Summary
Luckin Coffee, listed on the Nasdaq exchange, engages in the retail sale of freshly brewed drinks and pre-made food and beverage items in the People's Republic of China. In late March 2020, Luckin Coffee announced that it had found hundreds of millions of dollars of sales from the year 2019 were 'fabricated' wiping approximately 75% of the value off the company's shares.\(^1\) S&P Global Market Intelligence's Fundamental Probability of Default (Fundamental PD)\(^2\) showed the company having a 1-year default risk of 11.9806% (an implied 'ccc+' score)\(^3\) as of its March 2019 financial statements. Since March 2, 2020, the company's Market Signal Probability of Default (Market Signal PD)\(^4\) increased nearly 7 times from 1.6995% to 12.3877% on April 2, 2020 when the company announced the formation of a special committee to investigate the issues raised during the audit of the group consolidated financial statements.\(^5\) Furthermore, the company's default probability underperformed the wider Chinese restaurant industry default risk benchmark, indicating that this trend was specific to Luckin Coffee and not driven by wider market movements.

Luckin Coffee experienced a period of rapid sales growth over the course of 2018/19, with year to date (YTD) revenue growing year on year from RMB 841 million in fiscal year (FY) 2018 statements to RMB 3,395 million in fiscal quarter (FQ)3 2019. However, despite the reported sales growth over the period of 2018/19, fundamentally the company presented a weak credit profile with net income/total revenue in March 2019 of (156.07%).

Exhibit 1: Market Signal PD Escalation

Business Description
Luckin Coffee offers freshly brewed drinks, including freshly brewed coffee and non-coffee drinks; and food and beverage items, such as light meals. The company operates pick-up stores, relax stores, and delivery kitchens under the Luckin brand, as well as Luckin mobile app, Weixin mini-program, and other third-party platforms that cover the customer purchase

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2. Fundamental Probability of Default model is a statistical model that produces PD values over a one- to five-year horizon for all private companies globally based on company fundamentals. For more information, please see: https://www.capitaliq.com/media/203896-PD%20Model%20Fundamentals%20-%20Private%20Corporates_Whitepaper_September2017_FIN...pdf
3. S&P Global Ratings does not contribute to or participate in the creation of credit scores generated by S&P Global Market Intelligence. Lowercase nomenclature is used to differentiate S&P Global Market Intelligence PD scores from the credit ratings used by S&P Global Ratings.
process. As of March 31 2019, it operated 2,370 stores, including 2,163 pick-up stores, 109 relax stores, and 98 delivery kitchens in 28 cities in the People's Republic of China. The company was founded in 2017 and is based in Xiamen.

**Fundamental Probability of Default Analysis**

The analysis of S&P Global Market Intelligence’s one-year Fundamental PD reveals Luckin Coffee had consistent implied credit scores in the ‘ccc+’/’ccc-’ range over the course of 2017 to 2019. In the Q4 2018 filing, the company’s net income/total revenue margin was highlighted by the Fundamental PD model as being high risk and driving default with levels of (192.59%) versus benchmark median levels of 3.45% for the Chinese restaurant sector.6

In the subsequent Q1 2019 filing, margins continued to negatively impact default risk in the company with Q1 2019 net income/total revenues of (156.07%). In addition, net income/total liabilities fell from (142.74%) in Q4 2018 to (188.08%) in Q1 2019 further impacting default risk. While negative margins can be indicative of a company in high growth mode, fundamental credit analysis points to a company that is becoming increasingly leveraged and may face encounter cash flow issues faced with mounting liabilities and decreasing debt service capacity unless it continues to maintain its rapid expansion. Fundamental PDs produced over the course of 2017 to 2019 consistently pointed to a company that appears fundamentally weak when viewed from the perspective of debt service capacity and leverage.

**Exhibit 2: Fundamental PD Deep Dive**

![Fundamental PD Deep Dive](image)

Source: S&P Global Market Intelligence as of April 7, 2020. For illustrative purposes only.

**Exhibit 3: Key Developments**

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<thead>
<tr>
<th>Date</th>
<th>Type</th>
<th>Headline</th>
</tr>
</thead>
<tbody>
<tr>
<td>Apr-03-2020</td>
<td>Lawsuits &amp; Legal Issues</td>
<td>Barbuto &amp; Johansson, P.A. Announces Class Action Lawsuit Has Been Filed on Behalf of Purchasers of the Securities of Luckin Coffee Inc</td>
</tr>
<tr>
<td>Apr-02-2020</td>
<td>Executive/Board Changes - Other</td>
<td>Luckin Coffee Inc. Announces Formation of Independent Special Committee</td>
</tr>
<tr>
<td>Mar-27-2020</td>
<td>Executive/Board Changes - Other</td>
<td>Luckin Coffee Inc. Announces Board Changes</td>
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</tbody>
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Source: S&P Global Market Intelligence as of April 7, 2020. For illustrative purposes only.

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6 S&P Capital IQ platform as of April 7, 2020.