Q2 FY2019 Earnings Call Transcript – Oct 26, 2018

CORPORATE PARTICIPANTS

- Amit Jatia – Vice Chairman
- Smita Jatia – Director
- Suresh Lakshminarayanan – Chief Financial Officer
- Ankit Arora – Head, Investor Relations

Moderator Good day ladies and gentlemen, good day and welcome to the Westlife Development Limited Q2 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 this conference call, please signal for an operator by pressing "*" then "0" on your touchtone phone. I now hand the conference over to Mr. Ankit Arora – Head, Investor Relations. Thank you and over to you, sir.

Ankit Arora Thanks, Stanford. Welcome everyone, and thank you for joining us on Westlife Development Limited earnings conference call for the first quarter ended June 30th, 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 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 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 Ankit. Hi everybody and thank you for joining us on the call today. We have had yet another good quarter of results making it the 13th straight quarter of positive same stores sales growth. Our consistent strong results are a testimony that our strategy continues to drive long term profitable growth for Westlife. We have made tremendous progress in elevating the experience for our customers through modern and contemporary restaurants, enhanced hospitality and a modern relevant menu. Our customers tell us they value and appreciate the moves we're making to elevate the McDonald's experience.

All our strategic levers - that is our restaurants, our brand and our people are showing significant progress. This quarter we made another big bold move and launched a brand new platform - Rice. With this we have been able to expand our addressable market while providing another option of a wholesome and fulfilling meal. Platform are unique to McDonald's strategy as they strengthen the brand foundation. The response to rice has been encouraging and we hope to build on this platform as we go forward.

Our Business extensions – Mc Café and Mc Delivery continue to be important growth accelerators for us. As the beverage market continues to grow at rapid pace, the increased awareness of McCafé is helping the brand to establish itself as coffee and beverage destination.

We have been moving ahead at an unprecedented pace for McDelivery. It is tremendously effective in bringing profitable and incremental guest count. Third party aggregators continue to build occasion for eating outside food at home. Given this we are well positioned to take advantage of this complementary opportunity. We continue to accelerate our growth journey through them and our own digital assets as well.

In April this year we had launched our good food story and we are proud to announce that we have been adding more chapters to that. We have recently launched whole wheat buns and McDonald's is the first QSR to offer a whole wheat option across its range of burgers including breakfast. This is yet another leadership step towards providing more wholesome and nutritious food

On the back of a new platform launch, elevated customer experience and ROP 2.0, we have built a strong foundation for the business. All this has resulted in an increase in footfalls and higher spends by our customers at the restaurants.

We've demonstrated our ability to transfer winning ideas across our markets. Our strategy is working because it's grounded in evolving our business, based on customers' needs. McDonald's customers have high expectations that we will offer them great tasting food, value for money and enhanced convenience. As we make significant progress in each of these areas, we are continuing to see customer satisfaction scores continue to grow across the market.

Smita Jatia Thank you Amit and good evening everybody. Under the strategic pillars of - Our restaurants, our brand and our people, we continue to grow our brand and business profitably

Highlights for the quarter under growing market share and margin are – we achieved total sales growth of 32% with a PAT growth of more than 5.5 times at 78.7 Mn. This was aided by strong same store sales of 25.7% which came from the launch of the Rice Bowls and growth in Delivery and McCafé. We opened 6 new restaurants taking our total to 287 stores in 39 cities

Our dominance continues in Maharashtra and Karnataka followed by Gujarat and the southern states. We are opening our new 'Experience of the future Restaurants' providing our customers with an enhanced digital experience. These Restaurants are also on based on ROP2.0 platform for cost optimization.

Our brand imagery scores as reflected in our quantitative track also shows improvement in our quality, service, cleanliness and value parameters.

Under growing baseline sales, we delivered our 13th quarter of positive SSS @ 25.7% on top of 8.4% and 6.5% in the preceding years, leading to 50% increase in AUV in 4 years.

We launched our biggest menu platform of the year- Rice Bowls to drive meal occasion and permissibility. This has successfully driven new footfalls creating new occasions thus leading to incremental sales.

We added 14 new McCafé taking the total to 170 making us the 2nd player in the coffee market in terms of units. Continued awareness building through an Above the Line Campaign also helped in delivering higher SSS.

Delivery too continues to grow through our own digital assets of the web and app and through the third-party aggregators.

Moving on to slide 15- we have witnessed robust sales growth. This has led to significant improvement in our operational profitability helping us deliver strong growth in PAT and cash-flow. We have already achieved around 70% of cash profit in first half of the year compared to FY18

With that said, I now handover to Suresh to talk about the details of the financials.

Suresh L Thank you Smita and good evening everyone. As highlighted earlier, it's been a very robust beginning to first half of the fiscal 2019 where we have seen significant shift across all our financial parameters i.e. sales, margins, PAT and cash flow.

On Slide 20, we reported yet another strongest comparable sales quarter and 13th in a row at 25.7% delivering 30%+ sales growth in respective comparable periods of Q2 and H1 FY19. This is clearly aided by incremental footfalls due to launch of our innovative platform in form of 'Rice Bowl' and further driven by growth across our brand extensions of McCafé & MDS along with EOTF providing enhanced customer experience. Further, new restaurants opened during the last 12 months continue to perform as per plan thereby augmenting the aforesaid growth.

Moving to slide 21, talking about gross margins, our work around driving product mix led improvement continued and we were able to drive gross margins higher by ~90 bps to 63.6% compared to 62.7% in the Q2 FY18 and there was an improvement of 210 bps during the first half of fiscal 2019 compared to same period last year.

We have seen a huge growth in ROM by ~37% as restaurant operating margin expanded by 50 bps Y-o-Y to 13.8%. The robust SSG growth helped drive operating leverage across labour and utilities which was largely offset by the increase in advertising & promotion spends commensurate with the launch of the Rice platform and increase in costs on Y-o-Y basis because of denial of input tax credits. While A&P spends have been higher in Q2, however, please note that these spends for FY19 in % terms would remain at similar levels as last year. The growth in ROM in H1 FY19 over the comparable period was ~61% with a margin expansion of 270 bps.

Moving to slide 22, on account of reasons mentioned earlier coupled with the leverage on account of G&A costs, we have seen an improvement in the EBITDA margins by 50 bps. Margin expansion is higher in H1 FY19 by 240 bps over H1 FY18.

The bridge on the next slide shows the Op. EBITDA margins improvement in Q2 FY19 driven by the levers which we just discussed.

Lastly, the significant change in PAT trajectory continued from Q1 and in this quarter, we grew our bottom-line by more than 5.5 times Y-o-Y with PAT for quarter at INR 78.7 Mn and PAT margins stood at 2.2% vs. 0.5% in Q2 FY18.

To summarize, we are quite pleased with all our strategies playing out across the business and such performance in the first half of the year gives us confidence as we head into H2 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. As we move into the second half of the year, with relentless focus on strengthening our menu, service and experience, we believe we are well poised achieve our near and long term growth objectives.

We are well on track to deliver our 2022 vision through increase in our average unit volume leading to margin expansion and hence profitability.

We have been evolving our business in many meaningful ways and I am confident that this will enable us to deliver shareholder value. With this, I now open it up for Q&A.

Moderator Thank you very much, sir. Ladies and gentlemen, we will now begin the question-and-answer session. The first question is from the line of Kunal Shah from IIFL. Please go ahead.

Avi Mehta This is Avi here from IIFL. I had a specific thing about the ad spends. You highlighted that there was higher ad spends in the quarter. Would you be able to quantify the increase that was there in the quarter because the Rice Bowl launch?

Amit Jatia Yes, so we do not share breakup of ad spends on a quarter basis. Basically what is important for you to note that we are going to be within the range, similar to previous year. But, quarterly it varies depending on the ad campaign that we choose, so therefore we do not necessarily share it quarter-on-quarter.

Avi Mehta Just a rough approximation of what is the likely increase if you can share?

Amit Jatia We will not be able to share that. I think the important thing I can say is that as a percentage of sale for full year, it will be in line with whatever we have been doing in previous years.

Avi Mehta The second thing sir was typically 2Q is the seasonally weaker quarter, especially because the festive season was also delayed. Now despite this our AUV has seen an improvement even from 1Q level. I just want to understand this increase and whether there is any one-off over here and does this increase kind of put us into risk because normally 3Q is better than 2Q on an AUV basis. Would that relationship still hold?

Amit Jatia Yes, I think we are pretty proud of the fact that we are able to beat seasonality and obviously the rice launch has helped this along with the growth in McCafé and the growth in McDelivery. So, I do not see that there is an aberration. Smita, you may want to add some comments.

Smita Jatia No, I think all our platforms are delivering on a sustainable basis and that is why you see the increase in AUV on quarter-on-quarter basis and it is not just an aberration in one quarter.

Avi Mehta This quarter is colored because of the higher ad spends. So I was just trying to understand between AUV and margins. Would the first quarter be a realistic comparison even going forward?

Amit Jatia I mentioned that in the last call as well quarter one and quarter three are generally comparable, quarter two and quarter four are generally comparable. However, at least this quarter we have been able to beat seasonality. So you could take quarter one as the more sort of sensible base to move forward when you look at AUV and margin comparisons.

Moderator Thank you. The next question is from the line of Vicky Punjabi from JM Financial. Please go ahead.

Vicky Punjabi I just had two questions. One was on the fact that sir if I look at the P&L based on the restaurant operating margin, I could see some escalation in the corporate cost as line item as well, so basically it is 19.5 crores versus 17-18 crores you have been incurring over the past two quarters. Can you help me understand how this G&A line movement work and how can we see that going forward?

Amit Jatia No, the G&A is very much in line and when you will look at it on a full year level, so you will see that it will basically be margin-accretive for us and the operating leverage will come through with this kind of volume growth. So while this quarter over last year same quarter it is higher. Please take a look at a yearly basis rather than a quarterly basis on that.

Vicky Punjabi My question was what could be the reason for this kind of a fluctuation because it was like we saw 17-18 Crs being consistent over the past two quarters, but this quarter it has moved up?

Suresh L So basically when you look at Q2 versus Q1, the impact of our annual pay hike given to all employees gets effective and there is an increase largely on account of that. So as Amit mentioned we need to take a look at it from a full year point of view and very clearly with the way as I have mentioned the top line is growing, we clearly see operating leverage kick in and when you look at it for a full year basis you will definitely see benefits accruing on that line as well.

Vicky Punjabi Secondly, just on the capex side, I see the fixed asset base if I adjust for depreciation, has moved up by around Rs. 72 crores, we have opened around 10 restaurants over the past six months, so that kind of explains around Rs. 25 crores. What would be the balance attributable to?

Amit Jatia Reimaging.

Suresh L And also the restaurants that have opened since Q2 of last year.

Amit Jatia On year-on-year basis it would be 25 restaurants, not 10. So if you are comparing it with last year it is that. Secondly, the other impact on depreciation is all the reimaging, EOTF, McCafé additions and all of that put together.

Vicky Punjabi What would be the guidance for the full year in terms of capex?

Amit Jatia About 100 to 120 Crs will be for FY19.

Vicky Punjabi On the same store sales growth which has been quite healthy even in this quarter, given that the festive comes in the next quarter, do we expect it to improve from these levels in the next quarter?

Amit Jatia No, I think we should not get greedier beyond this, we are quite pleased with where we stand and for me same-store sales is compounding effect, so for example, last year in Q3, we did 21%. I personally think that as long as we are in probably double-digit, I think that is really healthy. I feel when you try to stretch it beyond that, it is not sustainable, that's my take. So, I continue to see the trends continue in this direction. I do not see an issue with that, I think all our platforms are working, but our guidance is that in 2022 we are saying that it is going to be high single digit to low double digits on a four year basis. So the key thing is the average unit volume is growing. I think that is very critical. So we have suggested that by 2022, our average unit volume would be 20% higher than where it is today. So that would come through the same-store sales growth.

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

Arnab Mitra Just a couple of questions: One of your main competitors highlighted this pressure coming in from aggregators on the cost side in terms of manpower. So are you likely to see any pressures from that in the second half? Secondly, given that delivery is not still a very large business for you, do you see this increased aggression as an opportunity to further expand delivery outlets for yourself or is it a competitive threat. How would you kind of look at it in this new phase when they are again kind of flush with money?

Amit Jatia From our point of view delivery has always been an incremental business opportunity for McDonald's. We are largely an in-store company and I think we have very strong in-store strategies as well as delivery strategies. I see aggregators as a partner to us and I can say that based on our math, every sale from the aggregator is margin-accretive to the business. So, I do not see us increasing any incremental pressure from aggregators. Whatever margin has to be factored in from an aggregator point of view is already in the P&L. So, I do see delivery business continuing to grow but because we are pushing breakfast, we are pushing McCafé, we have just launched the Rice platform, we have certain other strategies that we are working on, and we are trying to push the in-store business as aggressively. I think MDS is a good incremental complementary business for McDonald's. I think it is a brand extension and we like to keep it that way. What I mean by that is that while delivery is growing, it is fantastic, but we want to grow our in-store business at the same pace or higher.

Arnab Mitra I also wanted to ask on the staff cost side that is there any pressure because there is a hiring that they are doing and raising the level of salaries, or because you have more in-store it is not the same set of workforce that you are targeting?

Amit Jatia So, in our case some of the aggregators are using their own rider network to deliver our products and in some other cases we have outsourced the riders to another company and we have long term contracts with them and we are alright.

Arnab Mitra Secondly, while the growth has been very good, the RoM growth at 36% I know there is an ad spend angle there, but with 32% total sales growth and 25% SSG, should one expect much higher operating leverage on the RoM going ahead?

Amit Jatia So firstly ad spend does play a role and it is quite reasonable role because it is a launch of a platform and I think we launched it well and the results have come out quite well as well. Secondly, as I have explained earlier, and we share this on the investor presentation that the current AUV for us is kind of fringe. So, the relationship in terms of leverage does change once we get to about Rs.6 crores of AUV per restaurant per year. So the margin flow through with every dollar going above the Rs. 5 crores average unit volume starts flowing through much faster. Suresh, you may want to add something.

Suresh L Also, as we had mentioned earlier, if you look at the numbers, we have significant leverage kicking on the labor and also on the utility fronts and both of these are significant cost. When you look at Q2, you are actually seeing the numbers where they are which is predominantly because of the A&P which we have already mentioned on a full year basis we will be at level similar to last year. So therefore the leverage is clearly there, some initiatives are consciously done and decision is taken commensurate with the launch of a new platform which is there in the P&L and that is why you are seeing the numbers where they are at this point in time.

Amit Jatia And last point I want to make, look at us at H1 level, I keep telling you quarter-on-quarter I do not think our business which in the growth phase can give you the absolute result, it does give you a trend for sure. I feel if you focus on H1 and then on H2 in totality I think you might get a better picture of our business.

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

Abneesh Roy Sir in terms of Rice Bowl which you mentioned has picked up well. In terms of supply chain is there more complexity versus a normal burger because freshness and centralization could be different. Are you finding it a bit more difficult versus burger in terms of supply chain and sourcing?

Amit Jatia Globally, we do rice in most of our markets, so it is not new to McDonald's. McDonald's is not just a burger company globally, we do Wraps, we do Rice, and in fact if I look at global average volume it is almost $3 million. So, I feel that it has not been any problem for us in terms of supply chain or operational aspects in the restaurant.

Abneesh Roy In terms of pricing because aggregators are currently giving extremely high discounts, the other QSR player said, price hikes currently are looking difficult to take. What would be your take on pricing – are you looking at price hikes and what is the quantum of price hike, if you can give that number?

Amit Jatia We have been consistent for the last five years and you will hear the same thing from me, I cannot compare myself to anybody else because I do not know their strategy and how their business works or does not. But from McDonald's and Westlife point of view, we have consistently maintained that we increase our prices between 3% to 5% a year and we take that over two to three periods in the year, in some cases we have taken only 2% to 3% and in some years we have gone 4% to 5%. So we will continue with our strategy, we have a very-very good understanding, we do lot of research around consumer price sensitivity and we therefore continue to build along with that. So, I do not see any impact on our strategy based on whatever competitive pressures people are talking about.

Abneesh Roy And in first half you would have already taken one or two instances of price hike, right?

Amit Jatia So one small instance has been done, yes.

Abneesh Roy And sir you are saying aggregators are complementary. Two, three years down the line when you have much bigger delivery as a percentage of sales, would you not become too much dependent upon aggregator, what is your thought process there, because some of the other QSRs again have their own delivery team. So what is the thinking of your own team versus outsourcing?

Amit Jatia No, we used to have our own team earlier, the rider is outsourced. The key point I want to make to you is that it's not that we are not growing our in-store business as well. So for example, McCafé is all in-store business, McCafé is not a delivery business. I am just using McCafé as one example, the other example is breakfast, and another example is rice that we have just launched. So the idea is not to just let delivery grow alone. It is growing, that's great, the market is right, there will be a time when delivery five years from now may saturate, but our growth cannot stop. So, therefore in-store business has to continue to grow along with that. The key is another element for us is of course EOTF, the momentum the has been built around it and if you Google and see consumer reviews, they are absolutely fantastic and that is bringing more customers into McDonald's more often and as we accelerate that strategy, our brand differentiation is immense. You can visit the restaurant and see that as well.

Abneesh Roy Sir when you say you outsource the delivery person, I see the Swiggy guy only bring your order?

Amit Jatia No, as I said earlier, some 3POs do their delivery from their own people, some 3POs get the delivery done by us and all our own channels is done by us of course, and wherever the delivery is done by us, we have outsourced the riders to companies that are specialized in rider management and we have managed the cost quite decently so far.

Abneesh Roy Sir, next question is on SSG. Last four quarters you have done brilliantly in terms of SSG and so have the other QSR players, therefore entire industry has done well and you have done even better, so full credit to you. My question is why all the players done better at the same time and now it is coming in the base, will it be fair to say that now double digit same-store growth will be difficult, because you mentioned that you are confident of that, so if you could answer both parts?

Amit Jatia First and foremost I feel when we do 25% it is on an average volume that is almost double that of many of the players. I feel you do not take percentages to the bank; you take rupee amount to the bank. So for example let us assume this means Rs. 25,000 per restaurant per day of incremental sales. I think that means we have to bring in far more customers in far more often and therefore I feel our results are quite differentiated. The 25.7% of our numbers versus anybody whose average volume is slightly lower, would be very different, so that is point number one. Point number two, we have done it across 13 consecutive quarters including demonetization and GST. So, I feel in many ways, the foundation work that we have done has really worked and they have become platforms. Now moving forward, you have to be practical and realistic about what is going on. Firstly you cannot predict quarter-on-quarter. The important thing is that in 2022 we are saying that we would grow our average unit volume by 20% which means that high single digit to low double digit quarter-on-quarter on an average is where we are going to go. So the material thing is that if you have done 25.7% this year, 8.4% last year same quarter and 6.5% before that, as long as you are not losing guest counts and as long as you are not in negative territory and you stay in high single digit to low double digit, I feel it is outstanding for the industry, it is not just about us. Lastly, coming to your question on the industry obviously if eating out frequency keeps growing, everybody is going to do well. When negative trend came everybody did badly. What it shows is that obviously there is a trend which shows that there is a macro factor involved and within that macro factor, some brands are doing even better, some are doing better and some are not doing well. So, I think that is the differentiation of the individual brands within the macro that is how one's got to see it. But right now in QSR because everybody's results are up, the trend in the industry is positive for sure.

Abneesh Roy And sir this eating out, because aggregators have been spending a lot in the last four quarters, so that has helped and because now a new wave of funding has come and aggression has gone to the next level. For you and other QSRs, is that a positive?

Amit Jatia It is positive I would say but my point is, it is not earth shattering because in the big picture if you still look at the size of delivery business, it could be 500 million or 1 billion versus eating out market in totality in India which is more than 100 billion. Within that, Western Fast Food is smaller of course, about 2 billion right now. So what I am saying is obviously it is helping, but what is the extent of that, it depends on individual companies total delivery business growth.

Abneesh Roy And sir on the aggregators again since FSSAI has removed lot of the listings, so is that positive for you? And second, ad spend has gone up you said that is because of the rice launch. But has it also gone up because now aggregator says that this burger is for Rs.15, this ice cream is Rs.9.

Amit Jatia We do not react to such events. When aggregators do this you cannot do an advertising campaign. Rice launch was planned 10-12 months ago. When you do an ad campaign, you plan six months before that. So you cannot decide your ad campaign as reaction to such events, you can do some local store marketing to counter such things, but you do not change your strategy. If you notice that in our EOTF stores, we had launched rice one year ago and we had started providing to the customers and taking their feedback. So, we do not react to these small incidences, we will react to that in a small way at a local store level. On the licensees, if there are 1 lakh operators on the whole platform who are delivering on Swiggy, listing out 1000-2000 will not make a difference. To be honest I have not seen any major impact, I have not measured it as well, it has just started, so honestly I do not have enough information on that.

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

Bhavesh Shah Please correct me if I am wrong, but did you mention somewhere in your commentary that every sale from aggregator is margin-accretive for your business, can you share your more thoughts on this?

Suresh L It is margin-accretive, delivery business for us is completely incremental. Our business and restaurant is built for in-store and the way we globally look at the delivery business, it is margin-accretive. We have analyzed ordering from our own channels and we have managed third-party aggregators and we find that delivery business is incremental and margin-accretive for us.

Bhavesh Shah I was coming from the angle that these third-party aggregators they also have a component of take rate which they charge from the partner restaurants. So is it in line with what you would have expected?

Amit Jatia In our assessment when we look at third-party aggregator I cannot say anything more than this that, for us it is margin-accretive basically.

Bhavesh Shah I know it is too early right now, but have you done any assessment that historically you have said that your share in some of the malls, etc., is highest across all the restaurants. So do you have any such research or you have done something internal assessment which can probably show what has been your positioning in some of these third-party aggregators, I am just trying to understand that how this is impacting you at the top line level?

Amit Jatia It is a good question, we have thought about it. To be honest we do not have answer to that as yet because in that case we need data from third-party aggregators in terms of their total business.

Bhavesh Shah Second, Amit, we do not look at the business on quarter-on-quarter basis, but if I just plainly compare your first quarter gross margins with second quarter margins, there is a decline of 40 bps. So, is there any seasonality here or is there any increase in any particular input cost item, any thoughts on this?

Amit Jatia No, I just cannot respond to quarterly because we look at rupee margin we never focus on percentages and that's the way McDonald's globally looks at the business. For us it's about getting more dollars to the bank rather than percentages. So it depends on how we price a certain product. Also, when you sell more expensive products, your percentage margin drops down, but your rupee margin is very high. I can explain that to you offline, it is a simple excel sheet will tell you that it is better to get more rupee margin than percentage, but eventually it is a balance. So quarter-on-quarter gross margin has no seasonality impact, but some product mix movements may happen, 0.4% is just too small share if you ask me.

Moderator Thank you. The next question is from the line of Nillai Shah from Morgan Stanley. Please go ahead.

Nillai Shah My question is on understanding of the new customer acquisition for McDonald's. So how are you looking at new customer acquisition given that large part of your revenues currently is in-store. I am assuming you are doing it for the delivery model which would be easier. Do you track it?

Amit Jatia We do not have individual customer data that comes to the restaurant, but we have different research methodologies that we use globally to figure out whether we are bringing in new customers, whether we are increasing the frequency of existing customers etc. So, we have a model to do that, on lines with whatever we do globally, but if you ask me whether we know unique customers which are coming in, we do not have that at this point.

Nillai Shah What is your sense about what is happening over the last few quarters in terms of new customer acquisitions in particular? I understand one component will be increased frequency of existing consumers.

Amit Jatia So firstly I feel that the overall consumer confidence is better and therefore the earlier question asked about why everybody is doing well is because people are feeling better and people are eating out more often, that is our data research telling us that as well. From McDonald's point of view, it is everything, it is a bit of McCafé in terms of building a new occasion, we have data around why and how many new customers are coming in for McCafé, obviously we do not share that data, basically it's that along with breakfast, along with EOTF, along with the new value combos, the recent launch of rice. I have been explaining this over the last three to four years that platforms are very different from product introductions and we are very particular about platforms and when we introduce platforms they generally give you results for 10-years, for example, McCafé, we launched McCafé in 2013 but we are sitting in 2018 and I do not think you would hear us stop talking about it for at least another five years. Not only can we double the base of McCafé but we can grow the average volume of McCafé per restaurant as well because the beverage platform has not played out completely in India as yet. So, I hope this gives you a sense that we have to give consumers more and more reasons to visit us more often and to acquire new customers, starting point is value. When you acquire new customers, then you retain them through all the other things that I just described. Even breakfast is another example, that is a whole different market, whole different base of customers.

Nillai Shah Correct. So would you say that this growth trend over the last let's say four quarters or so have been more driven by new customer acquisitions or by increase frequency of your existing consumers?

Amit Jatia 25%+ comps has to be a mixture of everything. There is no one thing that is the key driver. Obviously without getting new customers, you cannot do 25%, it is a big base, and I feel personally it is 13-quarters, it is not just four quarters because it is compounding and especially in a difficult market doing 6.5%, 8.4% and then 25.7% in this quarter, I feel is quite impressive. So it is a bit of everything, it is a about bringing new customers through the Happy Price combos that we launched, it's new customer acquisition through a new occasion like McCafé, it's about delivery of course, it is a bit of breakfast, it is about the enhanced experience in an EOTF store, it is the new platform of rice because that resonate as a meal occasion. So, it is a bunch of all this together which drives frequency and new customer and average check, all three.

Moderator Thank you. The next question is from the line of Chirag Lodaya from Value Quest Investments. Please go ahead.

Chirag Lodaya I have a question on margins. So when I look at your numbers for say first half of this year or last full year, your all margin expansion has come from your RM deflation and payroll employee cost growing at a slower pace, which is being offset by royalty. So your other two line item which is occupancy and other operating expense for last full year FY18 it has grown by around 21% and for this year also, it has grown by 33% which is in line with your sales growth and at the same time G&A which is your fixed cost, last year again it had grown at 20% which is similar to your sales growth of 22% and first half as well same ratio. So where is this operating leverage kicking in from the numbers?

Amit Jatia I will explain that to you, it is very simple, I think we should focus on royalty that will answer everything. Royalty has not changed, royalty is

4%, but on the P&L it is showing 4.56% and that is everything to do with input tax credit of 18%. On entire occupancy cost there is an element of input tax credit of 18%, so therefore it not comparable to last year. The point is that percentages base line has changed from November 2017 and therefore once we come back into the comparison period after November 2018 they will become comparable again. So primarily what is there in the occupancy and other operating expenses, it is rent and 18% on rent which we used to get as input tax credit which now we do not. So that is a very big factor in this whole thing and same with G&A. The entire cost of whatever input tax credit we were getting out of our corporate office expenses is all gone. So it is not comparable to be honest, but the operating leverage is there, because at the end of the day if I go to the year-to-date period, last year we had loss of Rs. 1.5 Crores in the bottom-line and this year we have a profit of almost 20 Crores, I think that is operating leverage.

Chirag Lodaya Yes, that margin expansion is coming from your gross margin expansion and employee cost growing at a level lower than sales growth?

Amit Jatia I explained to you that the other two line items have the impact of input tax credit which is not there in payroll and employee expenses.

Moderator Thank you. The next question is from the line of Jiten Parmar from Aurum Capital. Please go ahead.

Jiten Parmar I have a couple of questions. The first one is basically I wanted to ask on the royalty. The royalty is up by 54% whereas the sales is up by 31%. So can you explain why the royalty has gone up and what is the percentage of royalty we pay?

Amit Jatia As I explained previously, the entire increase in royalty is the component of GST on which input tax credit is not available.

Jiten Parmar What is the target for new stores in second half and next year?

Amit Jatia Typically this year we will do anywhere between the 25 to 30 stores, we are quite on track with that. Our target by 2022 is 400 to 450 and we are pretty much on track with that as well. Essentially it means that between 25 to 30 stores a year, so in some years we have to be at the higher end and in some years we may be 25-27. So, we are pretty much on track with that.

Jiten Parmar We tried the new Rice Bowl I think it is a very good addition. Are we planning any extensions in these rice varieties?

Amit Jatia It will happen, right now we have to establish the platform because just one advertising burst never gets it into the consumers mind that McDonald's has rice. So what happens is you have to keep re-hitting the same thing till the platform gets established, then you bring the new news and then you do the line extensions.

Jiten Parmar Any thought towards basically non-fried patties, burgers?

Amit Jatia Yes of course we have the egg burger, we have grilled chicken patties, we have dosa masala brioche for breakfast and yes on the health we are continuing to do a number of things and as I said earlier now you have the Whole Wheat Bun that is available to the consumer, so it has been really appreciated by the consumer, and you will continue to see leadership moves from us in this area.

Jiten Parmar Any update on the North and East franchise, what is the status of that?

Amit Jatia No update.

Moderator Thank you. The next question is from the line of Pratik Poddar from Narnolia Financial. Please go ahead.

Pratik Poddar Sir actually I understood by what you said that the occupancy and G&A has gone up because of the lack of ITC. Still if you will see the run up of occupancy and the other operating expenses, it was 100 crores in Q3 last year, then 104 in Q4, then 116 in Q1, now it is 122, so as a percentage of sales also it has gone up a lot?

Amit Jatia That is because of advertising as I explained earlier that when I particularly compare last year this quarter to quarter of this year, the advertising expenses have played a role and last year in the same quarter, we had input tax credit available. So between the loss of input tax credit and increased ad expenses is where we explain the difference.

Pratik Poddar So ad spends become a part of occupancy and other operating expense?

Amit Jatia It has always been like that.

Pratik Poddar Coming to G&A expenses, even that has risen by about 30-32%.

Suresh L We had explained earlier, when you compare Q2 of last year with the Q2 of this year, there is a full year impact of the annual raises that have been given plus the new joinees and also as Amit mentioned earlier there is denial of ITC also in this quarter as compared to Q2 of last financial year.

Amit Jatia The important thing I can tell you directionally is that you will see G&A as a percentage coming down regularly. So by the end of this year you will see that impact as well.

Pratik Poddar Sir other question is, I see a good rise in capital WIP. So is it like we have done major of our capex within the first half for the remaining of the stores and that is why it has gone up?

Suresh L As Amit mentioned to you we are well on track to meet our target for the year, so there are restaurants that are opened and also the restaurants that are in ground break is what you see in capital WIP plus also the reinvestments that we continue to make. As we had indicated to you for the year capex would be to the range of about Rs.100 to 120 crores.

Pratik Poddar In terms of payable days, it has gone up from 93 to 103 for the H1. So how do you see for the whole year it panning out?

Suresh L It will be around those levels only, we do not see that changing radically, but also what happens is when you look at the payable days, please also understand, it is a combination of both opex and capex creditors. So sometime some swings could also be due to capex creditors and in terms of the work-in progress and in terms of a submission of bills, etc., but largely the opex numbers would more or less be steady but since we are incurring significant capex, some swings could be there.

Pratik Poddar Do we have a clarity on the royalty percentage for FY20?

Amit Jatia No, we will share that as and when we get that.

Moderator Thank you. The next question is from the line of Pritesh Vora from Incedo. Please go ahead.

Pritesh Vora Sir, how do management thinks about the long-term vision about the stores growth?

Amit Jatia If you download our presentation on the website, we have given some indicators there. We think that based on today's per capita income, etc., the total restaurants that we can build in our territory is about 800 restaurants or so, of which we have about say 287, so we have headroom for another 500 restaurants of which we are saying that by 2022, we should be between 400 and 450 restaurants in total, that still leaves another headroom for 350+. And, by then if purchasing power as well as the frequency of eating out grows, the potential changes quite dramatically again.

Moderator Thank you. The next question is from the line of Rahul Jagwani from SKS Capital. Please go ahead.

Rahul Jagwani Sir, I notice on some specific locations on the app you started delivering McCafé through the app. So is that something new?

Amit Jatia There is a trial going on for hot beverages, we do cold coffee across the board.

Rahul Jagwani Yes, this is like hot coffee like breakfast. Basically full McCafé menu is available?

Amit Jatia It's a trial going on, you caught on to it.

Rahul Jagwani Is that something you plan to implement everywhere?

Amit Jatia Yes, if the trials are successful, we will.

Rahul Jagwani What is the rate of basically sales growth through aggregators?

Amit Jatia No, we do not share the breakup of aggregator sales vs. our sales.

Moderator Thank you. The next question is from the line of Pratik Poddar from Narnolia Financial. Please go ahead.

Pratik Poddar Sir, I just wanted to get the number for McDelivery stores right now?

Amit Jatia 194 stores do McDelivery.

Moderator Thank you. As there are no further questions from the participants, I would now like to hand the conference over to Mr. Amit Jatia for closing comments.

Amit Jatia Thank you everybody for participating on the call today. We really appreciate it. If you have any further questions, please reach out to Ankit Arora. Also, let me take the opportunity to Wish Everybody a Happy

Diwali and a Prosperous New Year. Have a great weekend. Thank you. Bye.

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