Q1 FY2017 Earnings Call Transcript – Aug 5, 2016

Corporate Participants

- Amit Jatia – Vice Chairman
- Smita Jatia – Director
- Ankit Arora – Senior Manager, Investor Relations

Moderator Ladies and gentlemen, good day and welcome to the Westlife Development Limited Q1 FY17 Earnings Conference Call. As a reminder, all participant lines will be in the listen-only mode, and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during this conference call, please signal for an operator by pressing "*" then "0" on your touchtone phone. I now hand the conference over to Mr. Ankit Arora – Senior Manager, Investor Relations. Thank you and over to you, sir.

Ankit Arora Thanks, Zaid. Welcome everyone, and thank you for joining us on Westlife Development Limited earnings conference call for the first quarter ended June 30th, 2016. We are joined here today by Amit Jatia – Vice Chairman and Smita Jatia – Director of Westlife Development Limited. Unfortunately, Suresh is unwell today and he is unable to join us here.

Please note that results, press release and investor presentation had been mailed across to you earlier, and these are also available on our website www.westlife.co.in. I hope you had the opportunity to browse through the highlights of the performance. We shall commence today's call with key thoughts from Amit, who will provide the strategic overview, which shall be followed by Smita to take you through the key business initiatives, and she will cover analysis of the financial performance and highlights during the review period. At the end of the Management discussion, we will have Q&A session.

Before we start, I would like to remind you that some of the statements made or discussed on this call today maybe forward-looking in nature and must be viewed in conjunction with risks and uncertainties we face. A detailed statement and explanation of these risks is available in this quarter's press release and investor presentation and in our annual report which is available on our website. The company does not undertake to update these forward-looking statements publicly.

With that said, I would now turn the call over to Amit to share his views. Thank you.

Amit Jatia Thank you, Ankit. Good afternoon everybody, and appreciate you joining us on the call today. I am pleased to report that we continued on a positive trajectory as we moved into the first quarter of FY17. We have made solid progress across all our initiatives, leading to the fourth consecutive quarter of positive same store sales growth. It is a clear indication that despite a challenging operating environment and subdued consumer sentiment, McDonald's continues to make steady progress to satisfy the needs of our consumers across the marketplace.

Brand McDonald's took a leadership and differentiated approach, while keeping a sharp focus on our customer needs and have reinvested back in the restaurants through re-imaging, expansion of the McCafé business and constantly providing customers with innovative menu options building around our core products like McChicken, McFlurry, McVeggie and the Happy Meal program.

The delivery business continues to grow rapidly on the foundation of strong operations which is a very critical factor to the success of the business and our continued investment in the digital platform. The positive momentum in same store sales clearly reflects that the consumers are responding favorably to the meaningful steps we have taken.

Restaurant Operating Platform 2.0 continues to provide us with a solid base for new restaurant openings. Financial results have been encouraging. Even with 10% to 12% of our restaurant base being less than six months old, we have been able to maintain and slightly grow our RoM and in fact, grown our cash flow by more than 30% year-on-year. As we open more restaurants under the new platform, we expect to strengthen our portfolio and unit economics further.

The diversified composition of our restaurant portfolio of Drive-Thru, High Street, Mall Stores is an important competitive advantage in helping us weather the challenging environment and it will serve as a backbone for future growth of our business.

We are making good progress in all aspects of our strategy, and are committed to growing brand McDonald's to maintain our lead in the QSR segment in India.

I now invite Smita to take you through the specific results of the quarter.

Smita Jatia

Thank you, Amit. And good evening, everybody. Starting from slide four, under the Four Strategic Levers, highlights for the quarter are as follows. We ended the quarter at 3.4% same store sales growth, this is the fourth quarter of consecutive comparable sales growth in spite of Ramadan shifting to this quarter. We added six stores in this quarter, in addition to the 30 new stores in FY16. We improved gross margin by 140 basis points, ending at 60.5% and EBITDA margin expansion of ~30 basis points, leading to a cash profit improvement of more than 30%. In the quarter, we also added McCafé's, doubling our McCafé's in the last 12 months at 89 McCafés. McDelivery continued to be also a strong growth driver.

Moving into Broadening Accessibility, we entered two new states / two new cities, taking our total presence to 32 cities with six new openings in the quarter, our total restaurant count stands at 242. This presence is dominated in Maharashtra and Karnataka, followed by Gujarat and Telangana. As you can see, we still have a huge opportunity to further grow in the southern states. The New Restaurants are being opened on the new ROP 2.0 platform and are contributing to better financial performance.

Now, moving into the next lever of growing base sales through value, menu and brand extensions. On the menu front, we gave customers new news around the core burger, sides and deserts. The theme was around the flavor of Chinese cuisine which is the second most popular cuisine after Indian. We also leveraged the Angry Birds movie by doing a vertigration with the flavored cones, this was well timed with Ramadan where fast is broken with something sweet. Under Brand Extensions, we added 14 new McCafé's in the quarter, taking up current count to 89 and presence in 12 cities. As mentioned, in the last 12 months we have doubled the McCafé numbers. McCafé continues to drive a new customer base, thereby driving incremental sales. The new Iced Splash beverage introduced in this quarter, added variety and contributed to gross margin improvement.

The Mobile App & web platform, with digital marketing and strong focus on operational parameters continues to drive double-digit growth in delivery sales. Hence, menu innovation, McCafé with reinvestments in stores making it contemporary and McDelivery have all contributed in keeping the baseline trajectory in quarter one to be positive.

On the margin front, growth in same store sales and new stores, along with the improvement in gross margins through menu innovation has flowed through the operating EBITDA margin. We also got recognition at the Digital Media Awards for the Best Online Campaign and the Campaign with the Best ROI for our Indi-Spicy Campaign which we did in quarter three of FY16.

Now, moving on to the financial performance overview. Our total revenue growth was 10.9%, mainly driven by new stores, menu and brand extensions. EBITDA margins expansion on a Y-o-Y basis was primarily due to gross margin expansion, stable payroll and employee cost, reduction in operating cost and G&A leverage.

I now pass upon to Amit, to take us through the outlook for the next quarter.

Amit Jatia With respect to the way ahead, we expect an improvement in consumer sentiment in the next three to six months on the back of good monsoon and positive government reforms like the introduction of GST and 7th pay commission payouts. I believe that WDL is well positioned to capture the opportunity as the next cycle of economic change comes in. We expect to double the base of our restaurants over the next five to seven years, while opening between 30 to 40 new restaurants in FY17. We are on track to deliver on our expansion plans as laid out in our Vision 2022. We will continue to concentrate on the quality of real-estate and on building a diversified portfolio of formats like Drive-Thru, high street, mall and transit restaurants. We expect to grow our customer base, and therefore base line sales through menu innovation, aggressive growth of the McCafé portfolio and McDelivery. We will continue to differentiate the brand through brand building activities rather than depend solely on deep discounting to grow sales. We will continue to strengthen our affordability platform through the happy price menu to bring new customers into the QSR category to grow the base of the customers.

As the base of new restaurants built on the new Restaurant Operating Platform 2.0 grows, it will help us improve our margins as the new stores turn profitable faster, with growth of average restaurant sales through the expansion of McCafé, McDelivery and value. We expect to see improved restaurant operating margins in the coming years. We will focus on bringing more customers to our existing base, while opening new restaurants to serve future demand and unpenetrated markets.

We remain confident that our strategic direction aimed at improving operational efficiency and growing the customer base will result in significant improvement in shareholder value in the years to come.

With this, I open it up for Q&A. Happy to take any questions that you may have.

Moderator Thank you very much, sir. Ladies and Gentlemen, we will now begin with the question-and-answer session. Our first question is from the line of Sameer Gupta from India Infoline. Please proceed.

Sameer Gupta Sir, while SSS growth has been positive, but we see a marked moderation from the fourth quarter levels, so what is it? Is it competitive intensity or is it a general demand slowdown that you have witnessed?

Amit Jatia See, firstly, you cannot compare sequential quarter on comparable sales, comparable sales numbers are from the previous quarter of the previous year and a lot depends on how that previous year was delivered. So for example, if last quarter we did 8.4, this quarter we did 3.4, that does not mean next quarter should be 6 or 8 or 12, everything is relative to the same quarter previous year. Also seasons change and activities change too. So for example, particularly in this quarter there was a significant shift of Ramadan moving from quarter two of the financial year to quarter one, and that is a significant impact. So basically, we feel that comparable sales are compared to the same quarter of previous year.

Sameer Gupta Sir, in that case could you just quantify the impact of Ramadan, maybe just the first two months same store sales growth number?

Amit Jatia No, we do not break that out, unfortunately. But I must say that, we have seen that whenever consumers are out there, we are doing really well and it is not very consistent. So, some months are really good and then just one month alone averages it out. So if you again look at last year, when there is a great movie or when there is a great occasion, we see people coming in. Therefore, in Ramadan as footfalls dropped, we saw the impact. Overall, we do not share month-on-month data.

Sameer Gupta So is it like this event related demand you have seen in this quarter also or has it been less volatile in this quarter?

Amit Jatia No, volatility is there because month-on-month is different, but the point is, when consumers are out there we are seeing great results.

Sameer Gupta Sir also, can you share some numbers on how McCafé and McDelivery have done in this quarter?

Amit Jatia No, we do not breakout our brand extensions on a month-on-month or a quarter-on-quarter basis, we did give a lot of flavor in the Analyst Meet that we had in March. The good news is that we have been able to take the base of McCafé to 89, which is I think is a solid foundation. And additionally, Smita talked about the fact that we introduced the Iced Splash which has done really well. So, we are seeing the average volume for McCafé to grow quite well and we are seeing the delivery business growth maintained from what we shared in the analyst meet in March. So the trajectory has been maintained, that is what I can share with you.

Sameer Gupta Just one last question, on your store addition target, I understand this quarter Y-o-Y growth comparison might be not be the right thing to do, but in case the demand weakens or this demand volatility continues, would there be a revision in our store addition target for the year?

Amit Jatia No, I think the last two years have been more difficult than what I am seeing at least at this point in time, and we have never fallen back on new store development because that is what I keep saying that our vision is long-term, it is not about today. You see, there are a lot of under-penetrated markets and that has nothing to do with the current slowdown. So, if you are not present say a Dadar or in Sion, opening a store there makes sense whether the market is down or up. So we will continue with the trajectory. And as I have mentioned in the past, for us, the terms of the real-estate, the structure of the deal, the risk management is all very material because we are building a very solid portfolio from our point of view that basically kind of takes us through the next 10-20 years.

Sameer Gupta So wherever there is an opportunity you would look to grow or look to add a store over there.

Amit Jatia Absolutely, and you will see that, I mean in Mumbai itself which is a very difficult market, you continuously see us open restaurants in really difficult markets, like Hill Road recently, BKC in Bandra and there are some really very interesting sites coming along as well.

Moderator Thank you very much. Our next question is from the line of Abneesh Roy from Edelweiss. Please proceed.

Abneesh Roy My first question is, Kerala you have seven stores, now this Fat Tax, do you see this percolating to other markets? And what kind of impact you see on volumes because of this?

Amit Jatia See, my point is that it is just the way the Finance Minister has coined the term. Outside of which, fundamentally it is basically Sales Tax. Largely, most states were already at that number, and Kerala was lower and they have just brought it up to this number, that's it. Number two, with GST coming in, all of these variations go away. So I think it is a very specific, short-term thing that has happened in Kerala. We see, in fact, good results in the Kerala market, so even though we do not break it out by region, we are seeing pretty strong comparable sales growth even after the taxation has come through. And finally, that taxation is not any higher than what it is across the whole country in any case, 14.5% in Kerala is the same as Karnataka, Tamil Nadu and Hyderabad. So, I think it is just in line with the other southern states.

Abneesh Roy Sir, one follow-up on that, you said Kerala is doing much better, I see much lesser number of stores in Kerala versus Maharashtra, Karnataka, etc. So is it because of cannibalization that Kerala is doing much better?

Amit Jatia This is the part I try to explain to people that Rome was not built in a day. So for example, we opened Colaba 10 years later than our first restaurant, that does not mean Colaba should not have had a restaurant. And, same is the case with BKC which we opened 20 years later. The important thing is, you got to find the right location, you got to get the right deal structure and at the end of the day it is also about focus. Small cities you got to penetrate in a certain manner, we think we have a pretty good handle on that and therefore, in fact my strategy has been to go to one city and own it. So if you take a city like Pune, we have 30 restaurants in Pune today and we keep opening restaurants in Pune, because there is demand and there is opportunity. Yet, at the same time in Chennai we have built 10 to 12 restaurants and we think we can easily double the base. But again, it requires us to keep the focus, make sure that the quality of the real-estate is right and it takes time to penetrate these markets. So the point is, you will continuously see us build 30-40 restaurants, sometimes you will see us build two or three in Cochin, for example, right away and sometimes it just takes a couple of years to build a restaurant. Because, we look at real-estate as a capital thing rather than a revenue mechanism. And, that's why doing the right thing is more important and it takes time to get that going.

Abneesh Roy Sir, my second question is on your opening remarks, you said sentiments will improve. What I did not understand you expect sentiments to improve in three to six months because of GST and monsoon. Now GST will happen next year and monsoon might impact just a few of your stores, because that is largely rural and smaller towns. So I could not understand why sentiments should improve because of GST and monsoon?

Amit Jatia For GST I agree, but, I feel it is about the confidence index. In our view, we have always maintained that it is not about physical money in the hands of the consumer, it is how confident the consumer feels about tomorrow. To me, when GST was announced I think it is a positive thing moving forward. On top of that, monsoon is giving a positive feeling about where the country could head in the next six months to 12 months. Lastly, the Pay Commission of course, which I touched briefly in my remarks. So I feel if consumer confidence moves up, I feel that you will start seeing an uptick in the consumption. So that is really what I meant.

Abneesh Roy Sir, one development is, some pizza chains have launched burger pizza, so does that have any impact, especially on your youth consumers, could they gravitate towards the burger pizza?

Amit Jatia See, my point is that there are brands that are known for their core competencies, and as far as McDonalds is concerned, we believe that burgers are our core competencies and we know how to deal with anybody who comes in burgers. So whether a Burger King or KFC comes in, we compete with them effectively. So similarly, if another brand in Pizza whose core competency is Pizza chooses to come in the burger market, we know how to deal with it as well. We sell more burgers around the world and we compete with brands that you know of and in some cases, you may have not even heard, like Jollibee in Philippines which has around 500 restaurants. Of course, we to be ahead in competition and we have to be relevant to the consumer, we have to keep our brand connect strong in their mind and we will continue to drive that through our strategies.

Abneesh Roy Sir last question is on employee cost, so there is a lot of attrition happening in the E-commerce players, so does that help you in terms of delivery and general staff, so some savings can happen next year because of that?

Amit Jatia No, see basically, I mean that could be a small impact for sure and everything counts and helps actually, but for us it is more about productivity growth. The job of operation, especially in McDonald's, because we believe the QSR business is about pennies and therefore you got to be really efficient in your operations. And therefore we have to constantly keep looking at how to run better efficiency and better crew labor productivity. So we have given some really good results in the last year when minimum wages went up by 40% - 45%. Of course, wages keep going up and therefore productivity growth can never stop. And these small windfalls do help, because they sort of reduce the pressure on us. So you will continuously see us focusing on labor productivity, we are quite confident that we are going to work very hard to ensure that payroll expenses remain under control, so that as comparable sales grow we keep getting flow-through to the bottom-line.

Moderator Thank you. Our next question is from the line of Avi Mehta from IIFL. Please go ahead.

Avi Mehta Just one clarification required we have not adopted IndAS, is that understanding correct? And if not, could you please clarify that part.

Amit Jatia Yes, applicable to us from next year.

Avi Mehta So is there a special clause or is it just because of size, how does that work, if you can clarify.

Amit Jatia There is a difference on applicability because of share capital of the company. Therefore, we are covered in the second phase.

Avi Mehta And sir, you have done almost about 20 stores in 2016 till now, while one quarter is not a sense on entire store additions, but you are at a very healthy pace. Would you see upside to the 30-40 guidance that you have given?

Amit Jatia No, I feel it will stay within the range. We feel that it is about sensible growth. We feel we are aggressive. If you see the locations that we are building, especially in our key markets like Mumbai, Pune, Bangalore, Hyderabad, Chennai, Ahmedabad, you will see that these are marquee locations, very hard to get and you got to be aggressive to acquire such locations. So you will continue to see that pace, but we believe that currently with the environment where it is and the real-estate impacts us immediately as well. So, if you see suddenly mall growth to double, triple, yes we can increase the pace of growth. We are linked in some sense with what happens with new developments in real-estate as well. So, I always give this example that many years ago we could do only 10, and that time we thought we will never get to the 30s, today we are in the 30s and I feel over the years we will get to the 40s and 50s. But the whole environment has to change around that. So, we will stay within the 30 to 40, I do not anticipate us going beyond 40 at this stage for FY17.

Avi Mehta And sir lastly, you have done almost 3.4% kind of same store sales growth in this quarter, and despite that you have been able to see margin expansion. So, is it something that now clearly the focus is on getting this profitability lever significantly up and is there a target that you have in mind in terms of mix expansion that you could share for the year?

Amit Jatia We do not give guidance for the year, but I feel it is about both. You got to understand that I feel that the QSR industry is still very nascent in India, it is just the beginning, and therefore you have to do top-line growth and you have to get margin expansion. And good companies have to do that together. We are getting tremendous benefit from the restaurant operating platform 2.0 and we are very excited about what we can achieve with that, because the application of that to go back to our older stores and make reasonably decent improvements in those restaurants as well. So I think that you will continue to see us grow top-line and you will see us work very hard to get margin expansion too. The crux however is that as the wind turns we feel we are ripe for some really good benefits, but we got to see the trajectory from the consumer change a bit more before you will see more flow-throughs. But the direction that we are taking moving forward is to go in the lines of what we suggested over our 2022 target of mid to high single-digit comparable sales and to take our margins to low to mid-teens over the stipulated timeframe.

Avi Mehta Okay, well let me rephrase my question. You have seen 30 bps EBITDA expansion Y-o-Y despite a 3.4% same store growth and 6 stores addition. Any risks on this kind of trend sustaining?

Amit Jatia I do not see on the risk but you got to remember it is not just six restaurants, we have almost 25 to 30 restaurants that are less than six months old, because we have opened about 27 restaurants in last nine months and average age of these restaurants would be around six months. So I feel very positive about the fact that with 27 restaurants coming in the total base of 242, and yet we have not lost out on margin gives me confidence about our new platform ROP 2.0.

Moderator Thank you. Our next question is from the line of Hemant Patel from Alder Capital. Please proceed.

Hemant Patel Just a couple of questions, wanted to understand basic mix improvement on the portfolio. The context I was trying to understand is, we have a value portfolio and we have a lot of new introductions which you are trying to build upon, have you seen the value portfolio actually come off even in this down cycle and have you seen the new introductions actually taking off on overall basis? I am not asking for percentages, but just to understand the trends over here.

Smita Jatia So the value platform will always continue to help gain new guest counts or new customers. So I do not think there is a trade-off between either or. Obviously, the new variety and the new menu introductions are also towards your existing customer base. So again, if I have to say, I do not see trade-offs happening between value or menu, there are quarters where the value portfolio does incremental numbers and in some quarters it is menu introductions which do the larger numbers.

Amit Jatia Further, we use different levers at different times depending on how the consumer sentiment is and there is seasonality in our business, and seasonality plays a significant role in the eating out frequency. And that is how we sort of use these different levers. The good news is that we feel there is opportunity in both, and as Smita mentioned, one is an average check driver and also bringing frequency of our existing guests into our restaurant, while value to us is a recruiter for new customers into QSR.

Hemant Patel And just one more question on the same issue which is I am trying to understand the improvement in the gross margins that you have been having, is that, are there more efficiencies that we can generate out of our supply chain for food and paper cost as where we are at the moment?

Amit Jatia I think we can, because it is all about scale, when it comes to supply chain in QSR particularly, scale plays a very significant role. In fact, to that extent we feel that GST is going to help us because logistically it just changes the way we can manage movement of goods across territories. So we are quite excited looking forward to how GST and how soon that comes through. If it does come through in April, we are quite excited about what benefits it can bring to us on the supply chain. But for example, just as volume grows in South India and if we build a facility in South India, like we did a few years ago with buns, that brings in lot of efficiencies and significant improvement in our gross margin right there. And therefore having the plant locally gave us that benefit. So these opportunities are quite dramatic, but for that you need scale. So at the change of 50-100 restaurants that come in, these scales start kicking in. So I think for us, as I have always maintained, raw cost continues to be an opportunity and has worked for us, as inflation has been a bit under control. But, primarily we have been using product mix to our favor, which has worked quite well.

Hemant Patel And on Drive-thrus, could you give us a sense, I mean, we have had our focus on Drive-thrus for a while now, what has been the learnings, has it worked out to your expectation in terms of the throughputs that you were expecting?

Amit Jatia So, it is building continuously, we are quite encouraged with the results, we cannot share individual data but I can give you a lead. If you drive from Bombay to Ahmedabad today, you will see the power of the McDonald Drive-thrus. And what it does is, it builds unbelievable brand affinity because Drive-thrus do differentiate the McDonald's experience and it is a very hard bit of real-estate to do and therefore it takes a lot of effort initially, but as we have kept scaling Drive-thrus, customers get used to that and the convenience of just having the car park right up front, all these are very significant because I remind everybody that QSR is an impulse business and therefore convenience is very-very important in our industry. So we are seeing pretty decent traction on the Drive-thru portfolio, so we will continue with our stated strategy of building Drive-thrus in the future as well.

Hemant Patel And on a FY17-18 basis or let's say three years out, will our focus on Drive-thrus be more skewed, or basic standalone restaurants which are more mall or high street associated?

Amit Jatia No, it is a diversified portfolio approach, so we got to keep ensuring that we have a diversified mix because there are ups and downs, there are times when malls footfalls go down and during those times, our Drive-thru portfolio is pretty solid as it acts as a tremendous convenience for people who are driving around and not necessarily going for shopping into a mall or into a retail area. So as the portfolio gets diverse, we capture different occasions through these platforms. A transit location, for example, if you take our Andheri restaurant, so typically footfalls do not get impacted there and it is a little more resilient to what happens in a downturn. So that is why having a diversified portfolio gives you a bit of a hedge and gives you a much better portfolio of assets to build your business on. So you will see us continue in the same direction, I do not see it is changing in the next three to five years.

Hemant Patel And one last question, the newspapers were carrying about these health initiatives that the parent is actually putting across the global franchise and we also, I guess, are working on that. Could you shed some light on what really are these initiatives and would we be actually publicizing this for our consumers when they actually are buying a few products at the outlet?

Amit Jatia Absolutely, and we have done that. You might have seen a lot of media reports around the work that we have done, so I think 18 months ago we had talked about our sodium reduction and reduction of oil content in our sauces which has reduced the calorie content of the burgers by 8% to 9%. The other thing is the introduction of the egg burger, grilled chicken, some of the work we have done from day one around our ice cream which is only 3% fat. So, we have done a numerous work and you will continue to see us take a leadership position in the marketplace to ensure that we keep giving consumers what is the most relevant product for today. One big advantage we have had is that, one, we have a very strong vegetarian menu and therefore a lot of things are quite different from what you might see in other parts of the world as well, just like the egg example. So, we are going to be very transparent and communicate to our customers as well.

Moderator Thank you. Our next question is from the line of Bhavesh Shah from CLSA. Please proceed.

Bhavesh Shah Sir, can you share some details on how many restaurants or stores you have adopted ROP 2.0?

Amit Jatia Basically all the restaurants that we have opened after January 1 are on ROP 2.0, so that's a total of about 20 restaurants.

Bhavesh Shah And do you also have plans of extending this platform to the existing base of restaurants?

Amit Jatia So we will apply all the operating initiatives to the older restaurants as well and over the next 18 to 24 months we expect a large part of our operating improvements to have happened in the previous stores as well.

Bhavesh Shah And just to understand, if you open a McCafé in one of your existing stores, so do you also adopt all the new efficiency under ROP platform?

Amit Jatia Yes, we do. When we go in to a restaurant to do McCafé, you would have noticed in McDonald's that now there is a separate counter to order and collect, all these are very important steps from a tomorrow point of view, because this is what enables us to build the experience of the future for our customers. And we have a clear path on what we want to do. So every time we go into a restaurant, you will see digital menu boards, you will see the counter service to be split up, you will see a McCafé come in and you will see a bit of reimaging to ensure that the restaurant is relevant to today's customer experience.

Bhavesh Shah Sir my second question, your product mix has clearly helped your gross margins, but can you also share some trends or perspectives in your input cost?

Amit Jatia We have tried to keep input cost quite under control. Fortunately, in the last 18 months, inflation in food has been alright and also, because of our backward linkages to farms, it helps us to manage the input costs. So, I do hope it stays like that which gives us a little more room to work on other initiatives that we have.

Moderator Thank you very much. Our next question is follow-up question from the line of Abneesh Roy from Edelweiss. Please proceed.

Abneesh Roy Just a few follow-up questions. So you said because of Ramadan there was an adverse impact, so in Q2 that should ideally reverse because last time it was in the base quarter of Q2.

Amit Jatia Yes logically, you're right.

Abneesh Roy And sir, second one is more longer term, so now 24 x 7 malls in-principle is a reality as the Central Government has allowed and now state governments will have to allow that. So, is this really new thing for you, because lot of your stores are anyway having a higher opening hours, except in the malls. So in the malls do you expect more business because of this?

Amit Jatia 24 x 7 globally has been a very big initiative for McDonald's and has yielded good results for us in the past. The point is that there is a typical lag of 12-18 months after the government passes such enactment. Because, first we need to see the regulation and then we need to prepare our operations accordingly, it requires manpower, it requires training, it requires other elements that are required for a 24 hours operation. So my point is, it is something that can help at least a business like QSR because we are an impulse business and we are a convenience driven business. We have anticipated 24 x 7 from day one when we sign our real-estate contracts. And you will notice that in many of the malls we are right up-front. Therefore, we have the opportunity to actually run 24 x 7 operations even in the malls itself. So, I feel it has a positive opportunity for us in the future.

Abneesh Roy Sir on GST perspective, assuming say 20% rate, of course ease of operations will be there but at 20% is it negative from a margin perspective or you think you can easily pass it on?

Amit Jatia It all depends on the fine print. Generally, we are quite positive about GST because you have got to factor in that as the restaurant base grows, ease of doing business matters a lot and does help us from a productivity point of view, especially in logistics and movement of goods across states. And remember, we are moving frozen and chilled products, short shelf life products like buns, it is very important to be able to move into states without barriers. So that is one big benefit. Secondly, it all depends on the fine print of what other input taxes are subsumed together and on what we can get input credits. On first read it looks pretty decent, and our preference of the rate is 18% and at that rate it does work in our advantage.

Moderator Thank you. Our next question is from the line of Pulkit Singhal from Motilal Oswal Asset Management. Please proceed.

Pulkit Singhal Just trying to understand, I mean, gross margins, I have always been surprised that we operate at 60% gross margins and we see a lot of other food and beverage companies operate at 75% to 80%. And your scale clearly is the highest amongst all, so I do not understand why we are at such low gross margins. And maybe you can help me understand the reasons and also whether till what level can we go from here?

Amit Jatia There are different sectors. If you compare to say a coffee QSR or a beverage QSR like take Jamba Juice, I am talking global understanding of informal eating out because I think that is the kind of question. So, the gross margin for those people is definitely going to be better, but there will be other cost structures that as a percentage of sale will be much higher for them. So for example, if you take a beverage based business, their rent cost would be much higher because their average volumes would be lower, but their gross margin on a beverage business is always very high. Versus, if you see globally and if you see in Asia and if you look at brands that are burger brands, their gross margins would always be around the numbers that we are talking about. In more developed markets if you see the global published data, you might be able to see gross margins of QSR brands that are burger companies at 70% range. So there are two aspects here, for us in McDonald's in India, it is about growing the frequency of eating out and we believe that value is going to play a substantial role in that. And therefore for us to maintain the right price points to grow more users into QSR is more important than anything else at this point in time. The other thing is that different sectors of QSR, as I explained to you the beverage side, similarly if you look at desserts or pizzas, their model is different. So it has to do specifically with the sector of burgers, our overall investment is much higher to start with and the crew that we need to run a burger company is much higher. But, at the same time, our average volumes are very high and that gives us the benefit and the operating leverage. So, from our point of view 60% is actually pretty good, most of the people that we see around are 58% to about 61%. So we think in the last two years we have made substantial progress, of course we have said aspirationally we want to get to the 62% to 63% and we know we can do it tomorrow if we wanted to. However, for us it is about basically growing the frequency of eating out. And therefore, we think that we are moving at the right pace and you will continue to see this progress in the next 12 to 18 months.

Moderator Thank you very much. As there are no further questions, I now hand the conference over to the management for closing comments. Over to you.

Amit Jatia So, thank you everybody for participating and taking the time to be on our call today. We really appreciate it. If you have any further questions, please feel free to contact Ankit, and also our website has all the data that we just published. Thank you once again. Have a great weekend.

Moderator Thank you very much, members of the management. Ladies and Gentlemen, on behalf of Westlife Development Limited, that concludes the conference call. Thank you all for joining us, and you may now disconnect your lines.