

**RLX Technology Inc.**  
**Q2 2023 Earnings Conference Call**  
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Executives

Sam Tsang, Head of Capital Markets  
Kate Wang, Chief Executive Officer  
Chao Lu, Chief Financial Officer

Analysts

Charlie Chen, China Renaissance  
Lydia Ling, Citi  
Peihang Lv, CICC

**Presentation**

Operator: Hello, ladies and gentlemen, thank you for standing by for RLX Technology Second Quarter 2023 Earnings Conference Call. (Operator Instructions). After management's remarks, there will be a question-and-answer session. Today's conference call is being recorded and is expected to last for about 40 minutes.

I will now turn the call over to your host, Mr. Sam Tsang, Head of Capital Markets for the company. Please go ahead, Sam.

Sam Tsang: Thanks very much. Hello, everyone, and welcome to RLX Technology's second quarter 2023 earnings conference call. The company's financial and operational results were released through PR Newswire services today, and have been made available online. You can also view the earnings press release by visiting the IR section of our website at [ir.relxtech.com](http://ir.relxtech.com).

Participants on today's call will include our CEO Ms. Kate Wang, our CFO Mr. Chao Lu, and myself, Sam Tsang, Head of Capital Markets.

Before we continue, please note that today's discussion will contain forward-looking statements made under the Safe Harbor provisions of the U.S. Private Securities Litigation Reform Act of 1995. These statements typically contain words such as "may," "will," "expect," "target," "estimate," "intend," "believe," "potential," "continue," or other similar expressions.

Forward-looking statements involve inherent risks and uncertainties. The accuracy of these statements may be impacted by a number of business risks and uncertainties that could cause actual results to differ materially from those projected or anticipated, many of which factors are beyond our control. The company, its affiliates, advisors, and representatives do not undertake any obligation to update this forward-looking information except as required under the applicable law.

Please note that RLX Technology's earnings press release and this conference call include discussions of unaudited GAAP financial measures, as well as unaudited non-GAAP financial measures. RLX's press release contains a reconciliation of the unaudited non-GAAP measures to the unaudited GAAP measures.

I will now turn the call over to Ms. Kate Wang. Please go ahead.

Kate Wang: Thank you, Sam, and thanks, everyone, for making time to join our earnings conference call today. In the second quarter, we continued to forge ahead on our recovery path amid a challenging environment brought about by the lingering impact of illegal products on the e-vapor industry. However, we worked hard to improve our product portfolio and operational efficiency, and we're happy to say that our efforts yielded positive results in both our financial and operational performance for the quarter.

Before I go deeper into our second quarter efforts and performance, let me briefly update you on the recent market conditions. As we shared on our last call, the prevalence of illegal products in China has significantly impacted on the compliant product sales and slowed the industry's recovery in the post-regulatory era.

In March, regulators took steps to maintain a fair and orderly market and initiated a special action lasting over a month to combat illegal products. Although these measures were somehow somewhat effective, they ended in April, and we have since seen a resurgence of illegal products in the market.

As a compliant participant in the e-vapor industry, we have continued to strictly comply with regulations, concentrating on improving our products to cater to users' various needs and increase our competitiveness. Thanks to our growing portfolio of high-quality products and regulators' crackdown efforts, the overall market conditions have improved compared to earlier this year, and our sales improved quarter-over-quarter. However, the negative impact of illegal products continues to pose a challenge, and we anticipate more bumps on our path to full recovery. This is especially true when considering the difficulties our global counterparts have faced under similar circumstances.

Let's use the United States as an example. In 2020, California state lawmakers passed a law prohibiting menthol cigarettes and other flavored tobacco products. This law went into effect in late 2022. As a result, smokers have been looking for alternatives such as flavored e-vapors, which are becoming increasingly popular across the country. These products are available from both legal and illegal sources. Legitimate manufacturers are working on developing and marketing California-compliant products, but competing with the easy availability of flavored products in the market is difficult.

In the same way, China's compliant e-vapor brands are losing market share to illegal flavored products. Although our compliant products offer better quality and safety, the playing field is not level. Illegal products becoming a broader range of flavors and at a lower cost since their manufacturers do not pay taxes. These non-compliant products are unregulated and lack quality and safety assurances, which harms the overall reputation of the e-vapor industry.

Moreover, the illegal trade results in tax losses for the government, and find its way into young teenagers' pockets, even though shrinking size of compliant channels and the fast-growing scale of the illegal channels filled by illegal products. Though we believe that regulators will limit the impact of these products in the long run, their presence in the market will impede our recovery in the short term.

Nevertheless, we are confident that our premium products will continue to win users' trust and support. Adult smokers will realize the advantages of our products and develop new habits, which will ultimately boost our momentum.

Now, let's move on to our strategic efforts in the second quarter. First and foremost, we continued to enhance our product portfolio, incorporating user feedback and maintaining high-quality standards. We have started to announce that we expanded our cartridge offerings from 15 in May to 20 in July. We have top-notch research and development capabilities, efficient supply chain management, and strong quality control systems that allow us to produce high-quality products consistently.

Our RELX Physiochemistry Lab enables us to closely monitor the chemical composition of our e-liquids and aerosols, ensuring that any potentially harm emissions are kept to the minimum. Additionally, we are broadening our scientific research to further enhance product safety and explore the possibility of greater harm reduction. Our expanded research will cover topics ranging from chemistry and biology to social science.

At RLX, we prioritize user experience and highly value consumers' feedback, especially as we develop new products to meet their diverse needs while adhering to regulations. During the quarter, we continued to improve our user service management and systems to enhance our customer service team's abilities and ensure that users receive the best possible experience.

Additionally, we expanded our initiatives to address user feedback, encouraging them to interact with us more extensively and offer more specific opinions and suggestions.

Next, I would like to discuss our ESG initiatives. We recently released our third ESG report, highlighting our progress toward sustainability in 2022. At RLX, we believe that fulfilling our social responsibility is a key competitive advantage for our brand, which adult smokers trust. To guide our ESG efforts and disclosures, we perform a thorough material analysis each year, which examines various issues in relation to their importance in RLX's sustainable development and their relevance to our stakeholders.

In light of the introduction of regulatory policies and national standards for e-cigarettes, in 2022, we prioritized product innovation, harm reduction, and product quality in this year's initiatives. In addition, our materiality analysis considered external stakeholders' continued emphasis on corporate climate actions, prompting us to proactively formulate low-carbon development strategies and strengthen our climate-related information disclosures.

We also prioritize public health in our ESG efforts, investing in technological innovation to minimize the impact of e-vapor products on the public. Through our 1+4 research chain, we conduct systematic scientific evaluations and research on harm reduction. Validating these efforts, our subsidiary, Shenzhen Wuxin Technology, was appointed as the 2022 Guangdong

Provincial Engineering Technology Research Center for New-type Intelligent Atomizers and Inhalation by the Department of Science and Technology of Guangdong Province in December 2022.

We are committed to utilizing technology to advance public health initiatives and continuously refining our forward-thinking ESG strategy to benefit our company, stakeholders, and community for the long term.

As we move into the second half of the year, we expect an uneven and bumpy recovery. However, we believe our effective strategy, premium products, resilient business model, and core capabilities will guide us through the ever-changing markets. We will deepen our commitment to offering compliant, high-quality products to adult smokers, positioning RLX for long-term growth as we strive to create sustainable value for all stakeholders.

With that, I will now turn the call over to our CFO Chao Lu. He will elaborate further on some of our last quarter's initiatives and go over our operational and financial results in more detail.

Chao Lu: Thank you, Kate, and hello, everyone. I will now provide an overview of our operational and financial results for the second quarter of 2023.

Despite facing external challenges, we recorded total revenue of RMB378 million, representing an impressive 100% increase from the previous quarter. This improvement was mainly due to the efforts of regulators who cracked down on illegal products during March and April and our continuous efforts to improve our product offerings, which led to an increase in sales.

Kate mentioned that our company follows industry regulations strictly, and offers only products approved under the new national standard. Therefore, our sales recovery was somewhat disrupted by the resurgence of illegal flavored products after the regulators' special action ended in April. These illegal products are manufactured by unauthorized factories that offer a wide range of tempting flavors at lower prices than compliant products since they don't pay taxes. This creates an unfair market environment and affects the entire industry's recovery in the legal markets.

To promote the e-vapor industry's recovery and long-term, healthy growth, we have been encouraging consumers to call 12313 if they find people selling illegal products. Additionally, regulators offer rewards for information regarding potential violations of related regulations. We are hopeful that these efforts will be effective in progressively reducing and eliminating illegal products from the marketplace in the long run.

Regarding our profitability, we previously stated in our first quarter earnings call that we anticipate our margin will gradually increase as our sales improve in the upcoming quarters. The deleveraging effect caused by reduced sales is expected to lessen over time.

In the second quarter, our gross profit margin rose to 26.1% from the previous quarter's 24.2%. We are confident that our efforts to enhance operating efficiency and product design will further increase our core business gross margin.

We have made significant business changes in response to the new regulations and are working hard to control costs and make our operations more efficient. We are happy to report that our efforts have been successful, resulting in improvements in our overall operating efficiency.

Our non-GAAP operating expenses have decreased by 7% on a quarterly basis. It's also worth noting that, excluding salaries and welfare benefits, our non-GAAP operating expenses decreased by 58% compared with the same period last year.

In the second quarter of 2023, we recorded a non-GAAP net income of RMB86 million. Our non-GAAP basic net income per ADS was RMB0.064, and non-GAAP diluted net income per ADS was RMB0.062 for the same period. We are confident that our profitability will continue to rise in the upcoming quarters as we strive to enhance our supply chain and operational efficiencies.

Encouragingly, our operating cash flow has finally turned positive after 3 consecutive quarters of operating cash outflows. We recorded an operating cash inflow of RMB41 million in the second quarter of 2023, mainly due to better management of our working capital and inventory.

Our cash position remains strong. As of June 30, 2023, we had cash and cash equivalents, restricted cash, short-term bank deposits, net, short-term investments, long-term bank deposits, net and net long-term investment securities, net totaling RMB15.8 billion. We are confident that our strong cash position will enable us to navigate the changing markets. We aim to achieve additional cost savings and efficiency enhancements to speed up recovery.

This concludes our prepared remarks today. We will now open the call to questions. Operator, please go ahead.

## **Questions and Answers**

Operator: We will now begin the question-and-answer session. (Operator Instructions). Charlie Chen with China Renaissance.

Charlie Chen: First of all, very glad to see the industry revenue started to recover from the trough after what we have been through. I've got two questions. The first one is about the licensing and quota. So we are already 1 year after the first license, and the quota was allocated. So what about the licensing and quota status for this year for RLX?

And my second question is we see there is some resurgence of the non-[legal] products coming to the market again. So can you share us with some color on what's the momentum of those non-[legal] after the end of the crackdown? Are they still expanding, or what's the current status of those products?

Sam Tsang: Sure. Thank you, Charlie, for the question. So far, the first one is about the license. So our license for the manufacturing enterprise was successfully renewed in July, with a couple

of updates. First, regulators extended the term of the licenses. The licenses, we renewed, this year, were valid for 2 years, instead of just 1 year when we first obtained last year. This could provide us with other industry participants' greater stability and peace of mind.

Also, regulators have revised the wording for the approved manufacturing capacity, which provides better flexibility and adaptability to meet our users' demand. As you may recall, in our announcements made last July, we mentioned that the approved manufacturing capacity was 15 million rechargeable devices, 329 million rechargeable cartridges, and 6 million disposable products.

This year, there were no numerical requirements for approved manufacturing capacity. And the wording for approved capacity has changed to “not to exceed the number approved by the State Tobacco Monopoly Administration.”

And your second question is about the illegal product sales, how the sales are doing. I think unfortunately, these products are illegal and generally traded through the black market. So we do not have accurate data on the trend. Monitoring these unlawful activities after the special enforcement held in March and April has become increasingly challenging. Some operators have moved their operations online, and only sold to known users or customers. Overall, the illegal products are less widespread than that in the first quarter. Their availability varies from region to region, and areas with better enforcement have less availability of these illicit products.

Additionally, we do have some market observations. Our proprietary research study in e-vapor usage shows that in July, there was a drop in use per user for disposables like milk teacups and flavored cartridges illegally manufactured to fit our RELX devices. Illegal flavored cartridges may attract users with fruity flavors, but their poor product quality, including e-liquid leakage issues, have been a critical problem. Despite some initial bumps in the road, we remain optimistic about the future growth of compliance products. Thank you for your question.

Charlie Chen: Thank you.

Operator: Lydia Ling with Citi.

Lydia Ling: So I also have two questions. The first one is about like what's the view on your pace of recovery in the second half and so based on the trend so far? And so how would you see your operating target for the remaining of this year? And could you also share some color on your trend in July and August to date that will be very helpful.

And my second question is also regarding to the illegal product. So it looks like the impact of illegal product do prevail after the special action in April. So any color on regulator side further action against this? And also, will actually come to (indiscernible) that any measures from your side to take proactively against the impact and drive user demand?

Sam Tsang: Sure. Thank you very much, Lydia. So regarding the recovery pace for the second half, our visibility on the performance is relatively low for various reasons. For example, as mentioned in our prepared remarks, the impact of illegal products are still lingering. On the other hand, some indicators are relatively supportive or encouraging. For example, the number of retail stores have been relatively stable for the last few months.

Regarding recent momentum, we do see that our sales in July were slightly better than that in June. But we think that monthly sales do not accurately reflect our user demand recovery, as is subject to the orders from our regional commercial entities, which are less predictable than that from our previous privately-owned distributors. For example, some provinces we see have shown strong figures for months, but the other can drop in the following months due to inventory management and planning, and vice-versa. So looking at the monthly figures to evaluate the user demand could be misleading. That's why, evaluating user recovery over a more expanded period, such as per quarter, might be more reasonable.

Regarding future quarter sales, our sales will continue to grow sequentially if illegal product sales are not worsening. We also expect to see improved profitability due to our efforts in cost control as well.

And your second question is on the regulators' action on illegal products. So I think there are two ways to look into it. So the first way is that we try to diversify our product portfolio to meet the needs of different user groups, increasing the number of distinct cartridge flavors from 8 last December to 14 in June. We also offer products at various price points.

In addition, our teams are helping regulators to combat illegal products, and we encourage people to report any illicit sale by calling 12313. Regulators offer rewards for information regarding potential violations of related regulations to promote the e-vapor industry's recovery and long-term, healthy growth. Thank you.

Lydia Ling: Thank you.

Operator: Peihang Lv with CICC.

Peihang Lv: I have two questions. And the first one is from the perspective of consumer purchase. And since the GB standard has been implemented for nearly 1 year, and what are the notable changes in the latest consumer purchase compared to before?

And my second question is with regard to flavor, and what is the sales proportion of different flavors so far? And which product has been paid well at a higher rate of repeat purchase?

Sam Tsang: Thanks very much, Peihang. So the first one is on the user profile or user demographics. So although some sampling errors may be due to the differences in our user base between now and pre-regulatory era, we have observed several changes in our user profile. For example, the proportion of users aged 35 or above is increasing. Additionally, while users are still adapting new products, we see usage per user growing partly due to our product diversification. Still, it has not returned to the pre-regulatory level.

And the second question is on the flavors, and also, the repeat purchase rates. So currently, the Wang Jiang You Jing, which is one of the first two flavors we launch, remains to be the most popular flavor, likely due to the availability nationwide. Other flavors, especially those launched recently, are still being rolled out progressively nationwide.

Overall, repeat purchases have been gradually increasing. And additionally, users aged 35 and above have a higher-than-average repeat purchase rate, which is also rising.

Regarding the repeat purchase rate by flavor, for the first two flavors we launched last September, Wang Jiang You Jing and Sen Lin Fu Xing, their repeat purchase rates could reach close to 70% in July, although these numbers varies over time. Thank you for your question.

Peihang Lv: Thank you.

Operator: Thank you. At this time, I would now see that we are -- due to time constraints now, I would like to turn the call back over to the company for closing remarks.

Sam Tsang: Thank you again for joining us today. If you have further questions, please feel free to contact RLX Technology's investor relations team through the contact information provided on our website or Piacente Financial Communications. Thank you.

Operator: This concludes the conference call. You may now disconnect your line. Thank you.