Q1 FY2016 Earnings Call Transcript – Aug 7, 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 Q1 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 Inba. Welcome everyone and thank you for joining us on Westlife Development Limited earnings conference call for the first quarter ended June 30th, 2015. We are joined here today by Amit Jatia – Vice Chairman, Smita Jatia – Director and Suresh Lakshminarayanan – Chief Financial Officer of 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 shall 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 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 results press release and investor presentation and in our subsequent 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 and good evening, everybody and thank you for joining us on the earnings call today.

We continue to build on the strong foundation of brand McDonald's on the four strategic pillars of broadening accessibility, growing baseline sales, margin expansion and growth through people. We have made progress in each of the pillars that put us in a strong position for the future and leadership in the QSR segment. I am encouraged by the overall progress we have made in this quarter. McCafé and restaurant reimaging continue to strengthen the brand appeal and drive strong results for the business. The portfolio of re-imaged restaurants with McCafé are delivering comparable sales above market average, as this portfolio grows it will add positively to a comparable sales numbers and in line with our targets, we will continue to roll out McCafé and reimage the older restaurants over the next two years.

The delivery business is firing on all cylinders. Growth in this segment continues to be strong. We will further build our online platform and the delivery app to enhance customer interface and we expect this momentum to continue for the rest of the year.

Our in store remains under pressure due to lower footfalls and retail locations due to continued weak consumer sentiment leading to comparable sales being at a (4.9)% in Q1 FY16.

During the quarter on several occasions we have witnessed an upswing in our sales when consumer footfalls have increased driven by a good movie release or shopping festivals. This gives us confidence that as consumer sentiment and spending picks up we will read the benefits of our strong foundation and increased footprint. In the last few quarters our same store sales have trended upwards and we believe that the worst is behind us and hope to see an uptick in discretionary spend in the coming quarters.

New restaurant growth is the key driver for our business and in order to tap the large unpenetrated market in our territory. It is important to make brand McDonald's easily accessible to consumers. Opening of new restaurants will drive future earnings by capitalizing on a rapidly growing consumer base with a preference for convenience and away from dining options. Consumer convenience builds on our competitive advantage sustainable growth coupled with a strong real estate portfolio mix is critical to the long-term success of our leadership in the market.

We have opened six restaurants in the quarter taking the total footprint count to 213. We do expect to reach our overall stated goal of 230 to 250 restaurants by March 31, 2016. Our prudent focus on restaurant development cost have yielded good results and we will continue to deliver new restaurants at the lower end of per restaurant capex of Rs. 25 million to Rs. 30 million. Our thorough real estate planning efforts and implementation of a GIS solution is now reaping good results and helping us deliver higher than average sales from the new restaurants opened in the previous quarter. Maintaining unit economics is critical as we double our restaurant base. We have made good strides in this direction and you will see more positive results in the coming quarters. We are making positive traction on operating margins, we have arrested the decline and improved our margins on a year-on-year and a quarter-on-quarter basis.

This quarter we improved our operating EBITDA margin by ~240 basis points over Q4 FY15 while improving operating EBITDA by ~45 basis points over the same quarter in the previous fiscal. We have expanded gross margin by 40 basis points along with making positive strides in both payroll and utilities which should be margin accretive in the coming quarters. With a healthy improvement on both unit economics of new restaurants and operating margins we hope to gain margins as we build positive comparable sales in the coming quarters.

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

Smita Jatia Thank you, Amit. I will now take you through some of the highlights under our four strategic levers. Currently we stand at 213 restaurants with a growing Drive Thru's portfolio. In spite of soft sales growth, we are happy to announce that we had improved our operating EBITDA by 45 basis points year-on-year and 240 basis points quarter-on-quarter. Brand extensions of McCafé and deliveries continue to drive strong base line sales and our cash and cash equivalents stand at INR 1.5 billion.

Getting into broadening accessibility, we opened 28 restaurants in the last 12 months, with six openings in the quarter. Our presence remains strong in Maharashtra and Karnataka while we continue to penetrate the other geographies. To sum this lever, we stayed invested in the foundation for future growth. Our pull strategy of market planning is helping us deliver better sales performance on newer restaurants thereby reducing drag on operating margins. We also continue to increase our competitive advantage by building on our Drive Thru's portfolio.

Moving to the next lever of growing baseline sales. This summer we launched our brand campaign KuchPalOffline to build loyalty and connect with our consumers. Under that umbrella we introduced our sharing pack to build everyday value instead of deep discounting or BOGO offers. These did very well and they continue to be on our menu boards along with our extra value meal. To further create excitement in the summers, we gave customers choices through a new bun variant and real fruit smoothies. We also built on our Happy Price Menu by introducing deserts and drink varieties at affordable prices.

Our band extensions continue also to build strong baseline sales. Our McCafé platform continues to build momentum not only to drive sales but also get better margins. Today we stand tall with 46 McCafé's across seven cities adding eight more in this quarter. And hence we are on track to deliver 50 to 75 McCafé's by December 2015 and doubling the base in the next 12 months to 18 months subsequently.

As we all know the growing popularity of Food Tech and with our distribution network in place, our online web platform continues to drive baseline sales and continues to give us healthy growth. Along with adding McCafé's, we continue to reimage our old stores to keep them modern, contemporary, thereby enhancing our customer experience. Thus, summing up this lever, we drove strong brand connect through our marketing campaign, everyday value and menu innovation to build loyalty. Brand extensions giving us growth on baseline sales and finally, modern and contemporary restaurants through re-imaging.

On margin expansion we continue to improve on gross margins by improvement on product mix and supply chain efficiencies. Labor and utilities remain steady giving us the expansion of margin. We also received The Economic Times Award for excellence in Supply Chain Management and Logistics.

I now hand over to Suresh who will take us through financial analysis.

Suresh L Thank you Smita. Good evening, everybody. I will now take you through the financial analysis of results for Q1 FY16. While the overall environment continues to remain challenging, company registered 3.2% increase in consolidated revenues on a year-on-year basis largely driven by addition of new restaurants and various new menu additions during the last 12 months. While we saw comparable sales at (4.9)% for Q1 as consumer sentiment continue to be challenging, but, we expect it to gain traction in the following quarters riding on improved consumer sentiment. It is very encouraging to note that we have taken significant step forward in improving the operating performance of the company, we were able to expand our gross margins by around 40 bps on an already higher base of 58.8% in Q1 FY15 and we expect its positive trajectory to continue over a medium-term. Further the initiatives under taken over the last 12 to 18 months around utilities have started to yield results and thus help mitigating utility inflation during the reporting quarter.

Payroll expenses have been higher due to addiction of crew and other restaurant staff on account of new restaurants and therefore its impact on the restaurant operating margins. It is however heartening to know that we have been able to expand operating margins by ~45 basis points on a year-on-year basis and about ~240 basis points sequentially. I would like to state that we believe that as the consumer sentiment start to recover and people start to eat out more, we would significantly benefit from the higher operating leverage through better comparable sales and various other cost optimization initiatives under taken over the last 18 months and continuous efforts around driving efficient business unit economics.

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

Amit Jatia Thank you, Suresh. We believe that the QSR sector in India is still at a nascent stage and the opportunity is immense for brand McDonald's. We will continue to build the business in FY16 and beyond by enhancing the customer experience across all our strategic pillars. We will remain focused on seizing the long-term opportunities in IEO segment by leveraging our competitive advantages. We have a huge under penetrated market and it is critical to be easily accessible to the consumer. We have a robust three year strategic plan in place while we do not expect the operating environment to change materially in the near future, we are confident there are strong foundation and strategic plans will result in sustainable restaurant base line sales growth while expanding margins as we continue our focus on customer experience and operating efficiencies. Our number one priority will be to satisfy our customer needs by serving great tasting high quality food in contemporary restaurants. This focus on our customers is particular critical in this uncertain environment where ongoing volatility continues to negatively impact consumer sentiment and spending. We will continue to expand our restaurant base while improving unit economics for new restaurant openings yielding strong results in the future we will expand our portfolio of McCafé stores and continue our reimaging efforts that will lift the performance of the entire portfolio in line with our targets. Our marketing efforts will be towards building brand differentiation versus deep discounting followed vigorously in the QSR industry which will provide 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 restaurants to serve future demand. We are confident that the steps we have taken to improve our company's performance and financial position will result in significant improvement in shareholder value. With that said, I now open the floor for Q&A. Thank you.

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

Avi Mehta Just wanted to understand a bit on the royalty side. Now royalty in this quarter as a percentage of sales is at 2.5% I understand that for the year it was supposed to go to 3% could you please explain how should we look at this number?

Suresh L If you look at Royalty which was currently at about 3% and it moves up from mid of this quarter. So basically when you look at the entire financial year it will around that range. Currently in this quarter we have had some adjustment of tax credits and that is why you are seeing a slightly lower rate however as the year goes by it will even out.

Avi Mehta: So these tax credit adjustments, even though it is one-off, there would be benefit for the full year number, right?

Amit Jatia: It is very minor in the context of the whole year actually, therefore, it seems irrelevant.

Avi Mehta Okay, sir. The second thing was on the demand front, I mean I was just going through your commentary. You said that you're seeing some traction around consumer sentiment on various weekends or movie festivals. I just want to know how do you see the consumer sentiment behaving and can you give some guidance?

Amit Jatia Yes, I mean it is basically hard to say because we see in some months we see really good performance and then we suddenly find it kind of drying down. The important thing for brand McDonald's is that when people are out there when the footfalls are there on retail we see ourselves doing really. We have seen some of the results come from our competitors and we find that the numbers that we have had even though they are negative they are kind of quite healthy in that sense. Also as I mention to you where we have done delivery and particularly against store with McCafé and reimaging, it's performing extremely well but the in store business that has taken a bit of beating which is directly linked to footfall given that we are impulse business. I do feel we have bottomed out, I do feel that in the last three quarters if you see we were flat and then we have remained at like minus 4.5 over the last two quarters. I am pretty confident about the future, I can see some signs of change because we see some weekends, certain days, it's coming back like we have seen it in the past.

Avi Mehta Okay. You highlighted you have INR 1.5-1.6 billion of cash on your books. What I wanted to know however the financial income per say is low, so how should we see this going forward. Would we be reducing our cash level because the debt number or I mean the implied interest for the full year is 16 crores or so I am just trying to kind of build in for the full year how should we look at? Should this be lower?

Amit Jatia No, it is about even. The debt cost versus the income that we will get out of interest on the funds would be around even.

Avi Mehta So you are saying that should kind of sustain.

Amit Jatia Yes, it will.

Avi Mehta Okay. And last sir on the store closures, you have done store closures if I am correct in this quarter? Could you please tell us reason?

Amit Jatia Yes, there are two store closures. Sometimes on a food court, if a mall particularly shuts down, we have to shut down with it. For example this was Center One in Navi Mumbai and we really did well, made good return on the investment but along with the mall shutting down we had to shut that particular restaurant down. And the other one was also a mall store where that mall had lost all its tenants and then we decided to pull out from there as well.

Avi Mehta So would it be fair to say that this is a one off and hence, net additions for the year should still look at a probably 30 stores. Is that a fair run rate?

Amit Jatia Yes, that is a fair run rate.

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

Nikunj Doshi Just can you provide some break-up of revenues from McCafé and McDelivery?

Amit Jatia No, we do not break that out Nikunj. Unfortunately we do not share the breakups of each of our business models.

Nikunj Doshi Okay. And is it possible to give store breakups in terms of numbers of stores in mall, high street and Drive Thru's?

Amit Jatia Again we do not break that out. It is a very healthy portfolio from our point of view. I mean all I can tell you is we are not over dependent on any particular type of real estate and especially the Drive Thru business we build quite well and we do see solid traction from Drive Thru's over time. It is still early days but we are seeing decent signals.

Nikunj Doshi But number of Drive Thru's at least you can mention or it is not possible?

Amit Jatia No, unfortunately, we do not give the breakout.

Nikunj Doshi Okay. And in terms of the new store opening again focus is more on the stores in malls or what is the strategy?

Amit Jatia No, we have always maintained that it is a balanced approach. In the past it was very heavily towards Drive Thru's because we were behind on the percentage but we have caught up very well in the last three years. So you will see more and more Drive Thru's but today it is pretty balance and we expect it to continue in the same manner. When you penetrate a market or when you think about India there are different drivers. For example, if you would go on the Western Expressway in Mumbai there is a very good Drive Thru's opportunity if a real estate is available. However, if you go to Linking Road, Bandra it is better to do an in store than a Drive Thru. So they each increase our opportunity penetration actually. So and a mall is a whole independent market in its self because it is a big driver by itself. So we feel that they are all complimentary to each other and when we plan the market the market and the mini market and this is what Smita mentioned about, that our pull strategy is yielding result as we are able to deliver better results out of the new restaurants.

Nikunj Doshi And in terms of some of the malls we are seeing Desert kiosk and main store separate etc. So are we planning to replicate that across all the malls or any thoughts on that strategy?

Amit Jatia Absolutely we love our Dessert Kiosks and they are good brand extension that do very well for us. It is a decent base as of now and every mall that we go into we try having a dessert kiosk right in the center of the mall atrium.

Nikunj Doshi And what is your call on food inflation?

Amit Jatia Food inflation has been less of a problem in the recent past, there is volatility as always but the good news is that it has not been something that I have been worrying about in the couple of quarters.

Moderator Thank you. Our next question is from the line of Abneesh Roy of Edelweiss. Please go ahead.

Abneesh My question is in terms of market share if you could share some insights in the places where Burger King is competing directly. Can you share how much is the loss and in terms of pricing and promotion, are they predatory in terms of nature. Any insights there?

Amit Jatia Absolutely not. The best thing is that it is all in the public domain. Primarily they have operated in mostly food courts right now and if you go visit the food court we maintain number one status in the food court and yes, when they first open there was an impact but today we are back in fact in many cases with better sales before they came there.

Abneesh Number one status is understandable because you have the legacy advantage but you are saying in most of the places it is higher than what it was before they entered?

Amit Jatia I'm trying to explain that we are not trending negative comps in many of these places and number one status means that we have been able to retain the sales that we have had in the past. Because you see if any brand impacts us then whoever was number two in the past could have moved ahead but the important thing is we retain the number one status as a brand in the mall. And, when a new brand opens in any mall for the first time, during the first month people try that brand but eventually it all settles down and what we find is that we came back to our original sales. Hence, there was not really much of an impact on us.

Abneesh Okay. In some of your restaurants, I have seen near the entrance, a very prominent display of the delivery ability. So could you talk about that how has that shaped up versus what it was two years back?

Amit Jatia As I mentioned to you, in two years we have compounded extremely well on delivery and it is largely due to the macro sentiment. Lot of the business of McDelivery is being driven due to the online app and the online website and because of that I think the convenience to the consumer has gone up for all the delivery brands and therefore, delivery is growing very rapidly due to the e-commerce push and the good news is that we are a very strong player in that market given our distribution network of 213 restaurants, while, not all of them do delivery because if you are in a food court, sometimes you cannot do delivery but the point is that we have a pretty strong network where we are able to reach a very large number of customers through delivery. So because it is giving us traction we are promoting it also as much as we can.

Abneesh And online and app how much will that be as a percentage of delivery sales?

Amit Jatia It is about 40% of our total delivery business now. It has been growing rapidly over the last two years.

Abneesh You mentioned in-store dining has suffered more versus other formats. If I see in Q1, it was a dream quarter in terms of movies. So has that helped because essentially footfall in malls at least will be quite strong. So, could you talk about that part of the business in food courts wherein there is multiplex and how the growth has been?

Amit Jatia Absolutely, it depends on mall to mall. There are five good malls but there are 10 malls that are not doing so well also. As I mentioned in my opening comments, when there is a good movie or when there is any big event, that mall does well and footfalls come-in and we found ourselves doing extremely well and that has what given me the confidence that yes, it is about the macro to some extent. In fact, if I just move away a bit from macro and tell you that recently, I was looking at Euromonitor data and for the first time in five years, its growth rate predicted for industry in 2015 is 3.5%. It used to be about 10% to 11% in 2014 and previous years. So what I am saying is that when there are footfalls on the back of a good movie or a festival, we're generally very good in driving foot traffic and in fact positive comparable sales in many of those particular malls.

Abneesh Two follow-ups here – one is Q4 movie was extremely weak, so in that quarter, your same store growth was very similar to what we have seen in Q1. So where is the uptick which is supposed to come from movies?

Amit Jatia Because movies are not ever week right, so for example, if I just look at this week I do not see any movies and our business is week to week and day to day and if that particular weekend is gone, it is gone so you can never make up for it. So unless and until every weekend there is a great movie which is driving traffic to the malls or to movie theaters it does not work. It is very hard to judge, based on that. All I can tell you is if you look at something in the recent past like a Baahubali and Bajrangi Bhaijaan, those are the movies that really drive traction. And when such movies release I am pretty certain that the whole retail industry looks good. The important thing is that when we think about it from our brand point of view, we have realized which giving me the confidence for the future as well that quarter-on-quarter we have seen many types of these events happening and whenever those events happen we become the top capturers of the footfall and business.

Abneesh Lastly, any more mall closures in the next one year?

Amit Jatia Abneesh, that we need to check with malls. But there are malls that are not able to keep up the pace. The good news with brand like us is we have real estate competitive advantage which comes to play in such situations and one needs to understand the depth of this. The fact is that in most cases we're upfront in the mall. If you look at Crossroads, we have been there through the ups and downs of the malls. Also if you keep your overall breakeven points low, when the mall does five times of breakeven, it is great but even sometimes when the footfalls drop, we are at least able to generate a decent return out of that mall because we're in front of the mall. Therefore, our diversified portfolio helps us a lot. We are not just dependent on malls. We have our Drive-Thru's, we have our retail stores on the high street, and we have stores that are by the railway station etc.

Abneesh One follow-up on this, the Center One Mall which closed down I am sure you would have been aware I think sufficient time ahead that it is closing down. So in such a scenario in that micro market how have you planned for it?

Amit Jatia Absolutely, so you know we plan micro markets all the time. It may be because of a mall closure and sometimes leases come up for renewal too. So, it is not that we will blindly go and renew that lease. We re-look at the mini market because trading areas do shift and that we see as an opportunity to correct anything that needs to be corrected. In the case of Center One, we have been in very good shape because we have many stores in that area including one in Inorbit which is right next to Center

One, we have Palm Beach Galleria, we have Sector 17 etc. In Navi Mumbai, we have very strong penetration.

Moderator Thank you. Our next question is from the line of Sahil Chotalia of M3 Investments Managers. Please go ahead.

Sahil Chotalia My first question is with regard to the new ad campaign that that we have. Just wanted to understand what is the telecast medium. Secondly, whenever you have these kinds of marketing campaigns, what impact does it have on the business, is it a national television thing, is it local television, or is it print media or is it only in-store publicity that is done?

Amit Jatia Being an impulse business, top of mind brand awareness is extremely important in our business and therefore, we commit a lot of resources to adverting and marketing. In the recent past firstly we made a very big shift as you will notice that McDonald's is about brand differentiation and brand building rather than deep discounting. We have stayed away from that and we believe that it is yielding results for us including using McCafé to enhance the brand and the offering to the consumer. Typically we use television, digital, radio, outdoors and little bit of print. And, if there is national campaign and then it is supplemented with regional advertising too. So for example in South particularly you need to supplement the Southern TV channels because the national channels do not necessarily play the same role in South, so we have a pretty strong media planning system.

Sahil Chotalia Okay. And that has a direct impact on the business? I mean especially with youngsters, do they come and ask for these special packs or how does that go?

Amit Jatia It does work. So for example, we were on television in May with our brand campaign and that worked very well for us and we could see good results in sales as well. So, when we launch a new product we always put the product on television and the uptick from that at the restaurant definitely moves up.

Sahil Chotalia Okay. My second question is with regard to the franchising model. In McDonald's U.S., almost 80% is given out to franchises and I think in India we have the right to do that as well. And if I'm not wrong, we have 2 restaurants which are franchised. So, you are trying to operate everything on your own. So, any strategy you have on that and why are we not giving it or we might see that shift going forward?

Amit Jatia In 2005, we franchised with two restaurants and basically we have no plans at this point or in the near future to franchise any more. At this stage we feel this is a right approach to develop the market in the country. The speed that is required in our view is even faster at this point in time dealing with it on our own account. So our strategy is clearly not to use franchising.

Sahil Chotalia Okay. And when it again comes to players like KFC, so in China they have done phenomenally well as far as capturing the market is concerned and I think Yum! is trying to do that in India as well and they have plans for some 2,000 stores by 2020. So, we are a little slower by that comparison. So, what strategy do we follow in this? I mean is it like a cautious strategy or be profitable, grow slow or expand rapidly and earn later on. How does it work with McDonald's?

Amit Jatia McDonald's is of course as you know a huge global leader and therefore we normally follow our own path. I feel we are very aggressive but we believe sustainability is the right way to go. I will give you a great example. I can get into any malls and malls like brands like us because we drive huge footfalls but we are very selective when we choose the mall, we are very selective when we choose the location and we mitigate our risk on our terms and conditions. For example I can be on every food court but that does not build brand McDonald's. For us, the platform of building Drive

Thru's which is a very difficult task because it starts with acquiring land, building the standalone building, having 20 car parks etc. In Kalamboli, we have been there for the last 14 years and you can see the competitive advantage that we built through that. So we believe that, it is a marathon when you are building a business and a brand in India, you got to look at it from the consumer point of view. You got to look at it from a real estate competitive point of view. But, we believe sustainability with aggression is the way to go. So unit economics has to work well, the lease term, the location, market planning is all equally important. For example, we use the GIS software that is global software and that allow us extremely well to understand how to plan mini market. So we believe that when you are running a marathon in the long-term, we need to find ways through which we tend to get ahead.

Sahil Chotalia: Okay. And one last question, Domino's has actually gone into the deep corners of India, they have penetrated into Tier-I, Tier-II and they have gone really deep and that is proving to be a big advantage for them. So as McDonald's, when are we going to start penetrating deeper into India. Is it just the cluster thing that we follow and can we not break away from that and start going deeper into India and kind of create a base? Because, I am sure if you go in a new city in a very small town or a Tier-II city, people will be excited to eat McDonald's. So what is the strategy when it comes to penetrating into the deep corners of India?

Amit Jatia See, when you are trying to develop a country and that to in a retail location delivering what the consumer wants, it is not as simple at least for McDonald's. Domino's and we are two different businesses and obviously Domino's is doing what makes business for them but when it comes to McDonald's it is not that we are not present in cities like Nasik, Kolhapur, Vapi, Rajkot, etc. And if you go to these locations you will see how well we do and what we have seen is as we have built the brand, even when a competition comes even next door to us we find that not only we are able to sustain but we are able to maintain comparable sales and in most of these cases these are Drive Thru's. We have DT's in all the cities I mentioned above. We believe that it becomes a Community Center over time and because we are an all day dining restaurant we want to ensure that our customers get the right quality of food, the right value etc. because we run all day we have brand extensions like breakfast, McCafé etc. and we have many other dimensions to think about. So we are going to be aggressive as I said earlier. We are opening about five to seven cities every year. But if you are able to understand our strategy we went to Mumbai and we pretty much took Mumbai by storm and today we have over 70 restaurants in Mumbai. If you think about McDonald's model where we have to be on prime retail locations like in Bandra, Andheri Lokhandwala, these are absolutely marquee locations and that has given us competitive advantage in a city like Mumbai. So my view is that yes, we want to be in every single town because we know there is latent demand but we feel, doing that intelligently is going to give us better results than just trying to rush and put it there and finally not deliver the right value right quality, and right service to our customers.

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

Bhavesh Shah My question is on McCafé. Clearly, it has done extremely well for the overall portfolio but, why McDonald's is still holding back. I can see that you want to double your base to almost 150 by say December 2016 or March 2017. But why you want to wait till December 2015 and why not just push the pedal right away because it is clearly driving your footfalls and your margins?

Amit Jatia So, it is about strategy again so we first want to ensure that our markets like Mumbai, Pune, Ahmedabad, where we have been around for a while, we want to ensure that we first penetrate these markets. The thing is that we want to do McCafé along with re-imaging the restaurant and therefore that is the formula that works with the consumer. Everywhere we have done that, the results have been outstanding. So the point is there is a certain pace and like I said earlier for us, it is about sustainability and doing it right. We believe that 150 McCafé by timeframe you mentioned, I see we will be amongst the fastest coffee shop growth that you might see in the country.

Bhavesh Shah Okay. But, again if we just look Mumbai city you have close to say 70 restaurant and I mean still I think practically all the restaurant will be a good catchment areas to at least absorb one McCafé for sure. So why is it that you are still around let you say 40-45 number of McCafés?

Amit Jatia You will see that change quarter-on-quarter I mean we have aggressive plan but remember this is restaurant development we are talking about. So, for example when you have to go back and fix some McCafé into the restaurant sometimes it involve restaurant closures and we do not want to do that during prime time of the restaurant so there are seasons when the business is really-really good and there is footfalls on the retail stretch and we do not want to go and disturb the restaurant at that time. So basically there are many factors to it and along with that, reimaging is very important and when we do reimaging that requires a lot more time than just putting a McCafé. I do feel though that in less than I mean almost 12 months from when we really started rolling it out, we will be between 50 to 75 McCafés by December and then we are going to double that again in the next 12 to 18 months. So I feel it is a pretty strong and aggressive plan that we have on our hand. The other important thing is that McCafé is about customer interaction and Barista training becomes extremely critical when you are rolling out McCafé. So we feel that this has worked very well for us because not only it has motivated our crew to do something different but it has also created a tremendous excitement amongst our customers in our restaurants.

Bhavesh Shah So, is it fair to assume that wherever you are reimaging your stores you are also building a McCafé along with it?

Amit Jatia Yes, that is fair estimate.

Moderator Thank you. Our next question is from Arnab Mitra of Credit Suisse. Please go ahead.

Arnab Mitra My first question is on gross margins. Basically, till last couple of years you have been expanding gross margins pretty well by 150 basis points while it is still expanding, the pace has slowed down a little bit especially in the context as input cost are relatively benign. How should we look at gross margins is the mix still improving towards higher margin products and would we see a similar pace going ahead?

Amit Jatia See Arnab you got to look at it yearly. You cannot look at quarter wise because quarter is too small for our business which is growing. It is actually nascent and category is evolving and developing. Consumers are learning what QSR is. If you look at total eating out market, that itself is very low, so, my point is that our business really cannot be looked at quarterly. Look at it from a trend of a year or look at five quarter trends and you will be able to see the difference. This trend will continue because we do not want to lose the value equation of McDonald's. We yet believe that we need to recruit new users into QSR and we think that value is characteristic for what QSR is and McDonald's philosophy is every day value versus deals. And we are beginning to see the benefit of some of these steps that we have taken while these last couple of years has been difficult. Arnab, you will continue to see this trend and it will be in the similar pace that you have seen over the last couple of years but quarter-on-quarter you might not find and maybe some quarters you might even find it flat because we do not want to do a knee-jerk reaction to the consumers and especially if we are trying to get most of the gains through product mix it becomes even more difficult.

Arnab Mitra Sure. And in terms of menu pricing, what is the kind of increase on an average that you are being able to get now?

Amit Jatia Same thing as we have been saying about 4% to 5% a year, about 2.5% twice a year is roughly how we do it.

Arnab Mitra Right, sure. And just lastly you have been doing continuously new things coming into the menu like you have this Focaccia Bun and new kind of smoothies etc. I just wanted to understand is there a limitation how complex the menu can get or do you keep also seeding out something so that the overall complexity is the same in your stores?

Amit Jatia So we have learned luckily through many mature markets where the menu is quite evolved. We do consistently keep taking products off and putting them in. Also many times these are just what we call line extension where it is there for a limited period and then we pull that out. So consumers gets new news, like, last month, we had McFlurry which was a Banana Oreo McFlurry. So we keep doing things like that all the time and I think we have found a decent methodology of managing that and this where our supply chain partnership, our long-term investment in the supply chain helps with both product development and with our ability to manage inventory and new product what we call line extensions.

Moderator Thank you. Our next question is from Amit Kumar of Investec Capital. Please go ahead.

Amit Kumar Just one question, most of my questions were answered. I mean for the rest of the year as far as the core menu is concerned which is burger etc., what kind of innovations can we look forward to?

Amit Jatia Well, we are a food business and new news is important for our consumers so you will see continuous work around all our dessert options, our beverage options, you will see work on the main menu on the core menu you will continuously see that evolving for the rest of the year. You will see a lot of excitement and engagement with the consumers on the menu.

Amit Kumar Anything that you can share on the pipeline on the core menu products?

Amit Jatia Cannot share anything but we hope to pleasantly surprise you with a lot of good stuff.

Moderator Thank you. Our next question is from Vishal Gupta of India Infoline. Please go ahead.

Vishal Gupta I have two book keeping questions, one is with regards to other operating income that has gone up by around 200% so what is the reason for that?

Amit Jatia This income is basically what we when we do cross promotions with partners etc.

Vishal Gupta Okay, these are going to continue or this is one-off thing?

Amit Jatia No, by and large we hope to maintain our other operating income at these levels.

Vishal Gupta Okay. Sir one more thing on employee cost that has remained Q-o-Q despite addition of five stores.

Amit Jatia: So as I said in my opening comments we have done a lot of work around both utilities and payroll and some of our productivity gains are beginning to show and you will continue to see these gains in the coming quarters.

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

Nikunj Doshi Just two follow-up questions, in your press release you mentioned that there are 185 million customers we have serviced. So is this the number of tickets that we are talking or it is number of footfalls?

Amit Jatia No, number of customers. Footfalls could be more or less it is an approximation because you know it is judgment based on our research, etc.

Nikunj Doshi So is it safe to assume number of tickets?

Amit Jatia No, it is not. It is the number of customers that have broadly walked into restaurant.

Nikunj Doshi Okay. And so in terms of that any indication of growth in footfall that we have seen during this quarter?

Amit Jatia As I said earlier, we are in impulse business you do not make a planned visit to McDonald's. So for example if you got to one of the malls if people are in the mall we find that they are able to come to us and do really well. It is very hard for us to physically track numbers so we sort of work that on a certain methodology that we have. We do not break that detail out regularly so I cannot really comment too much on that.

Nikunj Doshi I just wanted to guess how the average ticket size has moved?

Amit Jatia The ticket price has been moving quite well, so what we are seeing that consumers along with the meal are buying sides which is helping us increase our average check. The McCafé has helped increase the average check quite well because if you look at our smoothies there are Rs. 185 and they have done really well for us. We do a lot of work around average check through product mix, through sides and through value added products like sharing packs that Smita talked about in her presentation. All that helps us increase our average check and there has been healthy growth.

Nikunj Doshi And another point you mentioned when we do re-imaging we maybe closing the stores, means sales could be affected during that period. In this quarter we have added McCafé. So is same stores growth decline could be attributed to that as well or is not the case?

Amit Jatia No, see one it is very-very small and out of eight, some could be some could be new as well so I do not know how many are reimaging but we have been able to get this pretty much to a decent level where we do not necessarily close very often unless and until it is a rebuild. So the impact is insignificant.

Moderator Thank you. As we have no further questions from the participant, I now hand the floor back to Mr. Amit Jatia for closing comments. Over to you, sir.

Amit Jatia Thank you everybody for joining us on the call. If you have any more questions, you please reach out to Ankit Arora at Investor Relations and he will be happy to address any other questions that you may have. Thank you and good evening.

Moderator Thank you. Ladies and gentlemen, on behalf of Westlife Development Limited that concludes this conference. Thank you for joining us and you may now disconnect your lines.