THOMSON REUTERS

EDITED TRANSCRIPT

Q2 2019 Luckin Coffee Inc Earnings Call

EVENT DATE/TIME: AUGUST 14, 2019 / 12:00PM GMT

CORPORATE PARTICIPANTS

Bill Zima *ICR, Inc. - Partner*
Charles Lu *Luckin Coffee Inc. - Co-Founder & Chairman*
Jenny Qian *Luckin Coffee Inc. - Co-Founder & CEO*
Reinout Schakel *Luckin Coffee Inc. - CFO & CSO*

CONFERENCE CALL PARTICIPANTS

Tony Wang *Credit Suisse - Analyst*
Lillian Lou *Morgan Stanley - Analyst*
Eric Gonzalez *KeyBanc Capital Markets - Analyst*
Ruochen Li *CICC - Analyst*
Billy Leung *Haitong International - Analyst*
Vincent Yu *Needham & Company - Analyst*
Interpreter

PRESENTATION

Operator

Ladies and gentlemen, welcome to Luckin Coffee Second Quarter 2019 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 Mr. Bill Zima at ICR for opening remarks and introduction. Please go ahead, sir.

Bill Zima ***ICR, Inc. - Partner***

Hello, everyone, and thank you for joining us on today's call. Luckin Coffee announced their second quarter 2019 financial results earlier today. The press release is now available on the Company's I.R. Web site at investor.luckincoffee.com.

Today, you will hear from Charles Lu, Co-Founder and Chairman of Luckin Coffee; Jenny Qian, Co-Founder and CEO; and Reinout Schakel, CFO & CSO.

We will be referring to a slide presentation on today's call, which can be found at the link in the press release we issued this morning and on the Company's I.R. Website, investor.luckincoffee.com.

During this call, the Company will be making some forward-looking statements regarding future events and results. These statements are made under the safe harbor provisions of the U.S. Private Securities Litigation Reform Act of 1995.

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. Further information regarding these and other risks is included in the Company's filings with the SEC.

With respect to any non-GAAP measures discussed during today's call, the Company reconciliation information relating to those measures can be found in the earnings release issued earlier today.

With that said, I would now like to turn the call over to Charles Lu, Chairman of Luckin Coffee. Charles, please go ahead.

Charles Lu ***Luckin Coffee Inc. - Co-Founder & Chairman***

Okay, thank you, Bill. And I welcome everyone to our second quarter 2019 earnings conference call. First, I would like to congratulate the team on a strong performance during the second quarter. I'm very pleased with the progress we have made across all of our key metrics. I will also like to thank all our investors and partners for their support.

China's coffee market is highly underpenetrated. With our distinguished value propositions of high quality, high affordability and high convenience, we believe we have addressed the pain point for the Chinese coffee market, which we believe we have -- we have significantly increased mass market consumption for coffee. We are very excited about the growth opportunities ahead of us and are very focused on a step-by-step execution.

And now, I will turn the call over to Jenny to discuss our second quarter in detail. And Jenny, go ahead.

Jenny Qian ***Luckin Coffee Inc. - Co-Founder & CEO***

Okay, thank you, Charles. (Spoken in Mandarin). Okay, translate it for me. (interpreted) Thank you, all, for attending Luckin Coffee's first earnings call after our successful IPO. It is a great pleasure to have the opportunity to interact with you and discuss our performance during the second quarter.

I'd like first to take this opportunity to thank all of our investors, partners and our customers for their tremendous trust and support. Thanks to you, we have been able to rapidly expand our operations and are on-track to be the largest coffee network by number of stores by the end of this year.

Please beginning with Slide 4, we are very pleased with our results during the second quarter. Net revenues from product grew around 700% compared to last year. And we experienced more normalized growth compared to our seasonally slower first quarter, which was impacted by the Chinese New Year holiday.

Revenue growth was driven by a significant increase in transacting customers, an increase in the average number of items purchased by our transacting customers as well as higher effective selling prices.

We believe this is the result of our distinguished value proposition by delivering our customers high quality, high convenience and high affordability. At the same time, we substantially reduced our store operating loss as the percentage of net revenues as a result of, first, benefits of scale and increased bargaining power; second, operating efficiency from technology; and third, higher store throughput.

Our CFO, Reinout, will speak to this in our financial performance in more detail later. But now, I'm pleased to say, we remain on-track to reach store level breakeven at some point during the third quarter.

As can be seen on Slide 5, we nearly doubled our net new store openings, which is 593 new stores in the second quarter on a sequential basis. We entered into 12 new cities in five new provinces.

And also, you can see the breakdown of our store part. We continue to place strategic focus on the development of pick-up stores, which not only provides high convenience for our customers but also provides us with significant costs advantages.

Finally, we remain on-track to become the largest coffee network in China in terms of number of stores by the end of 2019.

Please turn to Slide 6. Brand -- as mentioned earlier, we completed our IPO on NASDAQ in May this year. Our brand benefitted from additional awareness and global recognition.

On the back of our IPO, we launched a nationwide campaign, The Declaration of Luckin Coffee to advocate a coffee culture in China, educate consumers on coffee consumption and strengthen our brand identity.

Our brand identity, a combination of our three-pronged value proposition and attributes like to be confident, to innovate and to change is strengthened. Consequently, we acquired around 6 million new transacting customers during the quarter.

We strategically launched a new production line, Luckin Tea. A series of tea-based products as can be seen on Slide 7. Tea-based products have a high acceptance rate amongst our customers and addresses a large market in China.

According to Frost & Sullivan report, the tea market reached RMB68 billion in 2018 and continues to show strong signs of growth. While there are numerous tea brands in China, most tea-based drink shops are run by small operators, which makes it difficult to consistently maintain product quality and efficiently manage the supply chain. With our nationwide store network, established supply chain and a well-recognized brand, we believe Luckin can provide high quality, high convenience and high affordability.

We believe Luckin Tea is a strategic product for us. As it fits well with our target consumer and typically drives a different consumption moment at a different time during the day. This will drive overall retention rate and increase revenue per store. It also reinforces our mission to become part of our customers' daily life starting with coffee.

Now, please turn to Slide 8. On May 29th, 2019, we hosted a Luckin Coffee 2019 Global Partner Conference in Xiamen, which was attended by more than 1,000 representatives from top-tier suppliers to further deepen our existing relationships.

Luckin always hold the principle of "quality first" and we developed a strategic framework called the "The Partners of the Blue", consisting of top-tier suppliers. Currently, we have more than 300 Blue Partners.

It is our objective to exercise more control over critical components of our supply chain by working closely together with our most trusted suppliers to ensure high quality and low cost. A good example is the joint venture agreement we recently signed with Louis Dreyfus to jointly build a roasting facility in Xiamen, China.

Now, please move into Slide 9. As I am sure you are aware, we announced the signing of a Memorandum of Understanding with Americana on the 22nd of July for potential cooperation in the Greater Middle East and India regions.

We are currently in discussion with Americana. I will therefore not have any further updates to provide at this stage. In more general terms, we are excited about the prospect of expanding our disruptive technology-enabled model outside China, and our strategy is to combine Luckin's technology, branding and supply chain with the local knowledge and resources of local players.

All in all, we are very happy with our results in the second quarter. Our rapid growth and technology-enabled business model has created barriers to entry, providing us with a sustainable competitive advantage. I look forward to updating you on our progress in the near future.

Now, I will turn the call over to Reinout Schakel, our CFO and CSO to discuss our second quarter financial performance in more detail. Reinout, please?

Reinout Schakel ***Luckin Coffee Inc. - CFO & CSO***

Great, thank you. Thank you, Jenny, thank you, Charles. Good evening and good morning for everyone on the call. Thanks a lot for dialing in and listening to our Q2 results. I will discuss our financial results for Q2 in some more detail.

If we move to Slide 11, you can see that our operating growth in the second quarter regained momentum from a seasonally slower first quarter that was impacted by Chinese New Year holiday season.

I'd highlight our average monthly items sold metric in particular, which saw a return to a more normalized growth trend. During the second quarter of 2019, we sold nearly as many items as in full year 2018, which illustrates our rapid expansion.

Our net revenue breakdown can be found on Slide 12. Net revenue from products grew just under 700% year-over-year and 95% sequentially, driven by more transacting customers, an increase in the number of items purchased per transacting customers, and higher effective selling prices, which we calculated by dividing our net revenues from products by the total number of items transacted during the period.

It is worth noting that net revenues from other products as a percentage of total net revenues increased significantly to 23.2%, our highest quarterly contribution to date as we expanded our product offering.

At the same time, we further reduced our cost base and significantly reduce our store level loss as a percentage of net revenues from products to negative 6% during the quarter from a loss of negative 75% during the same period last year. As Jenny mentioned earlier, we remain on-track to reach our store level breakeven point at some point during the third quarter of 2019.

Reduction of our store level costs is best illustrated on Slide 13. As you can see, we have further reduced our per cup cost to RMB11.1 from RMB18.1 during Q2 2018. This is largely driven by benefits of scale and increased bargaining power, operating efficiency from technology and higher store throughput.

Store throughput measured as the average number of items sold per store per day, increased to 345 items during the quarter from 292 items during the same period last year as we expanded our product offering and our transacting customers are buying our products more frequently.

Moving to Slide 14, the percentage of delivery orders organically declined to 19.8% during Q2 2019. This reinforces the fact that Luckin is a pick-up model, not a delivery model. As many of you know, we utilized deliveries strategically.

As we enter new markets, we typically open centralized kitchens from where we deliver our orders to ensure high convenience from day one. We then used the data we collect from our delivery orders to highlight areas with high demands for our products, so-called heat maps. This information allows us to more precisely identify ideal locations to open up our pick-up stores.

And as pick-up store density increases in a given market, we can replicate the convenience of delivery at a much lower cost, this also explains the further reduction of net delivery subsidy to RMB0.8 per item during the quarter.

If we move to Slide 15, as mentioned by Jenny, we have invested in our brand and further strengthened our brand identity during the quarter. Our total sales and marketing expenses in Q2 19 amounted to RMB390.1 million versus RMB168.1 million in Q1 2019. This represents close to 63% of our total non-GAAP operating loss in the second quarter. Please note that our sales and marketing expenses do not include any of our promotions or coupons as these are already reflected in our net revenue from products.

The increase in sales and marketing expenses is predominantly related to investments in advertising, which amounted to RMB245.4 million for the quarter from RMB43.7 million during the previous quarter. This, for us, is a very strategic investment at this stage of our development as we believe a strong brand will enable us to continue to attract and retain customers.

And as you can see on this page, this has already resulted in strong growth of new transacting customers during the quarter. I would also like to point out that despite increased spending on sales and marketing year-over-year, new customer acquisition costs declined to around RMB48 in the second quarter from around RMB55 in the same period last year. This is largely due to benefits of scale, effective user engagement via our proprietary mobile app and a substantially higher number of transacting customers.

At the same time, you can see from the chart on the right that the transaction value per customer per month for each cohort generally increases as each customer cohort matures. We believe this is a result of our distinguished value proposition and our very well-recognized brand.

If we move to Page 16, you can see that we are very well-capitalized. Our liquidity, which includes cash and cash equivalents and short-term investments, exceeded RMB6 billion as of June 30, 2019. The increase in our liquidity was primarily driven by the net proceeds of the Series B investment, our successful IPO and the concurrent placement during the quarter. We also significantly improved our rate of operational cash burn to negative RMB375 million this quarter from negative RMB628 million during the previous quarter.

This brings us to the end of the presentation. As Charles and Jenny mentioned, we are very pleased with the results achieved during the second quarter of this year. In terms of our guidance for the third quarter ending September 30, 2019, we expect net revenues from products to be between RMB1.35 billion and RMB1.45 billion, representing an increase of 495% and 539% year-over-year, respectively.

And this concludes our prepared remarks. Operator, you can open the call for questions.

QUESTIONS AND ANSWERS

Operator

Ladies and gentlemen, we will now begin the question-and-answer session. (Operator Instructions). Your first question comes from the line of Tony Wang from Credit Suisse. Please ask you question.

Tony Wang ***Credit Suisse - Analyst***

Hi, thank you for taking my questions. So, congrats on the very strong set of results. So, basically, I have three questions. First is for Reinout, I'm wondering if you can update on the recent progress and outlook for some of your key operating metrics, including store traffic, ASP, unit cost and the store rollout for the third quarter. And most specifically, I think you provided kind of a very strong guidance for third quarter revenue, and maybe some colors on your thoughts on the key drivers for Q3?

And my second question is on the retention rate. I think you didn't disclose that in the marketing deck. So, maybe where you could provide some colors on the trend for the second quarter?

And lastly, I have a question on your alliance with Americana. I'm just wondering, management, if you could provide your thoughts on that partnership, including the rationale behind it, the timing and also the forms of the partnership you are looking for? Thank you.

Reinout Schakel ***Luckin Coffee Inc. - CFO & CSO***

I think we'll let -- we'll let Meng translate the question first. Maybe I can address question one and two and then I'll have Meng translate question three.

Tony, thanks for -- thanks for your question. And I guess just to -- first of all, your first question on sort of the trend that we see in Q2 and I guess also the trend that we're in Q3, what we've seen in Q2 is really sort of an enhancement of the business across all the key metrics that we saw more new customers coming in, we saw an increased number of items per customer and also, we saw an increase in the effective selling price.

And if you look at sort of the impact of that and sort of the -- sort of the drivers that has really been driving sort of net revenue growth, we continue to see those increases going into the third quarter.

If you look at the effective selling price, which I think is an important driver, the reasons behind an increase of the effective selling price is really a function of how we use technology and sort of dynamic pricing.

Secondly, it's also the number of new customers as the percentage of total transacting customers is decreasing, which means that you have less dilutive impact of free cups. And then we saw a small impact of sort of the VAT, which was reduced from 16% to 13%, but that only has a small impact on sort of the net -- on the effective selling price.

If we then look at sort of the cost improvements and sort of the per cup cost, we've seen that, again, due to scale and sort of our operating efficiency and higher store throughput, we've seen a reduction of our per cup costs and we expect to sort of -- to continue to see that trend going forward.

And I think that gives us a lot of confidence to give the guidance for Q3 both on the product revenue as well as on our target and our goal to reach kind of the breakeven point on store level during Q3 2019.

On your second question in relation to the retention rate, yes, that is right, we are not disclosing at this point in time the retention rate specifically. What we are showing, and if you go back to Slide 15, you can see that we are actually showing you the transaction value per customer throughout all the cohorts, which will be the function of the number of items each transacting customer purchases as well as the retention rate.

And as you can see, we see a continued trend of the transaction value per customer increasing, which is now around RMB70 per month per customer for our older cohorts, which obviously is a reflection of a positive trend of our key metrics. I think if you look at sort of the retention rate vis-a-vis what we disclosed in the IPO prospectus for Q1, there is no material changes in the retention rate.

For the third question, I'll pass it on to Jenny and Charles to comment on that.

Charles Lu ***Luckin Coffee Inc. - Co-Founder & Chairman***

(interpreted) So, first of all, thank you, Tony, for the question. We've got disclose more detail on the collaboration. Due to the restriction under confidentiality clauses, we are unable to identify the detail of the next step. But however, the overall direction will be -- so provide our technical expertise [supply chain system] (corrected by company after the call) and also leverage our brand equity to work with Americana and make use of their local resources to develop the business.

With regard to why we identified Middle East as the region for our next expansion, it is actually driven by the identification of our really excellent partners, first. We believe that our model and also our technology and knowhow is applicable to anywhere in the world.

However, the first excellent partner that we have identified is Americana. That's why we start with our Middle East region. And we believe that when we are able to disclose more detail, we will let everybody know. Thank you.

Operator

Your next question comes from the line of Lillian Lou from Morgan Stanley. Please ask your question.

Lillian Lou ***Morgan Stanley - Analyst***

Thank you, Charles, Jenny and Reinout for the detailed explanation and also congratulations on the good results. I have three questions. First of all, a follow-up question regarding third quarter guidance on product revenue. I'm trying to understand a little bit more about the management thought behind it, how to achieve such revenue. For example, what store counts kind of the target, customer acquisition target, product ASP and also the items, if any color on this metric will be really helpful for us to further understand the business trend for the next quarter? So, this is third quarter guidance.

And the second question is also in terms of the second quarter result. Is there any breakdown or the trending -- comment on the trend in the freshly brewed items i.e. how much percentage of coffee contribution to the revenue trends during the second quarter, and also any expectation to third quarter?

And lastly is on marketing expense budget. Any guidance towards the third quarter especially I think with the launch of the tea drink and also there are lot more promotion and marketing activities going on with new brand ambassador. So, just to try, again, and understand about the budget on this. Thank you.

Reinout Schakel ***Luckin Coffee Inc. - CFO & CSO***

Great, thanks, Lillian. Maybe I will kick it off and Charles and Jenny will supplement on the first and the second question. I think Jenny will take the third question on the tea initiative and to the rationale.

I think when it comes to kind of the guidance that we've given onto the product revenue; obviously, we have a relatively good visibility on sort of the trends that we're seeing not only in Q2 but also in Q3.

I think in terms of the sort of the key metrics where I can give some guidance, I think store rollout is going to be sort of in-line with kind of what we had projected for the full year on a sort of a run rate basis, that we will see -- continue to see store openings in line with what we have communicated previously.

If you look at sort of the number of customers that we have been acquiring in Q2 and also the beginning of Q3, you'll see that the number of customers continues -- the number of new customers that we've tracked continues to be very, very strong.

And I think lastly, when you see the sort of the increase of the effective selling price, despite the fact that we've launched a sort of a "buy 10 get 10 free' offer in combination with the launch of the tea, which Jenny will talk more about, you still see that sort of the effective price is holding up quite well and so that we expect that to ultimately continue to increase over time, normalize it for one-off promotions. So, I think that these are obviously kind of the key variables.

Lastly, I'll say, in terms of the number of items we sell per transacting customer, we've seen this increased quite materially as we discussed earlier in Q2, particularly after the launch of the tea product and we are expecting to launch more products in Q3.

We also anticipated that will further increase the number of items that we're selling per transacting customer, which then obviously leads to kind of the product guidance that we've given during this call and also in the earnings release. So, we have relatively high confidence on sort of reaching those targets.

Jenny Qian ***Luckin Coffee Inc. - Co-Founder & CEO***

(interpreted) So, first of all, our brand is our very key asset, important to continue to cultivate brands in China and also to strengthen our brand identity as well as to educate customers. Therefore we largely increased our spending on our sales and marketing. Also, to the opportunity of IPO, we do a lot of content, for example, the declaration of Luckin Coffee to -- strategically to increase our brand awareness and popularity among our customers.

So, for the second quarter, our advertising expense has increased to RMB245 million, so compared to first quarter, which is RMB43.7 million and also the second quarter of year 2018, which is RMB104 million.

Actually, we want to emphasize here the increase in advertising expenses is not to drive online traffic but also mainly to do branding and advertising to build up our brand awareness and the popularity.

So, here, we want to emphasize the key changes compared to the first quarter. First of all is the spending on focus media, which is right at around RMB140 million. The second is the daily interaction from the key opinion leaders and also the new media communication, which is RMB7.5 million. And also, we launched the WeChat location-based services, which is around RMB7 million. That's almost the mainly part that we invested in the branding and advertising.

But here, we want to emphasize that the total customer acquisition cost increased a bit to RMB48.1, but that is actually not only to drive the online traffic but also to do the branding and strengthen our brand awareness among our customers.

So, for the following quarter, actually, there's no specific guidance on marketing expenses, but we will strategically spend money on branding and marketing for this following third quarter.

Reinout Schakel ***Luckin Coffee Inc. - CFO & CSO***

And Lillian, let me just also come back --

Charles Lu ***Luckin Coffee Inc. - Co-Founder & Chairman***

Our major -- Reinout, you want to say something?

Reinout Schakel ***Luckin Coffee Inc. - CFO & CSO***

No. I want to address the second question but -- yes, I want to address the second question, but you go first, Charles, please.

Charles Lu ***Luckin Coffee Inc. - Co-Founder & Chairman***

Okay. (interpreted) I will also first supplement some of my comments on brand building. So, we recognize the marketing expenses in the second quarter has increased. This is because as we target to have -- to reach the store level profitability, after that, we actually realized that it's essential to increase our marketing expenses in order to build up our brand equity. So, that's we why moving towards the third quarter, our Company profitability in the next year, we will work our best to improve our customer base and also to build up more brand equity.

I would also like to emphasize that we prefer not to spend our marketing expenses on subsidizing customers. In fact, we want to spend more on marketing and also to -- on the KOL as well.

So, this is all because of -- yes, this is all because of spending on the ambassadors and also the other promotional activities.

Reinout Schakel ***Luckin Coffee Inc. - CFO & CSO***

Thank you, Charles. And Lillian, let me also come back to your second question around sort of the trends between sort of freshly brewed and sort of other products. I guess first, if you look at Q2, you'll see that we saw sort of roughly 63 million items freshly brewed and about 20 million sort of other products. If you look at the growth year-on-year, you'll see that the other products have been increasing faster than the freshly brewed drinks. That's really because during the year, we've introduced a number of non-freshly brewed items.

Going forward, I think with the launch of tea, the fruit tea, which is part of the freshly brewed category, we'll see sort of that sort of growth bouncing out again where I think the freshly brewed drinks and other products will probably grow in sort of a similar type of level Q-on-Q because we also will introduce new products in sort of the other product category where we, as we discussed earlier I think, really want to have new products regularly to keep our customers excited and make sure we find the right products for our customers.

Lillian Lou ***Morgan Stanley - Analyst***

Thanks, Charles, Jenny and Reinout. Just a very quick follow-up, I think on the second question, is it there -- is it possible to give us a better idea of the revenue contribution from coffee in particular in terms of the trend in last quarter and going forward?

Reinout Schakel ***Luckin Coffee Inc. - CFO & CSO***

Look, I think -- I think -- yes, if you would -- if you would take out -- if you would take out -- if you would look at coffee versus non-coffee in the last -- in the last quarter, you will probably see that we're getting closer to the sort of 50%/50% that we have anticipated by the end of this year.

We're not quite there yet, but I think that's the trend that we're seeing, and that's really a function of obviously, introducing products that are relatively popular, including the deer tea, and we do continue to expect that ratio to go to maybe 50/50 by the end of this year.

Operator

(Operator Instructions). Your next question comes from the line of Eric Gonzalez from KeyBanc. Please ask your question.

Eric Gonzalez ***KeyBanc Capital Markets - Analyst***

Hi, thanks and good evening. I just had two questions here. The number of new customers is really strong in nearly 6 million. The active customers though was maybe a little bit light at 6.2 just in terms of retention. So, can you bridge that gap for us? Was customer retention a little short of your expectations or was this a function of maybe being less promotional in the quarter as you -- as you drove the ASP and their cost -- ASP higher and cost lower?

And then the second question is, as it relates to guidance, the growth is still fairly impressive at 60% at the midpoint, but perhaps it's a little bit late relative to expectation. That said, your profitability in the second quarter was really impressive as was the declining of your per cup cost. So, I'm just wondering about the flow through from that quarter-over-quarter growth in terms of your ability to narrow the losses in the third quarter of both the restaurant and your operating cost at level.

So, in light of this, whether you think -- whether you're going to reach positive restaurant level margin in the third quarter or are you still looking just to achieve the positive margins at some point during the quarter? Thanks.

Reinout Schakel ***Luckin Coffee Inc. - CFO & CSO***

Thank you. Do we want to translate this question or shall I -- shall I get started?

Interpreter

Sure. (Spoken in Mandarin).

Reinout Schakel ***Luckin Coffee Inc. - CFO & CSO***

Thanks, Eric, for your questions. And I think maybe just sort of addressing your first question first, so I think what we've seen in the -- in the second quarter and what we actually are very happy with is first of all, the number of new customers that we have acquired is probably slightly higher than we had anticipated, close to 6 million.

If you look at the number of kind of transacting customer, the average monthly transacting customers that has been increasing 40% quarter-over-quarter, which is probably in line with our expectations, and then very importantly, you also see that sort of the GMV per customer per month continues to increase, which really indicates the fact that people are buying our products more and more often as they -- as they mature, as the cohort matures.

At the same time, we have been able to effectively increase our effective selling price and, again, we do that through dynamic pricing, making sure that we can give the right price to the right customer. And I think therefore, also, you see that sort of the impact from the retention rate has been -- has been very minimal in line with our expectation.

So, I think if you look at sort of the metrics and you look at them sort of side by side, I think we are very happy with the progress that we've made in Q2, not just on revenue but also on the cost side. On the cost side, continuing to decrease the per cup cost even though we have included in the freshly brewed cup cost also the sale of tea, which has a slightly higher per cost and yet, we're getting very, very close to our target for the end of this year.

So, I think overall, we are very happy with kind of the combined impact of sort of the customer acquisition, customer frequency and effective selling price as well as the overall cost reduction that we've seen in Q2.

Now, in relation to your question around sort of growth and guidance, again, I think -- I think we continue to see a strong trend of sort of increasing number of customers. We continue to see an increase in the number of items per transacting customer.

We're obviously also in a market where we see that sort of the impact of trade war and economy is starting to get felt in China. I think with our model, high value, high affordability, high convenience and particularly, the affordability becomes very, very important, I think we are, to some extent, shielded from what's happening in the broader economy. But obviously, that's something that we have to take into account.

More importantly, the way we think about sort of our growth trajectory in relation to getting to our profitability, as Charles mentioned, for us, it's very, very important to continue to invest in customer acquisition, continue to invest in promotions around sort of the tea launch because we do not want to forfeit growth at the cost of the profitability.

Obviously, we have to balance ultimately, our profitability and growth targets. I think we've done a good job on sort of getting very, very close to our store level profitability. We've got high confidence of reaching that store level profitability during Q3.

But obviously, we don't want that to be at the cost of acquiring new customers. And I think that's the balance that we have to make and that's also the guidance that we've been given, it's effectively based on that sort of balancing between those various aspects.

Eric Gonzalez ***KeyBanc Capital Markets - Analyst***

So, are you -- are you suggesting that maybe the better-than-expected profitability was maybe not the strategy there and we can see reversal of that in the third quarter like as you go for more customer acquisition? I'm just trying to figure out what the -- what the balance looks like going forward.

Reinout Schakel ***Luckin Coffee Inc. - CFO & CSO***

Yes, I think the balance will -- and again, we wouldn't be sort of giving guidance on the longer-term sort of customer growth or pricing. I think what you should expect from us is that sort of quarter-over-quarter; we'll continue to improve on store level profitability. And you will also expect us to improve quarter-over-quarter in number of transacting customers and the number of items per transacting customers.

For us, we are obviously, very focused on sort of both items, but we're not going to -- we're not going to sort of prioritize one over the other. It's difficult to give further guidance on that point on this call.

Operator

Your next question comes from the line of Yiqin Wang from CICC. Please ask your question.

Ruochen Li ***CICC - Analyst***

Hi, this is Ruochen from CICC. Congratulations on the result. And I also have three questions. And the first question is, have you got the number of stores we already opened in Tier 1 cities like Beijing and Shanghai and how many stores you expect to open in maximum in Beijing and Shanghai?

And the second question is that can you share with us the expected profitability of your Luckin Tea product; I mean the normalized profitability because I think the cost of the Luckin Tea will be a little bit higher because it's more labor-intensive and the raw material cost might be a little bit higher?

And the third question is that we saw in the news that you are also opening -- launching vending machines in some of the cities in China, so can you give us some color on the progress of the vending machines? Thank you.

Jenny Qian ***Luckin Coffee Inc. - Co-Founder & CEO***

(interpreted) So, we are reverting back to the first question on the store footprint. First of all, for our current stores in the Tier 1 cities achieved around 1,000 already. And we see a lot of potential opportunities in those Tier 1 cities because according to the Frost & Sullivan report we know now in China per capita coffee consumption is around six cups; even though in those Tier 1 cities, it's just around 15 cups. So, we see there's a large space to grow in other Tier 1 cities.

But also, we not only just focus on the Tier 1 cities but also in other tier cities. So, we see because of our high quality, high convenience and high affordability business model, we can actually expand our stores nationwide.

So, Charles just added not only because of the potential consumer demand in those cities because -- and also, we highly rely on our heat map and other data which are also applied based on our technology-driven business model.

For example, in Beijing and Shanghai, one good example is in the first store, we opened in the lobby at our Company building. So, currently, we already achieved around 1,000 items per day. So, we can see, for example, the companies with around 2,000 or 3,000 employees working in the building, will have a lot similar demand on our items. So, in the long term, we see a lot of opportunities and growing space both in the Tier 1 and other tier cities.

And for the third question, which is about the testing of our -- which is about a question on the vending machine, so, first of all, this is during the testing phase so currently we cannot be able to communicate further details during this call. But in general speaking, we believe with the rapid rising demand for coffee and for other products, we see a lot of other areas we could expect to grow our -- to grow our business where we expect a strong demand for our products.

For some of those locations which we cannot open -- justify to open a store there, we will enter this with a much more cost-efficient point of sales. Those locations, for example, are small office buildings, gas stations and railway stations. So, those are the opportunities that we could enter with our vending machines. But currently during we're in the testing phase, we cannot provide further details. But we will update you and the market later if we have the updates.

Reinout Schakel ***Luckin Coffee Inc. - CFO & CSO***

And then just coming back on your -- on your second question around sort of the tea product, I guess first of all, for us, tea, as Jenny mentioned is a highly strategic product launch. We see a big market, we see high acceptance rate with our customers and we think that with our model, the supply chain, our branding and value proposition, we're obviously very well-positioned to capture a big share in that market. Now, for us also, it's strategic because it drives a different consumption moment. Again, it fits well with our target customers and we're very excited about the tea product.

Now, your question around sort of specific profitability, it's something that we won't be able to provide details on, but in general, you will see that sort of the GMV per product for tea will be higher than the average GMV for freshly brewed, so it's contributing to some extent to the increase in GMV for the freshly brewed products.

At the same time as we mentioned that the per cup cost for freshly brewed is probably slightly higher than what you see for the freshly brewed cost of coffee. Overall, the margins will not be that dissimilar given those two sectors.

Operator

Your next question comes from the line of Billy Leung from Haitong International. Please ask your question.

Billy Leung ***Haitong International - Analyst***

Hi, Charles, hi, Jenny, hi, Reinout. Thanks for taking my question and congratulations on a very solid set of results. I also have three questions. The first question is related to our new products. So, I'm just wondering, after releasing some of the new products, for example, fruit tea, have we seen any changes in terms of our customer group? Have we seen, for example, more females or different age groups? That's my first question.

My second question is also on new product. Can the management share some color in terms of upcoming products for the next two quarters, in terms of timeline, et cetera?

And the last question is related on our outside China expansion. I think it's quite exciting. We are going to Middle East and India, which has very similar consumer behavior than China. I'm just wondering if the management sees any other areas geographically which also share very similar behaviors in China and has the potential coffee market as well? Thank you.

Jenny Qian ***Luckin Coffee Inc. - Co-Founder & CEO***

Okay. (interpreted) So, actually, the tea product target customers do match our existing customer group. Yes, so we see more female customers and more customers with lower ages, but there is not significant change. Because one of the main reasons because now, we're still selling our tea product based on our business model, which is mainly the pick-up stores located in the office buildings, so the main customers are still the office workers around the building. So, there is not significant change on our customer groups.

But we see the different -- differentiating of the consumption moment for coffee and for tea. For coffee products, it's mainly concentrated in the morning timing. And for the tea products, it's mainly -- it's around in the afternoon. So, we see this as differentiating of the consumption moment which also in total going to drive our per store revenues.

The second question on the upcoming products, actually, our strategy, we will continue to launch a new product because our position of our brand is to be part of everyone's life. The total SKU for our menu will be limited to around 100, among which, 25 to 30 for the coffee product will not be changed. But for the other SKUs, we will continue to change it based on the sales data and also based on the new demand from the customers. So, we will continue to launch new products to satisfy our customer's needs and also to take advantage of our mature supply chain to produce more better quality product to our customers.

Charles Lu ***Luckin Coffee Inc. - Co-Founder & Chairman***

(interpreted) Okay, first of all, we do not have a list of what next geographic areas to expand. As I mentioned, we are more driven by the identification of partners who will have the super local expert resources.

We are currently under the exploration stage of collecting data and investigating the model of the numbers of the customers in different areas. And our strength is more focused on knowhow and IT technologies and we will keep exploring different opportunities and also partners. Once identified, we will have more actions and we'll update everyone.

And there is one news that we can share. Actually, except the Middle East partners, we are actually talking to different potential partners in other region. And we will update the public once we have other significant progress.

Operator

Your next question comes from the line of Vincent Yu from Needham & Company. Please ask your question.

Vincent Yu ***Needham & Company - Analyst***

Hey, Charles, Jenny and Reinout, congrats on a great quarter. My first question is on the store expansion in lower tier cities as well. So, can you share more insights on, one, like a per store volume which is like numbers of items sold per store in lower tier cities compared with the first tier cities? And second, effective pricing, considering the pricing sensitivity. And three is the store opening and operating costs in these newer like lower tier cities.

And my second question is on per store CapEx, so coffee -- like coffee beans exposure -- expiration date is way longer than the fruit tea. So, are we going to see some increase in storage equipment for these raw materials per store? Thanks.

Interpreter

So, first of all, I will translate the points -- general points Jenny has given here. So, first of all, for our higher -- so, given our higher pricing sensitivities in Tier 2 and Tier 3 markets, we feel we are better positioned versus our competitors. And because we provide our value proposition, high convenience, high quality and high affordability to our customers, so we expect to gain market shares in those kinds of tier cities.

In general speaking, the CapEx compared in tiers -- second tier and third tier cities compared to the first tier cities, there are not that big difference. Even though the tiers -- the lower tier cities have a lower rental and a lower employee costs, but that has been offset by the slightly lower volume. So, based on that, we didn't see the big difference for our lower tier cities.

Also, for what the question mentioned by Vincent, because our tea products, rather there will be more investments in the new machines, but actually currently our tea production, will not require new machine. We can totally based on our current machines to produce our tea products.

Reinout Schakel ***Luckin Coffee Inc. - CFO & CSO***

Maybe I'll -- maybe I'll add to that, I think obviously one -- and that's also why tea for us is a strategic product because we think the tea consumption in lower cities will be -- will be quite strong.

In terms of -- and I'm generalizing here because it does differ from city to city also depending on when we enter that city. But as Jenny mentioned, I think first of all, pricing -- the pricing strategy is effectively the same so the retail price will not be different in Tier 1, Tier 2 versus Tier 3. But obviously, our pricing strategy has been also looking at the client behavior. You'll see that the volumes that you see in lower tier cities will be slightly lower than in Tier 1 cities, the coffee consumption.

Overall, the pricing strategy is not dissimilar, and then when you look at the per cup cost, as Jenny mentioned, you see that we have lower rental, lower labor costs, but it's somewhat offset by the fact that we have lower volumes in those Tier 2 and Tier 3 cities that the per cup cost is also not that dissimilar.

So, when you're thinking about sort of your margins and sort of your contribution margins, Tier 1 versus Tier 2 and Tier 3 on a relative basis, it is not that dissimilar.

Operator

Thank you, ladies and gentlemen. Unfortunately, we have ran out of time for any further questions. I would like to hand the conference back to the management team for closing remarks. Please continue.

Reinout Schakel ***Luckin Coffee Inc. - CFO & CSO***

Yes. Look, maybe on behalf of Charles, Jenny and myself, again, thanks a lot for joining the call. We are excited to bring you along with our journey; we're very much looking forward to keep you up-to-date on sort of the progress we're making quarter-on-quarter. And again, we thank you for dialing in to this call.

Operator

Ladies and gentlemen, this concludes our call today. You may now disconnect. Speakers, please stand by for a closing -- for your post-conference. Thank you.

Editor

Portions of this transcript that are marked (interpreted) were spoken by an interpreter present on the live call. The interpreter was provided by the Company sponsoring this Event.