Q1 FY2020 Earnings Call Transcript – July 25, 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 Q1 FY20 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. Thank you and over to you ma'am.

Devanshi Dhruva: Thanks Raymond. Welcome everyone and thank you for joining us on Westlife Development Limited earnings conference call for the quarter ended June 30th, 2019. We are joined here today by Mr. Amit Jatia – Vice Chairman, Ms. Smita Jatia – Director and Mr. Suresh Lakshminarayanan – Chief Financial Officer of Westlife Development Limited.

Please note that our 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, investor presentation and in our annual report which is available on our website. The company does not undertake to update any of 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. Good evening everybody and thank you for joining the call today. I am pleased to share that we are off to a good start in FY20. We have yet again clocked a profitable quarter with a healthy same-store sales growth. It marks the 16th quarter or fourth straight year of positive same-store sales growth. Over the last few years we have constantly anticipated our customers' needs, substantially innovated on our menu, launched the Good Food journey, maximized efficiencies through our ROP 2.0 platform and integrated technology across our business. As a result over the last three years we have grown same-store sales growth by over 40%, our revenues have grown at a CAGR of 18.4% and we have improved our operating EBITDA by 360 basis points. In addition to this we have also made a significant shift in our cash on cash returns on the restaurant base from 11.5% in 2004 to 20% in FY19.

The global economic environment has been volatile and volatility seems to be the new constant. Our bold move over the last few years and the robust business foundation that we have built puts us in a strong position to continuously navigate this environment. This as you can see reflects in our business results. We continue to stay ahead of customer expectations. Effective roll-out of McCafés, the new value platform and menu innovation have helped make McDonald's the customer's favorite QSR.

The 'Experience of the Future' restaurants are emerging as a key differentiator for us. Customers are loving the new dining experience; positive customer reviews are resulting in better footfalls which in turn is enhancing average volumes and operating efficiencies of these responses. Our strong customer connect, the Good Food journey and our investment in digital assets are beginning to yield results. We have been investing significantly in our digital infrastructure both at the backend and at the consumer end. We are weaving technology into operations, restaurants and brand extensions. It is aiding drive superior customer experience and enhanced business efficiencies. As more and more millennials join our customer base our business vision is to transform McDonald's into a brand that is in equal parts food and technology. We have a strong pipeline of initiatives that we believe will not only help in mitigating tough business environments but will further solidify our foundation.

With this we are well on our way to achieving our long-term goals and our vision 2022. Starting this quarter certain regulatory and accounting changes have come into effect. This has had some impact on our quarterly results. However, these accounting changes do not reflect our true business performance. Suresh will cover these aspects in the financial section. Smita will now take you through the key highlights of the quarter.

Smita Jatia: Thank you Amit. Good evening and thank you for joining the call today. We have kicked off FY20 with an encouraging quarter registering a strong topline growth of 11.8% and a healthy same-store sales growth of 6.7%. This marks a 16th consecutive quarter of positive same-store sales growth, something we are extremely proud of.

Before we move ahead, I want to apprise you all that starting this quarter WDL is mandated to report financial results as per the Indian Accounting Standards. Due to the nature of our business IndAS-116 that pertains to principles of recognition, presentation and disclosure of leases has a significant impact on the company's financial results. Suresh will be talking about the new standards implications on the financial results in detail later. I will however be sharing the comparable numbers that exclude notional accounting entries for all lease properties arising out of IndAS-116.

Moving to Slide #4, the key highlights of financial performance for Quarter 1, FY20 are as follows:

Our revenue grew 11.8% to Rs. 3.8 billion with a PAT at Rs. 57.7 million. Our restaurant operating margins stood at Rs. 515.3 million driven by enhanced operating and supply chain efficiencies. We registered a healthy same-store sales growth of 6.7%. Our operating EBITDA stood at Rs. 327.2 million. We opened four new restaurants taking the restaurant current count to 300 across 41 cities. Our brand, our restaurant and our people complemented by financial prudence remain our key strategic pillars.

Starting with our restaurants:

Our revenues continue to grow through the quarter and we achieve a healthy SSSG of 6.7% over a high base of 24% same quarter last year. Despite the headwinds that we are seeing in the economy now we continued to invest in the business and growth. As you know our strategy has always been to build the business for the long term and not get affected by the short-term quarter-on-quarter aberration. With a strong pipeline of projects and a laser focus on increasing footfalls in our restaurants we are confident of achieving a long-term task. We added four new restaurants in this quarter, Maharashtra and Karnataka have been our biggest markets with over 60% restaurants concentration even as we continue to expand our footprint across key cities.

This quarter also marked an important milestone in our journey as we opened our 300th restaurant in the iconic Churchgate area of Mumbai. Today as I nostalgically look back at our journey from the first restaurant in Bandra in 1996 to our 300th in Churchgate I feel a sense of achievement and pride.

During the quarter we continued to expand our Experience of The Future restaurants and these are now becoming the new normal for us. Customers are truly appreciating the contemporary look, the convenience of kiosk and table service, the payment option and our ever evolving menu. We now have 46 EOTF restaurants and we have seen increased footfalls indeed.

Moving into our brand; digitization is yet another important growth pillar for us. We are making great strides in building robust digital infrastructure to support our business both consumer facing and at the backend. As you may recall last quarter we launched the unique McDonald's app to give our customers personalized offer on a daily basis. In a short span of time our app has been over 1.6 million downloads with a healthy redemption rate. Our one plus one offer on our app on burgers got stupendous traction. The strategic intent of our business is to build Mac Donald's loyalists. When most brands resort to short-term discounting and giving freebies we have invested in building a differentiated platform to give our customers everyday value. These we believe will help build loyalty and brand connect with our customers.

We started this year with reenergizing over value platform McSavers in a big bold way. This quarter we delighted our customer with the Free fries on us campaign. As a part of the campaign we gave away a portion of our signature French Fries with the burger and beverage making it a complete meal. These truly brought alive our brand promise of value. To strongly establish this

proposition, we invested significantly in advertising and promotion. We front loaded our marketing plan and created three quirky TVCs to heighten awareness along with other digital and BTL activity. As a result, we saw a significant uptake in the meals. We have taken a strategic long-term view to increase investments in A&P this quarter to strengthen our value and digital platform. We are confident we will reap benefit of this additional spend in the coming quarters as well. Our brand extensions are as always bringing in good news. McCafé is now an undisputed favorite for coffee lovers. This quarter we introduced an innovative McCafé reward program to incentivize regular customers and drive frequency. While the program is only a few weeks old the response has been overwhelming. We launched two new coolers to beat the heat and this took the total number of beverages at McCafé to more than 45. We also did seven new McCafé taking the total count to 197. This makes us the second largest coffee chain in India by June.

McDelivery clocked in its highest sale and guest counts ever in May and June 2019. We would attribute it to two things, extended delivery hours to 3 AM during Ramadan in selected restaurants. This ensured that our customers got their favorite food at the time convenient to them. And secondly we launched attractive offers to capture the frenzy around World Cup and IPL. We continue to expand our delivery footprint through not only on our own channel but also as a strong partnership with third-party aggregator. McBreakfast is slowly but steadily becoming a habit for many. We are seeing many customers become regular for such products. Over the last quarter we took Breakfast to 17 more stores and brand a value campaign. This greatly helped in increasing trials in new stores and building frequency in the existing ones.

Our people make us the leaders that we are. They are the ones who bring customer experience alive in the restaurants. We have yet again been recognized as a Great Place to Work for the fourth consecutive year. We have also been awarded the Asia Business Unit top of the charts honor. This recognizes us as the top performing market in Asia for 2018, a testimony to the great work we have been doing together. McDonald’s has one of the best and most robust training programs globally. In India we have implemented these programs with an objective to build skills for life for our employees. Last week we signed a Memorandum of Understanding with the Ministry of Skill Development to provide training to youth to induct them into the retail sector. This is a great validation of our training program, our commitment towards skilling the youth of this country.

And finally scale for good, right direction we have been very cognizant about doing business sustainably. Be it our supply chain, our equipments or our restaurant operation, we are embedding sustainability across everything we do. We launched the Good Food story and reenergized our menu to make it more wholesome and nutritious. Now we have also invested heavily in deploying smart energy management systems, solar panels, waterless urinals and cooling solutions to maximize efficiencies and optimize resources. This is helping us reduce our carbon footprint significantly and will eventually also lead to long-term profitability. We are committed to using our scale for good for the betterment of the community. Three years back we launched Ronald Mac Donald’s House Charities India the non-profit arm. The mission being

to create and support programs that directly improve the well-being of ill children and their families. We built a family room and the OPD in Bai Jerbai Wadia to give terminally ill children and their families a place to rest and refresh. This year, we have achieved a significant milestone by reaching over 5500 families through our facility since inception. We are proud and are committed to expanding our network in other hospitals. All of you are welcome to visit our facility in Bai Jerbai Wadia hospital in Parel in Mumbai. Even at the restaurant level we undertake a lot of CSR initiatives to reach out to and help local communities with issues like sanitation, procuring basics and helping children. We hope to keep scaling these up as we grow our footprint.

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

S. Lakshminarayanan: Thank you Smita. As highlighted earlier we have continued strong on our growth path with robust performance in Q1 FY20 where we have seen positive same-store sales growth for the 16th consecutive quarter.

Moving onto Slide #27 as Amit and Smita mentioned earlier, starting this quarter we have mandated to report financial business as per the Indian Accounting Standards. Let me just take a few minutes to explain IndAS-116 and its impact on our financials in detail:

IndAS-116 has replaced IndAS 17 and required a lessee to recognize assets and liabilities for all fixed leases with a term of more than 12 months unless the underlying asset is of lower value. Accordingly, it recognizes right of use assets representing its right to use the underlying assets and a lease liability representing its obligation to make leased payments. Also fixed rentals will be replaced by, a). Amortization charge for the right to use assets and b). Finance cost on leased liability. This will result in an inflated operating EBITDA and lower PBT. It is pertinent to note that the impact of IndAS-116 is non-cash in nature therefore it will not affect the company's actual operating performance and most importantly cash flows. It is commercially prudent to secure long-term lease agreements in order to benefit in the future years as the business grows. In our case our lease periods are minimum 20 years as compared to the general industry trend of 9 to 10 years. However, accounting as per IndAS-116 leads to greater disparity in the reported net income statement in case of longer lease terms thereby inducing businesses to sign short-term leases which would be heavily counterproductive for the operating profitability and we do not endorse this thinking.

Hence, in the subsequent slides we will be discussing the comparable operating performance with you that is the last two columns in the table mentioned on Slide #28 which excludes these accounting entries for adjustments arising out of IndAS. These numbers will help you provide a better understanding of the actual operating profitability of the company and is comparable with the previous year.

However just for your information the IndAS on lease rentals would lead to an overall expansion of around Rs. 700 - 720 crores in the asset and liability and a decrease of around Rs. 28 crores in PAT for the full-year.

Moving onto Slide #28 as mentioned earlier, this slide highlights all line items with comparative changes in the P&L statement pre and post IndAS-116. This will help you give a better understanding of the company's financials and provide a like to like comparison with Q1 FY19.

Moving onto Slide #30; on top line we reported yet another quarter of positive comparable sales making it the 16th consecutive quarter of positive SSSG at 6.7%. Our total revenues witnessed 11.8% growth over Q1 of last year. Our focus on value platform, superior performance of brand extensions and enhanced customer experience through EOTF resulted in higher revenues. I'm happy to share that we have grown at a three year CAGR of around 18.4% from Q1 FY17 to Q1 FY20.

Moving onto gross margins and restaurant operating margins on Slide #31. Our continued focus on improving efficiencies resulted in increase in gross margins and grew up to 12.3% YOY and we clocked a healthy margin of 64.3%. In the last three years, gross margin grew significantly from 60.5% in Q1 FY17 to 64.3% in Q1 FY20 on back of continuous improvement in supply-chain efficiencies along with changes in our product mix and judicious pricing.

As Smita mentioned earlier, we made significant changes in our marketing strategy and frontloaded some marketing investments that will have long-term benefits. Our restaurant operating margin this quarter declined by ~3% to 515.3 million, largely on account of these A&P spends. However we would also like to mention that for the full-year A&P spends would remain in line with our earlier guidance.

Now, going to operating EBITDA on Slide #32. As compared to the restaurant operating margin our operating EBITDA margins decline was marginally lower than that of RoM, as it was partially set off by G&A efficiencies and the same stood 327.2 million for Q1 FY20. As a result of our sustained focus on menu, value, product mix, brand extensions and supply chain efficiencies we have been able to make significant growth in our operating EBITDA over the last three years wherein it has increased from 5% in Q1 FY17 to 8.6% in Q1 FY20. This slide also highlights the major levers that contributed to the YOY movement in operating EBITDA in Q1 FY20 as mentioned earlier.

Moving onto profit after tax and cash profits; our PAT stood at Rs. 57.7 million and cash profit at Rs. 282.1 million, impacted largely due to incidence of tax and operating margins.

In a nutshell although we witnessed the healthy top-line growth and expansion in gross margins our operating margins were impacted due to some strategic investments in brand marketing, the benefit of which we will be able to reap in the coming quarters. We believe that the company is

well on track for its vision 2022, all the initiatives and investments made currently propel us in the right that extent to achieve our target sales growth and margin expansion.

With that said I would now hand it back to Amit, who would take you through outlook for FY20 and give the closing remarks.

Amit Jatia: Thank you Suresh. Consumer sentiments may continue to remain weak in the near future as we see some macroeconomic headwinds visible from the GDP data quarter-on-quarter. However, we believe that Westlife has the financial and strategic strength to continue on its path to deliver vision 2022. With relentless focus on running great restaurants and delivering exceptional customer service we will continue to expand our EOTF restaurant foot print. We already have a significant coverage in Mumbai and Bangalore and we will soon be taking EOTF to new cities. Our aim is to more than double their numbers year-on-year. Technology has become a cornerstone of our strategy. We continue to integrate the digital platform across our business through enhanced customer experience and boost profitability. Our brand extensions will continue to be strong levers for growth for us. They are key differentiators that help us maximize dayparts, leverage occasions and broaden our customer base. Another figure of our growth in the coming years will be sustainability. We have been mindfully integrating sustainability in all our business processes. We are leveraging cutting edge technology to implement initiatives across our business to minimize resource consumption including electricity, gas, diesel and water. With the scale of 300 restaurants even small steps at that end will snowball into significant savings, both in terms of carbon foot print as well as business cost. With this we are well on track to achieving vision 2022 and deliver enhanced value for all our stakeholders. Let me now open up the call for Q&A.

Moderator: Thank you very much. We will now begin the question and answer session. We have our first question from the line of Avi Mehta from IIFL.

Avi Mehta: Just wanted to understand from the last comment that you made about consumer sentiment being weak in near term but you are on the path to deliver vision 2022. Would that mean that our initiatives kind of us give us the confidence to sustain SSS Growth in FY20 close to the steady state level which we kind of looked at 7% to 9%?

Amit Jatia: Absolutely, so it is 7% to 9% sustainable these words we have been saying for a while and yes we will do that in FY20 as well.

Avi Mehta: Given this macro the consumer sentiment being weak, do you believe that you would need to invest in sustaining demand and hence EBITDA margin expansion which we aim for as an annual basis that is one of our driver, would it be difficult to drive or it will be delayed is that how I should say?

Amit Jatia: No because one is as Suresh and Smita both mentioned that advertising and brand building efforts still are on the same basis as we have been for the last 4 or 5 years. They normally stay within 5% to 5.4%. I think we are very confident of the foundation that we build over the last five years and basically these are platforms and that's my big point to everybody that these are differentiators. They are not one time quarterly promotions. So, we feel that we will make a delta in our EBITDA margins this year as well. Like I mentioned over the last three years its 360 basis points, so similarly we do expect to make delta over last year on our EBITDA margin percentage as well.

Avi Mehta: The reason why I was asking is we have seen across the industry some signs of employee cost inflation inching up. I just wanted to know in that context. While you are right that ad-spend is a phasing issue, would 7% to 9% SSS Growth and our product initiatives be able to take care of the inflationary…?

Amit Jatia: Basically my view is that India has always been a high inflation market and if your sustainable SSG that we talked about is 7% to 9% it has to be tailed with significant cost efficiencies coming in every year. I don't think any company, in fact globally, can go away from that. So, we have a three-year window by which we have an expectation of certain amount of cost benefits coming back into the system and therefore I have always maintained that with SSG you got to maintain tight control on cost. So, we have reasonable confidence as we have through these difficult periods, so I'm not giving you trends of one year or two years but you look at the trends even on five years, you will see us moving forward. Also the most important thing is over the last five years our portfolio we made that quite solid. We made a lot of significant shifts and movements in investment in reimaging in McCafé. So, I talked about it in my commentary that in 2014 our cash on cash return at the restaurant level was 11.5%, today we are at 20%. So, we made changes and that's going to help us going forward.

Avi Mehta: Post IndAS-116 implementation how should we look at the EBITDA margin guidance? Does that have to be revisited because clearly the numbers now are all across the board in terms of the new rentals are treated. So, the 13% to 15% that we were aiming for vision 2022.

Amit Jatia: That is outside the impact of IndAS-116 and that's the way it's going to be because that to some extent is notional and therefore using that to cloud our judgment on what's right for the business is not really the way to look at it. On a comparable basis with the same trajectory of the past we continue to believe that by 2022 that's the sort of EBITDA we will hit.

Avi Mehta: Any indication of the likely CAPEX given that we are looking to add about 25 to 30 stores?

Amit Jatia: Essentially it's in the same territory about Rs. 1.2 - 1.4 billion. So, we don't expect to see our debt move up, we will stay in the same territory that we are in. Obviously which means it reflects what we expect out of EBITDA as well.

Moderator: The next question is from the line of Vivek Maheshwari from CLSA.

Vivek Maheshwari: I don't want to over read this aspect but first quarter '20 SSG 6.7 versus fourth quarter 5.6, so I mean in the context of the macro indicators and all, is there anything which helped given that base was always similar in the two quarters?

Amit Jatia: No, Vivek basically it's been a lot of initiatives so our digital app which we launched in January has been a phenomenal driver for us. So, as I've maintained this across our individual meetings with different people all the time is that what we learnt out of 2013-14 and 15 is that we need to build a pipeline where the economic environment is going to remain volatile and strategy advantage is transient. So, therefore like for example launching the app was a very important thing that we figured 12 months ago. Similarly, we already stocked that whatever we are going to do in 2020 is already in the pipeline in the field somewhere in our territory. The whole idea being that we have identified, based on our landscape study with the consumers across beverages, eating out etc. what all things, that will through these difficult times continue to add average unit volume and we are for example are quite confident therefore that as they say sort of come through with the GDP being a bit more of a challenge, we still remain quite confident about where we are heading. So, it's actually a lot of internal changes we made in 13-14 and 15.

Vivek Maheshwari: And in 6.7% SSG how was June number I mean was there any slowdown or it was pretty much even through the course of the quarter?

Amit Jatia: We don't sort of break that up but remember Ramadan was in fact in May which is normally a very important month for us and even through that I feel very proud that we have done 6.7% because while Ramadan earlier was within the same quarter but it shifting into May which is very-very important seasonal period for our business and then yet having us managed to deliver the 6.7% clearly talks about the work our team has done.

Vivek Maheshwari: Sorry if I'm hopping on this point but my only reason of asking you June or exit is basically have things worsened or are looking stable at this moment as we are almost end of July?

Amit Jatia: So, Vivek from my thought process that I'm saying we maintain 7% to 9%. You can clearly see that confidence is there, so you can see where the trends are heading at least from our point of view.

Vivek Maheshwari: On the product prices, any changes weighted average number that you can give if you have taken any?

Amit Jatia: No, price increase in last quarter we did not take.

Vivek Maheshwari: And just curious comics when you say 7% to 9% SSG what is the implied price hike that you build in this assumption because your comment about India being high on inflation also means

that the product price hikes will need to offset that? In case if we are in a scenario where inflation is benign what would that do to SSG, so what is the implied price hike 7% to 9%?

Amit Jatia: It's always the 3% to 5% that we do. Sorry I will just correct myself that we did on April 1 take a price increase of about 2%, sorry I thought it was in the previous quarter. But it is about that and typically we will maintain the 3% to 5%, so Vivek as I have always maintained for us it's a 20 mile mark. We recognize that inflation in India is at an X point, so while we don't share the data there is a tremendous amount of focus on initiatives around costs. So, lot of the sustainability work we are doing around water, gas, our own units all that is also helping us in fact on a cost basis. If you look at our two balance sheets which are there in the public domain for FY19, FY18, FY17 and if you look at the utility numbers you will find it reasonably flat. It will be much lower in commensurate to the growth in sales, so its initiatives like that which gives us the confidence that we should be able to maintain.

Vivek Maheshwari: Two more questions if I may, one is occupancy and other expenses 15% to 20% QOQ, YOY, can you elaborate a bit on this? I believe bulk of this is because of the A&P spends that you spoke about the marketing investments, anything beyond that.

Amit Jatia: No, largely it is A&P. As I have always maintained that for us it is all about total ad spend in the year and for us it's what's right for the consumer and for our business. Therefore, I have always maintained that in quarterly, even a small impact of Rs. 5 crore advertising spent here or there can make an impact on the quarterly balance sheet. But basically it's largely on account of advertising and there was a marginal impact because of the World Cup etc., so MDS really took off and therefore from a rupee from a percentage point of view it hurts you even though the contribution margin is possible. So, it was largely advertising along with a bit of delivery sales.

Vivek Maheshwari: And last small question, it's a small number but just conceptually why IndAS-116 impacts food and paper cost?

Amit Jatia: No, it does not.

S. Lakshminarayanan: This is actually technical and we can take it off-line. Basically what happens is in terms of classification where there are food costs involved and the food-promo that basically while we continue it as marketing IndAS requires us to classify it as food cost. That's the thing. It's a technical classification.

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

Anand Shah: Just first question on the gross margin, we have seen 30 bps expansion despite you running offers like Free Fries and One plus One on Breakfast and all, so should we take this trend to continue, it should accelerate?

Amit Jatia: As I have been mentioning for the last few quarters that we are kind of about there when it comes to gross margin. We don't want to push the needle, although, but luckily for us it's been product mix driven more than anything else, so you should not expect any more growth in gross margin.

Anand Shah: But on an aggregate level specially your platforms in terms of McCafé, McDelivery and all, are they gross margin accretive?

Amit Jatia: Yes, definitely McCafé, Delivery also I think gross margin it is accretive, yes.

Anand Shah: These are faster growing platforms by their contribution, higher growth, so technically you should continue to see a gross margin expansion?

Amit Jatia: It depends on the rate of change, so on a year-on-year basis you will but on quarter-on-quarter basis if you are adding 5-7 McCafés' it's not going to make a world of difference. But when you come across the same quarter in a year later you have 40 new McCafés', so yes on a year-on-year basis there might be marginal increase, because finally they are still a smaller percentage of our total business.

Anand Shah: The staff cost, on a per store basis also you have seen about a 7%-8% inflation. Last year was about 3% odd, so any change in any of the minimum wages in any of the states or so?

S. Lakshminarayanan: Basically, beginning of this financial year there were some readjustments in couple of states and also there is some impact arising out of the judgment of the Supreme Court regarding clarification of PF. So, those are the things which you actually see plus when you look at this quarter versus the last year in terms of this year. There will also be the full year impact of the new restaurants as well are the raises that have happened during the last year. So, this generally it will get evened out over a period of time but what you are seeing typically in this quarter is largely arising out of as I told you couple of changes in couple of states on account of minimum wages as well as the adjustments arising out of the PF judgment.

Anand Shah: So, on an annual basis what should one build in on a per store basis in terms of inflation would be like a 5% number, 7% number?

S. Lakshminarayanan: That if you look at in terms of historical trend, it's been around that range I think, so basically as far as your model goes you should factor that.

Anand Shah: Store guidance you are maintaining in that 25?

Amit Jatia: Absolutely.

Anand Shah: On this tax thing, your tax there was an entry there, so the accumulated losses are now expired and you are started to show tax in the P&L?

Amit Jatia: Full tax yes, proud Indian.

S. Lakshminarayanan: You are right, exactly that's the change that's happened over last year.

Anand Shah: So, what would your guidance for say FY20 and I am assuming FY20 would be complete full tax.

S. Lakshminarayanan: Yes, it will be.

Anand Shah: Even this year will be (+) 30%?

S. Lakshminarayanan: Yes, it will be at the 34.94%.

Anand Shah: It's already gone there.

Amit Jatia: The FM has given no indication. They might take it to 25 so we are keeping our fingers crossed.

Moderator: The next question is from the line of Abneesh Roy from Edelweiss.

Abneesh Roy: My first question is on the Swiggy. When I opened I see 30% off with up to Rs. 75, so will it be largely by the food tech app or it will be a balance wherein both of you are giving this?

Amit Jatia: It's the app, we don't give discounts on third-party aggregators.

Abneesh Roy: The other QSR said the dine-ins have seen huge pressure last two quarters. I clearly see you still bucking the trend by proactive measures but are you seeing this in the broader industry that dine-ins last two quarters have really started suffering and could it get worse for the industry?

Amit Jatia: We are fortunate that we have initiatives like McCafé and a couple of others like Breakfast that's all sort of dealings and coming along for us but typically when the delivery business grows at this rate there is pressure on in-store. It's a reality, absolutely for the whole industry and obviously we face those headwinds as well.

Abneesh Roy: When was the last time you have given Free Fries and is it again a proactive measure in the current slowdown or the food tech apps promotional strategy and are you able to quantify in some way that 6.7% SSG; some way are you able to quantify how much could be because of this, I know it's difficult?

Amit Jatia: First and foremost, our gross margins have been maintained, so clearly discounting is not the way we do it. Basically let Smita….

Smita Jatia: We have always given a good value on our meals, so if you look at it historically over so many years and if you have been to the stores that's what we call Everyday Value that is when you

buy an ala carte product it's at X price and when you bundle it in a meal you get anywhere between 25% to 30% of discount. So, instead of calling it a discount of 25% to 30% you have just bundled it as Fries on us, which is obviously the customer's favorite product. So, it's a more customer proposition and not something new what we have done.

Avanish Roy: In terms of McBreakfast as in the Breakfast option are you now happy with it, yes you have taken it to 180 stores but are you happy as in the customer has he really taken this in a big way because the early morning hours clearly…?

Amit Jatia: Globally Breakfast is very important for McDonald's and all the reports you might read Breakfast is actually a very-very core offering from McDonald's. I have seen the evolution of Breakfast in every single emerging country where it starts as a slower burn and then it keeps building-building-building. These are called platforms where you invest in and for us its really since we rolled out the new Breakfast platform a few years ago; we have consistently quietly been rolling this out and first we focused on Mumbai, got Mumbai right, got the awareness then we added Pune, then we added another city. So, for us it's working quite nicely but it requires a lot of time, effort and energy and we put specifically people brand managers who are running Breakfast for us and that investment along with specially working on the menu and constantly reinventing it. Recently we've launched the Breakfast value platform. All of this put together has really helped us grow the Breakfast business and we expect to continue that. So, these are all investments which add elements to the business which is how you counter a difficult economic environment because you are firing on all cylinders and you are growing different occasions, different dayparts but good news is that we have many such more initiatives that we are quietly working on.

Abneesh Roy: On delivery, the other QSR is doing delivery on its own although they are also listed on foot tech apps. In your case you are outsourcing it so in terms of brand of course the experience of the customer is different. Is there an inflection point where in you start doing the delivery on your own?

Amit Jatia: No we follow our norms. There is some delivery that we do of our own but third-party deliveries are done through them. For us it's alright, we don't mind. Globally by the way if you know we have tied up with Uber Eats and Uber Eats basically delivers for McDonald's globally as an example.

Abneesh Roy: But you said at some places it's your own so why at some places it's your own?

Amit Jatia: No not at some places. We have our own app right, so when we have our own app what I meant is that when customers order through our app it is our delivery rider who goes and delivers but pretty much all third-party and the delivery riders are also outsourced. For us we work with couple of these rider companies and our technology platform is completely integrated both with third-party providers as well as with delivery rider companies. So, most of the three POs deliver

on their own for us while for our own business that comes through the app we deliver with our own riders.

Abneesh Roy: But bulk of the delivery will be through the food tech apps currently, right?

Amit Jatia: We don't share that breakup actually.

Smita Jatia: So, can I just position this in a little bit different way? See the customer orders for different meals. Sometimes the customer wants to order only McDonald's food and if it is a loyal customer, he will come on our own app and that is where we are delivering our own food through a third-party rider integrator, but the order comes on our own app. However, there are times when people or families or friends order food from different food operators. That's when they use Swiggy as an aggregator because then they don't have to go to different brands apps and order. So, we see a healthy growth of delivery orders from our own app, through our McDonald's loyal customers and also from our aggregators and as I said in my commentary we partner with them therefore there is a win-win both for the third-party as well as for us.

Amit Jatia: We don't see any brand impact because today Swiggy, Zomato all these guys are brands themselves and when people order on Swiggy and a Swiggy rider goes the impact is more on Swiggy than on us.

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

Dhaval Shah: The free delivery which I think you have started from your app, earlier you were charging Rs. 30-35 for delivery. Is there a big number right now and is it showing in the cost side?

Amit Jatia: No, it's just promotion. It's just a promotion for a temporary period just to play and give consumers some engagement.

Dhaval Shah: Have we stopped it now or we are still going on that?

Amit Jatia: It is stopped, it was for IPL and World Cup it was specific to that.

Dhaval Shah: On the occupancy and other expense, so you mentioned that some part of his due to A&P. So, should we assume that this number should be more or less constant for the next three quarters because over the last 2-3 years as a percentage of sales this is the highest. It's something around 36% so how should we build this for the next three quarters?

Amit Jatia: The important thing is to see it from a year-on-year basis. For the year end March, 2019 it was around 34%, so obviously 2% is just if you think about it, it's about 7 crores or so. So, the rupee number is not really that large. What we are trying to say is that advertising per se for the whole year will remain between 5%-5.5% and therefore it will even out through the year. So, I feel last year's number is closer to where I would think about.

Dhaval Shah: So, you are saying of course in terms of as sales, right? As a percentage of sales that would be.

Amit Jatia: Correct.

Dhaval Shah: In terms of at the menu what you are offering, do we see any major competition after these third-party delivery apps have come in, as such burger as a food product there is not much competition is there? When you say, for example, pizza you have seen a lot of competition, so how are you seeing that scenario where customer wants to just offer only a Burger for a meal?

Amit Jatia: I feel it's great for us because burgers are more difficult environment to build. If you visit a McDonald's restaurant you will realize what it takes to get our products right and therefore we feel that obviously you are right that for pizzas I can see a lot of other local players who also play in the local market and the local trading area while for burgers you don't see that many. So, that is a great advantage for us which is why we have always loved Delivery because it's incremental business for us. So, we don't see Delivery as a threat; we see it as a very positive influence on us.

Dhaval Shah: You have launched lot of new menus like Rice Bowl you have launched and couple of other items in the past 1-2 years, so how is that shaping up in your total product basket? Would you call that very successful or is it still developing versus if you compare this product launch versus something new which you must have launched historically; how is it doing now?

Amit Jatia: We have learnt a lot with it and essentially we have understood what is a line extension versus what's the platform, so we have generally been very-very smart about it. The consumer loves variety and essentially for example doing a Mexican Aloo Tikki, doing a Lebanese Aloo Tikki or doing an Indi-spicy McSpicy. So, what we have done is we have taken our core products and we extend them to the consumer and they love that. At the same times there are platforms like Rice, so by and large I must say that we have done reasonably well over five year period on the menu and we have had more successes than failures. There are products that we take off from the menu as well and we keep adding them. There is a very process driven system by which we deal with that. I hope that answers your question but we learnt a lot over the years and we have applied that quite decently.

Dhaval Shah: So, going forward do we see more line extensions or platform extensions?

Amit Jatia: Mostly line extensions will be more, platform you don't build every day. You have to be very smart and select among platforms but yes over two years; one platform we feel is still possible while it will be mostly line extensions.

Moderator: Due to time constraints that was the last question. I would now like to hand the conference over to Mr. Amit Jatia for closing comments.

Amit Jatia: Thank you everybody for joining the call. We really appreciate you'll taking the time and have a good lovely evening and we hope to talk to you again on the next call. Thank you.

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