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Luckin: From Brewing Coffee To Brewing Fraud

Internationally renowned Chinese actors Tang Wei and Chang Chen had been quick to endorse internet unicorn Luckin Coffee. Countless positive factors converged as the company went viral. For consumers, nothing was more appealing than massive discounts and convenient service. For investors, the potential of China's market and Luckin's aggressive ambitions to lead were already considered lucrative.

From its first store in 2017, Luckin grew to over 4,500 stores in early 2020, a feat that took Starbucks China 20 years to achieve. Joining hands with tech-savvy giants Tencent and SF Express, Luckin provided 'significant advantages in cost and consumer engagement to drive mass-market coffee consumption in China (Credit Suisse)' and 'one of the world's greatest retail growth opportunities (KeyBanc Capital Markets).' Even if the company was in red, Morgan Stanley still expected Luckin's sales to grow 30 times between 2018 and 2020¹. Not surprisingly, other big names like BlackRock and Goldman Sachs were also connected with this unicorn.

While the halo of this rapidly growing coffee giant continued to shine brightly after its successful NASDAQ listing in mid-2019, clouds started to form in January 2020 when an anonymous report alleged that Luckin had dramatically overstated sales. On April 2, 2020, Luckin finally admitted the accounting scandal, and its stock price plummeted by over 80% in that month alone. Suddenly, the very 'optimistic' analysts turned cynical not only about the stock but also about its business.

Were Luckin's prior achievements all down to luck? Why was this company so attractive to investors? More importantly, why did this company's stock price go from peaking to bottoming out in less than 12 months? What is the way forward for Luckin?

The Company

In June 2017, Jenny Qian Zhiya established Luckin Coffee Inc (Luckin), an advanced technology-powered coffee chain, in Xiamen, China. While set up in China, Luckin was incorporated under the jurisdiction of the Cayman Islands as the group's ultimate holding company. Subsequently, it

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established four other offshore subsidiaries under British Virgin Islands and Hong Kong laws, along with 56 units registered in China. As Luckin CEO, Qian set out its mission 'to be part of everyone's everyday life, starting with coffee.' With great ambition, Luckin was determined to become the biggest coffee chain in China, surpassing Starbucks², which had launched more than 4,100 outlets in China since 1991.

Through funding from angel investors and Charles Lu, CEO of CAR Inc (a Hong Kong-listed company) and UCAR (a mobile ride-hailing firm), Luckin opened its first coffee shop in Beijing in October 2017. On Jan 1, 2018, the company extended its store network to 13 different cities in China including Beijing, Shanghai, Tianjin etc., marking the business' 'soft launch.' The initial product menu was relatively homogenous, consisting of predominantly freshly brewed coffee, espresso, latte, and related drinks (such as water, milk, and a few contemporary tea drinks). With its very aggressive expansion plans, Luckin opened more than 500 stores and sold over five million beverages within the first six months. Such achievements led to Luckin's success in raising US\$200 million of Series A financing from a group of investors, including Singapore's sovereign wealth fund GIC, Centurium Capital, Legend Capital, and Joy Capital. The round pushed Luckin's value to more than US\$1 billion, crowning the company as a rising unicorn.

With the newly raised funds, Luckin continued to grow at breakneck speed. By the end of 2018, Luckin managed to set up over 2,000 stores in 22 cities and sold 85 million beverages to over 12 million customers. Such a store network was more than triple that of Costa Coffee in China – the second-largest premium coffeehouse chain that entered the market in 2006. Moreover, it also represented over one-third of Starbucks' coffee outlets in China. Luckin gradually enriched its product variety by including pastries, juice, and wraps. Within a year of launch, Luckin's signature blue coffee cup with a white reindeer became an icon for trendy beverages wildly popular among China's white-collar workers.

Luckin's Business

Luckin held a firm conviction that customers should enjoy freshly brewed premium coffee at any moment, without necessarily visiting a coffee shop. "Previously, you had to look for coffee, but now coffee comes to you," said Qianⁱⁱ. The company's business was a 'new retail model,' which offered a set of unique value propositions to customers by delivering freshly brewed coffee and related products with 'high quality, high affordability, and high convenience.' Characterized by seamless online and offline integration, the new model hinged on smart devices and took advantage of advanced computing technologies such as big data analytics, artificial intelligence (AI), and Luckin's proprietary technologies. The adoption of these advanced technologies in Luckin was not surprising as Qian was previously the Chief Operating Officer of another tech-intensive company, UCAR.

To implement the 'any moment' strategy, Luckin established a coffee network comprising three shop formats: relax stores, pickup stores, and delivery kitchens³ (see **Exhibit 1**). Customers must complete all the orders and payments via Luckin's own mobile app, irrespective of whether they choose to dine in or take away. The relax stores and pickup stores were designed for customers to either enjoy fresh coffee on the spot or pick up mobile orders. Alternatively, customers could choose to have orders delivered to their desired location. While customers were waiting for orders, Luckin would livestream the whole preparation process through its mobile app. The firm guaranteed to deliver all orders within 30 minutes; otherwise, customers would receive a free drink. The goal was to ensure that customers could enjoy freshly brewed coffee anywhere – "the coffee is still icy in summer when it reaches customers, while still hot enough to warm hands in winter," said Qian⁴.

Committed to high-quality coffee, Luckin sourced superior Arabian coffee beans and appointed World Barista Champion teams to design their coffee recipes. The Luckin recipe even received the Gold Medal in the IIAC International Coffee Tasting Competition in 2018 and 2019. Moreover, Luckin priced its coffee in a very competitive manner. A typical beverage at Luckin was about 20 – 30% less than that of Starbucks. For example, a large latte at Luckin cost ¥24^① in its mobile app, whereas the same coffee at Starbucks cost ¥30. The company also initiated many promotion campaigns through its mobile app, such as ‘buy two, get one free,’ and ‘buy five, get five free.’ In short, Luckin tried to provide customers with Starbucks quality coffee at any moment but at a much attractive price.

Technology, particularly the company’s mobile app, played a vital role in disrupting the traditional retail model. The app was essential in enabling customers to order at ‘any moment’ in a cashless manner. It also helped the company leverage analytics and AI technologies to analyze customers’ behavior and further improve its product and service offerings. This made dynamic pricing possible which improved customer retention. Finally, technology adoption in supply chain management and operations enabled Luckin to optimize new store location, delivery routes, inventory, and workforce management.

Growth and Expansion

Still dissatisfied with its growth trajectory, Luckin was determined to open 2,500 new stores in 2019 and ambitiously planned to expand to 10,000 by 2021. “Luckin aims to become China’s biggest coffee chain brand by the year-end, totally surpassing Starbucks by cups of coffee sold and the number of shops,” said Qian⁵. In 2018, the company filed a lawsuit against Starbucks for alleged monopolistic practices in the country.^② Aiming to offer a wider variety of products, Luckin formed a strategic partnership with Louis Dreyfus Company, one of the world’s biggest citrus fruit juice suppliers. Such cooperation allowed Luckin to offer not-from-concentrate fruit juice throughout its network. Also, the company started selling other non-beverage items such as coffee tumblers and nuts.

In 2019, Luckin launched ‘Luckin Tea’, a related line featuring freshly made fusion-style mixing tea beverage with other ingredients such as fruit juice, milk, and tapioca pearls. Customers could place their tea orders through its proprietary Luckin Tea mobile app, which linked with the Luckin app. After testing the market in Beijing and Shanghai, Luckin opened its first tea-specialty store in October 2019^③. The differentiation into tea could offer synergies with its existing coffee product line as the two segments provided cross-selling opportunities. Moreover, Luckin’s own-operated store strategy focused on first and second-tier cities, while Luckin Tea adopted a partnership model^④ throughout China.

A major impetus of Luckin’s fast growth was its coffee’s attractive pricing, achieved through a subsidization strategy. According to an analyst from Bernstein, the effective price of Luckin’s coffee after discount could be less than half of that for Starbucks. The average net selling price per item in the

① ¥ = CNY = Chinese yuan renminbi; ¥1 = approximately US\$0.1537, US\$0.1454, US\$0.1448, as of the end of 2017, 2018, and May 2017, respectively.

② Luckin subsequently withdrew the lawsuit in the same year.

③ Coffee was also available in Luckin Tea shops.

④ Luckin’s partnership model did not require its retail partners to pay initial fees upon signing up as a partner. Luckin would supply the technology, products and supply chain in return for a share of revenue from Luckin’s retail partner.

third quarter of 2019 was only ¥11.2^①. Essentially, Luckin built up its massive customer base by leveraging a cheaper coffee to its primary rival, Starbucks. In the long run, Luckin believed that most of its customers would become loyal even without subsidization.

“Subsidies will remain as one of our core strategies, at least in the next three to five years. Luckin will not stop subsidies, and neither should our competitors expect us to stop... Profitability is off the discussion at this stage, what we see is [growing] speed and user scale,” said Yang Fei, Chief Marketing Officer at Luckin^⑥.

To maintain the subsidization strategy and continued growth, Luckin raised another US\$200 million through Series B financing at the end of 2018. In April 2019, Luckin completed a B+ round financing amounting to US\$150 million, with over 80% of the money coming from BlackRock’s private equity fund^②. Next, in May 2019, Luckin management (see **Exhibit 3**) took the company public through an initial public offering (IPO) of American Depositary Shares (ADS) on the NASDAQ of the US stock exchange. Despite Luckin’s short history, red financial performance, and non-US background, the IPO was oversubscribed more than 20 times^⑧. Kathleen Smith, a principal at Renaissance Capital, commented, “Not since the dotcom bubble of 1999-00 has a company achieved a US\$3 billion public valuation less than two years after its launch.”^⑨ With the IPO, Luckin raised an additional US\$571 million and was considered one of the biggest Chinese companies listed in the US in 2019. The stock (code: LK) soared to 47% above its US\$17 listed price shortly on the first trading day and closed at US\$20.38 per share. In January 2020, Luckin raised another US\$418 million from a follow-on share sale. The company also sold US\$446 million in senior convertible notes with a five-year maturity. The convertible notes offering was well received by the market based on China’s technology potential. As Gaurav Maria, an analyst from JP Morgan, commented, “...China was a hotspot, and tech companies in particular, which accounted for a record US\$5.3 billion of issuance, such companies are especially appealing to convertible buyers because their stock is so volatile.”^⑩ The proceeds from the listing and convertible notes issuance were for general corporate purposes, including store expansion, unmanned retail initiative, R&D, sales and development.

With external funding, Luckin continued to reach new heights in its expansion plans and operational efficiency. By the end of 2019, it operated 4,507 stores in over 40 cities in China. Average delivery time was reduced to 20 minutes, and customers increased. In January 2020, Luckin launched its autonomous retail initiative, which comprised a network of smart coffee machines in popular and high traffic locations such as gas stations, bus terminals, and airports to enlarge its customer base further. Despite Luckin’s achievements and encouraging growth prospects, the company had not made any profit since its inception. Although steep losses were not uncommon among start-ups during the high growth phase, long-term profitability was still a key concern for investors. This was echoed by the following comment from a Bernstein analyst, “...the key controversy is whether Luckin can generate sales in the absence of discounts.”^⑪ **Exhibit 2** contains information about the number of stores, cumulative customers, and related operational data, while **Exhibit 4.1** and **Exhibit 4.2** depict Luckin’s recent financial statements.

① Per company quarter presentation. In fact, the average net selling price in Q3 was 7% higher than the selling price in Q2.

② BlackRock also owned 6.58% of Starbucks.

Industry and Competition

With China being a traditionally tea-drinking nation, coffee began to gain a foothold as a consumer beverage, in the form of instant coffee, during the 1980s. The late 1990s to 2000s saw an increase in disposable income attributable to the Chinese economy's tremendous growth. Such an increase, together with the introduction of specialty coffee chains like Starbucks and Costa Coffee, triggered the quick expansion of China's ground coffee market in the 2000s. The new coffee culture was especially appealing to younger generations and white-collar professionals in first and second-tier cities. The forecast information in **Exhibit 5.1** and **Exhibit 5.2** suggested that starting from 2020, roasted coffee sales and the market size of coffee shops in China were expected to grow at a compound annual growth rate of about 11.25% and 13%, respectively.

Luckin's presence could be a natural response to Starbucks' unprecedented growth in China's coffee market over the last 20 years. As a specialty coffee house chain listed on the NASDAQ (stock code: SBUX), Starbucks differentiated itself by offering customers an experience beyond a cup of coffee: fresh coffee brewed in a cozy atmosphere with contemporary décor where customers could comfortably socialize or pamper themselves. Besides a loyalty program and occasional promotions, Starbucks did not offer discounts for prolonged periods as it believed that customers who enjoyed the 'Starbucks experience' would return automatically.

Starbucks entered the China market mainly through licensing arrangements, which enabled the company to gain deeper insights into consumer preferences in a complicated and diverse setting. Expanding its footprint gradually in China, Starbucks acquired some licensed stores while increasing its own-operated stores at the same time. **Exhibit 6** presents the historical store growth of Starbucks and Luckin in China. Luckin's presence appeared to challenge Starbucks, as indicated by the latter's declining sales growth per store in 2018 (see **Exhibit 7**). Nevertheless, Starbucks still aimed at opening 600 stores a year to reach 5,000 by 2021. Besides enjoying coffee from specialty chains such as Starbucks and Costa Coffee, customers could also grab fresh coffee in fast food chains (such as McDonald's and KFC) or convenience stores (such as 7-Eleven and Family Mart). **Exhibit 8** shows selected financial information on Luckin and Starbucks.

Accounting Malpractice Revealed

On January 31, 2020, an anonymous report on Luckin was released into the public domain, suggesting that its strong growth was due to fraudulent reporting. Besides, the report questioned the economics of Luckin's business. Based on on-site information collected by over 1,000 staff, the report exposed Luckin's inflated items sold per store per day by at least 69% and 88% in the third and fourth quarters of 2019, respectively. Also, the net selling price per item was inflated by a minimum of ¥1.23. Moreover, Luckin overstated over 150% of its advertising expenses during the third quarter of 2019, likely to offset its inflated revenue and store-level profit. Also, only 28.7% of items sold, rather than over 63%, as claimed by Luckin, were over 50% of the regular price in the third quarter of 2019. Finally, the report noted that Luckin's Chief Marketing Officer and co-founder was once imprisoned for 18 months for illegal business operations. He also founded another company affiliated with CAR that did business with Luckin.¹²

While the report appeared comprehensive and insightful, investors reacted with mixed views. Some short-sellers such as Muddy Waters Research considered the information reliable and shorted Luckin's stock. On the contrary, other analysts did not believe the report's accuracy citing unrepresentative sample size, inconsistencies with data from other sources such as Luckin App downloads, and discussions with Luckin's competitors. Some investors retained their firm faith in Luckin's business

despite the report's adverse claims.¹³ In a press release on February 3, 2020, Luckin denied all the allegations and called them malicious. Nevertheless, Luckin's stock dropped 23.7% that week. While the drop might have been due to the report, it might also have been due to the negative economic impact brought by the COVID-19 outbreak.

On April 2, 2020, Luckin announced the involvement of its Chief Operating Officer (COO), a director, and several employees in fabricating sales transactions. The fabrication was estimated to be ¥2.2 billion (US\$310 million) for the second to the fourth quarters of 2019. Some costs and expenses were also substantially inflated through forged transactions. The company formed a special committee comprising independent directors, along with independent legal and accounting professionals, to investigate the internal misconduct. Also, Luckin immediately suspended the COO and the employees associated with the wrongdoing. Despite such remedial measures, Luckin's stock trading was halted by circuit breakers five times within an hour after the US market opened. Luckin's stock price plummeted as much as 80% on the same day and closed at US\$6.4 from a previous close of US\$26.2. Overall, Luckin's value shrank by US\$5 billion in a single day. **Exhibit 9** illustrates Luckin's stock price pattern relative to Starbucks, the S&P 500 Index, and the NASDAQ Composite Index.

After the announcement, analysts viewed Luckin more critically, "It's a great morality tale. It seems to me that those of us who spent time in China could see from very early on that Luckin was inflating its numbers... Luckin was a company that was terribly interested in memberships and in tokens... but not in actual revenue," commented Anne Stevenson-Yang, research director at J Capital Research. William Yuen, investment director at Invesco, said, "Unless you are in a business that hasn't been in existence... then you're competing as a marginal player." **Exhibits 10** and **11** tabulate analysts' collective recommendations and consensus EPS estimates before and after the April announcement. How could Luckin's April announcement yield such a dramatic market reaction? Were there other pressing concerns from investors that drove this?

Exhibit 1 – Shop Formats in Luckin

		Number of Shops					
	Description	2Q2018	3Q2018	4Q2018	1Q2019	2Q2019	3Q2019
<i>Pickup stores</i>	Typically located in high traffic areas such as office buildings, commercial areas, and university campuses. These small-size stores (20-60 sq meters) have limited seating and inexpensive furnishings. They are designed for order pickup or delivered to customers.	356	903	1811	2163	2741	3433
<i>Relax stores</i>	Spacious and large stores (> 120 sq meters) for branding purposes.	22	45	86	109	123	138
<i>Delivery kitchens</i>	Small sites to make coffee for delivery orders. Delivery kitchens enable Luckin to increase its customer base. They might be turned into pickup stores if the customer demand in that area is sufficiently high to justify such conversion.	246	241	176	98	99	109

Source: Company Prospectus and Quarterly Earnings Release Reports

Exhibit 2 – Operational Data of Luckin

	1Q2018	2Q2018	3Q2018	4Q2018	1Q2019	2Q2019	3Q2019
<i>Number of stores</i>	290	624	1,189	2,073	2,370	2,963	3,680
<i>Cumulative no. of transacting customers (in thousands)</i>	485	2,918	5,984	12,530	16,872	22,777	30,724
<i>Average monthly items sold (in thousands)</i>	488	4,001	7,760	17,645	16,276	27,593	44,245
<i>Percentage of delivery orders</i>	61.7%	62.2%	51.4%	40.8%	27.7%	19.8%	12.8%

Source: Luckin Earnings Highlights

Exhibit 3 – Brief Background of Luckin’s Directors & Executive Officers

Name and Position	Age	Brief Biography
<i>Charles Zhengyao Lu Chairman</i>	49	Mr. Lu was the founder of CAR Inc. in 2007, and he served as an executive director, the chairman of the board, and the CEO for CAR Inc. from 2014 to 2016. He is currently a non-executive director and the board chairman of CAR Inc. Mr. Lu is also the chairman of the board and the chief executive officer for UCAR Inc. A substantial shareholder of CAR Inc., Mr. Lu obtained an executive MBA from Peking University in July 2010.
<i>Jenny Qian Zhiya Director and Chief Executive Officer</i>	42	Ms. Qian has served as our director since Aug 2017 and became CEO in November 2017. Ms. Qian served as a director and the COO for UCAR Inc. from 2016 to 2017 and an executive vice-president and the COO for CAR Inc. from 2014 to 2016. Ms. Qian obtained an executive MBA from Peking University in July 2012.
<i>Jian Liu Director and Chief Operating Officer</i>	36	Mr. Liu has served as our director since February 2019 and our COO since May 2018. Mr. Liu served as the head of yield management for UCAR Inc. from 2015 to 2018, and as deputy head of vehicle management center and the head of yield management for CAR Inc. from 2008 to 2015. Mr. Liu obtained a bachelor’s degree from the Central University of Finance and Economics in June 2005.
<i>Dr. Jinyi Guo Director and Senior Vice President</i>	37	Dr. Guo has served as a director since June 2018 and our senior vice president in charge of product and supply chain since October 2017. Dr. Guo served as the assistant to the chairman of UCAR Inc. from 2016 to 2017. Dr. Guo received his Ph.D. in July 2009 from Beijing Jiaotong University.
<i>Reinout Hendrik Schakel Chief Financial Officer & Chief Strategy Officer</i>	38	Mr. Schakel has served as our chief financial officer and chief strategy officer since January 2019. Mr. Schakel worked at the corporate & institutional banking division of Standard Chartered Bank as an executive director from 2016 to 2018. He has also previously worked in Credit Suisse. Mr. Schakel has obtained an MBA from Erasmus University.
<i>Hui Li Director</i>	50	Mr. Li is the founder and chief executive officer of Centurium Capital. He has been a director of China Biologic Products, Inc. since 2013. He previously served in Warburg Pincus, Goldman Sachs, and Morgan Stanley.
<i>Erhai Liu Director</i>	50	Mr. Liu has served as our director since November 2018. Mr. Liu is a founding and managing partner of Joy Capital.
<i>Sean Shao Independent Director</i>	62	Mr. Shao served as the chief financial officer of ChinaEdu Corporation, and of Watchdata Technologies Ltd from 2004 to 2006. He also worked in Deloitte Touche Tohmatsu CPA Ltd.
<i>Thomas P. Meier Independent Director</i>	48	Mr. Meier served as the president and CEO of Franke Coffee Systems from 2016 to March 2019. He previously worked for Lindt & Sprüngli as a managing director for the Asia-Pacific region and a vice president of Switzerland’s sales.
<i>Wenbao Cao Senior Vice President</i>	49	Mr. Cao has served as our senior vice president in charge of store operations and customer service since June 2018. Mr. Cao had over 23 years of work experience at McDonald’s China.

Source: Company Prospectus

Exhibit 4 – Financial Statements of Luckin**Exhibit 4.1 – INCOME STATEMENTS** (in millions of ¥, except per share data)

	Fis. Yr Ended	Three Months Ended						
	31-Dec- 2017	Mar- 2018	Jun- 2018	Sep- 2018	Dec- 2018	Mar- 2019	Jun- 2019	Sep- 2019
Freshly brewed drinks	0.2	9.6	100.5	192.7	346.9	361.1	659.2	1,145.4
Other products	0.0	1.4	8.4	34.4	91.4	84.0	210.8	347.8
Others	0.0	2.0	12.5	13.7	27.2	33.4	39.1	48.4
Total Revenue	0.3	13.0	121.5	240.8	465.4	478.5	909.1	1,541.6
Cost of materials	0.8	9.4	75.8	151.6	295.4	275.8	465.8	721.1
Store rental & other op. costs	1.6	20.2	99.9	172.5	283.5	282.4	371.5	477.3
Depreciation expenses	0.9	4.0	15.0	28.9	58.9	84.0	88.5	108.5
Sales and marketing expenses	25.5	54.4	178.0	225.3	288.4	168.0	390.1	557.7
Gen and admin expenses	22.0	39.0	74.9	118.3	147.5	173.0	265.8	246.1
Store preopening and other expenses	5.7	11.1	21.3	29.8	35.6	22.4	17.2	21.8
Total Operating Expense	56.5	138.1	465.0	726.4	1,109.2	1,005.6	1,598.8	2,132.5
Interest Income	0.0	0.1	0.1	3.5	5.2	1.6	14.1	31.9
Interest and financing expenses	0.0	0.0	(0.6)	(7.4)	(8.1)	(7.9)	(8.5)	(7.7)
Miscellaneous items	(0.2)	(7.1)	10.8	4.6	(22.3)	(18.2)	2.8	34.8
Net Income	(56.4)	(132.2)	(333.0)	(484.9)	(669.0)	(551.8)	(681.3)	(531.9)
Dist. for Preferential Shares	0.0	0.0	(794.0)	0.0	(777.2)	(20.9)	(533.2)	0.0
Income to Comm Shareholders	(56.4)	(132.2)	(1,127.0)	(484.9)	(1,446.2)	(572.8)	(1,214.5)	(531.9)

Exhibit 4.2 – BALANCE SHEETS (in millions of ¥)

	Fiscal Year Ended		Three Months Ended		
	31-Dec-2017	31-Dec-2018	31-Mar-2019	30-Jun-2019	30-Sep-2019
ASSETS					
Current Assets:					
Cash and cash equivalents	219.1	1,631.0	1,159.3	4,005.7	4,535.6
Short-term investments	0.0	130.0	0.0	2,062.4	1,030.0
Accounts receivable, net	0.0	4.6	7.5	7.0	22.5
Inventories	3.3	150.0	189.0	231.7	213.2
Prepaid exp. & oth curr assets	33.4	177.4	186.0	493.5	553.2
Amt due from a related party ¹	0.0	147.6	0.0	0.0	0.0
VAT recoverable	3.1	188.1	240.6	--	--
Total current assets	259.1	2,428.7	1,782.5	6,800.1	6,354.5
Property and equipment, net ²	32.4	426.9	426.8	1,064.0	1,238.2
Other non-current assets	5.8	85.4	87.6	296.7	436.4
Long-term prepayments	32.9	66.0	64.6	--	--
Leasehold improvements, gross	6.7	478.1	539.2	--	--
Total assets	337.0	3,485.1	2,900.7	8,160.8	8,029.0
LIABILITIES AND SHAREHOLDERS' EQUITY					
Current Liabilities:					
Acc, notes and other payables	5.4	502.1	431.3	258.9	351.6
Acc expenses & other liabilities	0.7	45.7	58.7	591.0	864.4
Warranty liability	0.0	19.5	27.8	0.0	0.0
Amounts due to related parties ¹	382.2	24.2	8.0	7.7	19.3
Current portion of LT debt	0.0	72.8	147.0	222.8	227.0
Capital lease obligation	0.0	108.7	109.9	61.4	29.8
Short-term bank borrowings	0.0	8.0	65.6	67.6	10.0
Total current liabilities	388.3	780.9	848.3	1,209.3	1,502.1
Long-term debt	0.0	227.0	152.7	77.0	0.0
Deferred revenues	0.0	126.5	78.8	52.6	93.0
Total liabilities	388.3	1,134.3	1,079.8	1,338.9	1,595.1
Shareholders' Equity:					
Redeemable Con. Pref. Stock	0.0	4,278.3	4,333.1	0.0	0.0
Common Stock ³	0.0	1,256.2	1,256.2	0.0	0.0
Additional paid-in capital	5.0	65.0	65.0	11,860.2	11,901.0
Accumulated deficits	(56.4)	(3,246.7)	(3,819.5)	(5,033.9)	(5,565.8)
Acc. Comprehensive Income	0.0	(2.1)	(14.0)	(4.4)	98.7
Tot shareholders' equity	(51.4)	2,350.7	1,820.9	6,821.9	6,434.0
Tot. liab & share.' equity	337.0	3,485.1	2,900.7	8,160.8	8,029.0

¹ Related parties include Ms. Qian Zhiya, Mr. Chen Min, affiliated companies of the Board Chairman, affiliated companies of CAR Inc, and a shareholder of the company

² Company presentation indicates that the capital expenditure in 2019 Q2 and Q3 amounted to ¥212 million and ¥352 million, respectively.

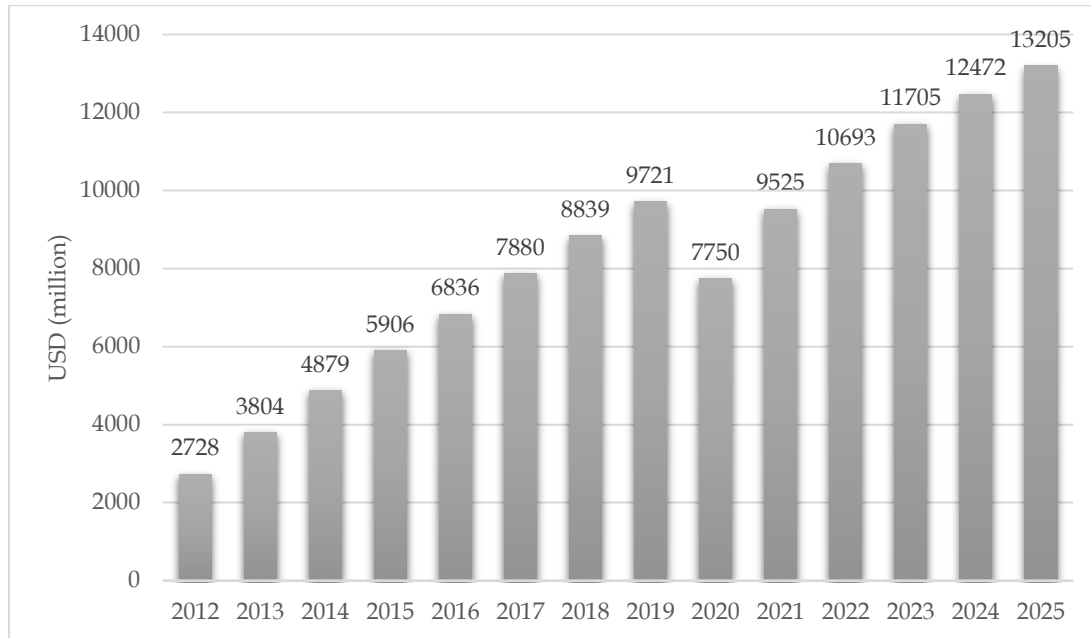
³ Common stock of ¥21,000 as of both June 30, 2019, and September 30, 2019.

Note: Luckin's 2019 financial statements were delayed due to its ongoing investigation on the accounting fraud.

Source: Thomson Reuters Eikon, Company Prospectus, Casewriter Analysis

Exhibit 5 – The Coffee Market in China

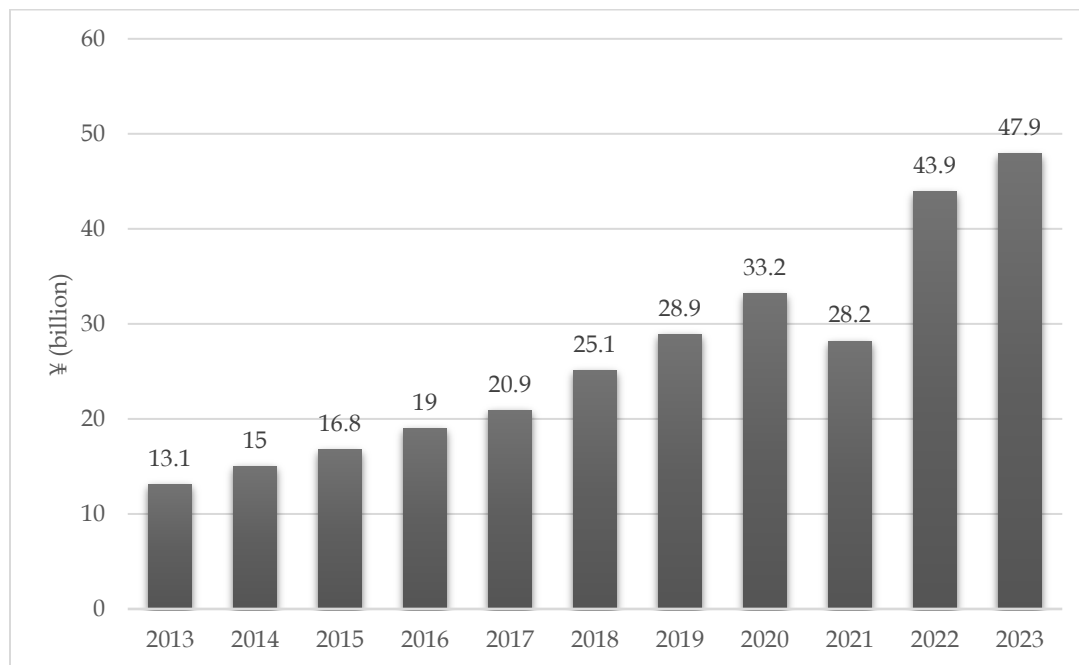
Exhibit 5.1 – Coffee Market Revenue in China



Note: Data Adjusted for Expected Impact of COVID-19

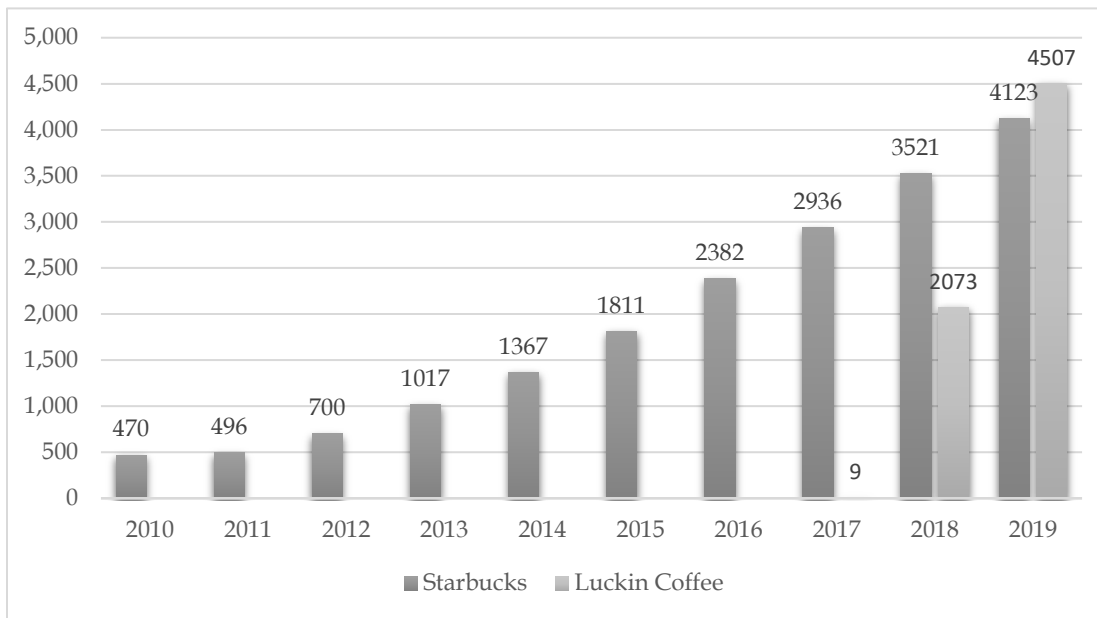
Source: Statista (May 2020)

Exhibit 5.2 – Market Size of Coffee Shops in China



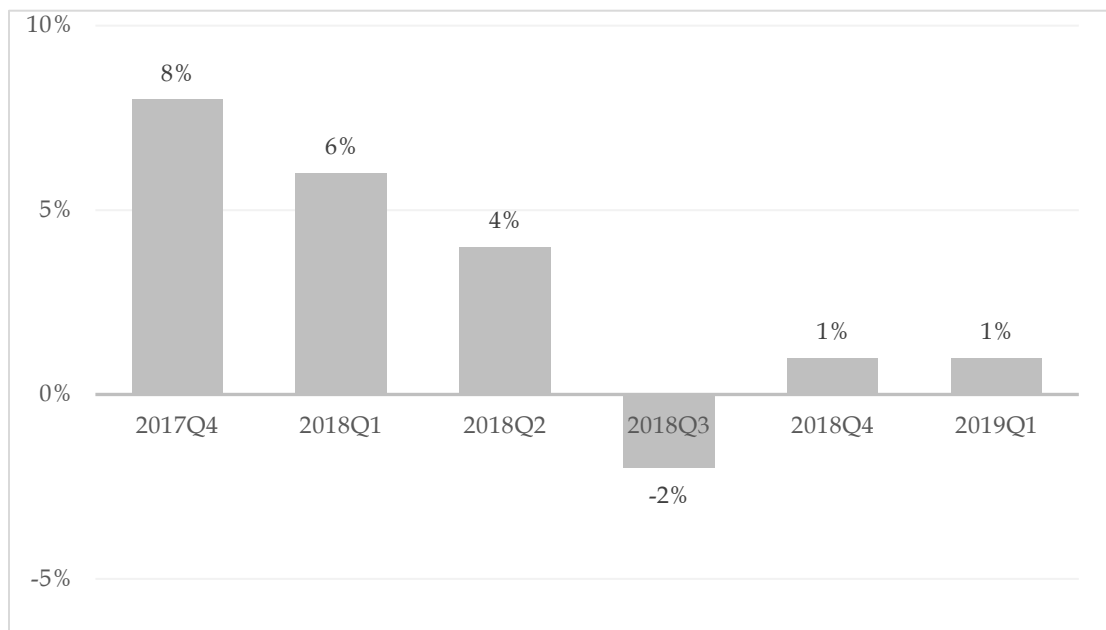
Source: Forward Intelligence (Qianzhan), Statista

Exhibit 6 – Store Growth of Starbucks vs. Luckin in China



Source: Company Annual Reports, Prospectus and Quarterly Statements

Exhibit 7 – Starbucks China Sales Growth in Comparable Store



Source: Company Statements

Exhibit 8 – Financial Information for Luckin and Starbucks

Company Name	Luckin	Starbucks
Sales (million)	¥3,395	US\$26,509
Total assets (million)	¥8,029	US\$19,220
Operating income (million)	¥(2,452)	US\$4,701
IPO year	2019	1992
P/E ratio	NM	29.97
Exchange listed	NASDAQ	NASDAQ
Liquidity and Leverage ratios		
Quick ratio	4.09	0.67
Current ratio	4.23	0.92
LT debt/equity (book) (%)	0.00	-179.19 ¹
LT debt/total capital (%)	0.00	226.28
Interest coverage before tax	-76.13	13.13
Total assets/total equity	1.25	-3.08 ¹
Activity and Profitability ratios		
Receivables turnover	150.87	30.16
Inventory turnover	14.88	12.44
Asset turnover	0.42	1.38
Cash turnover	0.75	9.87
Return on assets (%)	-30.31	18.73
Return on equity (%)	-37.83	-57.75 ¹
Operating profit margin (%)	-72.22	17.73
Net profit margin (%)	-71.70	13.58

¹ Starbucks' shareholders' equity became negative in 2019 due to an ongoing share repurchase program.

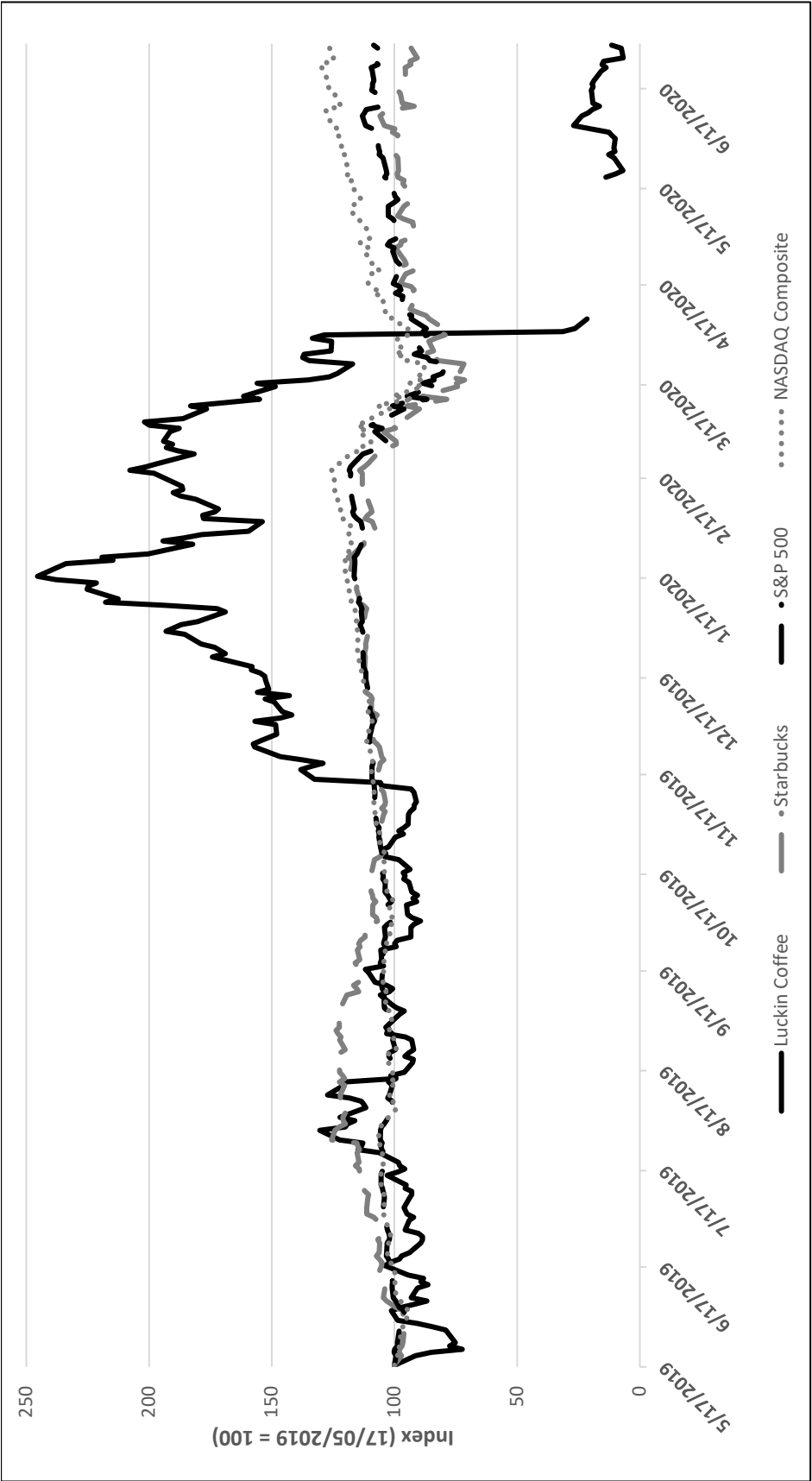
Note: NM = Non-meaningful figure; all data as per end of Sep 2019 (trailing twelve months)

Source: Thomson Reuters Eikon

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Luckin: From Brewing Coffee To Brewing Fraud

Exhibit 9 – Historical Stock Price Pattern of Luckin Relative to Starbucks, S&P 500, and NASDAQ Composite



Data: Thomson Reuters Eikon

Exhibit 10 – Analyst Recommendations

Period	# Analysts	Buy	Hold	Sell
Jul-2019	7	85.7%	14.3%	0.0%
Aug-2019	7	85.7%	14.3%	0.0%
Sep-2019	7	85.7%	14.3%	0.0%
Oct-2019	7	85.7%	14.3%	0.0%
Nov-2019	7	85.7%	14.3%	0.0%
Dec-2019	7	85.7%	14.3%	0.0%
Jan-2020	7	85.7%	14.3%	0.0%
Feb-2020	7	85.7%	14.3%	0.0%
Mar-2020	7	85.7%	14.3%	0.0%
Apr-2020	4	75.0%	25.0%	0.0%
May-2020	3	66.7%	33.3%	0.0%

Source: Thomson Reuters Eikon

Exhibit 11 – Consensus EPS Estimates*(Amount in US\$)*

Date	Year Ended 2019	Year Ended 2020	Year Ended 2021
30-Jun-2019	-1.446	-0.288	1.600
31-Jul-2019	-1.455	-0.281	1.605
31-Aug-2019	-1.457	-0.265	1.689
01-Sep-2019	-1.457	-0.265	1.689
30-Sep-2019	-1.383	-0.248	1.471
31-Oct-2019	-1.389	-0.305	1.399
30-Nov-2019	-1.296	-0.273	1.503
31-Dec-2019	-1.296	-0.273	1.503
31-Jan-2020		-0.165	1.664
29-Feb-2020		-0.175	1.441
31-Mar-2020		-0.175	1.441
30-Apr-2020		-0.172	1.280
31-May-2020		-0.203	1.465
30-Jun-2020		-0.206	1.129
24-Jul-2020		-0.206	1.129

Source: Thomson Reuters Eikon

Endnotes

- ¹ Maggie Fitzgerald 'Wall Street sees major growth potential for Luckin in untapped Chinese coffee market', CNBC news, June 16, 2020
- ² Sarah Dai 'China's loss-making Luckin Coffee start-up doubles down on subsidies to win customers from Starbucks' South China Morning Post, January 4, 2019
- ³ Luckin Coffee IPO prospectus
- ⁴ Sarah Dai 'China's Luckin Coffee confirms US\$200 million raised in latest funding round as it aims for even faster delivery time' South China Morning Post, July 13, 2018
- ⁵ Sarah Dai 'China's loss-making Luckin Coffee start-up doubles down on subsidies to win customers from Starbucks' South China Morning Post, January 4, 2019
- ⁶ Sarah Dai 'China's loss-making Luckin Coffee start-up doubles down on subsidies to win customers from Starbucks' South China Morning Post, January 4, 2019
- ⁷ Rita Liao 'Starbucks challenger Luckin's fundraising spree continues with \$150m investment' techcrunch.com, april 18, 2019
- ⁸ Devi Subhakesan 'Luckin Coffee's Upsized IPO: Why Investors Trod Where Analysts Feared?' May 20, 2019
- ⁹ Amelia Lucas and Leslie Picker 'Starbucks' China challenger Luckin Coffee prices IPO at \$17 a share' CNBC News, May 17, 2019
- ¹⁰ Hudson Lockett and Mercedes Ruehl, 'Luckin Coffee taps into thirst for Chinese convertible bonds' Financial Times, January 10, 2020
- ¹¹ Amelia Lucas and Leslie Picker 'Starbucks' China challenger Luckin Coffee prices IPO at \$17 a share' CNBC News, May 17, 2019
- ¹² Anonymous report titled 'Luckin Coffee: Fraud + Fundamentally Broken Business', January 2020
- ¹³ Bill Peters 'Luckin Coffee stock dive as these short-sellers battle over Allegations' Investor's Business Daily, January 31, 2020; Fang Yuan 'Opinion: Investors should not panic over the short report on Luckin Coffee' AllTechAsia, February 9, 2020