A Case Study on Corporate Debt Restructuring of Luckin Coffee

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Abstract. Amidst a global economic slowdown and escalating trade tensions, corporate debt issues are intensifying, leading to a growing number of enterprises facing financial distress and implementing debt restructuring. This paper employs a case study approach combined with financial indicator analysis, focusing on Luckin Coffee as the subject. Through debt restructuring, Luckin Coffee successfully returned to normal operations, achieving a win-win outcome for both the company and its creditors. Drawing on theories of debt restructuring and debt crises, this study thoroughly analyses the motivation and financial consequences of Luckin Coffee's debt restructuring. The study presents several key conclusions: the internal and external motivations include the impact of the pandemic on the global coffee market, poor sales performance and high costs, the problems with expansion pace and initial expansion model, and the default on notes; financial effects are observed in the improvement of the company's financial indicators, including solvency, profitability, operating capacity, growth capacity, and cash flow conditions. This study contributes to the body of research on debt restructuring and offers valuable guidance for similar enterprises facing comparable challenges.

Keywords: Corporate Debt Restructuring, Debt Crises, Financial Indicator Analysis, Luckin Coffee.

1 Introduction

Despite the diminishing negative impact of COVID-19 on the global economy, economic growth has not yet returned to pre-pandemic levels. Numerous enterprises continue to grapple with the aftermath of the severe shock, often relying on high financial leverage to sustain their operations. To alleviate debt repayment pressures and prevent business failures, debt restructuring has become an increasingly common strategy for companies worldwide facing financial challenges in the current economic climate.

A literature review on Luckin Coffee reveals that most scholars have concentrated on the causes and consequences of its 2019 financial fraud [1] [2]. With Luckin's operational performance improving in recent years, academic focus has shifted to its innovative business strategies [3]. However, research on Luckin's financial debt restructur-

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K. Zhang et al. (eds.), *Proceedings of the 2024 3rd International Conference on Economics, Smart Finance and Contemporary Trade (ESFCT 2024)*, Advances in Economics, Business and Management Research 305,
https://doi.org/10.2991/978-94-6463-548-5_31

ing remains scarce. This paper addresses this gap by examining Luckin Coffee's successful debt restructuring, offering a systematic analysis of its motivations, processes, and economic consequences to deepen the understanding of corporate decision-making during such events.

The case of Luckin Coffee's debt restructuring holds significant research value. Theoretically, this paper contributes to develop a more robust and systematic theoretical framework, thereby enriching the existing literature in this field. Practically, this paper offers a valuable decision-making framework for other enterprises facing similar challenges, alongside practical recommendations for both government and industry.

2 Literature Review

2.1 Motivation of Debt Restructuring

There are several crucial motivations for corporate debt restructuring from the debtor's perspective. First, a downturn in the macroeconomic environment, coupled with tightening credit policies, often leads to debt issues due to reduced profitability and higher financing costs, prompting companies to consider restructuring [4]. Second, government assistance and supportive policies can play an important role, especially when widespread debt problems cause economic disruptions. Direct financial aid and policy measures can facilitate and initiate debt restructuring [5]. The third factor is to defuse debt crisis and avoid corporate bankruptcy. Debt restructuring is an effective measure to alleviate debt crisis and avoid bankruptcy liquidation. Enterprises in financial difficulties tend to actively negotiate with creditors to alleviate the pressure of capital outflow [6]. Fourth, an unreasonable capital structure, characterized by excessive debt and high financial leverage from over-expansion or over-investment, can drive companies to restructure in order to adjust their debt, reduce financial expenses, and ensure sustainable growth [7]. The fifth factor is to restore investor confidence in companies. Debt restructuring can help the enterprise send a positive and favorable message, then reshape market image and broaden financing channels [8].

2.2 Effect of Debt Restructuring

Some scholars have examined the positive effects of debt restructuring. From a macroeconomic perspective, effective debt restructuring is essential to ensure that viable businesses can continue to operate, thus supporting broader economic recovery and maintaining financial stability [9]. From a microeconomic standpoint, debt restructuring can ease the repayment pressure of debtors in the short term and avoid bankruptcy liquidation due to debt difficulties [10]. By debt-to-equity swaps or debt relief, debt restructuring improves capital structure and restores the financial health, thereby allowing enterprises to better maintain long-term viability [11]. Additionally, creditors can reduce their potential losses from debtor bankruptcies by making appropriate concessions [12].

3 Company Overview of Luckin Coffee

Luckin Coffee Inc., incorporated in the Cayman Islands in June 2017 with a registered capital of 122.5 million US dollars, is headquartered in Xiamen and focuses on popularizing coffee culture in China. Its business revolves around two main areas: providing high-quality freshly brewed beverages, and profit-sharing with partnership stores while selling them equipment and materials. In 2023, Luckin surpassed Starbucks China in annual sales, becoming the largest coffee chain in the Chinese market with 10,628 self-operated stores and 5,620 partnership stores.

Luckin's shareholding structure reflects its robust management strategy and efficient operational mechanisms. Centurium Capital, the largest shareholder, holds 32.4% of the equity and 55.3% of the voting rights, securing a dominant position in the company. Joyl Capital, the second-largest shareholder, holds 4.7% of the equity and 3.1% of the voting rights, acting as a key strategic investor. With managers holding only 3% of Class A shares, major shareholders can effectively oversee management, reducing the risk of excessive managerial power misaligned with the company's interests

4 Case Study on Debt Restructuring of Luckin Coffee

4.1 Motivation of Debt Restructuring

4.1.1 The Impact of the Pandemic on the Global Coffee Market.

In 2020, the global economy faced a downturn due to the impact of COVID-19, which presented unprecedented challenges to the consumer market and placed severe pressure on the coffee industry. Worldwide lockdowns significantly limited daily activities and consumer behavior, forcing many physical coffee shops to suspend operations or offer only takeout services in compliance with health policies. As a result, these stores experienced reduced sales revenue, leading to substantial operational difficulties. The shift to remote work and the suspension of public events further decreased demand for coffee beverages, drastically reducing customer numbers. Additionally, business closures and rising unemployment prompted consumers to cut back on non-essential spending. According to Statista[1], global coffee revenues in 2020 were approximately 362.6 billion US dollars, a 16% year-on-year decline, underscoring the severe impact of the pandemic on the coffee market.

4.1.2 Poor Sales Performance and High Costs.

Primarily, slow sales revenue growth led to insufficient profitability. Luckin Coffee's major strategy for market expansion in China involves opening new stores across various cities, with the pace of expansion directly impacting sales revenue growth. In 2020, Luckin Coffee faced obstacles in expanding its sales network, leading to a 12.82% decline in self-operated stores, marking the first decrease in its history and signaling a significant slowdown in sales growth. Additionally, rising operating expenses further eroded profitability. From 2018 to 2020, Luckin experienced a continuous increase in

operating expenses, with leasing and operating costs being major contributors. Promotional initiatives and celebrity endorsements aimed at attracting and retaining consumers further escalated these costs. This demonstrates the challenges Luckin faced in achieving profitability and operational stability, characterized by weak revenues and high operating expenses.

4.1.3 The Problems with Expansion Pace and Initial Expansion Model.

Luckin's franchise model, encompassing both self-operated and partnership stores, faced two key issues. First, Luckin's expansion pace was overly aggressive. Beginning with its first experimental store in October 2017, the company rapidly scaled up, reaching 2,073 self-operated stores by the end of 2018. Although some self-operated stores closed at a loss in 2020, the total number of stores continued to grow, with partnership stores increasing from 282 in 2019 to 874 in 2020. This rapid expansion, however, prioritized speed over strategic planning, failing to secure a stable customer base and exacerbating financial instability. The second issue was the flawed initial expansion model. In 2018 and 2019, Luckin primarily expanded by opening self-operated stores rather than forming partnership stores, investing heavily in equipment, store renovations, and leases. However, the slow capital return typical of the retail industry meant that it took a long time for the company to recover its investments. As a result, this early expansion strategy yielded limited short-term benefits and further tightened the company's cash flow.

4.1.4 The Default on Notes.

From 2018 to 2020, Luckin consistently reported operating losses and insufficient capital returns, heavily relying on continuous debt financing to sustain operations and expand its store network. This reliance led to an increasing debt burden as a direct result, adding to the company's growing financial strain. To ease financial pressure, Luckin issued long-term convertible notes worth 460 million US dollars in 2020, raising total liabilities to 1,011 million US dollars. However, the appointment of joint provisional liquidators by the Cayman Court in July 2020 triggered a note default, exacerbating short-term debt repayment pressures. The principal, interest payable, and additional interest on this notes became immediately due and should be pay as normal debt. Unable to repay the notes on time, Luckin faced a cash flow crisis, ultimately leading to the proposal of debt restructuring. The default on these notes became the most immediate and central motivation for Luckin's debt restructuring.

4.2 Financial Consequences of Debt Restructuring

4.2.1 Solvency Analysis.

This paper analyzes Luckin's solvency using the quick ratio, current ratio, and cash ratio. In 2022, all three indicators improved, with the quick ratio rising from 1.18 to 1.71, the current ratio from 1.27 to 2.13, and the cash ratio from 0.98 to 1.25. These improvements reflect enhanced short-term solvency due to the resolution of note de-

faults and the settlement of 460 million US dollars in current liabilities after debt restructuring, which alleviated debt repayment pressure and increased financial flexibility. However, in 2023, these indicators declined, with the quick ratio dropping to 0.99, the current ratio to 1.39, and the cash ratio to 0.55. This decrease is primarily due to the imbalance between the growth of current assets and liabilities, driven by Luckin's aggressive expansion in China and Singapore. The expansion led to a significant rise in current liabilities, such as accounts payable for equipment and operating leases, while returns from new stores were initially low. If this misalignment between operational input and output continues, Luckin's short-term solvency could be at risk again, despite the relief provided by the 2022 restructuring.

4.2.2 Profitability Analysis.

This paper evaluates Luckin Coffee's profitability using operating profit margin, net profit margin, and ROE. Luckin's operating profit margin improved significantly, rising from -6.77% in 2021 to 8.70% in 2022, a 228.51% increase. This upward trend continued in 2023, reaching 12.15%, a 39.66% gain, indicating enhanced profitability and reduced reliance on external financing. In contrast, the net profit margin and ROE dropped in 2022 to 3.67% and 7.37%, down 57.42% and 44.75% from 2021. However, both rebounded sharply in 2023, with the net profit margin at 11.44% and ROE at 29.32%, reflecting increases of 211.72% and 297.83%. The 2022 declines were likely due to exceptional 2021 revenue, not adverse effects from debt restructuring. The rise in profitability in 2023 was also driven by reduced financial expenses post-restructuring. The surge in ROE can be attributed to Luckin's recovery from debt distress and its shift to a refined operational strategy, focusing on cost management and business optimization. This approach reduced inefficient investments and improved capital utilization and profitability.

4.2.3 Operating Capability Analysis.

This paper uses trade receivable turnover, current asset turnover, and total asset turnover to assess Luckin's operating capacity. Debt restructuring positively impacted the company's operations. Luckin's accounts receivable turnover rose from 62.9 in 2021 to 63.17 in 2022, a modest 0.43% increase, and then surged to 98.52 in 2023, a significant 55.96% jump. This improvement indicates that Luckin regained corporate reputation and customer trust post-restructuring, leading to faster payment settlements. Additionally, current asset turnover and total asset turnover followed an upward trend. In 2021, these indicators were 1.08 and 0.74, both below reasonable benchmarks. By 2022, they increased to 1.84 and 1.17, and further to 3.65 and 1.73 in 2023, reflecting improved asset utilization and a faster capital cycle. This enhancement was driven not only by increased sales revenue but also by Luckin's regained autonomy after being released from provisional liquidators' oversight. With restored independence, Luckin implemented more flexible and efficient asset management strategies, stabilizing cash flow and supporting its expansion.

4.2.4 Growth Capacity Analysis.

The growth rate of operating profit and the growth rate of total assets are selected to measure the development ability of Luckin. In 2021, Luckin's operating profit growth rate was 81.62%. However, in 2022, the company achieved positive operating profit for the first time, with the growth rate peaking at 358.05%. Although the growth rate declined in 2023, it remained significantly higher than pre-restructuring levels, demonstrating Luckin's strong profit growth momentum and positive growth ability. Meanwhile, Luckin's total assets grew by 35.23% in 2021. The growth rate dropped to -21.35% in 2022 due to unusual reasons, but rebounded to 69.55% in 2023, nearly doubling the rate from 2021. The completion of debt restructuring was a key factor in this increase in total assets, although other factors, such as the recovery of the coffee market and the company's ongoing expansion, also played significant roles. By successfully avoiding corporate bankruptcy and achieving a turnaround through restructuring, Luckin established a strong foundation for further asset expansion.

4.2.5 Cash Flow Analysis.

This paper examines Luckin's cash flow using net cash flow from financing activities and the cash-to-current liabilities ratio. In 2021, Luckin's net cash flow from financing activities was 237.68 million US dollars, but it dropped to -330.03 million US dollars in 2022, primarily due to the repayment of long-term convertible bonds. By 2023, net cash flow was effectively zero, indicating that investments from Centurium Capital and Joy Capital provided sufficient financial support, eliminating the need for additional fundraising. The cash-to-current liabilities ratio was 1.87% in 2021, reflecting inadequate operating cash flow. This ratio fell to 0.7% in 2022 the resolution of equity litigation related to fabricated transactions, leading to a liquidity decline. However, in 2023, the ratio rose to 53% following debt restructuring and the resolution of default issues, which reduced current liabilities and improved liquidity. Enhanced operating conditions further bolstered fund returns, addressing liquidity concerns effectively.

5 Conclusions

The motivations for Luckin's debt restructuring are fourfold: the pandemic's impact on the global coffee market, sluggish revenue growth paired with rising operating expenses, rapid expansion through a self-operated model leading to high debt, and the default on long-term convertible notes, which greatly increased short-term debt repayment pressure.

The financial consequences of Luckin's debt restructuring include marked improvements in solvency, profitability, operating capacity, and cash flow, with growth capacity gradually returning to normal levels. Despite a slight decline in solvency the year after restructuring, overall financial health continued to strengthen.

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