Q4 FY2015 Earnings Call Transcript – May 8, 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 Q4 FY15 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 fourth quarter and fiscal year ended March 31st, 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. Thank you.

Amit Jatia Thank you Ankit. Good evening everybody and thank you for taking the time to join us on the call today. I would request you to turn to page 3 of the earnings presentation. Before Smita takes you through the FY15 results I wanted to share some opening comments with all of you.

FY15 has been a challenging year for WDL as consumer sentiment continues to remain muted. Frequency of eating out remains stagnant in key markets while options for eating out continue to grow giving consumers more choices. When I look back at the year gone by I do feel confident that we have moved forward in all aspects of the brand although margins continue to remain under pressure primarily due to continued new restaurants openings. Many of our strategic priorities have started to positively impact business results; this will strengthen the foundation of our business further and set us up for continued leadership in the QSR sector. This is evident from the fact that our comparable sales performance improved significantly in the second half of the year where we delivered -2.6% comparable sales in the second half versus -8.5 in the first half. Many food operators are facing severe pressure even in the second half of FY15 which reflects the impact of our strategic priorities. We grew baseline sales through menu platforms like wraps reimaging initiatives, aggressive roll out of McCafé and through substantial growth in the delivery business. A diversified real estate portfolio helped us negate impact of malls that are either closing or losing share due to their tenant mix. We continue to improve gross margins for a second year in a row while maintaining value for our customers. In FY14 we improved gross margins by 160 basis points and added an incremental 80 basis points in FY15. Good work around menu through food festivals and growth in the beverage platform helped us deliver the improved margins. This is foundational work and as the economy picks up and we grow same-store sales, it will contribute healthily to the bottom line. Indian consumers are more online than ever before and I'm happy to say that McDonald's enjoys a significant presence in the online space through the McDelivery website and the McDelivery app. With over 113 restaurants delivering to customers we grew the delivery business by over 30% in FY15 and have grown the online business by over 300% in FY15 as well. We are well entrenched as leaders in the emerging food tech business. We continue to open new restaurants with a significant focus on key markets and under penetrated markets in Tier II and Tier III towns. In fact, we opened 25% of our new restaurants in the difficult Mumbai market increasing our presence in under penetrated trading areas across the city like Vasai West, Andheri East, Bhayandar, Nerul, Kalyan West etc. We also made huge strides in opening drive-thru's in line with our focus to keep the portfolio diversified. We optimized the cost of opening new restaurants and continue to innovate to further reduce costs. We do hope this will provide us with competitive advantage in the future.

I'm excited about the foundation of our business and the strong consumer connect brand McDonald's has built with its consumers over the last ~20 years. The QSR category is an impulse business and therefore footfalls in retail locations and malls are material for us to grow same store sales. The current consumer confidence has impacted footfalls in retail locations and reflects in our weak comparable sales for FY15 although reflecting an improving trend in the second half of FY15. Finally the true test for a food brand is in its performance in the food court where all competing brands both local and global have a presence. I'm proud to say that McDonald's has consistently won awards as the best food operator in top-performing mall food courts year on year clearly reflecting the power of the brand and the continued relevance of its offerings to the customer. As leaders, we need to look beyond the current economic environment to realize the true and full potential for brand McDonald's in India. Our strategic priorities reflect long-term thinking and we are confident that our actions today will make McDonald's a strong brand with a solid foundation to lead the QSR markets in India. I now ask Smita to take you through the results for FY15.

Smita Jatia Thank you Amit and good evening everybody. I will start with some highlights of the year gone by. Today we stand at 209 restaurants with an addition of 27 restaurants in FY15. We increased presence in seven new cities and now we are operational in 26 cities. A weak macro environment affected discretionary spend led to comparable sales to -5.6%, hence leading to a slow 3.2% revenue growth. Gross margins expanded by 240 basis points over the last two years and in FY15 by 80 basis points. This was led by a sharp focus on supply chain efficiencies, pro-mix as well as pricing. We relocated two restaurants and our cash profit for FY15 was INR 254 million with the cash and cash equivalent of ~1.56 billion.

I will now go into our first strategic pillar broadening accessibility – out of the 27 restaurants which we opened, seven were opened in Quarter 4 versus five in the same quarter last year. We continue to dominate our presence in Maharashtra and Karnataka while we build presence across other geographies reflected in the restaurant opening across seven new cities. To recap the strategic pillar of broadening accessibility we opened 27 restaurants, 25% in densely penetrated Mumbai. We expanded in seven new cities, we strengthened the drive-thru portfolio and more importantly we achieved reduction of 10% in our restaurant development cost thereby helping return on investment.

Now moving to the next strategic pillar which is growing baseline sales – the menu lever was used extensively across all customer segments. We started the year with the premium Royal Burgers, we then added the wraps at a value pricing of 49 onwards. We built our core product by adding new news through the bun and sauces. We also added wings in the South which was led by consumer impact. We topped this with the variety in desert by introducing the brownie-McFlurry and other flavors. Under the levers of platforms and value to grow baseline sales, in South we celebrated our world-famous price with a local adaptation of the Piri Piri spice. In Jan we had the Double burger promotion giving filingness and value to our customer. We also build trails for the breakfast day-part through an extensive sampling exercise during National Breakfast Day.

I'm happy to say that in FY15 our brand extension was a very key lever for growing baseline sales. McCafé for us has continuously given us great consumer feedback as we expand. In a short period of 18 months, we have 43 McCafes spanning across seven cities. It helps us build the breakfast day-part and the snack day-part with a completely different consumer segment. It also helps us with gross margins and to build our average check. On the delivery front, we grew the platform at a double-digit comparable sales month on month. Online delivery along with the mobile app has helped us drive this growth. We reimaged 22 restaurants making them modern and contemporary thus improving customer experience.

So to recap the pillar of growing baseline sales through the levers of menu, brand extension of McDelivery, McCafé and reimage we protected baseline. Because eating out frequency did not increase fragmentation of the market continued leading to comparable sales under pressure, in spite of this we grew our market share in most of our key markets.

Moving to the next pillar – soft sales coupled with high inflationary pressures resulted in pressure on margin. On the gross margin front, extensive work on raw cost, pro-mix and menu pricing together led to a 240 basis points improvement over last 2 years. While we improved the gross margin by 240 basis points new store drag and pressure on operating costs of our existing stores continued to lead to margin erosion.

Finally closing with the last pillar of growth through people – we are happy to announce recognition by various big mall players. This is amidst stiff competition in the food court by local and global player. Our initiatives around being the employer of choice were recognized by the Great Places to Work Institute. We ranked number one in the QSR segment and number four in the retail segment.

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

Suresh L Thank you Smita and good evening all participants. I will now take you through the financial analysis of the results for Q4 and full-year FY15.

So as Amit and Smita mentioned earlier while the overall environment continues to remain weak, the addition of 27 new restaurants and 32 new McCafé's during the last 12 months resulted in the modest increase of about 3.2% in our revenues on a year- on-year basis. Due to the continuing muted consumer sentiment persisting over the last 12 to 15 months, we saw comparable sales at -5.6% for the full year. However due to various strategic interventions as mentioned by Amit and Smita earlier, we saw an improvement in the comparable sales in the second half as compared to the first half of FY15.

On the expense line items, as we have indicated earlier that as the base of the new restaurants keeps moving higher which is currently at around 42% of the total restaurant base, the cost associated with those restaurants do impact the restaurant operating margins in the short to medium term. Resultantly we have been impacted by higher occupancy cost which led to opening of new restaurants and higher utility and labor costs due to increase in per unit rates by utility operators over the last 12 months as well as significant impact of changes in minimum wages across different states during the year which resulted in increase of our payroll expenses by around 20% in FY-15. While there has been significant drag on account of the new restaurants and other expenses it's extremely heartening to note that our strategy around driving gross margins in upward trajectory continues to yield results and we were able to expand our gross margins by about 80 basis points during the FY15 and one must also remember that this is on the back of another 160 basis points expansion in gross margins which we saw in FY14. Therefore, we have seen the impact of restaurant operating margins and operating margins of the company due to the reasons that I've highlighted above. I would like to state that we believe that as the consumer sentiments start to recover we would significantly benefit from the higher operating leverage and various other costs optimization initiatives that are being driven across organization.

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

Amit Jatia: Thank you Suresh. Western fast food represents only 1% of the total eating out market and is growing at a faster pace than Indian fast food therefore the key is for Westlife to navigate short-term challenges while building for the future. Our goal is to increase accessibility or brand McDonald's to the Indian consumer through expanding the restaurant network; we continue to expect to open 175 to 250 new restaurants in the next five years with a sharper focus on opening in new clusters for incremental and profitable growth. New openings will be targeted towards un-penetrated trading areas and cities to cater to new customers allowing them to experience brand McDonald's. We had a significant focus to optimize our restaurant opening costs and operating costs associated with it. We hope to continue to optimize on unit economics of new restaurants in the coming years. WDL expects to continue its reimaging program to modernize its older restaurants in Mumbai, Pune and Gujarat to remain relevant to changing consumer needs. Along with reimaging, Westlife we'll add McCafé's to its existing restaurant base while opening new McCafé's with new restaurant openings as well.

We expect to have about 50 to 75 McCafes by December 2015. We also expect to grow the base of McCafé over the next three years significantly.

The current base of over 209 restaurants allows us to ramp this up quickly. We will look at opportunities to optimize our real-estate portfolio especially in underperforming malls by relocating to better performing locations within the trading areas in case the need arises. Many of these older malls are now under stress due to newer malls and in some cases lack of right anchor tenants. Our risk management strategy, favorable location and commercial terms put us in a good position to manage that effectively, putting our assets to better use.

Baseline sales will be built through menu platforms like wraps, food festival, menu variety and extending the beverage platform. Westlife will continue to focus on brand advertising, digital platforms and using technology to further enhance customer service at the restaurants. Thank you and now I open it up for question and answers.

Moderator Thank you very much Sir. Our first question is from the line of Abneesh Roy of Edelweiss. Please go ahead.

Abneesh Roy My first question is on gross margin, for most food companies, the gross margins are expanded quite handsomely this quarter till now whatever results are there. But quarter on quarter, your gross margins have dipped by around 70 bps and last year same quarter, your gross margins improved Q-o-Q, so seasonality issue is not there. Could you explain why gross margins have dipped?

Amit Jatia You got to look at this little broader than quarter to quarter because at McDonald's when we do our pricing protocols there are some times three years, there are some times a year plus so what happens is if a specific protocol is ending at the middle of the year or in the specific quarter, therefore, we tend to get impacted because of that as well. Also, sometimes when we do promotions we look at rupee margin impact from the promotion rather than looking at percentage. So, for example, our Doubles promotion was more around building average check and be build average check sometimes as a percentage the gross margin takes a beating. So we feel that gross margin is a subject that's not a quarter to quarter thing, it's primarily something that you got to look at year-on-year. The last comment is if you look at it over two years, it's a 240 basis points improvement which we feel has worked very well for us without sacrificing value to the consumer.

Abneesh Roy You have managed really good improvement in last two years. Long-term where do you see this settling, do you see even gross margins at 65% at some stage, longer term?

Amit Jatia We don't give sort of forward looking statements but generically I have maintained that we will continue to improve gross margins at similar trends in the next 3 to 4 years as well. We do see that if it is done intelligently, it's a win-win for both the consumer and to the company. I think we have demonstrated it very well over the last even 10 years if you look at our numbers and we think we will continue to move in that direction.

Abneesh Roy Sir, competition definitely in one burger space has increased here, we see Dunkin Donuts also have more ads on burger than donuts itself and then so many other players have entered and you had this Doubles as limited time offer. Was it because of increase in competition?

Amit Jatia No see a brand has to keep itself alive and current to the consumer given that we are a food business if we are not giving new news on food all the time irrespective of competition or anybody else for that matter if you go back even five years ago we would always have a very strong calendar of advertising and customer engagement. As far as the Doubles, we have been doing it for the last three years. So if you go back into history and if you maybe even look at our previous investor presentations you will find that consistently we have done Doubles because it works very well with the consumer. So our point of view is that basically we compete with everybody across the board but when it comes to burgers we do believe that we have an edge in leadership and a very strong consumer connect. So it's a part of giving new news to the consumer more than anything else.

Abneesh Roy But sir do we track the market side data somewhere in burger space however the market share is in cities where new competition has come. You said in terms of food courts but that might be annual data and may not always represent for burger, it might be referred for the total food court. So any data you track which you can share?

Amit Jatia We have data, we have done this for the last five or six years but unfortunately we don't share this, this is proprietary research. But please understand that even if some of the new competitors who’ve come in they have one restaurant to maybe 10 restaurants and one restaurant and 10 restaurants on McDonald's India’s base of 370 restaurants is absolutely no impact. To me as you rightly pointed it out the best judge of performance of our brand is to go to the food court where every brand is present. There are many-many such food courts in India and my view the advantage with the brand like ours is that it’s visible on the ground and we are very confident. We have done well in all these food courts and we continue to grow our business there, wherever there is footfall and if footfalls are growing the McDonald's business is growing with it. That gives us the confidence that the brand connect and product connect with the consumer continues pretty strong and therefore we feel we continue to reinvest back in opening new restaurants, McCafé, reimaging that's what gives us the strength and the courage to keep moving forward.

Abneesh Roy Sir my last question is on same store sales growth, your second half performance has improved, and if we see consumer companies results it's a mixed performance. Two companies have pointed some recovery while many others are saying there is no recovery. What are you seeing directionally, are you seeing positive same store sales growth in FY16 and second is if you could tell what impact was from your app and online and how does that impact your ticket size?

Amit Jatia Sure I mean firstly we feel that the consumer sentiment continues to remain muted. We feel that footfalls in malls and retail locations continue to be under pressure and given that we are in impulse business we see that impact. As I mentioned before that in every economy these ups and downs are there but when the industry and the size of the market is so small really you got to move away from the noise and keep the focus on long-term growth, so that is one aspect. Two, what I'm particularly happy about in the second half that all the work we've put in the last 18 months before that are beginning to yield results. So for example one is decent traction on McCafé even though it's still a smaller base. We believe McCafé is bringing new customers at new day-parts and it's making McDonald's a destination for beverages as well. We feel delivery on top of that has also helped us substantially. Particularly my view is we are as food tech or more food-tech than most of the players you read about because we have very strong presence in the country and we have kitchens or rather restaurants across west and south over 210 locations. So given the fact that we were always using a call center which 5 or 10 years ago was I would say high-tech. The minute we moved to the app it increased consumer convenience and as I mentioned we have grown our online delivery business by 300% and it's definitely all of these things put together along with the menu work we've done with the Classics with the Twist and especially the wraps, all of them put together I think help us sort of move the trajectory for us a little bit better than many other players.

Abneesh Roy Okay Sir that's all from my side thanks a lot.

Moderator Thank you. We will take our next question from Resham Jain of B&K Securities. Please go ahead.

Resham Jain Just wanted to know what is the capex we have done in FY15 and if you can just highlight what is the breakup between new stores and others which includes reimaging and McCafé?

Amit Jatia So in roughly the capex is a little bit in access of 100 crores in this particular financial year and we don't breakup the details of the capex but obviously a bulk of it is to open new restaurants and the rest of it is to basically build McCafé and to do reimaging, refreshing of the restaurants.

Resham Jain And how you are planning for FY16?

Amit Jatia So as we've said that we continue to open between 30 to 40 restaurants a year. We do believe that the 175 to 250 over the next five years is something that we are striving for and therefore the capex will continue three in the range of between 100 to 150 crores a year.

Resham Jain And how many new restaurants you are planning this year?

Amit Jatia Like I said it's in the range of between and 30 to 40 restaurants.

Resham Jain Thank you.

Moderator Thank you. A next question is from Rajasa K of Jefferies. Please go ahead.

Rajasa K I had a question on the online business you mentioned that the delivery business grew 300% in FY15. Would you be able to share what it is as a percentage of your delivery business?

Amit Jatia Online is about 40% of our delivery business.

Rajasa K And within that would you say a majority is the app based orders?

Amit Jatia No it's a mixture of web and mobile.

Rajasa K Thank you Sir.

Moderator Thank you. A next question is from Manoj Gauri of Equirius Securities. Please go ahead.

Manoj Gauri I just wanted to know like any comments on the QSR industry like how do you see the growth in the coming years.

Amit Jatia As I've maintained that QSR is still very nascent especially the Western fast food market. To my mind the frequency of eating out in India even in key cities is still very-very small especially when I look at it in comparison to similar purchasing power markets in Asia. What I have seen is from 2004 to 2012-13, I have seen that eating out frequency in a city like Mumbai go up by three times and when it went up by three times, our same store sales more than doubled and pretty much everybody in the industry did well. We feel that as the consumer confidence starts coming back and footfalls return to retail locations. We are very confident that this industry has a good future. We feel that QSR will continue to grow faster than the rest of the eating out industry and we do believe that there is opportunity in the future for QSR.

Manoj Gauri Sir one more question regarding like you said that there are number of restaurants those are located in the stressed malls and you are just planning to relocate to some new malls or to the new locations so can you just give us the count like a many restaurants are in the stressed malls right now?

Amit Jatia Actually our strategy has worked very well for us. The best example I can give you Crossroads in Mumbai. When Crossroads opened we were there and when the Crossroads changed hands there was a time in the middle when the mall was being repositioned but our strategic thought process when we entered the mall was to be right at the front of the mall and therefore through its ups and downs McDonald's continue to do very well and continues to be a strong anchor in Crossroads. So what I mean is that even though some malls are going through their ups and downs and we are pretty certain that they will recover but while they are going through that ups and downs our strategy of risk management in some cases of being at the front of the mall, in some cases the way we have structured our deal has kind of work for us in this favor. So it is something that we are watching out for. There is no immediate impact that we worry about but it is something that we feel very proud in terms of our diversified portfolio and in terms of the way we've handled the real estate side of our business.

Manoj Gauri Sir one last question, can you just give some guidance like what is the number of cities that you are looking for?

Amit Jatia Then it's very hard to say that because we follow a cluster approach. Firstly what's good news is that McDonald's particularly has a huge unpenetrated market base. So we are even after opening seven cities we are only in 26 cities across West and South. We know that many of our competitors are in 100+ cities in the same area and we believe that that's all opportunity for us. But we, McDonalds, have the certain approach which is a cluster approach because for us it's important to ensure that we provide quality, service, and cleanliness and under our platform of supply chain management we think that the cluster approach of opening is the right way to do it. So you will see us enter in to new cities more and more because we do want to make our brand accessible to more and more customers and especially in difficult times like this, we feel that it does make sense to go into many of these under penetrated markets rather than going into trading areas that already have McDonald's presence.

Moderator Thank you. A next question is from Krishnan Sambamoorthy of Nirmal Bang. Please go ahead.

Krishnan Two questions, one is what is the number of store closures for FY15 and second, a significant proportion of your new expansion has been in the form of drive-thru's, what has been the performance here so far and how do you see that going forward?

Amit Jatia In FY15 we closed two restaurants. As far as drive-thru is concerned we don't break out the details of that but typically drive-thru's take time to build because you build them in emerging markets. So we have been very happy with the progress and that's why the number and percentage of our drive-thru portfolio is continuing to increase. Remember just like a retail location has footfalls and therefore we must be there, similarly on a high car count market we're having a drive-thru that gives us incremental business as well. So for example the Hub restaurant that we have on the Mumbai Western Expressway, the restaurant we have just before the Expressway on the way to Pune is all around car counts and it's an incremental opportunity over the visit that you could get from retail locations. We've found that many of these restaurants are built extremely well over time and that's exactly what we expect out of our drive-thru portfolio.

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

Bhavesh Sir couple of questions, when we talk about some of the awards that we have got in some of the leading malls like Oberoi and Infinity, so are there any specific criteria on which these awards have been given like attracting footfalls or revenues etc.?

Amit Jatia I think it's the being the best Operator and being the Best Operator in the food court clearly talks about of course the hygiene level, our speed of service and obviously sales because if you're not selling but you are the most hygiene operator in the world, it doesn't help the mall or the food-court. So I don't know their criteria but I know that we've consistently been winning in numerous malls and I believe it's to do with the way we operate our business and the way we provide the customer service and I guess more importantly the total volume that we've consistently built in that particular mall.

Bhavesh Sir my second question is on the delivery mode of business. It's doing extremely well growing almost 30% Y-o-Y, so have we evaluated something of even connecting it to some of the other delivery apps which are actually doing pretty well in the market like Foodpanda or TinyOwl?

Amit Jatia We do work with most of these chains.

Bhavesh And sir but my final question is on the royalty rates for FY16. How do you really see this rates to pan out in FY-16, I understand that some relief given by the parent company on this. So if you can just give me a number at what level one should expect FY16 royalty rates to come at?

Amit Jatia So it still December is going to remain at 4% and then it goes to 5% in the last quarter of FY16.

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

Vishal Gupta I only have just two or three more questions. One was with regards to what is the view on the raw material index as a whole for FY16? Do you think the raw materials indicate the low-to-moderate going forward?

Amit Jatia It's challenging, it fluctuates a lot so we were doing quite well until the unseasonal rains where the wheat crop has taken a bit of beating and then again diesel has gone back up by Rs. 3 or Rs. 4 impacting logistics, it's very hard to say. The good news is that McDonald's never operates on a day-to-day basis which is what I was mentioning earlier. The way we work with our supply chain we're completely backwardly linked to farmers. We have long-term protocols with suppliers but then yes if commodity prices change substantially then it does impact us. And lastly a lot depends on monsoon as well, so we continue to believe and watch it very carefully but all I can say is that I'm quite happy with the way it's panned out for us over the last 3 to 4 years.

Vishal Gupta Sir would you like to take price rise in case commodity inflation is there in FY16, in case of a weak consumer sentiment in environment?

Amit Jatia So we continue to do that, our point is that inflation is running anywhere between 6 to 9% depends on food, depends on consumer and therefore we always take a price increase of between 4 to 6% year-on-year. So in a high inflationary environment you have to keep pace with it.

Vishal Gupta In FY15, you already have taken price hike for 4% to 5%?

Amit Jatia Yes.

Vishal Gupta And one more point with regard to employees. We have seen a lot of online players, they are poaching employees from various organizations so in delivery or in other areas so employee cost risen due to this reason or due to the wage inflation that is going on.

Amit Jatia As we shared on the previous calls it was when the government increased minimum wages by 40% and then subsequently by another 10%; however, our philosophies always never to do kneejerk reactions. Over the last one year we worked very hard on productivity gains and we are quite confident that we will see some results from this productivity gains going forward. But it's not to do with competition, competition is always been there and it's always going to be there as well.

Vishal Gupta Sir one more book keeping question, with regards to the royalty rate. For the current quarter the royalty rate is around 1.8% so can you just throw some light on it?

Suresh L The quarterly number actually takes into account reclassification of Cenvat credit utilized during the year and therefore I would urge you to look at the royalty for the year-ended March 2015 which reflects the favorable impact of the one-time royalty relief given by McDonald's Corporation as mentioned by us even during our call in February and therefore the royalty for the entire year stands at 3.13%.

Vishal Gupta One more question that regards to tax, will you require to pay MAT in FY-16?

Amit Jatia It's hard for us to say that at this point in time.

Moderator Thank you. Our next question is from Resham Jain of B&K Securities. Please go ahead.

Resham Jain Just to elaborate on the question which was answered earlier, like you said that the softening in the raw material prices typically don't come immediately for McDonald's, so how should one consider the softening from material prices going forward?

Amit Jatia As I mentioned to you we do believe that we will continue with similar trends in the past on gross margins. As we have explained in the presentation that raw prices is only one part of the lever that impacts gross margins. We believe that menu pricing and product mix management altogether form the components of gross margin improvements and we feel that some of our work around McCafé, beverage platforms, and some of the work we have done around our menu like the 'Classics with the twist' and all have helped us move in the right direction without impacting consumer. Therefore we feel that the trajectory will remain the same but specifically it's very hard to give you a sense on commodity itself.

Resham Jain And secondly you have launched various new products for the last couple of years but any products which you have stopped?

Amit Jatia It depends because many times we do limited time offers in food festivals. So an example is if you look at "Classics with the Twist" where we took

McVeggie and McChicken and gave our consumers who liked that product, the whole new twist to it by giving an Italian sauce and new bun and some herbs. So those products were always there for say a limited time. PiriPiri for example at one point was limited time offer but then eventually consumers really wanted the product back and we brought it as a permanent item. So that's the way it works in the food business because you got to keep giving new news and it's not always permanent introduction.

Resham Jain And finally on the capex, I was just looking like 150 to 250 crores of capex over the next two years, this year we have generated close to 25 crores of cash so if you can just highlight if we require to do any dilution or something because for the kind of capex of 30-40 stores plus reimaging what we'll do, will it suffice in terms of capex plan which we have?

Amit Jatia I mean one is of course we do hope that business results do move up, we don't expect to remain where we are for sure, so we do hope that future cash flows will be useful. Two, we still ensure that we have at least Rs. 1.5 billion in cash that we have on our balance sheet so definitely for the year we are in good shape relative to anything else and let's see how the environment goes. But there are no immediate plans to really raise any capital.

Resham Jain But are you comfortable taking debt, you already have close to Rs. 1 billion of debt. Will you be comfortable raising more of debt?

Amit Jatia We have cash in the balance sheet as well so we will play this as we feel is relevant. But we want to take a conservative view on our books. We are not going to get very aggressive with debt. So the reserves that we have along with better business performance, it should help us get over FY16 for sure.

Moderator: Thank you. Our next question is a follow up from Rajasa K of Jefferies. Please go ahead.

Rajasa K I had a question on margins, now you mentioned that we saw high utility costs as well as hike in minimum wages. Now I just want to delve upon the timing of that so are we likely to see a bulk of that cost increase next year or is it behind us?

Amit Jatia Well it's mostly behind us; we haven't seen any crazy increases as yet but that's where again like commodity is very hard to say because as you know in India there is one utility provider and whatever rate they decide to charge we have to pay that. So, given the sentiment, given where the crude oil is, given that everything is going I feel it's not going to be extremely challenging because we have also done a lot of work around design and particularly in a newer restaurant we have been able to manage our utility unit consumption to start with better than we have been able to in the previous designs. So we created a bit of a hedge in our platform as well so I'm quite hopeful that FY16 should work out okay for us.

Rajasa K Right and how about on minimum wages?

Amit Jatia That is all behind us. It was all last year primarily.

Rajasa K And broadly speaking what is usually the timing of this wage hike or is it vastly different across states?

Amit Jatia It's different across different states, it's completely state driven and typically the government raises minimum wages twice a year. So, those things are completely outside our control but again our philosophy is that if you see a certain trend we don't wait and watch to see what's happening, there is lot of work going on around productivity growth where we are trying to improve the productivity of labor and we are again hopeful that that should negate impact potentially.

Rajasa K Secondly on pricing, how do you find the pricing environment right now, I mean demand is certainly weak but any comments on that?

Amit Jatia We stayed away from discounting I mean call after call I've mentioned that we don't believe in deep discounting, we believe in everyday value. There is no point in pricing a product at a price and then giving one free every X or Y day. Our philosophy is that can we give our customer consistency, can they rely on McDonald's to manage supply chain to give them the best price that we could and we bring our entire network, knowledge to be able to do that and our farmers have benefited in the bargain because we are very consistent with them and I think our customers are benefited as well. Many companies don't follow supply chain the way we do and therefore I think we are able to probably do a pretty decent job when it comes to supply chain. I feel that given that inflation itself is real in India, the price increases that we talked about, I think that's the way we will continue which is 4 to 6% increase in menu prices in a year.

Rajasa K And lastly you mentioned there is a 10% reduction in your development cost that's mostly related to the capex per store or is that a P&L item?

Amit Jatia That's capex.

Moderator Thank you. Our next question is from Jehan Bhadha of Motilal Oswal Securities. Please go ahead.

Jehan Bhadha Sir my question is broadly if I look at your historical margins, EBITDA margins so they have peaked in FY11 and 12 between 10 to 12%, so could you just throw some color as to what was actually the scenario at that time?

Amit Jatia Remember that we are in the growth mode as a company and that's the material thing to think about. I think today I can say that people understand e-commerce and similarly of course we are a retail brick and mortar business but in many ways we are in the same mode where we are trying to open new restaurants which short-term drag performance down and if you see our trends you will notice that on the base of very strong comparable sales growth we were able to take our EBITDA margins from almost 0 to 12.5 and if I go back five more years, we were probably -20%. And as we kept building the base of the restaurant, as supply chain efficiency started coming in, as we started managing a much larger base. For example my corporate overhead, our G&A which was in 2009 about 9% it went down to 5.25% and again when sales have kind of flattened its gone back up. But remember we are in the growth mode. We have to open McCafé's, we have to grow the delivery online business, we have to open new restaurants, we have to do many-many things, and we have to build the breakfast business. So we believe that for the next 5 to 10 years we are going to continue to go on that path but we believe that as the business matures, operating leverage is really the game in the retail business.

Jehan Bhadha So is it the case that during that period of FY-10 to 12 you went slow on your restaurant expansion?

Amit Jatia: No, not at all because between 2010 and between now I built more store than I built in the first 15 years of our business so we have been building about 30 restaurants consistently for the last four or five years, so it's not about that. But in that time as I mentioned earlier the frequency of eating out was growing in our country, the economy was growing between 6 to 9% and there the consumer confidence was high and because of that of course we were able to do good comparable sales growth. Our delivery business was growing some of the menu work we did that was yielding great results and as a result of all that there was tremendous slowdown of our comparable sales growth down to the margin level and that's how you saw that happened but that's typical of any retail business. Therefore, we are confident we are in a growth mode and therefore we know the corporate overhead will come down to where we needed to be. But this is not the time to think about that. This is the time to step on the gas, accelerate growth.

Jehan Bhadha Essentially if we were to assume that 10 to 12% EBITDA margin could be a long-term target if I'm not wrong and with an asset turnaround of 2x, you could do an RoE of over 20%, is that your target?

Amit Jatia Definitely, that would be the kind of goal that we have.

Jehan Bhadha And any sort of targets for next 2-3 years our target on margin front?

Amit Jatia No forward-looking statements from our point of view but trajectory will be towards growing the margin base.

Moderator Thank you. Our next question is from Ashish Jalan of Reliance Mutual Fund. Please go ahead.

Ashish Jalan Sir I just wanted to understand your strategy on the real estate front in terms of the locations where you plan to open the newer restaurants, essentially moving to Tier-II kind of towns there may not be too many mall options that will be available and even in the existing locations given that the footfalls are not coming in the malls so do you plan to open more in any other areas where you can get a larger delivery base or lot of public places where you can get ready customers?

Amit Jatia Yes absolutely I mean it's not about malls. Our point has always been that we have a diversified portfolio where we operate with drive-thru's, we operate in high streets, malls, food courts and specialty locations like by the railway stations. We believe we only have in India 370+ restaurants which our view is for a 1.2 billion people is underserved, even if you take Mumbai. For the first time we opened in Vasai recently and for that base of customers it was completely new McDonald's accessible to them so we believe that there are many-many such locations both in Mumbai and in new markets and we will continue to grow that. We are not dependent on malls for our opening, we do work with malls, we like malls but yet at the same time if there are no malls we to open drive-thrus, we do high Street retail locations. So I don't see that as an issue at all.

Ashish Jalan And in terms of the rentals do you see any easing off a or re-negotiation on the rentals that you have in the existing stores?

Amit Jatia See in India rentals never go down, they stay static at best. I wish they would go down as well but really and what we find is that deals are possible today. People are seeing that there is softness and I think brands like McDonald's that are out there looking for deals, brands that have built a good reputation like us where we pay our rents on time, we enter into long-term contracts, and we honor them. So we have a good reputation today so we are able to get good favorable terms with landlords. But it's not just about the rent alone, it is the total package which makes the deal really viable for us where we manage our risk as well so we are able to get that today.

Ashish Jalan One last query on the overall consumer preference was more healthier product and where as the brand positioning for McDonald's globally has been quick and relatively attractive priced product so in terms of the consumer preference do you see long-term portfolio to be completely different from now on or do you see the preference changing drastically over a longer tenure?

Amit Jatia We are in the consumer business and therefore if consumer needs change we have to change with it and I think we have done that so far. I think McDonald's from 2002 to 2003 onwards made lot of strides and therefore the last 10 years have been very good for the system. Similarly in India there are number of things that have worked for us. First and foremost we have a strong vegetarian menu. Two, we have a strong chicken platform. So we feel that we have a grill platform on chicken, our soft serve and our milkshakes are 3% fat, recently we cut down the calorie content in our sauces by 40 to 50%, we've cut down sodium content so we continue to build trends. The important thing is to offer choices to consumers so we have an egg product that is a steam product, we have whole variety of products that our consumer who wants to eat a certain type of food, so I think it's about choices in our restaurant. Any restaurant you go to it, it's about choices.

Moderator Thank you. We will take over next question from Vishal Gupta of India Infoline. Please go ahead.

Vishal Gupta Can you please explain why the royalty rates were low, I didn't get you earlier.

Amit Jatia Firstly just to explain the royalty as we explained in the last call, McDonald's supported us in these difficult times by reducing our royalty by 1%, one part is that. The other is as you know we pay service tax on the royalty so it was just a previous quarter adjustment. So if you look at the entire the year it reflects the full position.

Vishal Gupta So earlier quarter you had paid an extra amount, so this quarter you reversed that?

Suresh L It’s the reclassification that’s all.

Moderator Thank you. Ladies and gentlemen that was our last question. 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 additional questions, please contact Ankit Arora at Investor Relations. Also our website has all the information. We thank you for your patience and thank you for being with us today.

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