Q2 FY2016 Earnings Call Transcript – Nov 6, 2015

CORPORATE PARTICIPANTS

- Amit Jatia – Vice Chairman
- Smita Jatia – Director
- Suresh Lakshminarayanan – Chief Financial Officer
- Ankit Arora – Senior Manager, Investor Relations

Moderator Ladies and gentlemen, good day and welcome to the Westlife Development limited Q2 FY16 earnings conference call. As a reminder, all participant lines will be in the listen-only mode. There will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing '*' and then '0' on your touchtone telephone. Please note that this conference is being recorded. I now hand the conference over to Mr. Ankit Arora – Senior Manager, Investor Relations. Thank you and over to you Sir.

Ankit Arora Thanks Mallika. Welcome everyone and thank you for joining us on Westlife Development Limited second quarter and half year ended September 30th 2015 earnings conference call. We are joined here today by Amit Jatia – Vice Chairman, Smita Jatia – Director and Suresh Lakshminarayanan – Chief Financial Officer, Westlife Development Limited.

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 will be followed by Smita to take you through the key business initiatives and Suresh will cover analysis of the financial performance and highlights during the review period. At the end of the management discussion, we will have a Q&A session.

Before we start, I would like to remind you that some of the statements made or discussed on this call today may be 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 results 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.

Amit Jatia Thank you, Ankit. Good evening everybody, thanks for joining us on the call today. I am happy to say that we have made good progress on our long-term strategic plan built on the foundation of our four strategic pillars of broadening accessibility, growing baseline sales, margin expansion and growth through people. We have made meaningful progress across each of these pillars. Our long-term strategic plan which aims to enhance shareholder value through increased profitability, improved cash flow and prudent allocation of capital is working. We have seen positive response from consumers to the actions we have taken and this progress is reflected in our second quarter results. The vote of confidence from our customers place us in strong leadership position in the QSR segment.

I am happy to report positive comparable sales of 1.7% for the quarter which was a tangible sign of progress and reflects the initial steps we have taken in the areas that matter most to our customers, which is great tasting and high quality food, convenience and value. While the broader QSR industry is dominated by discounting Westlife's investment in long-term brand building has helped significantly in delivering positive comparable sales in the quarter in a weak consumer environment.

In quarter two we were able to leverage the strengths of brand McDonald's in our marketing initiatives building on the unique restaurant experience as well as the menu offering. Our investment in brand building through our award winning brand campaign "Kuch Pal Offline", reimaging of older store along with strong rollout of McCafé, continued focus on the delivery business and exciting limited time menu items like Banana Oreo McFlurry and the Chilli Paneer Pockets is differentiating us within the

QSR industry and helping us navigate the soft consumer environment in the country. Even as consumer sentiment remains muted we will continue to build on our strategic pillars to gain incremental consumer spends at McDonald's and we expect to continue to investment in brand building, aggressive implementation of our beverage strategy, iconic menu introductions and line extensions along with specific focus on reimaging and delivery. We are increasingly confident that as consumer sentiment picks-up, we will reap the benefits of our strong foundation and increased footprint.

In the last few quarters, our same store sales have trended upwards and we believe the worst is behind us and we hope to see an uptick in the discretionary spends in the coming quarters. In Q2, we kept our focus on reimaging to provide a modern and progressive restaurant experience to our guests and additional McCafé's to our existing restaurants taking the total McCafé count to 52 which is a three-fold increase pretty much in the last 12 months. With respect to new restaurant openings, we have the inventory for FY16 all tied-up and under various stages of construction and we will meet our target of 30 to 35 restaurant openings for FY16. We have been diligent in both restaurant location selection and on restaurant development cost consistent with our long-term strategy to improve profitability of the existing restaurant base, we will be at the lower end of our targeted new restaurant capex of Rs.25 million to Rs.30 million per restaurant which helps us in maintaining healthy unit economics, as we grow the restaurant base.

I am pleased to state that we have made significant progress on our operating margins which are now beginning to reflect in our operating results as well. Over the last year we spend time in reviewing all our sourcing costs and the various taxes that impact us due to regional presence. Over the last few years, we have been very conservative in recognizing these cost and taxes. On detailed assessment, we have been able to optimize the same leading to a significant gain of Rs. 23.4 crores pertaining to the prior period recognized in this quarter. Additionally, we have made positive gains in crew productivity, continued improvement in food and paper cost leading to a normalized operating EBITDA margin improvement of 425 basis points.

The improvement in gross margin is driven by favorable product mix shifts based on our menu initiatives. With a healthy improvement of both unit economics for new restaurants and operating margins we hope to gain additional margin as we build positive comparable sales in the coming quarters.

I now hand over Smita to take you through the specific quarter results.

Smita Jatia Thank you, Amit. Some of the highlights in Q2 are as follows. We are happy to announce a positive 1.7% comp sales growth after the gap of eight quarters of flat or declining SSSG and a normalized total sales growth of 8.4%. Along with sales growth, we have had a healthy normalized EBITDA margin improvement of 425 basis points. Sales growth has been contributed by the positive momentum of the delivery business and McCafé, supported by investment in the brand as well as every day value and menu introductions.

Starting with our first pillar on broadening accessibility, while we have opened 27 restaurants in the past 12 months, we are on track to open 30 to 35 restaurants in the financial year. We continue to grow in all parts of our region increasing our presence and accessibility.

Some of the key highlights under this pillar is that we continue to invest in the long-term growth. Our drive through portfolio continues to grow giving us competitive advantage, market planning along with the focus on unit economics is giving us better results on new store profitability thereby reducing drag on margins.

Moving on growing base line we are happy to say that we are beating seasonality and have been able to grow baseline sales. This has been due to continues focus on every day value rather than deep discounting helping build loyalty to the brand.

In this quarter, we grew baseline also by introducing Chilli Paneer Pockets, as a new side item. This enabled add-on sales and increased average spend. This introduction also led to gross margin improvements. To complete the meal offering, we had a limited time offer in our popular McFlurry range along with a vertebrate program with the ever favorite movie Minions. This again gave value and variety and helped in building brand loyalty. Under brand extension, our McCafé restaurant along with reimaging continues to beat the system average. Today we have 52 McCafé's in a span of two years and we have met our target openings of 50 McCafé's to 75 McCafé's by December. Through our web and refreshed mobile user interface delivery continues to drive strong performance thereby again building base line. Hence recapping this pillar, our upward trajectory in base line sales has been contributed by investment in brand building through a strong brand campaign "Kuch Pal Offline" every day value and providing new news through menu thereby building loyalty, keeping our restaurants modern and contemporary and investing in future growth platform of McCafé and Delivery.

Improvement in top-line also contributed to margin expansion of 425 basis points. We have improved gross margin through healthy product mix movements as well as focus on crew productivity initiatives such as better staffing, training and shift management, has also yielded us result. This has led to margin improvement quarter-on-quarter thereby taking us close to our margins of FY14.

In this quarter, we are also proud to announce our external forum recognition. Our brand campaign "Kuch Pal Offline" won the Best

Innovative Campaign by the International Advertising Association. We won the "Make in India" Award for our robust supply chain and in the All India Women Barista Championship, we also stood among the top five.

Now I hand over to Suresh to take us through the financial section.

Suresh L Thank you, Smita. I will now take you through the business performance for the second quarter and half year ended fiscal 2016. This has been an encouraging quarter across key operating elements of top-line growth, comparable sales and margin expansion. Before I get into the analysis of the same, I would like to draw your attention to Amit's opening remarks regarding review of all our sourcing cost and various taxes that impact us due to our regional presence.

Upon an in-depth assessment, we found opportunities to optimize our input taxes accordingly we have recognized the additional credit of Rs. 234 million in the current quarter. The reported numbers have been included in slide 21 for your reference.

However, to help analyze and discuss the normalized performance I would request you to move to slide 22. And now let me talk a little bit about the top-line growth. Various ongoing strategies for the last 12 months have yielded significant results in our Q2 performance. Our efforts around the four strategic pillars helped us deliver first quarter of positive comparable sale of 1.7% after last eight quarters of flat or declining same store sales growth trend. We saw a top-line growing by 8.4% over the same quarter of previous fiscal and a comparable revenue growth in H1 was around 6%.

Now moving over to gross margins. All our strategies around the brand building and providing variety to the consumers in this quarter through the popular Happy Meal property of Minions and new McFlurry varieties associated with it and also the introduction of the Chilli Paneer Pockets on the menu helped increase the average spend as well as drive better system wise gross margins.

During the last 12 months, we have more than tripled the number of McCafé and such accelerated roll out has also positively impacted the gross margins. These initiatives along with supply chain efficiencies resulted in an expansion of 165 basis points in this quarter. It is heartening to say that our initiatives and efforts over the comparable periods of around more than last two years have resulted in a consistent gross margin expansion and we shall continue to focus on the same to drive this upward trajectory further.

I will now move onto the operating expense and the margin expansion. Payroll inflation had impacted our restaurant operating margins in the past and Smita also mentioned this, we had under taken specific crew productivity initiatives to address the same. These initiatives have yielding positive results by contributing approximately 160 basis points improvement in the operating margins. Sustained efforts in this direction would continue. Efficiencies across occupancy and other operating expenses have further contributed to the improvement in the operating margins and therefore on overall basis we have expanded our restaurant operating margins by 480 basis points in this quarter. The aforesaid operational efficiencies along with stable G&A expenses during the quarter had led to an operating EBITDA expansion of approximately 425 basis points.

Lastly, this has been a promising quarter from an overall business and financial performance. We shall continue to build on our strategic initiatives across the system and as consumer sentiments turnaround and become more favorable we believe we are rightly placed to take advantage due to our strong brand connect with the consumers as we strive to deliver greater value for our stakeholders.

With that said I would now hand over back to Amit who would take you through the outlook and give the closing remarks.

Amit Jatia Thank you, Suresh. The short-term outlook for the country remains challenging with the slow economic growth. We see varied consumer behavior and therefore it is hard to predict any consumer acceleration in the near-term. The QSR sector in India is still at a nascent stage and therefore the opportunity is yet immense for brand McDonald's. We basically have two tasks ahead of us. The first task is to open new restaurants in under penetrated which is independent of today's operating environment. We are focused on acquiring good quality real state and will look to open 175 new restaurants to 250 new restaurants over the next four years to five years to double the base of our restaurant while improving unit economics for new restaurants yielding solid results in the future.

The second task is to grow our restaurant sales which will help us grow our margins as average restaurant volumes build. We will aggressively expand our portfolio of McCafé restaurants and continue our reimaging efforts that will lift the performance of the entire portfolio in line with our targets. We expect Delivery to continue to add to same store sales as we make continues enhancements in our digital engagement with the consumer. Our marketing efforts will be towards building brand differentiation versus deep discounting followed vigorously in the QSR industry providing us with long-term brand loyalty and reinforce our leadership in the QSR segment. We remain committed to being the most accessible brand to consumers and we will focus on bringing more customers to our existing base while opening new restaurant to serve future demand.

Despite current market conditions, we remain confident that the measures that we are taking to improve our performance and financial position will result in significant improvement shareholder value and acceleration in the business momentum when the macroeconomic environment recovers. Thank you and I now open it up for Q&A.

Moderator Thank you very much, sir. Ladies and gentlemen, we will now begin the question and answer session. We have the first question from the line of Avi Mehta from IIFL. Please go ahead.

Avi Mehta Sir, just wanted to understand the first comment that you made towards the start, two things in that one is you said that worst is behind us and are you seeing an uptick in consumer sentiment I could not quite pick-up that. And second I miss the comment on the per store capex, that was the first question. And the second question sir, I wanted to understand is on the royalty bit. It is at round 4% level now. How should we build that going forward if you could share that.

Amit Jatia Sure in terms of uptick and consumer demand obviously I mentioned in last call as well that basically we flattened out and I think we bottomed out from a market point of yet I yet do not see that the consumer environment has changed back to the good days that we had a few years ago however, I am strongly of the opinion that the category is yet very nascent and especially from a McDonald's point of view all the work we are doing in certain areas where business has been good is actually yielding very positive results for us. So for example when we added McCafé we actually entered the retail coffee business in the country and that has been a good incremental business both helping us with average store sales as well as margins. And today of course we have only 52 versus 45 in the previous quarter but I feel as this base grows up at least at McDonald's you will continue to see slightly better results moving forward. The second big thing that is working well for us particularly for us is Delivery because I feel that what happened a few years on the eating out market is happening is happening the delivery business and the good news is that with a very strong presence of delivery because of our restaurant base we are able to month on month establish new sort of benchmarks when it comes to the delivery business. Thirdly, as you would have noticed that we focused on brand building and we are focusing on menu work where we engaging with the consumer and we are beginning to see decent results in that area as well. So in summary, I feel we have bottomed out and I feel that we are confident that many of the initiatives that I just talked about will continue to yield better results at least for brand McDonald's. On your second question, we generally to give sort of range of Rs.25 million to Rs.30 for new store capex. I am saying is that we are going to be at the lower end of that range of Rs.25 million to Rs.26 million which will actually fantastic because when you think about even Rs.5 million per restaurant and if you actually think about 200 restaurants we are talking of hundreds of crores of savings in investment which actually do change the unit economics quite nicely. So we are very happy that the efforts we have put in over the last two years are beginning to yield results for us. Thirdly royalty levels currently are at 4% basically so that is the number you should take into your thinking.

Avi Mehta Okay. Sir, lastly we did no closed any stores. So what is this exceptional item linked to the Rs.2.7 crores? We did not close any stores or am I missing something?

Amit Jatia Yes, so basically when refresh and re-image our restaurants, sometimes we have to take some write-offs along with that so most of the parts are related to that actually.

Moderator Thank you. The next question is from the line of Nikunj Doshi from Bay Capital. Please go ahead.

Nikunj Doshi Just wanted clarity on this 23 crores write back in taxes so, is it that this taxes we already paid and we are claiming refund or this is just non-cash item or how exactly it was accounted earlier then?

Amit Jatia Basically you see it is linked to a number of things that we kind of looked at and we have been looking at everything for the last two years so, as you can imagine we operate in various regions we have distribution centers in various place as well and when we did ad detailed analysis we realized that there were gains that we were very conservative in recognizing some of these input taxes. So essentially after getting the right advice we have been able to recognize that in this particular quarter. So it is a cash item, it is not an accounting transaction.

Nikunj Doshi No, sir we will have to claim refund from the authorities or it will be adjusted against future tax outgoes?

Amit Jatia So it is a bit of both.

Nikunj Doshi Okay. And I am seeing in your results, the occupancy and other operating expenses so, what exactly it consist it and secondly, it has come off sequentially so it was 73.8 crores in the June. In this quarter it has come up to 69 crores. So what exactly it accounts for?

Amit Jatia So basically occupancy and others has a whole variety of things starting with rent, utilities, advertising, outside services, maintenance, and repairs etc. And as I have been saying primarily we open a lot of new restaurant the drag has been there. However with the cost structure for the restaurants already starting to come down and many of our efficiencies coming into play. I have mentioning at every call that we have been working very hard on the utility side as well. So all of these things together have sort of accounted for some benefits that we have got into this particular line item.

Nikunj Doshi And if I see again like general administrative expense also on sequential basis marginally down, yet our EBITDA margin if we see on sequential basis slightly off, so any particular reason out there?

Amit Jatia Okay. So basically it is the financial income in the past that we had sort of realized which has not been done in this particular quarter. Yes, so it is accrued there though. So actually if we had recognized that, it would be even better.

Nikunj Doshi No, because sequentially I am noticing marginal decline in EBITDA.

Suresh L There have been improvement in all operating parameters, hence, it is only because of the financial income which is not realized this quarter.

Nikunj Doshi Okay. In terms of the stores opening means any particular reason we have slow in this quarter, only three stores opened?

Amit Jatia No, it is not like that because like I have always maintained the real estate cannot be look quarter-to-quarter we are have building dry through in fact the good news is that pretty much all the restaurant we need to open in this financial year innovative and are at various stages of construction right now. Our very heavy energy have gone in the last quarter in working on reimaging and McCafé it did not matter to us if few restaurant were sort of push into the following quarter. The important thing is if you see year-on-year it is still 27 restaurants, so if you look at every quarter our annual number of 25-27 has always been there. So to that extent all I am trying to say is that our EBITDA has not impacted positively because of that.

Nikunj Doshi I just wanted to know this three number is gross or net? So it is net I mean it is basically we have not closed any restaurants in this quarter?

Amit Jatia No.

Nikunj Doshi And secondly, this delivery you mentioned so, is it possible to share what percentage of the revenue comes from delivery or it is too early to give that?

Amit Jatia No, Nikunj, I am sorry we do not share the break-up all I say is overall it is not a small business per say in totality, so it is a significant size business for McDonald's in the country but we do not break it up as yet. The good news is that it is moving very well as we talk quarter-on-quarter.

Nikunj Doshi And what percentage of the stages would be delivery offering right now?

Amit Jatia It is over 100 stores now

Nikunj Doshi So, it's sort of sizeable business, that is what I wanted to know.

Amit Jatia Yes, it is and every new restaurant we open, we generally start delivery with it as well. So every new restaurant that we will open will normally have most of our brand extensions. So which is where the average volume per store you know is getting favorable.

Nikunj Doshi And what is your gut feel again this time we have seen this festival season shifting a bit so, obviously October to December quarter has to be much better. So what is your gut feel on the same store sales wise?

Amit Jatia The real shift between October and November it is not between September and October. So the point is within the quarter last year Diwali was in October while this year it is in November, so school holiday everything shifts but the important thing is within the quarter you will see the Diwali impact in any case.

Moderator Thank you. The next question is from the line of Bhavesh Shah from CLSA. Please go ahead.

Bhavesh Shah Sir, my first question is on staff cost. In the opening remarks you said you have done several initiatives which have helped you to keep your staff cost low. So could you just elaborate some of the initiatives that you have taken during the quarter or probably during last few months which is helping you to curtail this cost?

Smita Jatia So, as I mentioned in my section Bhavesh that over the last 12 months we have focused a lot on staffing, on training and better shift management which has obviously given us better crew productivity and thereby impacting the staff cost positively.

Amit Jatia So as I had mentioned earlier Bhavesh, that even when the impact of the minimum wages came on to us our philosophy is long-term so we do not believe in knee-jerk price increases to the consumers. We take reasonable increases from a consumer point of view but then we put it back on to us to get productivity growth which generally McDonald's as a company globally does very well with. So our operations team got inside and I always believe there is always room for improvement so, it took us about two or three quarters but I had mentioned this in my last quarter call as well, that you will start seeing benefit from our payroll and crew productivity initiatives and you can factor that quarter-on-quarter going forward.

Bhavesh Shah Okay. So just one more thing a follow-up on this one, so staff productivity means less number of staff per store?

Smita Jatia It does not mean less number of staff per store, it means actually staffing the store with the right strength. So in some stores it could be more and some stores it could be less but having the critical strength and better trained employees will obviously give you better crew productivity so instead of having two people for the same job if it is a trained person you can have one person for that same job.

Bhavesh Shah Understood. Sir, my second question is on your gross margin uptick I know you do not give any specific numbers with respect to different segment but you did call out some of the statements that your new initiatives on some of the new product side you have introduced Chilli Paneer Pockets which you have and that has added to your overall gross margin. If you can give some color and how much contributed by with more and more selling of McCafé into the system as well as some of the new menu innovation that you are doing. So if you can just give some indication that what exactly is driving that gross margin apart from of course the price hike that you are taking. So can you give some indication and what is really driving this apart from just giving these three as in broad indicator?

Amit Jatia Firstly, there have no price hikes in this quarter. We believe that there are three drivers to gross margin improvement of course it is menu prices it is raw cost and it is product mix. And we keep our menu prices as maintained before between 3% to 5% in a year of course it depends if inflation really jumps up then we have to relook at that. But we believe that there is a lot of work we can do on the other two fronts which is raw cost and product mix. Now raw cost we generally use especially in the recent times to mostly mitigate the increased cost and some other categories. So primarily the improvements that we have been to deliver quarter-on-quarter is coming through product mix. I must say that McCafé definitely plays a significant role in this because beverages are good and profitable category and obviously the price points of McCafé products are also very attractive. On the other side, I have said this before, when we did the Aloo Wraps. So if you look at Aloo Tikki Rs.29, if you look at the Aloo Wrap Rs.49 with Chipotle Sauce with a different flavor and brand Aloo Tikki has its value and Aloo Tikki lovers tend to then give the product a try and it can give you very good gains in gross margin. Similarly, when we did the sides as Smita mentioned, Chilli Paneer Pockets were all incremental sales and because they were incremental sales we have priced it at Rs.35 but with a good gross margin that was done in product design and therefore that's done extremely well for us. In the past we have done Focaccia Bun where people could pay Rs.15 more and buy the Focaccia Bun and that gave tremendous variety, it lifted the brand in many ways because consumer got the choice of a really nice flavored Focaccia Bun and it gave us gross margin improvements as well.

Bhavesh Shah Understood, sir my last question is on your outlook page you have called out for consumer sentiments continues to remain muted, where as your commentary it is fairly positive especially on your opening remarks side. So is this disconnect what you are really seeing on the ground right now more to do say in the month of October or November or something I am just trying to reconcile your thoughts on this?

Amit Jatia So what I am trying to say is that I definitely see erratic consumer behavior at the ground level. There are some months that do really well and some months suddenly in the last 10 days, we just see consumer disappear so it is definitely not that consumer footfalls are on the rise and I am seeing great stuff happening. I mean if you look at industry results and if you look at our results, we feel that our contrarian view of focusing on the brand, on working around menu and consumer engagement through that and particularly the growth of McCafé and our Delivery business, we feel has given a tremendous differentiation in the market where consumers are finding that brand McDonald's has always been up and current. So for example, all the investment in reimaging if you go and see our newer restaurants they are connecting extremely well with the consumer and I feel to some extent that has been giving us tremendous gains in the marketplace.

Bhavesh Shah Okay. So sir, if you I am not very sure if you will comfortable to say this, but what has been your experience after the September quarter especially in the month of October and November? Are you seeing some sort of pick-up or is it that you continue to see similar traction with consumer that what you have been seeing in the past couple of quarters?

Amit Jatia As you could guess obviously, I cannot talk about this particular quarter at this point in time so, it will be tough for me to answer that.

Moderator Thank you. The next question is from the line of Puneet Jain from Goldmans Sachs. Please go ahead.

Puneet Jain My first question is actually again the respect to employee cost. I just want to understand what is the salary increases which you gave to employees? Is it linked to minimum wages because you network has expanded by close to 10% on a year-on-year plus there will be some salary increases also which you may have given.

Amit Jatia No, basically you see minimum wages impact to that only because in that particular month the government took it up by 40% to 50% and we were above minimum wages but that sort of crossed the threshold at that particular time. So that is what it is I mean salary increases in general are between 4% to 5% a year. I mean in sometimes in high inflation time we could have gone up to 6% to 7% as well. I have always maintained that we work very hard on productivity growth and we believe that there is always opportunity to work like Smita mentioned earlier in getting more productivity by better training and identifying opportunities in improving the processes at the restaurant that can yield gain back to us. So if you notice in the last five years I mean until if you take out the last two years and you go back three years before that, you will notice that our payroll cost have remained very steady because we are very focused on particularly gross margins labor and utilities. We have to keep an eye because these are big cost for us.

Puneet Jain Okay. My second question is though you may not call for mutual sentiment but if you go back and look at Q2, was there any month like which was weaker on a same store growth basis compare to the full quarter because this year the inauspicious period actually fell in September and October this year versus last year being fully in September so, maybe Diwali is in November and last year it was in October so it was the same quarter but there has been clearly some shift of inauspicious period.

Amit Jatia That happens every year but the point as I mentioned to you the primary thing is Diwali, you see other auspicious and non-auspicious do not impact us substantially. The other one that was material that was in the first quarter was Ramzan. So the important thing is that given that every year Shradh, etc., all either August or September so, the point is it still remains in the same quarter while if you look at Diwali it is either October, November if you look at last 10 years that is what you will see.

Puneet Jain But Shradh varied between Q2 and Q3, otherwise it's in Q2

Amit Jatia No, it does not hurt us. I mean what really impacts us is holiday. So typically Diwali impacts us because school holiday start at that time and celebrations start around then people are out shopping, people are out on the street. So that is the time that impacts us. All of these other things may have minor variations here and there.

Puneet Jain Okay. And finally, in terms of new store opening is there any particular state you are current focusing on in terms of new store opening?

Amit Jatia No.

Puneet Jain You said that you are more penetrated say in Karnataka and Mumbai obviously because of key metros but I do not see similar penetration in Tamil Nadu. Is there any specific reasons?

Amit Jatia No, there is a no specific reason we are growing Chennai, we follow focused growth strategy, as we have stated that many times that there are 6 key cities where we are really working so we open clusters and then we go and own those clusters so opened Bangalore as late as 2006 and today we have a very strong presence in Karnataka. Chennai we entered only in 2009 or so and therefore basically we are still building out there. For us long-term sustainability on the real estate is important and Chennai has a challenging real estate market which we are working through. So you will continuously see progress across the board all I see is opportunity if you ask me that that opens up more and more opportunity for us as I mentioned in my closing remarks the two jobs are separate building same store sales is separate from opening restaurant in under penetrated markets and both of these I think will expand our margin especially as we have improved unit economics quite well.

Puneet Jain Okay. So it is nothing to do with that Tamil Nadu may have separate food preferences. It is just because of your strategy of opening clusters and expanding.

Amit Jatia Absolutely.

Moderator Thank you. The next question is from the line of Nillai Shah from Morgan Stanley. Please go ahead.

Nillai Shah One question from my end in the past you have always maintained the growth in your business is contingent on high street traffic in terms of number of people out there and shopping. Last quarter was not the best of the shift in the festive season. Everybody that we speak to and all the numbers out and management commentaries out and they seem to suggest that 3Q is going to be a really strong quarter partly because of consumer sentiment and partly because of shift in festive season. Would you share same optimism on Q3 growth given that this is a view that most of the high street retailers have at this point in time?

Amit Jatia In my mind the festive season has shifted from October to November because Diwali to me is strong and then there is Christmas and New Years and both of them are pretty much contained within quarter three as far as last year and this year are concerned. So we have always maintained that the in-store business is dependent on footfalls and we have always maintained brand extensions – Delivery McCafé, Breakfast, Desert kiosk that we do, are all incremental business opportunities for us and while the in-store business is recovering, we have been using these extensions to help us grow our business which if you see quarter-on-quarter in the last three quarter or four quarters you see a certain consistent trend that has been coming together. So it is very hard for me to say what is going to happen in over the next two months because honestly what I have seen in the last six months to seven months is very inconsistent, one month could go really well and in fact in the last week suddenly see sale drop which then start hurting comparable sales. So very-very hard for me to comment on the third quarter but I do not think there are favorable what we call in McDonald's terms trading days that will benefit us because of shift of the festive season timings.

Nillai Shah Sure. And the other bit is more longer-term is that you know in terms of your cost productivity measures and you have been said this all for quite some time. How much of this is driven by your internal processes versus what you are getting from McDonald's parent?

Amit Jatia No, parent is supporting us of course in all the knowledge base. So for example McDonald's supports us tremendously on any initiative where we need help. So for example suppose if crew cost are going up then we have the whole systems benefit available to us to learn from what is going on. For example, there is the Innovation Center in Oakbrook and we take the help of the Innovation Center to help us towards the new tools that are required to grow crew productivity. So primarily it is all driven by us. The best practice sharing from McDonald's is obviously always there. And the first thing we do for example if we want to do anything to do with utilities the first call is made to the expert on utilities within the McDonald's system. We learn, we get all the best practices shared, and then we adapt that to the local environment and then of course we go ahead and execute that. So you will see that if gross margin improvement is not one quarter job by the way I mean in the last two years and half years we have improved it by almost 300 basis points now and that is primarily driven by the things I talked about earlier which is very local in execution. The crew productivity is good local work supported by best practices from

McDonald's and actually even in utilities we have done pretty good job again supported with knowledge from other markets within the McDonald's system.

Moderator Thank you. Next question is from the line of Krishnan Sambamoorthy from Nirmal Bang. Please go ahead.

Krishnan A couple of queries. One most of the multiplex players have done fairly well in this particular quarter and a reasonable proportion of your stores are in malls. Have you seen a subsequent benefit of that in terms of demand on your side?

Amit Jatia See I do not think substantial restaurants are there in malls, it is pretty well-diversified portfolio. One thing I can tell you if there are good movies and they do well we definitely benefit from that as well. There is no doubt about that. But I do not think that our business can be driven on movies because they are still a weekend or an evening business largely. Obviously, even multiplex occupancies in the day are weaker relatively and we need all-day business to really grow our comparable sales.

Krishnan Yes, okay. And my other question was regarding utility cost which you just briefly highlighted in response to the previous question. Anything to call out there in terms of marked savings in any particular aspect because this is an important part of your overall operating cost element?

Amit Jatia No, we have been saying this in the last three-four quarterly calls or four quarterly calls that you see utility rates are not in our control but what is on our control is therefore design. So what we have always down when we find a particular cost moving up dramatically we zoom out and we take look at the entire design of our restaurant that is what I have been mentioning in terms of unit economics we do not look at only the cost of building a restaurant but we look at the cost of operating a restaurant. So in the last three years to four years given that we knew utility cost in India are going to rise, we in fact one headcount resource only working on utility design and what we have been doing is there is a lot of new technology that has been coming in and we have been doing a number of experiments in different restaurants and we allow that experiment to run for three months to six months and then if that experiment works then we roll that out across the board. So one example I will give you only for the sake of giving you their example, we worked with IIT some years ago and we developed a system where we captured all the heat from our air-conditioning system and the entire hot water generated in the restaurant was generated through this heat that we captured and we eliminated the boiler and we eliminated LPG gas that was needed. So we have been doing a number of such efforts both with IIT, with suppliers and we have done it and I do not think we can fall back on that because utilities for all of us in the industry is going to continue to be a big challenge.

Moderator Thank you. Next question is from the line of Aditya Joshi from Nirmal Bang Securities. Please go ahead.

Aditya Joshi Sir I just wanted to know whether the Focaccia Bun will be continued or it is a replaced by a New Masala Bun right now?

Amit Jatia Very good question, it is replaced by the New Masala Bun and again what I am excited is that consumers get new news and engagement from brand McDonald's while the Focaccia Bun was new news for three months or four months. Now the New Masala Bun is something that the consumers are trying and these are kind of things that are working for us versus just trying to bring people by giving them discounts.

Aditya Joshi Okay, sir, thanks. And other question was there any shortfall of procurement of tomatoes this quarter because in few of the restaurants, we visited we found out that the tomato ketchup or the tomatoes were not used many a times.

Amit Jatia Yes, sure. So this is not the first time every time around this time we have an issue because of issue called Fruit Fly. So, there is Fruit Flying issue in tomatoes particularly in West India especially around Mumbai where there are so minute that they are not visible by naked eye. And as you can imagine McDonald's standards are just at a different platform and therefore we had to pull tomatoes because there was no way to source it given the pest infestation had happened but it is back on it might have been for a few days but we are getting better every time and year-on-year you will us sort of come out of the problems.

Moderator Thank you. Next question is from the line of Resham Jain from B&K. Please go ahead.

Resham Jain Sir, my question is on the digital platform for delivery like a lot of other delivery players we have seen there a lot of pop-ups which comes during the day or week while in McDelivery we are not seeing that happening is there anything specific which we are looking there?

Amit Jatia So see firstly of course it is continues improvement on the digital platform so for example we just released a new user interface and we are getting extremely good feedback around that. The second thing is we do want, do not want to keep bugging the consumer with too many notices so for that is a bit of a thought process that we do have. So there is global best practice on a certain number of such offers that we should be giving and our new user interface is enabled around that. So of course you will see some and we do hope that we can live with the best practice and not overdo it.

Resham Jain Right, because what happens is almost someone like me who is a big fan of McDonald's, when something new comes up if it pops-up I come to know about it and then again go there.

Amit Jatia No, it is something we must do all I am saying we must also restrain that to a certain number so that you are not bothered with it on your phone all the time.

Moderator: Thank you. Ladies and gentlemen that was the last question, I now hand the conference call over to Mr. Amit Jatia for his closing comments.

Amit Jatia Thank you, everybody for joining the call and listening to us, we really appreciate that. We are encouraged with the results that we have had in this quarter. Our confidence on the way forward is strong, obviously the ups and downs of the marketplace are something that we will have to deal with but I do believe that the foundation of the business is getting stronger for us at McDonald's, so hoping that we continue to have the decent trends moving forward. Also if you have any additional comments, please feel free to reach out to Ankit who can share with you any other details that you may want or if you have any questions. Thank you and Happy Diwali to all of you.

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