Q3 FY2019 Earnings Call Transcript – Feb 01, 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 Q3 FY19 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 the conference call, please signal an operator by pressing '*' then '0' on your touchtone telephone. I would now like to hand the conference over to Ms. Devanshi Dhruva – Deputy Manager, Investor Relations. Thank you and over to you ma'am.

Devanshi Dhruva: Thanks Janis. Welcome everyone and thank you for joining us on Westlife Development Limited earnings conference call for the third quarter and nine months ended December 31st, 2018. We are joined here today by Amit Jatia - Vice Chairman, Smita Jatia – Director and Suresh Lakshminarayanan – Chief Financial Officer of Westlife Development Limited.

Please note that the results, press release and investor presentation had been mailed across to you earlier, and these are also available on our website www.Westlife.co.in. I hope you had the opportunity to browse through the highlights of the performance. We shall commence today's call with key thoughts from Amit, who will provide the strategic overview, which shall be followed by Smita to take you through the key business initiatives, and Suresh will cover analysis of the financial performance and highlights during the review period. At the end of the Management discussion, we will have a Q&A session.

Before we start, I would like to remind you that some of the statements made or discussed on this call today maybe forward-looking in nature and must be viewed in conjunction with risks and uncertainties we face. A detailed statement and explanation of these risks is available in this quarter's 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.

Amit Jatia: Thank you. Hi everybody, thank you for joining the call today. I am pleased to share that building on the back of robust growth last year, we have yet again delivered strong top-line growth coupled with solid same-store sales growth resulting in significant margin and cash flow growth as well.

This is a 14th quarter of positive same-store sales growth and we have more than doubled our margins and cash flow over the last 24 months. With this we continue to make strong progress towards achieving our vision 2022.

As I reflect over the last few years, I can confidently say that Westlife has been able to build a differentiated consumer focused platform by taking bold initiatives to meet the ever evolving consumer needs in a very fast paced business environment. Since its launch in 2016 our ROP

2.0 platform has consistently delivered strong results for all our new restaurants. In a relatively shorter span we have launched over 180 McCafes across the country. We continue to put in significant investment in reimaging our restaurants to remain relevant to our ever demanding consumers.

Digitization remains a key tenet of our strategy to deliver convenience and value to our customers and we continue to leverage it strongly as we cater to more and more millennials. All these initiatives have helped us lay a solid foundation to grow the business.

We began laying the foundation during a very difficult economic period. As consumer sentiment started turning around we have been able to make significant strides in our business which is validated by our robust business results. We are now taking bolder steps to build a stronger differentiator for our brand through a renewed value strategy and menu innovation.

Taking a big leap ahead in our 'Good Food Story', in yet another industry first initiative we have introduced 'Whole Wheat Buns' as an option for the consumer to cater to the demands of our ever evolving consumers. With these initiatives we reinforce our commitment to our consumer who is and will always remain at the center of our strategy.

Smita and Suresh will take you through the results of the last quarter December 2018. Let me move this to Smita now.

Smita Jatia: Good evening everyone and thank you for joining the call today. We have delivered a strong, profitable quarter, registering a healthy same store sales growth for 14 consecutive quarters. We are satisfied with all the initiatives we have taken to deliver a great customer experience powered by our restaurants, our brand, our people along with strong financial discipline.

Here are some of the highlights for the quarter; we achieved total sales growth of 21.5% year-on-year with a PAT at 136.6 million, a Y-o-Y growth of 76.4%. Our operating EBITDA grew by 31.7% Y-o-Y with the margin expansion of 113 basis points. This was aided by same-store sales growth of 14.5% which came from a menu innovation and strong growth across McDelivery, McCafe and Breakfast. In addition to strong sales we also saw a 23% growth in restaurant operating margins driven by enhanced operating and supply chain efficiencies. We opened 8 new restaurants taking our restaurant count to 292 across 40 cities.

Maharashtra and Karnataka continue to be our key markets with over 60% of our restaurant concentration. We added 8 new restaurants across regions in the last quarter with the new city launch in Thiruvananthapuram.

We increased the number of our EOTF Restaurants to 20. 'Experience of the Future' restaurants remain a key differentiator for us and an important lever to elevate the digital customer experience along with table service. EOTF was a unique proposition where our consumer can customize their food, this will help to strengthen their preference for the brand.

Moving to slide #10; the third quarter is traditionally one of our busiest quarters. We worked towards providing variety through menu innovation and convenience to our customers which translated into strong SSG of 14.5% over 21% same quarter last year.

Strong SSG also helped us maintain a strong baseline growth and operating leverage. Let me now take you through specific initiatives that we launched this quarter.

The highlight of the quarter was 'What's your Spice Fest' under which we offered our customers 11 new products (including 2 McCafe beverages) with different spices from across the world. This was all limited period offer that was launched with the idea of offering variety during the festive season and drive frequency. This also aligns with McDonald India's vision of bringing global flavors to our customers at affordable prices thereby strengthening our Burger leadership.

As you will recall we launched our Good Food Story in April this year with a commitment to provide more wholesome and nutritious food choices to our customer. Furthering on our commitment we launched whole wheat buns as an option with all our Burgers. The buns were launched in Mumbai and the West at a nominal additional charge. These buns have been very well received by our customers and they have added to our cash flow. We will soon be rolling them out across all markets.

Breakfast showed a strong growth this quarter as a result of the Egg Festival campaign and value offering of the Rs. 99 meal. The campaign helped to enhance awareness and visibility of our exclusive Egg menu. Breakfast is just another way we are adding convenience to the fast-paced lives of our customers, offering our products in stores and on delivery.

McDonald's worldwide is associated with various sporting events. In this quarter we forged an alliance with the National Basketball Association to encourage children to 'Switch off and Play'. Under this campaign customers were given an NBA basketball with every family meal. This initiative led to an increase in the meal uptake and improvement in average cheque.

McCafe is the fast becoming the preferred beverage destination with an array of hot and cold beverages. Keeping in line with consumer trends McCafé continues to add non-aerated fruit and dairy based beverages to its menu. In the third quarter we have added 2 new dairy based beverages to McCafé portfolio of our menu of hot and cold beverages. We stand at 182 McCafé making us the second largest coffee player in units.

Delivery has been growing steadily over the quarters. We remained focused on growing coverage through our owned and third-party aggregator partners. We also ran a trial of late night and hot beverage delivery option this quarter which was received very well.

Our digital and tech initiatives aided in diving robust growth of 4.3X in sales over the last 4 years.

Moving to slide#19 because of all these successful initiatives we have been able to maintain a robust sales growth, a healthy 3 years CAGR of 20.68%.

We have focused on improving supply-chain efficiencies along with our product mix, that has aided the healthy expansion of our gross margins. Increased sales volume helped us optimize our operating leverage resulting in increased ROM and EBITDA margin.

This has led to a significant improvement in our profitability helping us deliver strong growth of 76% Y-o-Y in PAT. Our nine-month cash profit is 108% of our FY18 cash flow.

With this I hand it over to Suresh, who will take us through the details of our financial performance.

Suresh L: Thank you Smita. As highlighted earlier it has been a continued robust performance in fiscal 2019 where we had growth across all our financial parameters that is sales, margins, PAT and cash flow.

Moving onto top-line growth on slide #25; we reported yet another quarter of robust comparable sales. This makes it the 14th consecutive quarter of positive SSSG at 14.5%. Our sales witnessed 21% growth over Q3 of last year and 28% over comparable nine months for the period ending 31st December, 2018.

This growth is clearly aided by incremental footfalls due to launch of whole wheat buns, the NBA initiative, Spice Fest, Breakfast promotion as well as the continued impact of the launch of our innovative platform Rice Bowl in the previous quarter.

It has been further driven by impressive growth across our brand extensions that is McCafe, MDS and Breakfast along with EOTF providing enhanced customer experience. New restaurants open during the last 12 months continue to perform as per plan thereby augmenting the aforesaid growth.

Moving on to slide #26 on gross margins; our work around driving product mix led improvement continued and we were able to drive gross margins or by 88 bps to 63.94% compared to 63.06% in Q3 FY18. If we take the nine-month period of fiscal 2019 there has been an improvement of 168 bps when compared to the same period last year.

On the restaurant operating margins we have seen of growth by around 23% for the quarter as restaurant operating margins expanded by 23 bps Y-o-Y to 15.25%. The robust SSSG growth helped drive operating leverage across labor and utilities. However, this was partially impacted by denial of input tax credits. While A&P spends have been higher in Q3 please note that these spends for FY19 in percentage terms would remain at similar levels as last year. The restaurant operating margins for nine months in FY19 have grown by of 45% over the comparable period last year - that translates into margin expansion of 180 bps.

On operating EBITDA moving to slide #27, all the above initiatives coupled with the leverage on account of G&A costs has resulted in significant improvement in EBITDA margins that have gone up by 113 bps. Margin expansion is higher in the nine-month of FY19 by 194 bps over corresponding nine months of FY18.

The significant change in PAT trajectory continues in this quarter. We grew our bottom line by 76% with PAT for the quarter at Rs. 136.65 million and PAT margins stood at 3.69% vs. 2.54% in Q3 FY18. PAT for nine months ending this fiscal has shown a growth of ~431% over the corresponding period last year.

Moving on to slide#28, the bridge on the slide shows the operating EBITDA margins improvement in Q3 FY19 driven by the levers we just discussed.

To summarize we are quite pleased with all our strategies playing out across the business and such performance in the year gives us confidence as we head into Q4 to deliver our sales and margin targets for FY19.

With that said I would now handover back to Amit, who would take you through outlook for FY19 and give the closing remarks.

Amit Jatia: Thank you Suresh. With respect to outlook, the business environment has and will continue to remain volatile as we have seen in the last two decades. Yet we need to navigate this environment to deliver on our business goals and vision for 2022.

We continue to focus on good quality store openings, aggressive expansion of our brand extensions and continued focus on reimaging our restaurants. We will continue to rapidly grow our Experience of the Future stores (EOTF as we call them) creating a differentiated McDonald's experience in West and South India.

The food delivery category is growing fast and we are poised very strongly to cap into this market through owned as well as third-party platforms.

In the coming year we will build on current menu platforms and experiment with new ones while building new and enhanced experiences leading to better customer satisfaction. We will continue to strengthen our good food story through our menu. This will help us grow our customer base and our business delivering higher shareholder value.

Thank you very much and with this I would like to open up for Q&A.

Moderator: Thank you very much. Ladies and gentleman, we will now begin the question and answer session. We take the first question from the line of Avi Mehta from India Infoline. Please go ahead.

Avi Mehta: Suresh mentioned towards the end that you are on track to maintain your FY19 guidance. Just wanted to understand what does that mean? Would it mean a double-digit SSS growth sustaining in 4Q despite the base turning bit difficult or how would you look at it?

Amit Jatia: He means that whatever sort of are the expectations for FY19 for the year I think we will be on track to deliver those numbers. That's what I guess he means.

Suresh L: That's right. Exactly, in terms of margin expansion and growth etc.

Avi Mehta: So let me kind of rephrase it; then in that case given your comment on the demand and what you said while the business is volatile and with the initiatives that you are taking, how should we look at SSS growth in the fourth quarter? Do you think this momentum—maybe not at that level—but do you see double-digit trajectory is achievable?

Amit Jatia: It's hard for me to talk quarter to quarter as you know. But all I can say is that in our vision 2022, in order for us to deliver the numbers that we projected, typically on a year on year basis. as long as we are at 7% to 9% of same-store sales growth I think we are able to deliver that. So, for the whole year rather than talking about the quarter I think we will stay double-digit and the important thing is after four year-on-year continuous growth per quarter as long as in the fifth quarter we continued to grow in the territory that I just mentioned I think we feel that will be quite nice.

Avi Mehta: On the CAPEX levels; this is coming from the fact that you have done a great job in terms of innovation and kudos to team for that. In new product innovations now as you kind of keep on introducing the frequency I see kind of improving. Does this entail in anyway either a higher CAPEX on the store or a lower gross margin or how does it flow through, because in the sense we are asking a lot from the supply chain, so how does this play out? I just wanted to understand.

Amit Jatia: Firstly if you get higher base of customer walking in, net-net that's great, because as I mentioned before and as we discussed in our investor meet I think earlier this year or last year, basically we said that our journey is to take our average unit volume up to at least around 6 to 6.5 crores and as that happens the flow through to the margin will continue to come in. I don't think with more customers coming in and with us reimaging and renewing our stores anything really changes from whatever we have done so far. Increased volume basically helps us through contribution margins in the supply chain margin efficiency is never end. My point is that it's not that next year we will not demand more and also technology and the changes that happen in the marketplace continuously open up opportunity for getting productivity growth. So to my mind even 5 years later if you ask me the question is supply-chain is fully done, the answer is no. So, on one side we hope increased volumes will help build sales, on the other side will continue to push for products. So that what we've talked about in terms of our vision 2022 we continue to push towards double-digit EBITDA margins.

Avi Mehta: This difference I'm not sure if you are willing to share that but how would the split of online ordering be among our own platform versus third-party platforms? Would you be willing to share that?

Amit Jatia: So we don't share the breakup. But as I've maintained in my last call I mean you were on the call as well where everybody was really focused on margins because of delivery etc. I don't know why but certainly that came up. My point is that we've always maintained and we continue to maintain that incremental delivery business online, off-line in any way is good for the business because it's all incremental for us. We are largely an in-store business and even as delivery percentages keep growing, it does not matter because the bulk of the business will always remain in-store for us and therefore its margin accretive for us.

Avi Mehta: And delivery among third-party apps and our own app, how would that be?

Amit Jatia: When we say delivery it's a combination of our own assets as well as third-party platforms that we use. The important aspect is the point I want to make to you is I have maintained this throughout the last three years that I do believe that consuming food at home, outside food at home is a phenomenal opportunity and is going to grow very-very nicely. I feel McDonald's is extremely well placed to be able to cater to that. Not only with the base of restaurant and as the base of restaurants is growing but more importantly to our operating platform, our packaging, our ability to deliver food to the customer quickly when the order comes in so all that really integrates very well with both third-party and ourselves. So, he will continue to see Westlife really gain from the growth in delivery business.

Moderator: Next question is from the line of Niteen Dharmawat from Aurum Capital. Please go ahead.

Niteen Dharmawat: The first one is regarding the CAPEX, so just wanted to understand what is the upfront CAPEX required on an average per store considering Tier 1, Tier 2 kind of city and is there any rule of the parent also in supplying the equipments like kitchen equipment kind of things?

Amit Jatia: Basically we have the global suppliers who we work with and McDonalds Corporation is not an equipment supplier. So we don't buy in fact anything from McDonald's Corporation. So that is point number one. Point number two is we've given the basic guidance that typically it costs about 2.3 to 2.5 crores to build the restaurant. Obviously McCafe is on top of that and as we build more Experience of the Futures stores then that's also on top of that as well. So, that's roughly the CAPEX and we continue to strive very hard to keep taking cost out of the system, so we maintain this range by and large.

Niteen Dharmawat: Is the pricing same for the end product for the customers coming in from different cities, so if you have store in Mumbai versus store in Indore, so will the pricing be the same for both the locations or will there be a difference in the pricing for the product?

Amit Jatia: By and large it's the same but we are not against differentiated pricing. We had that before GST particularly because of the tax issue but after GST and standardized taxation we went to a single price point but we have differentiated pricing in some stores. But by and large it's the same.

Niteen Dharmawat: In future also will you be going in owning the stores or will you be going through sub-franchisee route too?

Amit Jatia: The good news is we are quite clear and consistent and I'm quite happy about that. Essentially we intend to own and operate all our stores. There is no plan to franchise in the near future.

Niteen Dharmawat: Final question about the future CAPEX, is it going to be through internal accruals only or will you be taking some debt and what is the consolidated debt on the books as of Quarter 3?

Amit Jatia: Basically from 2010 onwards it's all been through internal accruals and the capital we have had. We've remained debt free from 2010 and we expect to remain debt free going forward as well as we can see it and also this quarter as of December 31st we are plus cash.

Moderator: The next question is from the line of Anand Shah from Axis Capital. Please go ahead.

Anand Shah: First on this store expansion we have seen about 14-15 stores getting added on a net basis for nine months, so what is your full-year guidance? And in the future for FY 2021 are you looking to accelerate the store expansion pace?

Amit Jatia: So essentially to answer that question the net openings are normally around 25 to 27 a year and our guidance is to be between 400 to 500 stores by 2022 December and I think we will stay within that range. The openings will continue to be within the 25 to 30 range.

Anand Shah: But between 400 to 500 maybe you look to accelerate a little bit or is there any pushback there or are you slightly…?

Amit Jatia: No there is no pushback. We follow the consistent strategy and in the very early days we were doing 5 to 10 stores, then it became 10 to 15 then it became 20 to 25 then it became 25 to 30. The important thing is during the downturn, I think when I see the industry there have been ups and downs in opening stores in the sector, while with HRPL and Westlife it's been consistent. So in 2013-14-15-16 we were continuing to open between 25 to 30 restaurants, so we believe that there is a certain way in which we approach our store, the way we do real estate, the 20-25 year deals that we do that all we feel build a very solid real estate portfolio and we look at real estate as a very important raw material just like we look at our products. So therefore we believe that in the current environment this is the right growth. Of course we continuously ask ourselves a question why not 30 to 35 and if the answer comes to that, that's exactly where we will go up. But our objective is to basically work based on the market and the customer and not really based on any other parameter. So, as I see it right now that's why we gave out a vision 2022, between 400 to 500 restaurants is where we will end up and that's what it is, and that really means that between 25 to 30 restaurants a year, some years could be 25, some could be 30.

Anand Shah: Just on this EOTF restaurants upgrade that you have done can you share your experience on what kind of uplift you've seen in the revenues or margins post the EOTF change?

Amit Jatia: We don't share the breakup based on EOTF restaurants but all I can tell you is the consumer experience around that is absolutely fantastic. And as I said if you Google, say McDonald's Nariman point or McDonald's Hill Road there are 2000 reviews on that which is all absolute customer oriented reviews and you will see that the average ratings are 4.2 to 4.3 out of 5. And the feedback is absolutely fantastic that clearly tells us that that's the direction to go in. It is a really differentiated customer experience and therefore we are accelerating that. So while we don't share specific numbers all I can tell you is the customer proposition is very solid.

Anand Shah: I have experienced some of those stores, those are great. That is definitely there. But I just want to sense as to what kind of upscale you would have seen post EOTF coming up…?

Amit Jatia: Net-net we like it.

Anand Shah: And what will be the plan of rollout for this EOTF to other stores like currently you indicated we have 20 odd stores, right?

Amit Jatia: Yeah we like to stay ahead of what we comment so all I can say is we're getting more aggressive around the openings around EOTF stores. I think what we will do these at the year-end we will give a little more color to this question and give you a better sense on how many EOTF stores we intend to open in the future. But the important thing is it is rapid. If I can use the past analogy of McCafé where we have been opening a very large chunk of McCafés and in a very short span we had at 180 McCafés and as our vision 2022 defines going towards 300 you will see EOTF in a pretty similar light. It will be the rapid expansion.

Anand Shah: The royalty part now given that there is clarity and there is the door number there, to your vision 2022 guidance could this mean incremental margins of that was already baked-in in your vision 22 guidance?

Amit Jatia: No, like I told you earlier and I have said this consistently that whatever the royalty was my vision 2022 stayed and whatever it is now it stays. There is no change one way or the other. We stick to what we have projected for 2022.

Anand Shah: So that's was the 13%-15% band?

Amit Jatia: Absolutely.

Moderator: The next question is from the line of Jiten John from CLSA. Please go ahead.

Bhavesh: This is Bhavesh here. Can you share some thoughts on overall demand trend for the industry? Are you witnessing any macro tailwind which you have been calling out in the past few quarters, so can you share some thoughts on that?

Amit Jatia: I can tell you that as generally the consumer sentiment has been pretty positive and I think particularly also the delivery business has also been very robust. The two things together on a strong platform has really accelerated the growth. So if you recollect in my earlier calls 2013-14-15 I used to always say that as long as the foundation is solid when the tailwind start coming in you'll start seeing that reflect in our same-store sales growth. So if you see there is a slide in our earnings call today which says that in the last 4 years we've grown same-store sales by 50% per restaurant across the base of 250-260 restaurants. That's pretty solid. So, I feel that it continues but it's a volatile market, events happen, there is elections coming up. So I don't know what's going to happen. But if you take the noise out I am pretty confident that the platforms that we've built our long-term platforms and therefore the vision 2022, average of same-store sales that we are talking about which is 7% to 9% is something that I see. It may not be quarter to quarter but year-on-year I do expect that to happen. So it's a decent consumer sentiment as of now.

Bhavesh: On outlook you mentioned about volatility, so were you referring to elections?

Amit Jatia: No, in my view I believe that we live in a volatile world and events happen very quickly. Things change dramatically. There are things that happened globally that start impacting. Oil is 90-60-40, dollar moves here, dollar moves there, so it's a volatile world and what can impact the consumer at what point we don't know. But what I'm saying is that businesses have to navigate that environment so that's why we laid out our vision 2022 giving a very clear path as to what we are shooting for. So that's what I mean that it's a volatile environment but we have to navigate it and therefore it's not a quarter to quarter story, it's a year-on-year story.

Bhavesh: On your occupancy and other expenses, I believe last quarter you had some elevated spends given promotions for the Rice Dish if I'm not mistaken? So what really drove increase in this P&L line item in this particular quarter?

Amit Jatia: We mentioned that it's basically the last impact of ITC which will even out after the next quarter onwards because what happened is that remember it was done on 15th November so we had 45 days where the service tax component on rent, service tax component on for example royalty all that is really the change that you see in the P&L. the best line item to see is royalty which earlier was 4.3% became 4.6 so there is the 0.3% impact just because of service tax. So, these line items are not really comparable, but primarily as I had mentioned in the last call, that advertising spends are typically between 5% to 5.5% and that's what it will be for the FY for the whole year.

Bhavesh: But in this particular quarter, did we have any high A&P Spends or it was just one of the regular quarters?

Amit Jatia: As I hear from Suresh, it was higher than the average.

Suresh L: Because it's a busy quarter and therefore it was high.

Bhavesh: If you look at normal EOTF restaurant versus a regular store for you, so is there any difference in CAPEX per store that you are incurring right now?

Amit Jatia: Yes, there is an added element of CAPEX for the EOTF elements like the self-ordering kiosk, the design elements and all of that but there is a small increase.

Bhavesh: Is it meaningful in terms of your CAPEX outflow, if you really scale up that particular?

Amit Jatia: No, not really. It's about 7%- 8% of the total investments, so I feel it's manageable given the results that we get out of that.

Moderator: The next question is from the line of Pratik Poddar from Narnolia Finance. Please go ahead.

Pratik Poddar: Since we have added 8 stores in the quarter, is it like we have close down 3?

Amit Jatia: Yes, we have.

Pratik Poddar: That means the amount that is shown in the operations P&L is for assets written off on closure for these 3 stores, right?

Amit Jatia: Correct.

Pratik Poddar: So, in the future, could you just help us to understand how can we look for such expenses because it's like 2 crores this quarter and impact of it?

Amit Jatia: You got to look at it from an FY point of view, from an FY point of view, it's normally irrelevant. I think it is about 2- 3 crores a year. So, about 5 crores a year is what roughly it is for the whole year and typically we do close 2 to 3 restaurants a year. If you look at our history of 23 years, it is about 1 or 2 a year. That's where we expect it to be, in terms of closures and in terms of the impact you can say 3 to 5 crores a year.

Pratik Poddar: Another question I have is on the corporate overheads, so in this particular quarter, it grew by around 30% Y-o-Y. So, can you just help us on that?

Suresh L: You can't be actually comparing all the rupee growth because what happens is current year there are also adjustments for revisions etc. that happen, and therefore what we need to look at is from a G&A point of view, the corporate overheads in terms of what is the leverage it is giving to the business and there we can very clearly see an expansion of the margins.

Amit Jatia: For the quarter, it's only 4.3%, and for the year, it's about 24.4% and as Suresh mentioned, that it's all about expansion around EOTF, McCafé, Delivery, we are building new lines of business. But on a year-on-year basis, let's wait until the next quarter as well. It will even out quite nicely. Important thing is that we will get operating leverage benefits from G&A within the financial year.

Pratik Poddar: In terms of interest expenses, if you will see that we always keep on stressing that we are actually net cash, but as we can see we are getting ending up paying higher interest than the other income earned.

Suresh L: Sorry, you cannot see that in isolation because also when you look at there is a corresponding income line on the top, and also please understand that all income has not yet been recognized. So therefore, when we look at it as Amit mentioned earlier that we are actually net cash positive, so therefore, to that extent on a quarter, you may see a difference, but there is still income that is not being recognized in the book, so we are fairly alright and neutral in as much as that is concerned.

Pratik Poddar: Basically, on a yearly basis, we can be a little bit sure about setting it off?

Suresh L: I would say, it will be almost flat.

Moderator: The next question is from the line of Mayur Gathani from OHM Portfolio. Please go ahead.

Mayur Gathani: What are the specific reasons for the closures? You said 1 or 2 closures annually and then we have 3 closures this quarter itself?

Amit Jatia: No closures, finally you have a base of almost 300 stores and some stores of course could be ending the term, although so-called, most we have not have many stores closed because of end of term. Then also, what happens is markets move, sometimes the mall comes and we relocate into the mall so that store closes down, so there are issues like road networks change, metro station is coming somewhere, so we may move the store 100 m, 200 m, mall may not work out, and the mall may shut down. We have had a couple of occasions of that as well. So, I feel on a base of 300 restaurants, I think it's a very decent number to have a couple of stores in a year move around.

Mayur Gathani: Royalty, is that frozen or there could be some changes going down in the year. Let's say a volume increase, and hence the royalty could increase?

Amit Jatia: No, it's frozen. The number is frozen.

Mayur Gathani: Did you say advertisement expenses was more this quarter, compared to last quarter or was it more year on year?

Amit Jatia: We don't discuss advertising expenses quarter-on-quarter. Essentially, for the whole year, the guidance is that it stays within 5% to 5.5%. Some quarters are down, some quarters are up. It depends on the program, like last quarter it was about to Rice, so it was quite up. This quarter is slightly higher than what it normally is. So, the important thing is that it evens out for the year, which is why we kind of keep it simple that is 5% to 5.5% for the year.

Mayur Gathani: I was just considering because the Rice thing in previous quarter had a lot of more advertisements and expenses. When will we be the full taxpaying company?

Amit Jatia: Our profit has moved from 6 crores to 33 crores in nine months. And we are delighted that the all the cash flows come to us. And we hope that the trajectory continues, but basically some of our past losses are helping us essentially stay out of the tax bracket. But we are more than happy to pay tax as the business grows.

Suresh L: And you will know it when we start paying taxes.

Mayur Gathani: And one-off expense you said for the closures, 1 or 2 closures is around 5 crores a year, right approximately?

Suresh L: The number that we have quoted to you is a mix. You must understand that it is also closures and also when we do upgrades, there are certain write-offs that we take in our account. So, it's an amalgam of both of them and it is not to be viewed only in isolation. Is that clear?

Mayur Gathani: And also, you said that, when you are spending on per store basis that 2.3 Cr or 2.5 Cr for a store, there is 7% to 8% incremental cost for the EOTF stores. Is that understanding?

Suresh L: Roughly yes, you are right.

Moderator: The next question is from the line of Dhaval Shah from Girik Capital. Please go ahead.

Dhaval Shah: On the royalty front, now it is clear for around 4% for FY21 and 4% for FY20, so know how to see this, so in the store level P&L for the first 3 quarters, it is coming to 4.5%-4.6%.

Amit Jatia: That's because of GST because of the impact of denial of ITC. So, 4 is the base rate and there is GST, over and above that, that is why you see that 4.3% or 4.6%, so, the base rate is 4.

Dhaval Shah: Can you tell us what will be our accumulated past losses which are helping us offset it?

Amit Jatia: We don't discuss that. But the important thing is that it's always good to pay tax because you only pay tax when you make money. So, we are delighted whenever we are able to pay tax. The important thing is we made investments for 20 years in the business. We have taken a very long-term view. And in the early days, all the losses are getting the business going was really what helped us to get here, so as the losses get written-off obviously, we will start paying taxes.

Dhaval Shah: Now to achieve our vision of 13% to 15%, so it can come by two ways, one is you're operating leverage, and the other is gross profit expansion. If we see our history, we have grown from, we were at 55% - 57% GPs many years back and now we are at almost 64% for this quarter. Going forward, how can we expand our GP, it can come more from due to McCafé because that business is high GP or it will be more driven by Op Leverage. How should we understand that?

Amit Jatia: We've discussed that, we have shared that in our investor day presentation where we are saying that it's primarily around average store volume. As our average store volumes grow, the operating level, which comes through, including in gross margins as well because you are giving more volume to suppliers. I would like to sort of keep it simple, gross margins are pretty much there. We have mentioned that in the last call as well, 62% to 64% is the range that we would like to stay in because it is yet about acquiring new customers, rather than pushing towards just getting gross margins. And the important thing is, finally rupee margin is what is material, as you sort of getting more and more incremental volume. So, I would say that I have sales continue to grow and average unit volume continued to move towards the 6 crore number, we see that, the flow-through should continue to start coming down. Like in this year alone, we made pretty good delta on our operating EBITDA, and the idea is that by 2022 we should be in the 13% to 15% range based on operating leverage lastly.

Dhaval Shah: How is the trend in terms of your raw materials inflation and so for next 6 months, what you think? So, your two main would be, one would be wheat and the cheese and which are the major ones?

Amit Jatia: That I think you are thinking of some other brand because we don't buy so much cheese. But basically, we buy patties and we buy a lot of Aloo and things like that. What I have noticed, is that every year some commodity goes up and some commodity goes down. So, it's all kind of evens out. But we are not foreseeing major inflation that is sort of staring us in our eyes right now, I think it's all what I say business as usual.

Dhaval Shah: And any trouble you see in terms of employee, because of this threat from the aggregators?

Amit Jatia: We never really talked about aggregators employee troubles. From our point of view, everything is to be managed and obviously with scale, with demand for good people increasing, it's been a challenge for my entire 23 years' experience in this business. So, I don't think the challenge is going to go away today. In 10 years ago, it was other brands coming in, today its aggregators, tomorrow is going to be something else. You need good human practices, good people practices, essentially to address these issues and I think we are quite alright and aware of the issue.

Dhaval Shah: There is online ordering gives you higher margin compared to eating at store?

Amit Jatia: As I have explained before, there is all accretive towards to our in-store business. It's all incremental, so we look at it that way globally.

Moderator: That was the last question for today. I would now like to hand the conference over to Mr. Amit Jatia for his closing comments. Over to you, Sir.

Amit Jatia: Thank you very much for joining the call today. Really appreciate your time, and I hope we have been able to address some of the questions. If you need any more clarifications, please do write to Investor Relations and we will be delighted to respond back. Thank you once again and have a lovely weekend.

Moderator: Thank you very much. Ladies and gentlemen, on behalf of Westlife Development Limited, we conclude today's conference. Thank you all for joining us. You may disconnect your lines now.