values. If we don't find suitable candidates, we prefer to wait. We don't pursue numbers; even if we can't open a single franchise store, it's not a problem for us. We believe it's more important to open one successful store at a time.

Lu Cheng: Thank you to the previous investor. Before the conference, we received many questions from investors, and most of them have been answered here. There is one question that the management hasn't explicitly addressed yet. We hope the company can introduce its strategies for different regions in China. Are there any particular focuses, and are there any differences in the strategies for different regions?

Zhao Lin: Our strategies will certainly undergo some changes. We will not blindly pursue expansion into lower-tier cities, as our brand positioning dictates our approach. Unlike before, we will focus more on market share and brand presence in higher-tier cities, such as first- and second-tier cities. That is our main objective.

Lu Cheng: Thank you to the management, and thank you to all the investors for your attention. As usual, after the conference, we will promptly upload the transcript to our IR website at ir.naixue.com for your reference. If you have any further questions, please feel free to contact us via the IR email provided on our website. That concludes today's conference. Thank you, everyone.

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