Q2 FY2020 Earnings Call Transcript – October 24, 2019

CORPORATE PARTICIPANTS

- Amit Jatia – Vice Chairman
- Smita Jatia – Director
- Suresh Lakshminarayanan – Chief Financial Officer
- Devanshi Dhruva – Deputy Manager, Investor Relations

Moderator: Ladies and Gentlemen, Good day and welcome to the Westlife Development Limited Q2 and H1 FY 2020 Earnings Conference Call. As a reminder, all participant lines will be in the listen-only mode. And there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during this conference, please signal an operator by pressing '*' then '0' on your touchtone phone.

I now hand the conference over to Mr. Devanshi Dhruva -- Deputy Manager, Investor Relations. Thank you and over to you, ma'am!

Devanshi Dhruva: Thanks, Raymond. Welcome everyone and thank you for joining us on Westlife Development Limited's Earnings Conference Call for the quarter ended September 30th, 2019.

We are joined here today by Mr. Amit Jatia -- Vice Chairman; Ms. Smita Jatia -- Director; and Mr. Suresh Lakshminarayanan -- our Chief Financial Officer of Westlife Development Limited.

Please note that our financial results, press release, and investor presentation had been emailed across to you earlier and these are also now 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 a 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 Press Release and Investor Presentation and in our Annual Report which is available on our website. The company does not undertake to update these forward-looking statements publicly.

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

Amit Jatia: Thank you, Devanshi. Good evening and thank you all for joining the call today. I am delighted to share that we continue to build strong momentum towards our Vision 2022. Our bold moves and differentiated actions continue to make McDonald's consumers favorite place to eat. This clearly reflects in our results as we have compounded our same-store sales growth by over 58% in the last four years.

This quarter makes it the 17th consecutive quarter of positive comparable sales for us. Our strategy centered on customer experience, digitalization and maximizing efficiencies is gaining momentum and delivering consistent results. This is the reason we have been able to achieve these results despite a challenging economic environment and slower-than-expected GDP growth along with tepid consumer sentiment. Over the years, we have stayed the course of our growth through volatile economic cycles by taking consistent and sustainable actions to stay ahead of consumer expectations - be it giving them a completely new dining experience through experience of the future or a new reason to visit us through McCafé and Good Food Journey. These bold moves have empowered us to navigate headwinds and deliver consistent results.

Our strategic intent is to become one-for-all and all-for-one destination, where we have something for everyone across all day parts and occasions. Be it great dining experience, a great coffee experience, great delivery experience, great value, great variety and great convenience overall.

Technology has been at the base of all our initiatives. We were one of the first players in the industry to create a proprietary digital delivery platform even before the delivery space started exploding. With McDelivery platform, McDonald's App and the experience of the future restaurants, we continue to take a technology forward approach to consumer convenience and delight with an aim to become a food tech brand as well.

I will now hand over to Smita, who will take you through the key highlights of the quarter.

Smita Jatia: Thank you, and good evening, everybody. We are very pleased to report that we have yet again clocked a profitable quarter with a strong top line growth of 13.3% and an SSG of 7%. This marks the 17th consecutive quarter of positive SSG for us.

This quarter, we also achieved another big milestone. In August, the shares of Westlife Development started trading on the National Stock Exchange. This means that a broader base of investors now has the opportunity to participate in our growth journey.

Moving on to Slide #05:

We have been consistently working towards broadening our accessibility by adding new restaurants and deepening our penetration. Our value platform is another lever we are deploying to acquire new customers and build McDonald's loyalists by owning the snack and meal occasions.

With our brand extensions, we are also leveraging occasions like coffee and breakfast and giving our customers more reasons to visit and revisit us. This is helping us establish McDonald's as a multi-use destination and thus growing baseline sales. This coupled with strong cost controls and enhanced operational efficiencies is aiding margin expansion. You will be happy to note that this quarter, we have achieved a double-digit operating EBITDA at 10.3%. In fact, both our restaurant operating margin and our operating EBITDA have expanded more than 200 basis points on a year-on-year basis.

As you can see on Slide #06, our core strategy has been centered around our restaurants, our brand and our people, coming together to create a world-class customer experience. This coupled with a strong financial discipline has given us consistent and sustainable results.

As we all know, for the last few months, the economic environment has been challenging and customers have been spending cautiously. Yet, we have put up a strong performance because our approach based on delivering consistent 'value for money' experience has resonated well with our customers.

If you look at Slide #09, you will see that this quarter, we have clocked a 7% SSG over a high base of 26% same quarter last year. This is extremely robust as the rupee value of SSG continues to grow substantially even with the high single-digit comparable sales due to the compounding effect of a higher base.

Our presence continues to grow across West and South. This quarter, we have launched a highly anticipated and our first-ever restaurant in the orange city of Nagpur, which got a stupendous response and is doing extremely well. More than 90% of McDonald's stores in west and south now have modern and contemporary interiors. **Our customers are** showing great love for our digitally enabled experience of future restaurants, and we are aggressively expanding and accelerating our EOTF footprint across cities. We currently have more than 50 EOTF stores across Mumbai, Bangalore, Panaji, Hyderabad and Chennai.

Moving on to Slide #13:

As you are aware, everyday value has been a cornerstone of our strategy. We started this year with energizing our value platform with the McSaver meals, 'fries on us' campaign. This has helped in establishing McDonald's as a meal destination and boosting our meal sales significantly. We have also extended the value platform to our brand extension by offering compelling combos on coffee, delivery and breakfast, which has helped us boost trials and volume.

As you can see on the next slide, we have been leveraging occasions to drive more people into our restaurants. We created great buzz around Friendship Day, French Fries Day, Chicken Wings Day and Navratri to give our customers one more reason to celebrate with their family and friends.

We have also been working towards further strengthening the brand. After the election campaign last quarter, we launched the Truly Indian Burger campaign on Independence Day to tell the story of our locally sourced sustainable ingredients. This campaign helped us increase awareness, drive engagement and increase brand love.

Moving on to Slide #16 – Our brand extensions have been strong pillars of growth for us. McDelivery is giving us spectacular results, and average sales per day per has increased almost fourfold over the last quarter**.** Agility to adapt to changing consumer preferences has been our key strength, and we continue to fire on all cylinders. We are tapping into exploring delivery market, both through our own delivery app and through strategic partnerships with third-party aggregators. Our intent is to give our customers a seamless online and offline experience.

This quarter, we significantly increased our delivery penetration, taking the total number of delivery hubs to 239 with a reach which is among the highest in the industry.

McCafé has been beating its own records and sales have grown close to 10x in the last four years. We now have 205 McCafés and recently celebrated the big milestone of serving 10 million cups of coffee, a testimony to the love customers have for us. With this strong base of loyal customers, we have launched a reward program to drive frequency. Some of you may have also seen our campaign in the Mumbai Mirror, which helped us increase visibility and awareness.

Digitization has been the base of our growth levers. We are mindfully weaving technology across our operations and customer touch points. The strategic intent is to deploy an omnichannel approach to acquire new customers, increase average check and build McDonald's loyalists.

Our EOTF restaurants and app have been a great platform to enable this. The McDonald's app has seen more than 2.3 million downloads so far. With a 50% quarter-on-quarter increase in active users, it is fast becoming a platform of choice for customers to engage with us.

Moving on to people – Our people are at the core of our organization. We are now a family of more than 10,000 people, with one of the best gender ratios in the industry. In fact, we were recently named as one of the best working places for women in the country. This quarter, the efforts of our people won us several accolades including the DMA Asia ECHO award, EMVIEs and Spikes Asia award for our election campaign, "Make Your Choice". Our brand advocacy campaign also won a Gold SABRE Award.

Last quarter I shared that we had signed an MOU with the Government to partner with them to further the Skill India Campaign. I am pleased to inform you that we have already started our first program, BBA - Retail Operations. This unique program offers students a combination of classroom training and on-the-job training to help bridge the entry level challenge gap in the industry. The first batch of 30 students have been inducted into the program and are undergoing skills training as we speak.

We have always been committed to growing our business in the ways that is good for **our community** and the planet. To match steps with the government's initiative to make India single use plastic free, we have proactively eliminated all single use customer facing plastics from our restaurants. This has helped save close to 500 tonnes of plastic in a year.

Our nonprofit arm, Ronald McDonald House Charities, celebrated its third anniversary last month. We are proud of the impact we have been able to create with this and are committed to expanding the program to reach out to even more number of families.

You will see a pipeline of unique and compelling initiatives from us in the coming months as well. With this, I hand it over to Suresh, who will take you through the details of our financial performance.

S. Lakshminarayanan: Thank you, Smita. Good evening, ladies and gentlemen. Before moving into the financials, I would like to take a moment to share with you all that we are very proud to inform that Smita Jatia is one of the four Indian women featured in Forbes Asia Power Businesswoman list in 2019. It is under her and Amit's leadership that Westlife Development has grown consistently, and we have been able to deliver such strong results.

Secondly, Akshay Jatia, who leads our brand extensions and digital divisions, has been conferred with the 21st Century Icon Awards 2019. The awards celebrate the success of the next-generation leaders and Akshay was recognized from a global list of next-generation leaders for the technology revolution that he has brought about in our company. We would like to congratulate both of them for their contribution in making Westlife Development what it is today.

Now coming to this quarter's results:

As highlighted earlier, we have continued strong on our growth path with a robust performance in Q2 FY 2020 where we have seen positive same store sales growth for the 17th consecutive quarter despite the challenging times.

Moving on to Slide #27 – Since last quarter, we are mandated to report financial results as per the Indian Accounting Standards (Ind AS). By now, most of you know that due to the nature of our business, IndAS 116 that pertains to principles for recognition, presentation and disclosure of leases, has a significant impact on our financial results.

Hence, in the subsequent slides, we will be discussing the comparable numbers with you, that is column A, D, and E in the table mentioned on Slide #27, which excludes the adjustments arising out of IndAS 116. These numbers will help to provide you a better understanding of the actual operational profitability of the company and is comparable with the previous years. However, just for your information, IndAS 116 would lead to an overall noncash expansion of Rs. 700

crores to Rs. 730 crores in the asset and liability and a non-cash decrease of Rs. 31 crores in the PAT.

Slide #28 shows the reconciliation bridge between the adjusted PAT to reported PAT, highlighting the impact of IndAS 116 on our profitability, which as we had explained, last quarter has the impact of reducing actual rentals and inflating interest and depreciation, however, all of them non-cash.

Moving on to the top line growth in Slide #30 – We have reported yet another quarter of positive comparable sales, making it the 17th consecutive quarter at 7%, on a base of 26% for the same quarter last year.

Our total revenues witnessed 13.3% growth over Q2 of last year. Our focus on value platform, superior performance of brand extensions and enhanced customer experience resulted in higher revenues. I am happy to share that we have three year CAGR of 19.2% from Q2 FY 2017 to Q2 FY 2020.

Moving on to gross margins and restaurant operating margins in Slide #31 – Our continued focus on improving buying and operating efficiencies, coupled with the favorable product mix and judicious price changes, resulted in improved gross margins over Q2 FY 2019. We were able to drive gross margins up by 204 basis points to 65.3% in Q2 FY 2020.

In the last three years, we have seen our gross margins expand by a whopping 480-plus basis points on the back of our focused initiatives as mentioned earlier.

Our restaurant operating margin boost was primarily on the back of operating efficiencies along with favorable gross margins, leading to a margin expansion of 233 basis points and ending this quarter at 15.9%.

Moving on to operating EBITDA – The ROM improvement and the efficiencies in G&A expenses have resulted in a higher operating profitability. The operating EBITDA margins have increased by 245 basis points Y-o-Y during this quarter.

As a result of our sustained focus on menu, value, product mix, brand extensions and supply chain efficiencies, we have been able to increase our overall operating EBITDA by ~490 bps over the last three years. This slide also highlights the major levers that contributed to the Y-o-Y movement in operating EBITDA as mentioned earlier.

Moving on to the next slide. Our profit before tax stood at Rs. 180.7 million with PBT margins at 4.6%. PBT for Q2 FY 2020 almost doubled over Q2 FY 2019 due to higher sales and improved operating performance.

From FY 2020, Westlife Development falls under the bracket of full tax rate. And hence, to that extent, PAT with previous years may not be comparable. PBT would enable you to get a sense on the actual improvement in our operating profitability over Q2 FY 2019. Our PBT has grown 15x in the last two years. Overall, we have seen around 580 basis points improvement in PBT in the last three years.

Slide #34 highlights our PAT which stood at Rs. 129.1 million, witnessing a growth of over 200% despite the incidence of full tax rate from FY 2020 onwards. Overall, our PAT margins have expanded by around 470 basis points in the last three years.

Our Q2 FY 2020 cash profit stood at Rs. 409.7 million, witnessing a 2.8x growth in the last three years.

In a nutshell, we witnessed a healthy top line growth and significant expansion in operating margins and bottom line. We believe that the company is well on track to achieve its Vision 2022. All the initiatives and investments laid currently will propel us in the right direction to achieve our target of sales growth and margin expansion.

With that said, I will now hand it back to Amit, who will take you through outlook for FY 2020 and give his closing remarks.

Amit Jatia: Thank you, Suresh. Recently, the government has been taking positive steps to give the economy the fillip it needs. The recent corporate tax cut is definitely a welcome step that will give businesses a significant growth impetus and spur consumption. While the economic environment remains volatile, the opportunity for the informal eating out (IEO) industry is robust. The western fast food category is growing consistently, and Westlife will continue to be at the forefront of this growth.

The IEO industry is pegged at $195 billion by 2023 and we have a solid strategy in place to grow our market share. We will continue to reinvest in the business to bolster our foundation, increase EOTF footprint aggressively and enhance the consumer experience. Our value platform remains a strategic priority and we will continue to strengthen it to establish McDonald's as an everyday value brand.

Our brand extensions give us a strong competitive edge to tap into occasions and drive frequency. We also remain committed to move ahead on our Good Food Journey to further increase brand permissibility.

We recognize that economic cycles of growth and downturns are shorter, and the change is quick. With a strong pipeline of consumer tested initiatives to be deployed over the next 2 years, we feel better prepared than ever to operate in this reality. With this, along with continued innovation, as to fiscal prudence and a rock solid foundation, we remain strongly on track to achieve our ambitious Vision 2022.

Thank you very much, and we would like to now open this up for questions.

Moderator: Sure, thank you very much. We will now begin with the Question-and-Answer Session. The first question is from the line of Nitin Dharmavat from Aurum Capital. Please go ahead.

Nitin Dharmavat: Thank you for the opportunity. My name is Nitin Dharmavat. A couple of questions, so you mentioned about growth in app downloads. So, I wanted to know consumer demand in terms of business numbers, how is that on the app? Is it growing at the same pace as it was during the last or last to last quarter? So, that I wanted to know. The second question is about the number of restaurants. We have a target of reaching to 500 restaurants. And currently, we are present in 42 cities. So, what is the target number of cities for these 500 restaurants when we are coming up? And my third and final question is about what are the top three challenges that we face as of today?

Amit Jatia: Okay. I will just cover a couple and then Smita will talk about the app downloads. In terms of number of restaurants, we are pretty much on track. And essentially, as we have said before that by 2022 end, we should be at least 400 restaurants. Obviously, the 500 looks tough, but we will be at the lower end for sure. So, we will stay within the range. We will continue to add 25 to 28 restaurants a year. And as you would have noticed that for us, sustainability and the quality of real estate becomes extremely prime and one of the big reasons for our consistent performances is the consistency in the quality of real estate as well. That gives us the ability given that we give rent increases every five years of 15%, that gives us consistency during the ups and downs of the cycle. In terms of the top three challenges, I have always maintained that one of the biggest challenges in India generally is inflation because there are many factors outside our control and they have many times controlled by a state utility board or something like that. So, whether it is utility, whether it is minimum labor wages recently, or for example, duty - import duties on oil and things like that. So, I would say, very broadly, it is inflation. The other is always getting quality people and retaining and training them is a challenge, not that we have not been able to circumvent it but that is been sort of the second one. And the third is the quality of real estate is always a challenge. So, many times, if you want to say open in a key market, the quality real estate means it should be legally viable, it should be financially viable and the space should allow us to open a restaurant of our size and scale. So, if you were to take that away, obviously, our growth rate could go up even higher. So, I would say these are the three broad challenges. In terms of growth in app downloads, I think Smita can cover that.

Nitin Dharmavat: Yes. Just a linked question to what you stated about the challenges that we are facing. So, what is the criteria to close down a restaurant because you said that you opened five new restaurants this quarter end, the total is now 304. What is the cost of closure of the restaurant? And how do we handle human resource in such a closure? And what do we do with the infrastructure setup that we already put in such a restaurant?

Amit Jatia: So, fortunately, we do not close many restaurants. I mean over a 20 - 23 year cycle, at best we may have closed 25 restaurants. So, it is pretty much one to two a year. So, it is not a very major thing we think about. And there are no real criteria in the sense that it depends on trading area shifts, right? If the consumer has moved, it is pretty much when we would close a restaurant. So, let us say, a very large mall has come about and that has started impacting a retail location or vice versa, yes, that is when such shifts happen. The good news is that in terms of people management closure is very easy because we are opening restaurants. So, we just move people there. And whatever assets can be retrieved from the restaurant, we do. So, you will notice that every year, about Rs. 2 crore to Rs. 3 crore write-off is there, maybe Rs. 4 crores to Rs. 5 crores total, which deals with such impairments. And that is pretty much what it is. Yes. Smita?

Smita Jatia: Yes. So, just to clarify, we have two apps. One is our delivery app and one is our other McDonald's app. To your question, if I understood rightly was that how are we seeing the downloads and how is the business moving in the same direction. So, as I said, McDonald's delivery app is also doing very well, as I mentioned in my commentary that our delivery business has grown 100% year-on-year. And therefore, it is doing very well for us. In terms of the other app, the app is actually designed to help us build loyalty with customers. So, this is an app which gives various offers for various occasions. So, if you come for coffee, you get a coffee offer. If you come for breakfast, you get a breakfast offer. If you come for a snack, you get a snack offer. So, this app for us is more to help us increase frequency and to build loyalty and that is what we are seeing, what is happening. And between the two apps, that is the testimony of how we have been able to create brand loyalty and increase frequency, as we said, we have again had our same-store sales at 7%, which is 17th consecutive quarter. And at the same time, we have clocked the top line growth of 13%.

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

Avi Mehta: It is a very good performance. Congratulations on that. First, on the SSS growth trends. I mean you are clearly seeing an uptick from 1Q to 2Q, you have been able to kind of healthily maintain that. Is this, in some sense, the demand environment or is it more or less flattish trend and you are kind of gaining in it because of your initiatives? Or if you could kind of give me a context of, how should we look at it as we go forward? And if you would give me a sense on how the festive period has been, given that there is a lot of hope around there being some signs of an uptick in consumer sentiment? Are you seeing that?

Amit Jatia: So, from a SSG point of view, we always maintain that in Vision 2022, the sustainable growth rate is really around 7% to 9%. As I mentioned in my call, economic cycles are volatile, so predictability on what is really going to happen is hard, but we have internally decided that whether economic cycles maybe whatever, that is a reality, what initiatives on the consumer side can we do, that gives us the sustainability to deliver the 7% to 9%. So, we have broken that up into components, okay. And then we are pushing each of those components, irrespective of the pressure we face from the economic downturn. So, I must say that, yes, we can feel the headwinds. But I feel one of the big reasons we have been able to sort of overcome that is that one within the category, western fast food is growing, so that has definitely been positive for us. And the second aspect is that our initiatives, particularly around the consumer occasions for like the McSaver combos, the incremental occasion on McCafé that is continuing to gain momentum, and we are seeing very strong growth year-on-year in each of these categories. So, put all of that together, and we feel that sustainable of 7% to 9% we feel is deliverable. Answering the second question, obviously, it is too early for us to say about the festive period. And it gets a bit into the next quarter. So, I would like to refrain from saying that, but we will consistently, we are quite confident of delivering the 7% to 9% same store sales growth year-on-year and in FY 2020 as well.

Avi Mehta: But Amit, I mean, given the first half performance has been so stellar, would it be more appropriate to assume it to be at the upper end of this range in FY 2020 at least? I understand you have been consistently saying the 7% to 9% range has been the steady state that you want to kind of aim for. But at least in this year, given where you are, would it not be a right, I mean if you could help me understand that part as well?

Smita Jatia: So, if I could just add, demand creation is also something, which at least we, as a brand, see is that eating out is a lifestyle change, which we see happening at the consumer end. And obviously because we are a low ticket eating-out option, demand creation for us has been pretty much constant, as what Amit is saying, sometimes a little better sometimes. But if I draw a baseline, it is pretty much constant, and we do not see it so drastically getting impacted by changes in what the economic environment is. And to top it all, our initiatives, which we are doing, which is basically, we are focusing on how do we build snacking occasion and be leaders; how do we build coffee occasion and be leaders in that and so on and so forth, whether it is delivery. So, for us, it is more like a strategic initiative and it is a destination which we need to go. And it is not a quarter-on-quarter change. And therefore, for us, Amit has always maintained, it is about running a marathon. And these initiatives, along with what we are seeing as a lifestyle change of eating out, is what is helping us deliver these numbers. So, to answer your question specifically, do we see an upside by the end of the year? I think we are going to be on these initiative platforms. There is nothing which is going to take. And what is happening in the economic environment will tell us whether we are going to be able to accelerate further or we are going to maintain this same balance trajectory.

Amit Jatia: Trajectory.

Avi Mehta: Okay. Smita, thanks a lot for that. That helps put it into context. The second bit, while first quarter was a blip, clearly you are back on the trajectory of delivering EBITDA margin expansion. And there is been a very handsome increase which can be seen this quarter. So, could you give us a sense on how should we look at this line item as well? Any number that you would want to kind of call out on margin expansion in FY 2020? Or how should we look at that?

Amit Jatia: So, as I have always maintained, for us, sustainability and consistency is the way we do things. I mentioned in the call in the first quarter that over the last three years, around 120 basis points we have consistently increased, maybe in one year, it was 100 and the other it was 150, but roughly that is the average change that we are making year-on-year. And we hope to maintain that because in order for us to deliver the 13% to 15% EBITDA by 2022, that is the rate we want to maintain and we are confident of maintaining it. So, I cannot give you a pinpointed number, but I can tell you for sure that 100 plus basis points is the endeavor for this year, at least in FY 2020. So, if you take the average, we expect to at least maintain somewhere around that.

Avi Mehta: If I kind of analyze the components of it, there has been a decent gross margin expansion as well, along with, obviously, cost control that you have done. So, is there any one-off line item over here? Or this is more to do with the mix? Or how should I look at that? Because Q-o-Q, there is almost a 100bps movement.

Amit Jatia: It is not one-off. Essentially Suresh spoke about it. We have got some work done around buying efficiencies. There are some operating efficiencies, because there is a certain percentage of the food cost that gets impacted by operations as well at the restaurant level. So, that is been very tight controls on that as well. And finally, as McCafé, etc. continues to grow for us, the product mix shift has happened. So, I have always said that gross margin is not really what we are driving beyond the 64%. But the good news is and as always maintained, that yes, if McCafé continues to grow strongly, that does add and help margins as well. So, that is working for us. And I do not see this as a one-off blip. So, it is not a onetime quarterly. We expect it to sort of maintain.

Avi Mehta: Okay, perfect, Amit. Congratulations again on this performance.

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

Abneesh Roy: Certainly, a good show in current challenging times. My first question is in terms of the dine-ins, what other players are saying is there is a slower growth there versus delivery. In your case, also, would you have seen some element of that? I understand for you, delivery is much smaller. So, if overall headline numbers are good, which means you would not have seen a big impact, but still if you could discuss some bit on the dine-in slowdown? And second is burgers and especially McDonald’s able to insulate itself from the slowdown because of the proactive measures?

Amit Jatia: Okay, sure. So, from a dine-in point of view, yes, there are challenges, because the delivery side is growing very, very nicely. Luckily for us, McCafé acts as a dine-in opportunity as well, because that experience that we are able to add of a fresh, handcrafted coffee, is helping us sustain that. So, we are using occasions, like breakfast, like McCafé, and Smita talked about snacking, So we have some thoughts around that and because of which we are able to offset that by a lot of hard work. But there is pressure on the dine-in bit. Although I would like to sort of zoom out and tell you that overall, I'm loving it. See as long as there is demand for having outside food, whether it is at home or in the restaurant, and as long as the choice is ours, which is McDonald's, overall we love it. As I always maintained that wherever the opportunity lies, we have to find the business model that makes it profitable for us. And fortunately, we have been able to do that even with the delivery growth. So, I hope that answers your question and gives you a bit of context as to how we see delivery. As it continues to grow, we are working very hard to ensure our business model remains profitable. Meanwhile, we are building in-store business, where there is pressure, through these various occasions for the consumer. In terms of the second question was burger… Sorry, what was the second question on burgers?

Abneesh Roy: Yes, essentially, you seem to be seeing a lesser slowdown versus most other parts of the QSR and overall space. So, is it because burger is lower price and you are able to escape the overall slowdown or proactive measures? You mentioned, of course, the McCafés.

Amit Jatia: Exactly. I think I answered that in the first instance. See, we are a full service restaurant and we are very strong in desserts, beverages, burgers, wraps, chicken. So, if you look at our investor presentation, we have given a lot of context around the size of each of these categories**.** And I have always maintained that we are just at the beginning of the cycle. So, therefore, that is why I challenge internally always saying that let us not talk of an economic slowdown because there is so much that we can do in each of these categories. The key, though, is to build the pipeline because it is not overnight that you can change that on a quarter-on-quarter basis. So, our investment in breakfast, for example, starts to pay off, and that impact helps, the investment we have done in experience of the future is changing the consumer journey. So, all of this comes together is making the difference. It is not just alone low prices, because if that was the case then in 2013, 2014, 2015, yes, our prices were even lower. So, we would have had that benefit as well. So, I hope that answers your question.

Abneesh Roy: Sir, that was quite helpful. My second question is in terms of the cloud kitchen. You are not just a burger chain anymore. You have different offerings. And if I take all that into account, in the key cities, in the bigger cities, cloud kitchen, is it a concern for you, especially because they are coming out with not just pricing as a competition, but very differentiated and good products? And of course, their fixed cost is very low. So, if you could discuss that risk?

Amit Jatia: See my point of view is that, I have said this before also, that finally we have to compete, whether it is cloud kitchen or anything else, everything has its pros and cons. Obviously, on this call, I cannot sort of discuss this completely. But for us, with zero incremental cost, these 300 restaurants are delivering significant numbers on delivery. For me, the flow through to the bottom line is incomparable. And therefore, while even cloud kitchen cost is even 10 lakhs, mine is zero. You see, because I am serving the consumer as well as I am using that same platform to deliver. So, if suppose we were investing for delivery 1 crore in every restaurant, your question is relevant, but otherwise it is not. Outside of which, all new fads are always supposed to dismantle the current business, but it does not work like that. And now that is a complete different and big subject, which we can chat offline. But we love it. We love cloud kitchens, we love delivery and we feel we can compete with all of them head on, because the important thing is consumer wants McDonald's. That is the key.

Abneesh Roy: And sir, my question was also, are you also evaluating cloud kitchen in some parts wherein…

Amit Jatia: No.

Abneesh Roy: Yes.

Amit Jatia: No, we do not think, it is too early for us. We think we want to get from 300 to 400 to 500 restaurants, which increases our point of distribution in any case. So, why add the incremental cost of a cloud kitchen just because everybody else loves it and it is the sexy thing to do?

Abneesh Roy: And globally, does McDonald's does that in any market?

Amit Jatia: Not to my knowledge. But it could be. I am not fully up to speed with it.

Abneesh Roy: And sir, last question. You have seen food tech apps being a big disruption last two to three years. Last one month - two months, it seems slight reversal in that entire thing, because of the fight with the restaurants and fight with the employees. So, in that context, are you getting some benefit because of these two?

Amit Jatia: No, these are very minor disruptions, more played out because, again, it is interesting news for everybody. But from our point of view, we partner with aggregators. We think they bring something to the table by making us more universally available. And for me, it is a marketplace. And in the marketplace, finally it is the brand, the product and the price point that makes the difference, and our ability to efficiently deliver. So, I think if we keep focus on the fundamentals for us it is not been a problem.

Abneesh Roy: And sir, one follow-up. So, now one more large company will enter that space. So, is that positive? And are you already obviously in discussions?

Amit Jatia: I love it. You see, when there are more competitors in the aggregator space, that is good for all its customers. So, we are happy. The more demand for the consumer, the more people will compete to get the same consumers. So, we are fine with it. The crux, if I to tell you, is do consumers want to order from McDonald's. As long as that answer is yes, we are good.

Abneesh Roy: And sir, one follow-up on the growth SSG. Have your stores and malls seen better growth versus non-malls? Why I am asking this is the multiplexes have seen the best quarter in many years. So, does that benefit you also because the multiplexes are based in malls, so as an effect, do you also benefit?

Amit Jatia: We do, but we do not break up our results by mall and non-mall. But remember, we have a very diverse portfolio, which includes drive-thrus, by the way. We are the only brand with the highest number of drive-through's. But when you deliver like even a 7% - 8% same store sales growth, it is got to be reasonably consistent. We are on a 300 store base. So, while we do not break that up but yes, when good movies come, we do see benefits in the business.

Moderator: Thank you. The next question is from the line of Gaurav Jogani from Axis Capital. Please go ahead.

Gaurav Jogani: Congratulations once again on the good set of results. Sir, my question is with regards to the delivery bit. Now you have seen higher growth rates in the delivery space. So, what would be the contribution of delivery now to the overall sales for you?

Amit Jatia: We do not share that data. Sorry about that, Gaurav.

Gaurav Jogani: Okay, sir. And sir, the next question is with regards to your gross margin expansion. So, it has seen a healthy expansion this quarter. But this is despite the fact that you have been giving so many offers of the McSavers and the fries offers. So, can you help us out, like despite this offers and all, still how are you able to expand the gross margins?

Amit Jatia: That is a great point. So, I mean the point is you see, you have got to be very smart about what I call sustainable price pointing. So, when we did the happy price menu in 2004, if you see the chart, we have improved our gross margin, but we were able to maintain the Rs. 20 price point for a while. So, that is the strength that we have as a brand and as a business. And that is how. But we do not resort to very heavy discounting ever. It is always about one, customized offer to a specific customer; and two, even on aggregator platforms, you will never see discounting from McDonald's per se. So, it is the way we sort of are able to put the package together.

Gaurav Juwani: Sure. And sir, the last bit. Like you alluded, also pricing as one of the levers for this expansion. So, can you help us out, what would be the weighted average price increase that you would have taken?

Amit Jatia: So, last I said on the call, we took one in April, which was about 2% or so, and that is about it. So, in a year, we typically take between 3% to 4%. And recently, we have been trying to stay on the lower side of it. So, that is typically what we do weighted average in a year.

Moderator: We will move to the next question. The next question is from the line of Chirag Lodaya from Value Quest. Please go ahead.

Chirag Lodaya: Congratulations on a good set of numbers. Sir, my first question is on overall operating leverage. So, first half, we have seen almost 110 basis point improvement in gross margin. But when I look at your EBITDA margin or the restaurant operating margin, it is somewhat 20 bps - 30 bps higher than last year in first half. So, what is the cost which is growing very fast?

S. Lakshminarayanan: Yes. So, Chirag, if you recollect, during the call for the quarter one, that we had indicated to you that we have made upfront investments on the advertisement and promotion. And therefore, to that extent, there was an impact. And we had mentioned at that point in time that, that kind of evens out across the year because we have a range of about 5% - 5.2% on the A&P. So, largely that you see on the H1 is basically because of that. But as Amit indicated to you in terms of any trade, it seems at this point in time and when you look at for the entire financial year, you will see that consistent delta of 100 bps to 120 bps on the operating margins. And that is how it is.

Chirag Lodoya: And sir, when you say 100 bps or 150 basis point improvement in your overall EBITDA margin, that is actually coming from gross margins, but we are not seeing any operating leverage coming out. Even if I look at the last three years numbers, despite having 15% - 20% SSG, it is all driven by gross margin flowing down to EBITDA. But on a cost basis, you are not seeing any improvement. So, can you help us understand a bit what are the costs which are growing at much faster rate?

Amit Jatia: See, basically, labor has been sometimes up, sometimes down. So, yes, I would say that because of gross margins, et cetera, we have been able to get benefits through McCafé implementation and the way we have been able to play with our product mix. From our point of view, you see there is also investment, particularly in the occupancy and other operating expenses, that we have been consistently making, and that is where some of that hidden benefit of, for example, the utility. If you look at our individual line item year-on-year, which we give in our annual report, you will notice that we have made significant delta in the utility operating efficiencies and operating advantage, but there is one or two other costs within there where we are investing, which has been taking that away. So, I would agree with you that, by and large, apparently it looks like that, but there are other line items.

S. Lakshminarayanan: So, Chirag, I would suggest that we should take this offline because if you have actually attended some of the meetings that we have had, in the conferences, we have indicated to you that largely, we are at an inflection point. And we have also explained at that point in time as to how the restaurant margin behaves over different average unit volumes. So, I think, I can explain this to you better or you get in touch with Devanshi later and we will explain this to you as to how it kind of works out.

Amit Jatia: Also, the few, last few years number is not comparable because remember, we had the GST benefit and then input tax credit went away, which completely changed the valuation. So, really, that is why I was also wondering that, that should not be true. But again, offline we can share with you, and you will see that the quarter in which input tax credit went away, how the numbers changed dramatically and how they were different before that. So, we can cover that offline with you.

Chirag Lohiya: Fair. And sir, in terms of CAPEX, so we have spent almost Rs. 65 crores in H1. What is full year target? And I am just trying to understand what is the area where we are spending? Because nine stores we have opened and Rs. 65 crores is the CAPEX. So, can you help us understand the breakup of CAPEX?

S. Lakshminarayanan: Chirag, when you look at that number, also understand that there is also capital work in progress. So, our plan for the current year is to open around 25 restaurants. We are well on path to do that. In terms of total CAPEX outlay for the year, we will probably be around the Rs. 120 crores mark. Rough and ready, about 80% of that would be because of the new restaurants. And plus, we also have reinvestments that we do in terms of whether it is in the rollout of McCafé, upgrading to EOTF and other maintenance CAPEX that we would need to do. If you also look, historically, that has been the kind of outlay that we have had over the last three to five years.

Moderator: Thank you. The next question is from the line of Aditya Joshi from Karma Capital. Please go ahead.

Aditya Joshi: Congratulations on a great quarterly performance. Sir, my question is related to the government of India's new initiative, which is Fit India Movement. Sir, how do you see this impacting the overall QSR space and, if at all, and Western fast food in particular?

Amit Jatia: Well, basically, to remain fit, you have got to exercise. And as long as you exercise, that is great. My point is that, I have said this before, this is a nice offline conversation, I do not see Western fast food going anywhere. Of course, we as a company, as I said in my opening comments, the good food journey we began two years ago, and we are consistently adapting all the new technology, new changes that are coming within the food space. But just for your information, that if you eat what we call, like, say, Dosas Idlis or whatever for that matter, and if we stay on a couch and are watching television, it is not going to help. So, it is about what you eat and what you do. Pretty much that is what it is. So, I do not see that as an impact. But I think the other way to answer your question is that, yes, there are changes that from a consumer point of view and perception around what they eat and what they do. And I think we are on the forefront of that. We can send you some materials on all the work we have done. And I think you can see that in our results, that consumers love it. Like one example I will give you is we started offering a whole wheat bun, and consumers are now switching quite nicely to that. If you look at we have ordered in fact, recently, we have launched a grilled aloo burger, which is an option to a fried aloo burger, so stuff like that. I mean, we have tons of things around that. So, we are not too worried about it. But yes, the important thing is to note that there is a shift in the consumer sensitivity around healthy eating and need to stay ahead of the curve in that change.

Aditya Joshi: Got it, sir. And sir, second question is related to the eating out frequency in India as of now. Sir, how is it over the last two years to three years and where it stands right now? If you can just call out the eating out frequency number right now.

Amit Jatia: See, we do not share that breakup per se. But typically, it is all right. I mean it is about 12%, but it depends on city to city. The eating out frequency for the whole industry has been reasonably flat recently, which is where I talk about the headwinds from a consumer point of view. However, at least in the category of Western fast food, it is been growing nicely. So, it is been all right. And that is what it is.

Moderator: Thank you. The next question is from the line of Ashish Kanodia from Ambit Capital. Please go ahead.

Ashish Kanodia: So, of the next 100 stores to achieve the target of within 2022, I just wanted to understand what will be the key focus area of the stores? Will it be malls, high streets, Tier-I - Tier-III cities? Where is it going to be? And what would be a mix?

Amit Jatia: Yes. So, as we have always said, the good thing is we are consistent. About 70% of our stores firstly will be in 6 key cities which is Mumbai, Pune, Ahmedabad, Chennai, Bangalore and Hyderabad. So, these are the 6 key cities. Of course, we have beyond that presence in Baroda, Surat, etc., and we continue to open there. In terms of our mix, we believe in a balanced portfolio. We do not want to be, for example, only in food courts, and we do not want to be only in malls. So, we have a pretty balanced way of being at transit points, building drive-throughs, definitely being in good quality malls, being in food courts and in being in retail high street locations. Also, different markets have a different game. For example, if you look at Mumbai, there are not that many malls that you will see. So, therefore, the strategy in Mumbai has to be high street, while in other places it will be around malls. In a small town, we prefer to be in a mall, for example. So, the good news is we have a very balanced portfolio. And that is the plan we have moving forward.

Ashish Kanodia: Great. Just a follow-up on that. So, if my understanding is correct, do we have a differential price point based on the location of the store? So, how much of that is attributable to the gross margin improvement we have seen over the last couple of years?

Amit Jatia: So, that is been consistent overall. I mean we believe in demand based pricing forever. So, that would not have shifted. That would not be impacting the gross margin.

Moderator: Thank you. The next question is from the line of Pritesh Chheda from Lucky Investment Managers. Please go ahead.

Pritesh Chheda: Sir, in your past presentations, whenever we have made on the margin expansion as the scale improved for our business, a lot of emphasis was put on operating leverage or store operating part. What we are seeing is a good amount of gross margin expansion. So, question here is that what can be the scope of gross margin expansion incrementally? Also considering the fact that we are moving or adding a lot of non-burger product. And if I have to look at, let us say, comparable companies in the food space, data where we have, they have a gross margin of 75%. So, for our business, our price point, our product portfolio, is the opportunity that over the next five years to seven years a 75% gross margin over 64 – 65% that we see today is a possibility? Or I am making a very wishful thinking for that?

Amit Jatia: Globally, our gross margins, firstly, I will answer the second question first. Globally are in range; globally are in the 70% - 75% range. But I do not think that is our strategy in India, because for us, it is more about demand creation and about the value platform and bringing new consumers to the fold and growing average store sales, than to basically focus on gross margin. Also, from an operating leverage point of view, I think Suresh had covered that, there are two things. Firstly, within this food and paper cost that we talk about, there is a reasonable amount of percentage that comes because of efficiencies at the store, okay? So, within our world, internally, we call it controllable, which are controlled by the restaurant, and that is an operating leverage game as well. The second thing, alluding to a bit of what Suresh said, and I have explained this in many calls before, that there is a certain minimum threshold of sales that you need, which is kind of fringe results, which is where we are currently. But as we keep adding the average store sales and keep taking it to over the Rs. 6 crores - Rs. 6.5 crores number, yes, the flow through keeps getting unbelievably better. So, that is point number two. So, you will continuously, as you see that, it will start playing out. Thirdly, you will see, in the past, our G&A used to be 9%. Today, we it went to 6% and today we are hovering in the 5% - 5.5%. Also, we are making significant investments. Lastly, last point is that if you look at our annual report and you look at utility cost, I gave the example earlier, and you look at that over three years, and you take that as a percentage of sales, you will see significant shifts there. And there are many such line items. However, as the business model is shifting, we have given away certain benefits for investing in the future, which is all in that occupancy and other operating costs. So, instead of that going up, we have been able to just transfer some of the efficiencies into more growth related opportunities. So, in summary, I feel that you will continue to see operating leverage come as the average unit volume keeps going up. Point number two, gross margin, as I have said before, we do not want to push the envelope on that. So, the territory we are in is where we are. However, the gain we have got this time is not a onetime gain. We expect it to continue and maintain, 50 bps here, 50 bps there. So, I do not know if that addresses your question, but that is really what it is.

Pritesh Chheda: On burger, are there fairly high gross margin versus burger?

Amit Jatia: We do not share that breakup. I missed the first question because it was not clear. What was your question?

Pritesh Chheda: I said 75% gross margin, as the model scales up, is a wishful thinking or is a possibility?

Amit Jatia: It is wishful at this point in time. We are not shooting for 75%.

Pritesh Chheda: And the example that you alluded internationally, which has a 75% gross margin. I was just referring to my past notes, whenever we have interacted with the company, there are example of LATAM was given where the gross margin is 65%. So, is this a new 75% normal or are we referring?

Amit Jatia: No, you should just see the global McDonald's Corporation balance sheet and annual report, and you will see it.

Moderator: Thank you very much. We will be able to take one last question. The last question is from the line of Darshil Shah from Capgrow Capital. Please go ahead.

Darshil Shah: Yes. Apologies my line was disconnected earlier. So, I have a question regarding your EOTF stores. So, how many of the stores are EOTF and digitally enabled right now?

Amit Jatia: I mean okay, over 50.

Darshil Shah: And have you seen better traction in these kind of stores in the stores which have table services and all of that?

Amit Jatia: Yes. I mean consumers love it. And for us, that is critical. So, if you can just Google the stores which are EOTF, you will see the consumer responses. And that is what is encouraging us to continue to grow EOTF experience and stores. Obviously, the results are reflected in the consumer response.

Darshil Shah: And there is a material difference between your consolidated P&L for the slide on your restaurant business. So, I was wondering what is causing that difference?

Amit Jatia: No, we do not have any other business. We have only one business called the restaurant business. No, standalone Westlife, there is no real business. Everything is in HRPL. And therefore, everything is HRPL. And, the statutory cost would be audit fees, et cetera. But basically, it is only one business that we have, which is HRPL and the McDonald's business.

Darshil Shah: Because I was looking at the earnings release. So, in the earnings release, if you look at the snapshot of your P&L business versus the fully detailed P&L, so there is a material difference between all the line items. For example, your employee expense is close to Rs. 58 crores for the quarter, whereas in the snapshot, which was given, your employee benefit is close to Rs. 43 crores. So, there is a Rs. 10 crore difference there.

S. Lakshminarayanan: Are you comparing the standalone and the consolidated?

Darshil Shah: No, both are consolidated.

S. Lakshminarayanan: Sorry?

Darshil Shah: Both of them are consolidated.

S. Lakshminarayanan: No, I am not getting this, sorry. What we have published is a consolidated and there is a standalone result, right? Which statement are you referring to?

Amit Jatia: I think best to do this offline.

S. Lakshminarayanan: Yes. Actually, you can maybe call us after this and we can talk to you.

Moderator: Thank you very much. That was the last question. I would now like to hand the conference back to the management team for closing comments.

Amit Jatia: Well, I would just like to thank everybody for being on the call today. Have a lovely day. And I would like to say Happy Diwali to everybody, and wish you all the best for the season. Thank you.

Moderator: Thank you very much. On behalf of Westlife Development Limited, that concludes the conference. Thank you for joining us and you may now disconnect your lines.