# Q3 FY2014 Earnings Call Transcript – February 10, 2014

**CORPORATE PARTICIPANTS:**

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- Ms. Smita Jatia – Director, Westlife Development Limited
- Suresh Lakshminarayanan – Chief Financial Officer, Hardcastle Restaurants Pvt. Ltd.
- Ankit Arora – Manager, Investor Relations, Hardcastle Restaurants Pvt. Ltd.

**Moderator** Ladies and gentlemen, good day and welcome to the Q3 and nine months ended December 31, 2013 earnings conference call of Westlife Development Limited. As a reminder all participant lines will be in the listen only mode. There will be an opportunity for you to ask question after the presentation concludes. Should you need assistance during this conference call, please signal an operator by pressing "*" then "0" on your touchtone telephone. Please note that this conference is being recorded. I now hand the conference over to Mr. Ankit Arora, Manager – Investor Relations. Thank you and over to you Mr. Arora!

**Ankit Arora** Thanks. Welcome everyone and thank you for joining us on Westlife Development Limited third quarter and nine months ended December 31, 2013 Earnings Conference Call. We are joined here today by Amit Jatia, Vice Chairman, Smita Jatia, Director, Westlife Development Limited and Suresh Lakshminarayanan, Chief Financial Officer, Hardcastle Restaurants Private Limited.

Please note that results, press release and investor presentation has been mailed across to you. And, these are also available on our website www.westlife.co.in.

I hope you had the opportunity to browse through that highlights of performance. We shall commence today's call with key thoughts from Amit, who will provide the strategic overview. He will be followed by Smita to take you through the key business initiatives and Suresh will cover analysis of the financial performance and highlights during the review period.

At the end of the management discussion, we will have the 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 risk 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. Over to you Amit.

**Amit Jatia** Thank you Ankit. Good morning everybody. Thank you for taking the time to be with us on the call today. If we can move to the first slide, I will just quickly share with everybody the broad strategy for the business over the next I would say three to five years our key pillars for great growth continue to be broadening accessibility, food image, modernizing the customer's experience and energizing people. We believe that over the next five to ten years as we develop the Indian market primarily we need to continue to broaden accessibility to our customers who do not have a McDonald's in the large underpenetrated markets, at the same time we need to continue to build on value to penetrate deeper into the population.

Moving on to the second slide on the results and the highlights for the Q3 FY 2014, in terms of restaurant expansion our total restaurants are now at 183 with a gross addition of about 10 new restaurants in the quarter of October-December, while the year-on-year addition is at 30 new restaurants.

Our revenue growth came at about 4% year-on-year which was primarily impacted due to comparable sales which were about -9.8% in this particular quarter. The economic slowdown and impact on consumer spending has been the primary reason for negative comparable sales after 10 years of really solid growth in our comparable sales and primarily footfalls on the high street are something that has impacted as per our analysis.

We are also really proud to share the launch of global brand McCafé in India in October 2013. Today, we already have three McCafé's in the Mumbai region and we are quite delighted to see that the performance is pretty much in line with what we had thought. We have also happy to say that one of our big ways and movements forward is to improve our gross margin and we been able to expand that quite well year-on-year. We are quite pleased to say that this is due to product mix, menu pricing and raw cost management, so all the three levers have worked quite well for us. Irrespective of the difficult times that we are facing, we have been happy to provide stable cash profit of 166.4 million in the last quarter.

Let me handover to Smita to take you through the next slides.

**Smita Jatia** Thank you Amit. Moving on to new restaurants which has always been our biggest focus which is to broaden the network to the consumer as Amit mentioned, year-on-year we have opened 30 new restaurants with the continued focus on Drive Thru which is our big competitive difference. In the quarter we have opened 10 restaurants which is evenly spread across all our three regions.

Now moving on to the marketing initiatives, as Amit mentioned that the economy is under pressure and consumer sentiments are low, in such an economy frequency of eating out has dropped and our biggest challenge is to increase this frequency without giving deep discounts. In order to do so what we have done is we have provided more value to our consumers through different promotions as well as loyalty program. All these have helped us improve frequency of McDonald's customers visiting us.

Moving forward we have also seen that customers who are coming to us we provide them with greater values through our double promotion, these are essentially consumer's favorite products given to them in a better and a bigger way. This promotion has helped in driving footfalls and at the same time giving more to the consumer. We continue our focus on families, we had two very big properties Tom & Jerry and Doraemon in the last quarter which helps drive consumer footfalls and families especially in the season of Diwali, Christmas and New Year.

Lastly coming to our newest kid on the block which is McCafé, we are very proud to say that having launched the first McCafé in October we were able to rollout total of three McCafé's very quickly in Mumbai. These are a range of products which a consumer can get starting from cold as well as hot beverages. What McCafé has done is helped us drive a bigger consumer base, a different consumer, build a different day part as well as improve gross margin. So we are very excited about this initiative, which is going to help us touch the INR 1,400 crore coffee market which is growing year-on-year at about 13% to 14%.

So now I will pass it on to Suresh.

**Suresh L** Thank you Smita. Good morning everybody. I will now take you through the financial analysis of our results for the Q3 FY 2014. So if you move on to slide No. 14, as we are well aware and as Amit also mentioned earlier the economy continues to be sluggish and the consumer sentiments are pretty muted. It is in the background of this that the revenues have increased by over 4% over the corresponding quarter of the last year.

We have also opened about 30 new restaurants in the period ending in the last 12 months, period ending December 2013 and as you had seen from the marketing initiatives that Smita talked about we have done various initiatives on the consumer front also launched products special like the double burgers and also tried to build a consumer loyalty through smile cards and the unique gifts festival.

Now if you move on to slide 15 and let us understand a little bit about our restaurant operating margins. The focus on improvement in operating margins at the restaurant level continues and as Amit also mentioned about the gross margin improvement there has been a very focused and sustained efforts by our supply chain and menu management team and through a combination of all the three levers that is on the raw cost management, on the menu management as well as on the product pricing, we have been able to improve our gross margins by over 305 bps over the corresponding quarter of the last year.

We have also invested in new restaurants. It is a significant investment in 30 new restaurants over the last 12 months and while all this has been happening as you are well aware the inflation continues to hit us hard. We have worked on various initiatives to bring on utility costs and despite the tough economic scenario and the inflationary headwinds and significantly large new restaurants openings, we have managed to improve our restaurant operating margins by around 75 bps over the corresponding quarter of the last year.

And if we move on to the slide 16 which talks about our EBITDA, as you are well aware we are currently in investment mode both on the restaurant front as well as on our people resources and the team, and this requires significant investment on talent acquisition, talent management and development. Resultantly, the corporate general and administration overheads have increased by 120 bps year-on-year as a percentage of sales; however, we view this as a significant investment that is going to help us propel in our journey ahead and therefore while it has a short-term impact on the business we see it as a significant investment for our journey in the future.

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

**Amit Jatia** Thank you Suresh. In terms of the outlook for the business, we feel that we will continue to drive opening of restaurants. We feel that in a journey of 15 to 20 years, as country gets developed one has got to take a long term view and there is a huge underpenetrated market for restaurants and therefore we continue to open restaurants even through this difficult period.

We are also excited about expanding McCafé. The initial results have been great as Smita mentioned to you. So we intend to open between 75 and 150 McCafé's over the next three to five years. Menu will continue to play a huge role in our business, not only will it help us drive new customers through introduction of innovative products across day parts but it will also help us improve our gross margins through better product mix management so there is a lot of work going on menu and you will see that unfold over the next two to three years.

Lastly even though the environment has been very challenging and we are using this period to work very hard on getting our cost structure right, we have been able to work very hard on making sure that even with the dollar appreciating substantially over the last 12 months, we have been able to keep our investment per restaurant cost pretty much stable because of optimization and localization of a lot of the kitchen equipment. Also we are working very hard to ensure that utilities which is a very big challenge for us, we come out with new ideas and technologies to ensure that as utility rates keep increasing we are at least able to deal with that more effectively, so we are quite confident that when we emerge out of the economic cycle, we feel that we will be a much stronger business and as the wind starts moving in our direction we should be able to take the business quite forward.

Finally in terms of closing remarks, the consumer sentiment is weak and I do not expect that to change in the near term. So, basically as a business we are prepared to deal with this over the next six to nine months. We feel that we need to continue restaurant expansion to drive penetration and increase accessibility for long term competitive advantage. We continue to focus hard on Drive Thru's in those areas. Cost optimization products have worked quite well for us and we are hoping that while we have got some good benefits on the gross margin side, we are looking at some more benefits on the investment side as well as other operating cost and we believe that we have a strong brand that connects well with the consumer and that will help us drive a long term shareholder value. Thank you.

**Moderator** Thank you very much. Ladies and gentleman we will now begin with the question and answer session. The first question is from the line of Prasad Deshmukh from DSP Merrill Lynch. Please go ahead.

**Prasad Deshmukh** Good morning Sir. Couple of questions; firstly what are you exactly doing to lower the cost structure and how do you measure the cost saved in that?

**Amit Jatia** In terms of cost structure particularly we are looking at the investment side to start with because if the investment in building a new store in itself goes down that changes the economics quite well for us, given that our business is capital intensive so a lot of the effort is around localization. So we have achieved a lot of localization in the previous years but given the way the dollar has gone we want to ensure that pretty much in the next three to five years everything that we do is local and that could give us a 10% - 15% reduction in our development cost. So the measurement is very simple that if it earlier took Rs.100 to build a store it should basically now take Rs.90 to build a store just as an example. On the other side, in terms of operating cost, our biggest focus is around utilities and essentially you know we get a lot of support from global McDonald's because there is a lot of work around new technologies because utility is the problem across the world so we have a lot of new ideas that we are in the process of testing out in different stores across our territory and as the results keep coming we keep deploying there. We are quite proud to say that a large part of the impact on utilities is because of unit rates going up not necessarily unit consumption going up. So the measurement is extremely simple, that if you are able to reduce the units of the electricity used to deliver the same sales, then we will get some benefits.

**Prasad Deshmukh** Second question is on a demand side, typically your kind of businesses depend a lot on how much discretionary spends pan out in a particular year or a quarter, are you seeing any signs that this is likely to pick up especially in the metros kind of market?

**Amit Jatia** Absolutely not, at this point in time we have not seen any shift in the consumer sentiment or consumer spending, we find that footfalls are low and given that we are in an impulse business, if people are not out on the street, shopping or buying or doing things there is a clear impact to our business. So, I do not see that changing in the next six months to nine months.

**Prasad Deshmukh** Just one last question, in this McCafé kind of a space how many players typically exist in a developed market?

**Amit Jatia** In the developed market, I mean coffee players will be numerous, I mean it has intense competition as it is in the QSR segment and generally McDonalds has done extremely well with McCafé because McCafé is always a part of the McDonald's restaurant and what it does is that by adding McCafé to the regular restaurants, I call it you know 1+1+1=5 so not only to customers get great coffee but they can also go to the front counter and may be buy a Mac Fries and that help the business in totality for us.

**Prasad Deshmukh** Thanks a lot for taking my question Sir.

**Moderator** Thank you. The next question is from the line of Hemant Patel from Axis Capital. Please go ahead.

**Hemant Patel** Couple of questions over here. First on food and paper cost, Amit you just alluded that that has been a one of the focus areas for reducing your cost could you give us some instances and how this has been manage in inflationary environment?

**Amit Jatia** So we at McDonald's believe that you need to manage gross margins intelligently, as I mentioned earlier there are three levers. One is you constantly focus hard on raw prices coming into the restaurants so yield improvements at the farm level etc., etc.. An example around that would be how we moved or opened a new bakery in South India and the entire transportation cost of the fresh buns that was going from Mumbai impacted the P&L positively quite well. The second example would be product mix and we believe that promix helps dramatically. An example for that would be the Veggie Pops that we had introduced in the restaurants and also the double burgers. So, we are giving more values to the customer and when the customer buys them, our gross margin on all these new products that we are designing are quite healthy and that gives us the positive benefit to the bottom line and finally in the inflationary environment that we are in, menu prices need to stay keep pace with it otherwise we tend to fall back and therefore that is the third sort of lever and all three of them together have given us this benefit that is now reflected in the P&L.

**Hemant Patel** What is the weighted average increase in Menu prices for the nine months?

**Amit Jatia** Normally between 3% and 4% has been effected.

**Hemant Patel** In terms of same store sales growth, if I were to do comparable versus some of the other QSR players we seem to be impacted more so and this comes despite a fact that we are a value player. Could you give us some insights or your reading into what is actually impacting us so much?

**Amit Jatia** When you look at comparable sales, I feel in a market like India which is sort of evolving and growing there are many, many factors which do not make the comparable sales comparable with others. So for example if I were to look at just a delivery counts our numbers are far, far better than total counts and therefore that would be the right comparison with some of the players. As far as we are concerned the point is that we serve a very, very large base of customers. I mean you read a presentation we do about 165 million customers annually so when the footfalls on the street are not happening in a market like India which is evolving we do take a beating sometimes. So to give you an example, in a developed economy the down trade happens into QSR. So people move from fast casual into QSR and therefore QSRs do really well. What we have learnt this time around while in 2008 when the last time things were tough we did quite well. We are finding that the sentiment here is pretty low and basically the down trade is happening to street vendors and to clubs and the canteens. So people are not going out as much and because we are dealing with largest number of people, we have taken some of the hit actually.

**Hemant Patel** If I were to flip it in another manner is our exposure being larger to let us say a Mumbai, Pune and Bangalore impacting us more. So, is same store sales are comparable numbers in Tier II cities is it better-half than Tier I?

**Smita Jatia** I think it is pretty much evenly spread markets which are newer and which have had store openings over the last one to two years, we have always seen that these stores in the coming years give us better counts and the system average, so the new stores definitely give us better counts whether they are in new cities or in existing cities but by and large if you see that pretty much negative trend is seen across all regions.

**Hemant Patel** Smita you eluded on the marketing initiatives just wanted to understand either the economic benefit or the impact over the next two years on your gift festivals and this smile card schemes that you are actually talking of?

**Smita Jatia** The basic thing which I mentioned was that in a market where frequency of eating out is dropping due to lower consumer sentiments the biggest challenge is how to increase that and from that point of view what we are doing is rather than giving deep discounts, our focus is to drive further loyalty and we will continue to do promotions as well as smile cards which will help drive this loyalty.

**Amit Jatia** So Hemant that is the big difference that we have sort of brought to the table that we are taking longer term view rather than just give products away at zero cost to the consumer, we prefer to use smile cards which brings loyalty and frequency back on to McDonald's.

**Hemant Patel** Just one last question, in terms of menu management you have had introductions in the past just wanted to understand the traction of these introductions, for instance your breakfast menu which you started off two years back has that caught on and how was things panning out on that?

**Amit Jatia** Breakfast is actually doing quite well for us and again when we look at comparable sales of these different brand extensions in day parts, they have done quite well compared to the average numbers that we have just talked about, while we do not give a breakup we are quite encouraged with breakfast and what we have realized is that we actually need to invest even more to get the breakfast day part going and you are going to see that in the next six to nine months, these are the best learning and best practices we have got from McDonald's in other markets where breakfast takes about 5 to 7 years before it really starts contributing until then we need to keep investing in building the habit of the consumer for breakfast.

**Hemant Patel** Amit will you be able to share if I were to include breakfast and the new products how much of they will be contributing to the overall business at the moment?

**Amit Jatia** No Hemant, we are not able to break that up unfortunately.

**Hemant Patel** Alright! fair enough thanks a lot.

**Moderator** Thank you. The next question is from the line of Vivek Maheshwari from CLSA. Please go ahead.

**Vivek Maheshwari** Good morning everyone. My first question is on the gross margins again so the performance 56.5% what you've done no forward-looking statement here but the kind of inflation that we have particularly in the milk prices and all do you think this should still sustain or there is a possibility of any slippage herein at least in the shorter term?

**Amit Jatia** See the point is that again we look at our business from a very long term point of view, given that we deal with commodity short term blips will be there we cannot risk them away because we like to give consistency to our customers, so if for example we sense that milk prices are up for three months or two months depending on how much that increases. we like to ensure that our customers are still able to buy our ice cream or cheese etc., at the same price; however, if we feel that milk prices are now reset at a different price point we might look at that quite differently. So the good news is that we keep a lot of focus on commodities, plus we do a lot of hedging. So a lot of the commodities that we have would be hedged for the whole year and therefore we get some benefits in the way we think about it and lastly, we also do backward integration, so for example for a lot of our products we work directly with farmers and therefore the pricing that we get is quite different from the pricing that most other people in the market players get and we think as we grow this is going to be an increasingly important competitive advantage in our business.

**Vivek Maheshwari** Second on some of the cost heads so you know your store additions are 30 on a Y-o-Y basis or 20% but your staff cost for example increases only 9% so how do you explain that because I would imagine even at the existing store level you will have wage inflation on a Y-o-Y basis?

**Suresh L** Vivek, basically if you look at that in terms of what we have mentioned on the G&A that does not include the restaurant staff that goes into the restaurant operating expenses. It goes into the store operating costs. So are you referring to the store operating cost you referring to the G&A cost?

**Vivek Maheshwari** No, I am referring to store operating cost and even if you look at you know the store operating cost is trailing the store additions you have on a Y-o-Y basis so which means that either the existing stores would have seen you know significant savings, I mean how to read into it because 20% store additions versus a 10% staff cost or overall store operating expenses?

**Suresh L** Yes, so obviously there would be efficiencies that would kick in from the existing operations and that is what we leverage on.

**Amit Jatia** So we focus very hard on productivity Vivek. I mean the important thing I want to say is that it is not a cost that has worried us so far but basically recently there has been a wage increase of about minimum wages have gone up by about 30% to 40% especially in Maharashtra, so in the future it is going to be a bit of a challenging issue for us but so far it has not been a worry because we manage productivity of labor very well and also we have part time labors as well, so because of these two we have been able to deal with it effectively so far but there are changes in the legislation and regulation and that may have certain bearing in the future.

**Vivek Maheshwari** Just a small bit on this, so you are saying if there a part time say employees that you have at a store level if footfalls are lower can you realign or recalibrate store head count. Is that correct in the shorter terms if there are these blips?

**Amit Jatia** Absolutely, by and large yes, there are limitations to what extent because finally you know it is a balance between how we deal with people versus cost and you have to balance that well. You cannot just cut it so much that they have no investment left in the brand and the business.

**Vivek Maheshwari** A third thing on corporate expenses those are also up 55% - 60% so any specific although it is a small number I understand but anything over there?

**Amit Jatia** See that is the critical that we are in the growth mode of our business and I do not see that changing for next five to ten years. I think overall if you look at a trend of five years we managed our overheads very well at the corporate office but as we going to scale our business we have always said that we want to do between 75 and 100 restaurants now we want to open another 75 to 150 McCafé's, we want to put more investment in breakfast, we recently just launched our new online delivery platform which in fact is done extremely well for us. So as you are building these platforms and as you are doing in a business that is growing where we should be hundreds of restaurants in the future this is a cost that does not worry me because we know that in the past we managed it well and when the time comes it will all sort of payback to us quite well.

**Vivek Maheshwari** But the thing is why are you saying Amit, it will take say you do not expect this to change in the five to ten years because I would imagine the benefit should run high may be for three four years but you know there after the payback should start, so the margin should get an uplift from corporate expenses we should trail say whatever revenue growth or same store sales growth?

**Amit Jatia** Vivek absolutely correct, and the important thing is we have already done it so if you were to just track the past you will see that we have been able to bring G&A cost very, very well under control so if you were to ask me it is not something that worries me, the point is that you will see the benefit trickle down and you should expect that. All I am saying definitive timeframe it does not matter you know whether it is one year or two years, the important thing is that we have a very good grip on this particular area. So to give you an example if I want to accelerate McCafé, I need the right team to be able to accelerate because it involves work of the restaurant, it is like a whole new format being rolled out including marketing, including engagement with the consumer, supply chain because while we have introduced the base line products in McCafé there is a roadmap we have for the next three to five years. So that means a very solid team to be able to take that up. Secondly if we want to take our restaurant growth up from the 30s to the next level again work needs to start today, GIS software, building inventory and pipeline of stores and sites so that is where the investment is going but if you were to ask me it's not something that worries me at this point in time. I have more other things to worry about actually. Also if you look at from 2008 until 2013 we have been able to bring down our overhead from 9% to 5% - 5.5% range. So just in the last five years we have shaved 400 bps of the G&A cost as a percentage of sales.

**Vivek Maheshwari** Finally on delivery so you are promising now 29 minutes delivery could you elaborate on that and is it possible to get a number of how much deliveries to your total revenues or orders today and where do you see that changing over the next say five years?

**Amit Jatia** So the elaboration on that is Vivek, please order, give us some business and get the product in 29 minutes. So that is our offer. The whole idea is we are pushing ourselves because in delivery, delivery times are very, very material and we want to push ourselves to be able to be more efficient and effective in the future. We have seen some good traction in this area but we do not break up numbers. All I can say though that the online delivery platform has particularly worked extremely well for us. We launched it in the end of December. We are running in the first week of February and consumers are absolutely loving it. We can see that because we also allow cashless on the delivery platform which is online and we can see that consumers are loving it also our riders are able to come back faster because now they do not have to wait for change and all that cash transaction is over.

**Vivek Maheshwari** Understood, thanks and all the best.

**Moderator** The next question is from the line of Avi Mehta from IIFL. Please go ahead.

**Avi Mehta** Thanks for taking my question. Congratulation on the gross margin bit. That is very, very impressive. Just wanted to understand, continuing on that front while I believe I would appreciate this is an ongoing process but would this quarter's gain would be a run rate say at least for the short term and then slowly some benefit start coming in because I am just taking your comment that nine months growth is likely to be weak and I am just trying to project how should I look it for next few quarters?

**Amit Jatia** Like I said we deal with commodities so it is very hard for me to give any forward-looking projections on this. All I can say is the trends you will continue to see in this direction. It might not be as sharp as what you saw because at the end of the day given that consumer sentiment is also quite difficult, we have to be very, very smart in the way we manage a promix shifts so I would say that look at this more as a trend, do not look at this last quarter alone please look at our gross margin movements over the last two years or three years and I will ensure that the trend line moves in the same direction.

**Avi Mehta** Then just continuing on that line while I appreciate your point that customer sentiment you don't see it shifting, do you see any kind of bottoming out now at a level wherein it does not look like it is going down further from that level or is it very difficult to take a call?

**Amit Jatia** I think definitely bottomed. I mean I do not see it getting any worse than this but it is the bottom that I can assure you.

**Avi Mehta** Lastly, just wanted to take one specific line item which we were discussing the occupancy in the other operating cost that is something that we saw a sharp increase in the first half and now it is kind of moderation, what line that is the store addition related line item the occupancy and operating cost or what all does this include it? Can you just clarify that?

**Amit Jatia** Occupancy and other operating expenses include both old stores and new stores. Now if you recollect and if you see our investor presentation normally it takes about two to three years for a new store to sort of establish itself in the trading area, so normally they always start with much lower sales than our existing stores therefore the big impact on this line is always from new stores where the rentals start higher, the utility cost start higher but as sales continue to grow in this newer stores these cost start coming down. So you know primarily if we were to look at a same store sales the margins obviously look much better so the margins that you are seeing today is a combination of both old stores and new stores. So primarily the key line item in this occupancy and other operating expenses, utility is the very big one, rent is also the very big one in this so these would be the really two big costs that are included in occupancy and other operating costs.

**Avi Mehta** Sir I understand the reason, you are targeting and taking initiatives to reduce the utility cost, however, rental if you could just give a sense on how does that move - what is the kind of resets that you have, when do they kick in is it linked to more to revenues?

**Amit Jatia** Yes we have both we have linked to revenue as well but our revenue shares are not like the other players in the market. The other thing is that basically we typically do resets every five years of about 15% sometimes between 15% and 20% but our resets are five years versus the markets being at three years, so we recognize and our landlords recognize that we are long term players. We do long deals of 20 to 25 years and we have built into our model the fact that in the early years it takes time to build a store and a location which is why we look for longer resets so it gives us five years to establish ourselves before rent starts kicking in.

**Avi Mehta** Okay, this is all from my side. I will come back if I have more questions.

**Moderator** Thank you. The next question is from the line of Pulkit Singhal from Tree Line. Please go ahead.

**Pulkit Singhal** Thanks for taking my question. Just quickly on the McCafé if you could let us know what could be the incremental investment or incremental cost and are these all going to be within existing stores or they going to be outside so how do you look at this format?

**Amit Jatia** So globally McCafé is always a part of McDonald's so it is the store in store sort of format. That is how we typically look at it. We do not break out the investments but generally investment is about 30 to 35 lakhs to build a McCafé.

**Pulkit Singhal** Then these would probably just help two or three employees inside I mean it just an incremental?

**Amit Jatia** Exactly, see because the rent is already incurred the entire fixed cost is already there. That is what I mean by 1+1+1=5 in McDonald's and because we are in the investment mode both with breakfast whether its delivery, whether it's McCafé, whether it is dessert kiosks and the inline business because our menu is yet to play out from a global point of view therefore we feel that in our business it is a five to ten year view that we have taken in the past and that we need to continue to take at least over the next five to seven years that I see in the Indian market.

**Pulkit Singhal** So there is no incremental space that you need to get so no incremental rent at all?

**Amit Jatia** No, so we have built this I have said this before that when we take between 3,500 and 4,000 square foot even five years ago when we were doing deals it has already factored McCafé so that was already in my P&L and therefore McCafé always brings in incremental business and helps the P&L quite effectively.

**Pulkit Singhal** When you talk about new stores, how many years that take to be reach the average sales per store that you have for your business?

**Amit Jatia** Typically we say that it takes two to three years for the new store to establish itself in its territory because customers you see its about customers habits changing and for customer to build McDonalds in the travel path so that takes time because you know it is not that we open the store and the next day customers know that is in their travel path. They will all come because we are a brand that has decent pull, but for it to become part of the life of the consumer it takes two to three years.

**Pulkit Singhal** And if comes to your store expansion plans I mean right now Tamil Nadu, Madhya Pradesh and Kerala seem to be very low on the focus area, any particular reason for that?

**Amit Jatia** It is not that. Generally our philosophy has been going to a town and own it and build at least critical mass before you move to the next because you got to recognize that we are moving one there is television so if you are on television you need to ensure you have enough mass of one language before you open up another language. The second thing is we are moving fresh and frozen product so when you are moving products and if it is not done in an economical manner, our gross margins will take a really big beating. So, it is all on the path and primarily we have said before that six key cities will be about 60% of our new stores and the balance 40% will be in clusters, so do not look at just the state, you can look at the cluster. So for example Bangalore, Coimbatore and Pallakad, Coimbatore is in Tamil Nadu, Bangalore is in Karnataka, and Pallakad is in Kerala, and they form one cluster. So, it is not about states. It is about how the national highway connects these towns.

**Pulkit Singhal** Got it. Thanks.

**Moderator** The next question is from the line of Vishal Shah from Allard Partners. Please go ahead.

**Vishal Shah** Good morning. My first question is you said that the footfalls on the stores especially on the high street stores are coming down. Is there any indication that these stores within the shopping malls are getting more impacted than the standalone stores?

**Amit Jatia** No we do not see that way. Right now this is an across the board phenomenon, and we do not see there is one particular portfolio is doing better than the others. In malls what has happened is that when the malls in the recent past have done their end of season sale we have seen some benefits, but the minute that particular day of end of season is gone the high street and the mall become pretty similar.

**Vishal Shah** But as a strategy on one side you will see benefit of online sales coming through over the years, but globally it has been seen that as online shopping picks up, the stores within the shopping malls get more and more impacted. So as a strategy when you are opening new stores, are you trying to go more away from shopping malls and try to focus more on standalone stores?

**Amit Jatia** We have always said that for us it is a portfolio approach. If you look at our investor presentation, that is one of the big things we have been saying that we do not believe in sort of being 90% in any one particular format. In fact we believe that we get long-term competitive advantage by building Drive Thru's and that has been the key shift in our thinking and while Drive Thru's take a bit longer for payback etc., we find that it gives us long-term competitive advantage. Even when we go into a mall, you will find that McDonald's are upfront in the mall with access independent of the mall. And the best example is SoBo Central, Mumbai, that even when SoBo Central was being renovated the McDonald's there continued to do extremely well because we had access from the street and customers could visit the McDonald's even during that period of time.

**Vishal Shah** My second question is on the forex side. You mentioned that you will be focusing more and more on localization over the next three to five years, the benefits of which would come. As of now, both on the capex side as well as operational side, what percentage of your costs are linked to dollar?

**Amit Jatia** Operationally, pretty much 95% is local, so only 5% may have things that are linked to dollar. On the capex we do not break it up, but it is about 20% or so.

**Vishal Shah** And, on royalty payment?

**Amit Jatia** It's in rupees.

**Vishal Shah** Just on the rental side, now when you are opening new stores and entering into new agreements, what kind of benefits are you seeing, because in current environment you might be seeing some benefit on lower rental costs also when you are entering into new deals?

**Amit Jatia** Actually, while I must say that today deals are happening, in India, I feel rentals have always been so high that even when you think they are low they are still very high. That is the problem, because also sales our new stores are opening at lower sales right now, because while same store sales are measureable, new stores are not measureable because there is no reference point. So, I must say that the sentiment on leasing is better, and if we go into a deal today the deals happening, but we are being very, very tough on what we can afford given the particular environment and that is all good for us because five years ago, we noticed that the deals that we did five years ago, today have been a tremendous benefit for us, and the deals that we are going to do today if we are tough on that and we get a good deal, I know, that as the economy starts picking up, we will really get some good benefits in the future.

**Vishal Shah** So, as of now you have not seen any particular benefit on the rental cost, right? It still remains to be tight?

**Amit Jatia** It is lower, but sales are also lower.

**Vishal Shah** Thanks a lot.

**Moderator** Thank you. The next question is from the line of Sanjay Singh from Standard Chartered. Please go ahead.

**Sanjay Singh** Just wanted to look at the QSR business if I look at since I do not have time series data available for you guys, if I look at Jubilant same store sales growth last four quarters from Q3 FY 2013 to Q3 FY 2014, it has fallen from plus 16% to now -3%. Even for you for whatever three quarter data is available it has fallen quite sharply off the cliff. While we all know and we are all aware that the economy is going through a bad time, but if I look at comparables like Shopper Stop, comparable like Specialty, Mainland China, or even comparables from the consumer staples space, the drop has not been sharp as this. Specialty has been doing just double-digit top line growth, Shopper Stop has fallen from 5% same store to 2.5%, Hindustan Lever from 5%-6% volume growth to 4%. So this four quarters movement if it was a trend line it has been very, very sharp in QSR. So any thoughts about that why is it so much sharp in global economies during downturns QSR does well, my understanding is not the same in India, but can you just share some thoughts – what is your analysis of why this trend line is so sharp in the case of QSR?

**Amit Jatia** I feel personally, it is very hard to compare them because I think our data is all available on our website, if you look at the investor presentation you will see five to six years data on same store sales and you will notice that in the industry, everybody, that is all QSR players in India have done extremely well for 10 years, before this particular period. So, the first negative same store sales quarter I saw was two quarters away when we were flat. We were about +0.5%. So the point is that the way the business has grown, we have seen times and remember, that our average core sales are much higher than just a plain delivery store sales etc., so you got to see that in some context of that, but we have had 22% or before that 17%, 12%, 9%, 19% same store sales, so when you compound that the base that we have built over the last 10 years has been phenomenal. Now you got to track all these other brands that you talked about around the same period. Everybody's base was 100 10 years ago, what is our base today versus them. So, therefore my point is also if you look at hyper marts for example there are a lot of essentials there as well, and because of inflation running very high a lot of the volume growth has come probably because essentials have to be brought and now its price pointed at a different place while eating out is already a very small category in India, and I have always been saying in every discussion I have had with people that the crux for us is if I look at 2003 to today, we have been able to grow the frequency by 2.5 times of people eating out in a month. I think the crux is going to be how we can take it from where it is today to 2.5 times again over the next five to seven years and when I compare even Mumbai to Jakarta, I clearly see that opportunity. So, I feel it is not really comparable. I think the QSR players also in Indian market are not all comparable, but it all gives you a trend line and I must say that yes, QSR has been a bit more hurt in the last couple of quarters.

**Sanjay Singh** If I get your summary correct, it is basically you are saying that base for most, it is a successful QSR players like you and even Domino's is very high and hence on that base same store sales growth has been difficult. Is that right?

**Amit Jatia** In some ways, yes, because I am saying you cannot compare it over three quarters. All I am saying is you got to go before that as well, and I would in fact love to learn from this as well, if there are correlations it helps us run our business better in the future. All I am saying is that do not look at only the three quarters that we have gone down, look at quarters where Jubilant were doing 36%, we were 22% to 23% and we were compounding at that range for three or four years. So, we are coming off that base is my point.

**Sanjay Singh** We are just trying to understand this slowdown and unfortunately, it is just three quarters old. So that is the data we have. Another thing you were talking about lower footfalls in malls and high street. I mean high street footfalls probably there is no data point, but when I look at some of the malls, which reported, the Phoenix Mills reports solid small data that looks pretty exciting, I mean, a high street phoenix which is a mature mall is 17% Y-o-Y footfalls increase and Bangalore and Pune is 32% for them, so ideally your malls should do the store should be doing very well?

**Amit Jatia** Sanjay, the answer to this is very simple that the malls there are five or six good branded malls and they generally run a good shift and typically our results pretty much go with the mall, because what we notice is when people are coming in our brand is able to really attract them very well. So, while we do not give breakup data, all I can tell you the Phoenix Mill again we do extremely well, and Phoenix Mill data of our numbers would be quite different from the data that you do are seeing in totality, because we have 183 restaurants of which about 140 or 150 might be comparable. So the point is the big base, one or two good things, unfortunately will not impact it that much.

**Sanjay Singh** So maybe Phoenix is a more anomaly because it is a well run joint venture?

**Amit Jatia** There are few more like that. There are five to six malls that do extremely well and the important thing I can leave for all of you on the call is that if a mall is able to drag the footfalls we are yet to able to capture them and keep our sales quite well.

**Sanjay Singh** Just one last thing on why QSR is running down so fast is it possible that last one to two years, the number of store openings not only from national players or branded players but even small start up etc., has been very high and hence so to say competition has been quite dramatic. Is it something which worries you?

**Amit Jatia** The eating out frequency is so small, that I do not see that as an issue, but let me give you a structural aspect which Smita had mentioned earlier, basically in our category, while globally down trade into QSR, India is not yet at that point, and therefore basically it is moving down to hawkers. Now remember there was a new tax on QSR, which was 5% of service tax that was put in on April and all our trends started changing at that point in time. So, given that 5% incremental tax from price increases and the huge consumer sentiment on this sector we have all been taking a bit of a beating and people are moving down to street vendors who have zero tax, there is no service tax, there is no sales tax, there is no tax at all and if they are able to maintain the prices consumers are down trading into canteens, into clubs, that is what are research shows us right now.

**Sanjay Singh** You do not think it is a possibility that everybody is looking at the long-term growth story so positively that in the short-term there has been a glut of capacity so to say?

**Amit Jatia** No question. I do not think so, because you got to see that also. You got to give credit to the fact that when the economy was running for 10 years between 8%-9% everybody did well, and today economy is now at 4%-4.5%. So the fact is that eating out frequency is not growing, which grew in that period of 10 years. So, I do not think competition is really what it is, is my take, because remember the branded guys are who you are talking about, at the end of the day, it is still $100 billion market, that is eating out market. So, my point is that I do not see that as an issue at least at this point in time, the branded guys have a tremendous opportunity in the next five to 10 years to take their share from maybe 2% points to 3% in the total eating out so, I do not think it is about that to my mind.

**Sanjay Singh** Thank you very much. That is it from my side.

**Moderator** Thank you. The next question is from the line from Varun Lochab from CIMB. Please go ahead.

**Varun** Thanks for the opportunity. My question was again related to the sales slowdown. You would have probably done some analysis in terms of have you been losing some market share, if I look at say overall QSR and the broad eating out space because given the proliferation of brands and the number of outlets that you are opening at least in the bigger cities, do you track any data, which shows you are losing out market share at least in the organized space?

**Amit Jatia** We do track data and my point is the best way to assess that is for you to go to any food court today, and make your judgment call, because what you will notice is that if you are in a food court, any food court in the city you see the number of McDonald trays on the table and you see the number of everybody else and I think it will answer the question to you on the spot. We do track market share and as I mentioned to you the primary down trades are not happening between players and therefore we have in fact been able to not only maintain but in certain cases increase our market share as well although we do not share that data. This is a track that we do over the last 15 years. This is done on a weekly basis across the whole year which gives us enough strength on where we are heading, but primarily the entire QSR segment has lost to roadside vendors to clubs and to canteens.

**Varun L** So probably organized players would have lost market share in totality?

**Amit Jatia** Exactly, they would have, yes.

**Varun L** On the cost side, when I look at the same cost of occupancy and other operating expenses in absolute terms like from Q1 to Q3 there is a big decline. So, I would have presumed with store openings and all, that cost in absolute terms will be very difficult to come down, so is there a lot of variable cost also sitting in that? Like from 66 Crores three quarters back that cost is 55 Crores in this quarter, absolute?

**Amit Jatia** That is the June quarter. We will have to sort of get back to you on that. I do not know if it means some openings or maybe a product launch or something. It could be something like that. We have to sort of examine and get back on that, but really we do not see this varying so much quarter-on-quarter. By and large that might be an aberration in the future as you have seen in the two quarters already, there is a reasonable consistency on that. Sometimes there could be some costs that might impact it if there is a big product launch or something but outside of it, it should be fine.

**Varun L** The control over the fixed cost seems to be very commendable given the store openings, so I just wanted to understand how should we think of the operating leverage and despite in this environment you are not seeing a lot of negative operating leverage despite the weak same store sales growth so is the current number sort of more reflective of what we will see going forward?

**Amit Jatia** No, I cannot say that. All I can say is that the range that you are seeing is what the range you will continue to see because new store drags that particular number down. I think that quarter might have been a bigger aberration but we can get back to you on that, but the other two quarters are more reflective of the current situation.

**Varun L** Thanks a lot and all the best.

**Moderator** Thank you. The next question is from the line of Kunal Bhatia from Dalal & Broacha. Please go ahead.

**Kunal Bhatia** Thank you for the opportunity. Most of my questions have been answered. Just wanted to take your view on currently, on a longer term horizon you did mention that you will be opening another 75 to 100 stores going forward in the next three to five years. Just wanted your sense on the market as a whole and how many stores are possibly that this market could absorb going forward?

**Amit Jatia** Again when you are building a business for a retail network or a category, we have learnt in the last 17 years that if 10 years ago, we would look at what was prevalent at that time we would have never built the business to where we are. I am particularly very bullish about where QSR can go and I feel that basically McDonald's with its supply chain and the brand, and the menu connect there has been able to develop with these consumers is extremely well placed to take that advantage. Any business that is built out over years looks at the short-term economic cycle and adjust its business but does not sacrifice its long-term growth opportunity. So, in summary, I am quite bullish about the sector. I am quite bullish about the Indian economy. I have always found that in a couple of years we do start rising back up and we believe that as this rise comes, we will get the flip that we need and therefore we need to continue to invest, because the market is very underpenetrated and the last example I can give you is very simple whatever is the economy if I do not have a restaurant in some part of Thane, the consumers there are there, we know that and I can clearly open a store there and they will come to us, because let us assume for one second there are no stores around there, so there are many such pockets in India at this point in time. Our McDonald's assessment is that we can with the current purchasing power, build at least 800 stores in total. It is there in our investor presentation, and given that we are only at say 180 we think that we have opportunity for 600 for at least over the next five years.

**Kunal Bhatia** Sir, you did mention about underpenetrated, any stats on that?

**Amit Jatia** Very simplistically, the 600 stores in underpenetrated areas, like if you look at south Mumbai alone, we have a handful of stores so I think the every neighborhood can have a McDonald's. So I think it is very widely underpenetrated. The challenge is just dealing with the rent structure, title, getting the real estate, operating cost of utilities. That is where it takes a little bit longer to mine the potential.

**Kunal Bhatia** Secondly, my question was on currently how has been your breakeven period for the store? Has it gone up from the previous time period and now?

**Amit Jatia** It is typically two to three years. Currently sales of new stores are weak, so who knows the next cycle just in next year alone it could jump up and make up for this year so, I maintain that it could be two to three years at this point in time.

**Kunal Bhatia** How much would be the capex for the new store?

**Amit Jatia** It is between Rs.25 million and Rs.30 million per restaurant.

**Kunal Bhatia** For 3,500-4,000 square feet approximately?

**Amit Jatia** Yes.

**Kunal Bhatia** Thank you so much.

**Moderator** Thank you. Ladies and gentlemen due to time constraints that was the last question. I now hand the conference over to Mr. Amit for his closing comments.

**Amit Jatia**

Thank you very much attending the call. If you have anymore questions, please write back to Ankit Arora and he will be happy to respond. His contact details are there in the presentation as well as on the website. Really appreciate your patient hearing to our results. Thank you and look forward to your participation in next quarter's call.

**Moderator**

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