Q1 FY2022 Earnings Call Transcript – Aug 13, 2021

CORPORATE PARTICIPANTS

- Amit Jatia – Vice Chairman
- Smita Jatia – Director
- Pankaj Roongta – Chief Financial Officer & Vice President - Finance & Accounts
- Devanshi Dhruva – Manager, Investor Relations

Moderator: Ladies and gentlemen, good day and welcome to the Westlife Development Limited Q1 FY22 Earnings Conference Call. As a reminder, all participants' 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 phone. Please note that this conference is being recorded. I now hand the conference over to Ms. Devanshi Dhruva – Manager, Investor Relations. Thank you and over to you, ma'am.

Devanshi Dhruva: Thanks Margaret. Welcome everyone and thank you for joining us on Westlife Development Limited earnings conference call for the quarter ended 30th June 2021. We are joined here today by Mr. Amit Jatia – Vice Chairman, Ms. Smita Jatia – Director and Mr. Pankaj Roongta – CFO and VP (Finance & Accounts) for Westlife Development Limited.

Please note that our financial results and investor presentation has been mailed across to you and these are available on our website as well. I hope you had the opportunity to browse through the highlights of the performance. We shall commence today's call with key thoughts from Amit, who will provide a strategic overview, which shall be followed by Smita to take you through the key business initiatives with overall operational progress, the impact and response during the second wave and the strategic imperatives that lie ahead and Pankaj 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.

A request to all participants that due to the current uncertainties, members of the management are joining the call remotely and there could be some time lag when responding to your queries. I urge you therefore to kindly bear with us.

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 the 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 these forward-looking statements publicly.

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

Amit Jatia: Thank you Devanshi. Good evening everybody and hope you and your families are doing well. I am happy to share that the business is firmly back on track. Revenues are building strongly. Brand trust is rising consistently, and our convenience channels are accelerating at an unprecedented pace. These are the building blocks for brand McDonald's and have firmly entrenched us in the marketplace. We are excited to chart the next phase of growth as we all learn to live with the challenges of COVID-19.

QSR by definition is driven by impulse and convenience. As consumers discovered new ways and means to experience the brand, our convenience channels have accelerated. Based on our experience of the last 18 months, these positive changes are here to stay. This has very strongly reflected in our recent results. Even with severe restrictions on in-store dining, our sales in July 2021 were almost the same as July 2019 pre-COVID.

Additionally, there are some positive tailwinds for the category towards the organized sector. Consumers are increasingly choosing trusted brands with high standards of health and hygiene, which puts us in a strong position.

The future lies in being an omni-channel brand that's available whenever, wherever, and however, the consumer likes. In the last few years, we at Westlife have invested substantially in our digital capabilities that have been pivotal to our off-premise business going leaps and bounds in a sustained manner.

We have also been focused on building a real estate competitive advantage by understanding side-by-side performance through extensive research. We have taken the time during the pandemic to reorient the portfolio and are using GIS tools to identify large growth opportunities for the brand. We will continue to grow in our core cities and also expand our footprint in Tier-2 towns that have presented a significant opportunity for growth.

Finally, our menu continues to be an important lever for the brand. As you are aware, last year we launched our fried chicken product. This has further accelerated our journey of chicken leadership. We believe this product has the potential to add about Rs. 50 lakhs per store per annum and also strengthen our meal proposition. Globally McDonald's corporation has the highest average volume across 30,000 plus stores led by servicing all day parts and menu segments and we hope to tread a similar path.

We believe we are firing on all cylinders including brand, cost, menu, and access. With this we are confident of charting accelerated growth and creating new benchmarks for the industry in the coming quarters.

I now hand over to Smita to take you through the highlights of Quarter 1 FY22.

Smita Jatia: Thank you Amit, and good evening everyone. I hope all of you and your loved ones are safe and healthy.

I am happy to share that business has bounced back strongly. Our strategies of survival and revival have helped us develop a definitive playbook that has made our business resilient to external environment to a very large extent. This is strongly reflected in our results. Despite all challenges due to wave two, we saw more than 176% growth across revenues and SSG. Our business continued to hold strong notwithstanding the lockdown. Our new cost structure and robust revenue recovery have been pivotal to our performance with convenience channels creating new benchmarks. Revenues from our convenience channels have been consistently rising over the last one year. In the quarter under review, overall convenience jumped over 200% YoY. This was driven by delivery, drive thru, and on-the-go. Revenues from drive thru - that is our key competitive advantage grew by 115% YoY and 52% quarter-on-quarter. McDelivery continued to rally and grew close to 200% YoY and 36% QoQ. It touched a new high yet again in June 2021. This in spite of dine-in restrictions easing in the month. It has been heartening to see off-premise consumption grow consistently even as restrictions around on-premise have been easing. It is now apparent that there is no of cannibalization and this in fact is incremental revenue, driven by new habits, new customers, and new brand use cases, adding to our topline strength. This presents immense growth for us.

Consider a simple data point. In July 2019 before COVID our revenue stood at 130 crores where 70% was through dine-in and only 30% through our convenience channels. Now fast forward to July, our revenues are close to 90% of July 2019 even with continued dine-in restrictions. In fact, we have seen 100% recovery in all markets outside Maharashtra that continue to be under strict COVID restrictions even in July. The interesting thing to note is that 62% of this is convenience led. Even as malls continued to remain muted drive thru and high streets have completely recovered. This makes us believe that when all formats are open, we will be pegged for accelerated growth.

With this strong foundation, we will pace ahead with confidence in the coming quarter, with our key levers of

1. Menu and product leadership
2. Accelerating the omni-channel and digital presence
3. And finally network expansion and re-investments to keep the brand model.

In order to dominate the snacking and meal occasion this quarter, we launched some very powerful campaigns, including the BTS meals that got unprecedented response from our customers. We also roped in Rashmika Mandana, a popular film star as our brand ambassador in the south to build stronger brand resonance. With a compelling proposition, we are ready to dominate the 5,000-crore fried chicken market.

Technology and digital acceleration continue to be the cornerstone of our strategy. We have been leveraging technology to offer enhanced customer experience. Our digital channels are continuing to outperform despite dine-in restrictions easing up. We are building digital sales in store also by leveraging our McDonald's app - a unique offer engine that provides personalized offers. The app has over 5 million total number of downloads, a 45% jump year-on-year. In the quarter under review, our total guest counts on our app tripled YoY reflecting enhanced customer experience and value.

Finally, on the network. We continue to invest in the business by both reimaging our existing stores, as well as opening new ones. We have added 7 McCafés and 11 experience of the future (EoTF) restaurants in the quarter. In fact, we had 5 new stores ready to open during the quarter of which we have already opened 2 in July and many other are under groundbreak. We are also expanding our network in non-core and emerging city. We are guided by our commitment to scale for good and have been taking definitive steps to positively impact the environment and society that we operate in. Over the last years, we have gone through various ESG led initiatives, not only reduced our carbon footprint, landfill and energy waste, but also enhanced operating efficiencies and saved costs. This includes usage of energy management systems, production of biodiesel from used cooking oils and eliminating of single use customer-facing plastics. As a direct impact of these initiatives in the last financial year alone, we have saved close to 7,500 tons of carbon emission through our proactive steps, which is equivalent to planting close to 350,000 trees. We have also been working towards fostering inclusion across all our brand touch points. I am happy to share that EatQual, our campaign around special packaging for our customers with limited upper hand mobility has bagged several recognitions.

And last but not the least, we have concluded the first round of vaccination for all our employees, while over 1000 have been fully vaccinated. We have also announced a comprehensive COVID support program to ensure physical and emotional wellbeing of our employees.

With this, I now hand over to Pankaj who will take you through the highlights of our financial performance.

Pankaj Roongta: Thank you, Smita. Good evening all. I hope you and your loved ones are keeping safe. We have entered FY22 on a firmer footing. Our sales have been a whopping 176% growth on a YoY basis amounting to 259.2 crores. The same store sales growth has jumped 183% on a YoY basis. This is on back of the historical highs made by our delivery and other convenience channels.

Let me share some key highlights with you. Our convenience channels that includes delivery, drive thru, and on-the-go consolidated grew by 202%, of which delivery grew by 200% YoY and 36% on quarter-on-quarter basis. June 2021 was the solstice for us, and we have witnessed the highest ever sales in delivery. Drive-thrus have grown by 115% YoY and 52% on quarter-on-quarter basis. Even on-the- go has been consistently growing at a robust pace. We saw a steady built up in the in-store business and July has seen an even a stronger uptake. In fact, I mentioned earlier, we are happy to share that in July we have seen 100% recovery in all the markets outside of Maharashtra and 100% recovery in all drive-thru and high street stores. This means convenience is here to stay. And with the steady buildup of dine-in volumes, we will chart accelerated growth in the coming quarters. We have complemented our revenue growth with continued cost leadership. We have maximized our supply chain efficiencies, continued to rationalize food cost. As a result, we have maintained a gross margin of 65.4% during this quarter representing a 218% growth over the last year. We continue to target meaningful margin expansion and our tracking towards our long-term margin objectives, demonstrating our ability to accelerate value regardless of the environment. We have a revised cost structure in place and are continuously improving our operational efficiencies. As a result, we have seen a 204% improvement in our restaurant operating margins that stood at 9.8% for the quarter and our operating EBITDA stood at 2%, which represents a 112% improvement over the same quarter last year.

What I would also like to highlight is that with the recovery of volumes in the month of June, our restaurant operating margins zoomed to 16% for the month and consequently operating EBITDA jumped to 9.2%. And hence, we believe that with the volume recovery is gaining pace we are heading for strong and sustainable margin expansions. Throughout the pandemic we kept a razor-sharp focus on maintaining a stronger balance sheet and robust liquidity position by optimizing our treasury and working capital.

FY22, has started on a strong note and we are confident that we will only accelerate from here on. Our relentless focus on internal improvement and driving synergies across our portfolio will help us extend our continued best-in-class track record. As we go ahead, our priorities are clear growing our footprint, accelerating our convenience channels and maintaining fiscal discipline. We are in a strong fiscal position to deploy our capital for business expansion. The pandemic has thrown some great real estate opportunities for us. And like Amit said, we see a great potential in the Tier-2 cities that have shown greater resilience. We will increase our presence in these cities over the next few years in addition to the metros.

With this, I will now hand it back to Amit to take you through the outlook for the coming quarter. Thank you.

Amit Jatia: Thank you, Pankaj. Volatility is the order of the day, but with our strategic framework, we believe we are very well positioned to navigate through these challenges and continue growing market share. We will continue to make big bold moves and keep pushing the envelope on innovation and customer experience thereby making the brand a true millennial brand. With business back on track, we will pick up our pre-COVID pace of re-imaging restaurants and expanding network. While we continue our strong focus on our six key markets, our network in Tier-2 towns are consistently growing, opening up huge opportunities for us, which we will effectively tap into. We will also continue to make significant investments in strengthening our technology backbone, which we believe will be a key business driver from hereon. With this, we are confident about our continued market leadership on the back of brand equity, menu innovation, cost leadership, and technology.

I now open up the call for questions. Thank you.

Moderator: Thank you very much. We will now begin the question-and-answer session. The first question is from the line of Avi Mehta from Macquarie.

Avi Mehta: I just wanted to start with your comment on the convenience bit. It seems convenience is a new normal. Given that is the expectation, could you share, if you are exploring any change in the store addition or store format to suit that demand more? And could you share the guidance what we should build in for the year forward?

Amit Jatia: Basically, in terms of the store format, first, we have been consistently and continuously incorporating the fact that there's more and more external business. Many-many years so we had adapted for take-away. So, we have two windows, just like a drive-thru. We have consistently improved our drive-thru ability so that we can push more cars through the window. And as delivery business kept picking up, we wanted to ensure that delivery riders are not consistently coming in and crowding around the front counter which impacts customer experience. So, that kind of work we have already done. I think the key question everybody does ask is about store size. And like we have mentioned before, I don't see us reducing the size at this point in time. My point is, that we obviously want to take our average unit volume per annum, we still want to grow that by 50% to 100% over the next 5 to 10 years. And I feel that even if in-store remains 30% to 40% of the business, it is going to be a much larger business size to start with per restaurant. And therefore, even globally we are thinking and talking about it, there is no immediate shift in the size of the store format at this point in time. In terms of store addition, I think for us real estate competitive advantage is very important and it has played out very well. We can see the fact that we have driven-thrus and the fact that we were very well penetrated in the retail locations rather than being only mall dependent has worked extremely well for us. However, we do believe that we are seeing a new buzz in Tier-2 cities. We think it is here to stay, and we believe that therefore from the 25 to 30 store openings that we are doing, we have had a complete relook at the whole market over the last 18 months. We have used GIS software; we have used a lot of research that we have been doing on side-by-side performance. And we believe that the potential overall in our territory is about 1000 restaurants. However, it's got to be mined in an intelligent manner. So, we are hoping to be able to push the envelope to between 30 and 40 in the coming years and therefore accelerate our pace of opening as we go along. We do believe that there is an opportunity in the organized sector now, which has accelerated over the past.

Avi Mehta: Where I am coming from, as you rightly alluded, it was essentially on the store size. And if that reduction can drive an ability to kind of add it at a faster pace, that is what I was trying to understand. But I got a sense that you are looking right now at 25, but this is under discussion.

Amit Jatia: Avi, my point is we have seen enough global markets where we have gone with smaller sizes and then it comes to bite you after 10 years. The one thing that you cannot change is the size of the store. You can change the décor, you can change the layout, but the size of the store is not in your circle of influence. Even earlier over the 25 years we have experimented with everything. And the thing is that size is not just saving a little bit on the rent, it takes away from us our ability to get to say 8 crores or 10 crores per restaurant per year.

Avi Mehta: The second bit I wanted to ask is on the guidance for the EBITDA margin, which we had earlier called out, mid-teens number is what we were kind of planning, but that was a pre-IndAS number. Now, while you have given a reconciliation, I realize that you have not given the IndAS adjusted financials the way you were giving last quarter. So, would you be able to give us an updated guidance on margin on a reported basis or could you guide us how should we look at from an 2023-2024 perspective?

Amit Jatia: That's an excellent question, Avi. So, for example, if I were to take just June sales and because it's been so volatile and uncertain, I think June, even though there were too many COVID restrictions, still it is a more stable month. For example, in June, even with all the restrictions, our sales were more than November 2020, which was a Diwali month and by then restrictions had kind of reduced a lot. Firstly, that was very heartening to see in terms of sales. In terms of margin, let's forget about IndAS, but restaurant operating margin in June as a month was 16%. So, very-very solid. Even though sales were still much lower than what they should be normally. So, we still maintain our guidance that we will be as per the old accounting standards. We will be at the mid-teens, low to mid-teens in EBITDA margin by FY2023 is what we have talked about. So, we can still feel that we will get there. And what we will do is we move towards what the industry is doing the rest of all our QSR peers, where we are just going with the accounting standard, but we will try and add in our MIS some sort of a reconciliation so that you can refer back to the pre-IndAS as well.

Avi Mehta: Amit, just a request if I may, the slide that is there in the presentation which gives the IndAs adjustments, if you could continue with that, that would be extremely helpful to help us appreciate how we are on that path. That was the only request.

Amit Jatia: Noted. It will be done.

Moderator: The next question is from the line of Gaurav Jogani from Axis Capital.

Gaurav Jogani: My question is with regards to the other expenses, specifically the G&A expenses. If you see while the sales QoQ have declined but occupancy and other expenses haven't declined much, so is there some one-off there that you would like to call out there?

Amit Jatia: You have got to understand that it's a very volatile, uncertain quarter, and there are restaurants where we have fixed rentals, there are restaurants where it's revenue share. And all the landlords, because this came up quite suddenly, we were not able to get everything at that time. So, I personally feel that it's not the right quarter to judge that. I think what is important is if you look at last year quarter ended March 2021, versus that if you look at G&A, I think we have done quite well. Even though this time around, there were no salary cuts, no deferments, nothing like that. I don't know if that answers your question, but I personally feel it's not the right comparison given so much uncertainty, what was on what was not on, some landlords have supported some have not supported. So, looking at it as a percentage of this quarter may not be the right thing.

Gaurav Jogani: While I get you, that as a percentage of sales would not be the right metric there. My question was largely on the absolute number, but I get your sense that, as you get more concessions ahead maybe this might come down. Will that be a right understanding in that sense?

Amit Jatia: Yes, as a percentage, it will come down, because sales already, for example, in July have continued to grow. And with the announcement of Maharashtra that from 15th August, they are going to permit in-store, I think that is going to help us dramatically. You have to understand that each market which was very volatile sometimes on, sometimes off, sometimes shut down on weekends which is the core part of our business, so, it becomes very difficult to negotiate with landlords accordingly and that too in a short span of time.

Gaurav Jogani: The next question is with regards to the store opening guidance. This time you specifically alluded, all these stores opening in the Tier-2 city where you are seeing great opportunity and also you alluded that you would be now looking for 30-40 stores per year. So, is that you are upping the guidance in terms of the store opening from the 25 to 30 earlier that you were envisaging?

Amit Jatia: Yes, absolutely. We do believe so. We have used this pandemic to really look at the portfolio and when we look at the portfolio it is based on facts and data, and this data cannot be collected in a year. So, when you look at Mumbai, we have 100 restaurants in Mumbai. 100 restaurants is very-very-very strong penetration. So, if I further go into a mini market of Andheri, there are say 8 restaurants in Andheri. Now, when you put the 9th restaurant, if you don't know where customers are coming from and where they are going, you tend to cannibalize into other restaurants. So, with all this work that we have done, we have found that there is yet pretty much gap in every market. Also, with what's happened, a number of restaurants have shut down as well. There's a shift towards organized. The delivery business has increased. More recently our chicken launch has made ourselves more relevant in certain markets in south India as well. And looking at all of that and especially Tier-2 as well, where I have been very selective in the past, we have upped our guidance around that.

Gaurav Jogani: Just a follow up to this, so would there be any change to your CAPEX guidance and if you can guide us anything on that, given the fact that you have also highlighted that you would be investing more on the tech front as well. So, what would be the CAPEX roughly for this year and the next year if you can help us out?

Amit Jatia: It will be typically in the 100-150 crore range. Again, this year because we lost the first quarter in openings, we yet believe we should be in the 20 to 25 range. We are going to push ourselves as hard as we can over the rest of the three quarters and then if there's a third wave and again construction stops, then it is what it is. But we are pushing for between 20 to 25. Now if it is 20-25, you know that we spend roughly 2.5 to 3 crores per restaurant. So, you know you can do the math accordingly. If you are able to get between 30 and 40, it's still I would say 120 crores. Plus, if you take everything else, it will not exceed 150 crores. So, the 100-150 crores guidance stays.

Moderator: The next question is from the line of Percy Panthaki from IIFL.

Percy Panthaki: The fried chicken launch that you have, and you mentioned that you think you can garner about 50 lakh per store from fried chicken. So, is this 50-lakh incremental or 50 lakhs is from fried chicken, but of course, it would cannibalize some part of the other menu. So, just wanted to understand in light of this, how much if let's say there is a complete normalcy from the COVID front, FY23 what would be your sales per store kind of a target?

Amit Jatia: It's a good question. I am talking off incremental sales, not cannibalized sales, that is part number one. Part number two, we have always maintained that our average unit volume target was to first achieve between 6 to 6.5 crores. So, we were at 5.5 crores pre-COVID and the target was to get to between 6-6.5 crores . In our investor day in 2018 we had given three levers, which was delivery, McCafe and menu. Delivery has way outperformed, and I think it's here to stay. And that alone, this is the important part what I am going to tell you, that the incremental business of convenience that we have got between delivery, on-the-go, take away and drive thru, even if in-store comes back to 80% of what it was, that's a 10% same store sales growth. So, I am expecting at least another 50 lakhs per restaurant per year to come out of that. And chicken I gave you an indication, so it means almost 1 crore, which kind of takes us to the 6-6.5 crore per restaurant target that we have talked about for our vision 2023.

Percy Panthaki: So, this 6-6.5 crore is for fiscal 2023 itself, right?

Amit Jatia: FY23, that was our vision. Obviously, some part of it depends on normalization of COVID.

Percy Panthaki: Assuming a completely normal COVID scenario, would you say that FY23 can achieve this target?

Amit Jatia: I mean anywhere between 6-6.5, yes.

Percy Panthaki: And secondly, I wanted to understand, in terms of menu innovation, you have done this fried chicken and you have done several other menu innovations also in the last 2-3 years. Of course, this is a continuous process, and it will continue even 10 years down the line. But would you say that the main gaps in the portfolio are now sort of plugged and incremental menu innovation is not going to be as big bang as what it was earlier?

Amit Jatia: I feel thankfully that's not the case. I think even if you look at global McDonald's after operating for 70 years, still menu plays a significant role in the way we are able to grow our business. Even after 70 years, McDonald's globally continues to deliver same-store sales growth and the average unit volume, even after 70 years, even in very-very developed market continues to grow. And therefore, I believe that menu innovation just does not stop. We have also just touched the tip of an iceberg on so many categories. More recently, we launched our Gourmet burgers. The response for the gourmet burgers have been absolutely tremendous, and yet we haven't even marketed it completely. It's only available on delivery, but wherever we have launched it, the incremental volume per restaurant has been very-very nice. So, all I can say is menu innovation even 10 years from now will continue to be as robust as you see it today. In the food business it never stops.

Moderator: The next question is from the line of Kapil Jagasia from Edelweiss.

Kapil Jagasia: If I heard it right, you have researched for opening around 1000 restaurants. So, even if we go by the increased guidance of opening 30 to 40 stores, so these 1000 restaurants would be fulfilled in like how much time? Like we are right now at 305 stores or so, so that would take a tremendous amount of time.

Amit Jatia: So, the answer to that is that there is an absorption rate factor there as well. So, while there is 1000 restaurants possible, so I will give you an example, you take Ahmedabad, take Pune, take Bombay, any of these markets, we have been around for a while. So, let's say I am just making up the numbers to make my points. So, don't go by the number themselves. But you take Ahmedabad, we have 20 restaurants, 25 maybe. I think basically we own that market. Can Ahmedabad not be 35 to 40 restaurants over the next 5 to 10 years? Absolutely it can be. But can I open all of the 10 together tomorrow? Absolutely not. So, what happens is, there's an absorption rate, frequency of eating out, continue to rise, brand relevance rises for the consumer in that market for our brand, so all of these factors are there. So basically, even though the gap is there, again Mumbai, while let's say we can do 200 restaurants in Mumbai, even if real estate was available, I cannot snap my finger and open a 100 tomorrow. An example is you take Andheri. So, let's say we have 8 restaurants in Andheri. We started with one. Then we put two. If we would have put all 8 together, lot of money would have been lost and we would not have got the average unit volume and we would have had to shut down. So, there is an art and a bit of science in this and based on whatever our knowledge is, that is the potential. Earlier many-many years ago, in one of our investor calls, we had talked about 800 restaurants, and I had said how the 800 restaurant changes. 800 restaurants become a 1000, because of per capita income growth it becomes on real estate growth, it grows based on relevance of brand, frequency of eating out, purchasing power and all of these. So, there are many-many factors involved with that. I hope I am able to answer your question.

Kapil Jagasia: Definitely. That was very helpful. And just one book keeping question from my side, other income has dropped on a YoY basis. Would it because of securing lower rental this quarter?

Pankaj Roongta: Yes, that’s right.

Kapil Jagasia: So, going forward, we should be modeling this number for the rest of the year?

Pankaj Roongta: As we were saying earlier, we will keep on sharing the IndAS and the adjusted numbers so that you can get a visibility on a quarter-on-quarter basis.

Moderator: The next question is from the line of Jaykumar Doshi from Kotak.

Jaykumar Doshi: I want to know what are your thoughts on Delco format? We understand your viewpoint in response to the question Avi asked earlier. But today when you open large stores, you can't cover the entire city very well from a delivery opportunity perspective. As a consumer there are pockets in the city where a delivery from McDonald's can take maybe 25-30 minutes which if it's cut down to 15-20 minutes, you will be able to capture a larger pie of the market. So, what is your thought on attempting or trying out with pure Delco stores? Some of your peers are planning to do so or already started to do so. And what will be the CAPEX if you were to open, from a return ratio perspective, is it viable or do you think it's not viable economically?

Amit Jatia: Thank you for the question. It's not that we have not tried or attempted or thought about Delcos. I go back to my old point that I have made many-many times that McDonald's is a high-volume company, and our average unit volume comes from servicing all day parts, different menu segments, etc. If I would have gone just on penetration alone without considering long term, today we would not have been able to bring McCafe in every single restaurant. Imagine if you have 1800 square foot restaurants where the kitchen takes a large part of it, and you don't have even capacity in the kitchen, because the tighter you make it, the tighter your cold chain and all that starts suffering. And five years later, you will see problems. So, we have seen very-very difficult real estate markets globally. And when we benchmark those markets every time, we have gone to penetrate the city with smaller formats, it has never panned out. The Delco model has been tried by McDonald's in many markets. Yes, the world keeps changing every day. But even with that, the CAPEX does not drop significantly enough to give us the return that we are looking for. Now coming back to the other aspects. See, with 100 restaurants in Mumbai, I feel we capture pretty much 95% of those. As we are going to open new stores, the delivery market is going to be incrementally small and we rather capture that delivery market with the opening of a restaurant, because I go back to my thinking, my point I always make is one plus one plus one is equal to five is equal to seven. And what I mean by one plus one plus one, is that when you have the in-store business, you add to that takeaway, on-the-go to, drive-thru wherever possible and delivery. On top of that you add McCafe, on top of that you add breakfast, our return as a business is always much better with that. So, I mean, on the call that's the best I might be able to explain to you. But we have looked at this regularly and we will continue to look at it. What I am saying is it's not that we are ignorant about what a Delco can do or cannot do. But whatever we have seen so far, and even globally, there's a lot of work and discussion around this. But at this point in time, only Delcos look very unlikely, at least for brand McDonald's. We pretty much have 100% percent coverage of say a Mumbai city, with the 100 restaurants that we already have.

Jaykumar Doshi: Idea for asking the question was on one side you are super bullish on the convenience opportunity and confident that it will continue to stay so there is a permanent structural change in the consumer habits as far as ordering is concerned. And the other side, you are relying on the experience of globally of success of Delco based on pre-COVID era where delivery had not taken up, delivery was not as mainstream as it is today even in the Western world. Maybe over the next 1 or 2 years we will get to know where it settles eventually.

Amit Jatia: I am sorry to let you know, but there are enough markets in the world today where delivery even pre-COVID was 60% of their business by the way. And I can offline tell you which markets they are. So, remember we do over $ 5-10 billion of sales in delivery globally. And we have almost $ 100 billion of system wide sales. We have quite a bit of an understanding on how that works. And convenience is not only about delivery and delivery is no structural change by the way. It's an incremental use of the customer where they can order outside food at home as well which in India has grown substantially because of what it is. If you go to Singapore, you go to Indonesia, you go to many of the middle Eastern markets 40% of the restaurant business was delivery even pre-COVID. Maybe today that has become 60%. So, my point is that, firstly any brand that lives in the past will not see tomorrow. And if you recollect my comments in the past, you have to keep evolving every day and we are a brand that is built on evolution and innovation, and we are going to continue to leave that. So, I take your point and I hope you get my point as well.

Jaykumar Doshi: Definitely. That's a very helpful. Second question is, could you talk a little bit about success of McD and contribution of fried chicken McD sales globally and what is the initial response that you have seen in the stores where you have launched early on in terms of average unit volume. And just a final follow-up, this Rs. 50 lakh per store you think that is a potential across your portfolio, or that is largely in south and perhaps not so much in Ahmedabad or Mumbai?

Amit Jatia: You might notice that I am very cautious with my comments, and I only make comments when I firmly believe in what they are. So, firstly globally McDonald's is very strong in chicken by the way. I mean with our $ 100 billion in sales, we still might be the largest chicken company in the world yet. In Southeast Asia, we do very strong business in all of Asia rather around fried chicken and particularly Malaysia, Indonesia, and many such markets, we are pretty a number one also in that category. So, in India, I have always chosen to go step by step. So, even if you look at chicken nuggets, while globally it’s a core McDonald's offering and people swear by our nuggets, but yet we brought chicken nuggets only in around 2008-2009. Almost 10 years after we had opened. So, I believe chicken in South India, of course is a 5000-crore market. And we believe that this is now the right time to start playing in it, but I believe that there is similar potential in west as well. Actually, in my opinion, it's much more than 50 lakhs, but I always believe that it is a step-by-step approach. So, that's how, we think about it. It is an all-India opportunity, it's not just limited to south, although south is slightly more skewed towards chicken. So, then South could be for example, 75 lakhs per restaurant per year. But I am giving you a bit of an average for our west and south area.

Moderator: We take the next question from the line of Amnish Agarwal from Prabhudas Lilladher India.

Amnish Agarwal: I have a couple of questions. My first question is on the chicken segment only where Amit you are indicating 50 lakhs or maybe it’s going up to 75 lakhs sales. First of all, how would you compare yourself vis-à-vis one of your other global competitors like KFC because that company is having a run rate of around say 3.5 crores per store in India and chicken is their major product. So, how do you look at then your sales in the longer term? Or is there a big difference in the product offering or the way you can say KFC as a store is positioned in the minds of consumer?

Amit Jatia: This has nothing to do with KFC or anybody else. Chicken is a segment in the country, and I am only talking about fried chicken, but we have our chicken burger which in itself do over hundreds of crores of sales. I am not even talking about that. We have the McChicken spicy, which by the way, people swear by and has to significant increase in our business when we launched it. We have chicken nuggets, we have chicken wings, we have chicken this and we have chicken that. Fried Chicken was a category we decided to launch only a couple of years ago. And it's not that we did not know what to do with it because globally we have a pretty strong position in that particular area. But it was just, you have got to do the right thing at the right time. And menu and business evolves every day. You can't put all the 1000 products at one shot because consumers also get confused. So, in the last 2-3 years, we have invested in step-by-step improving and increasing our chicken menu like we did with burgers. So, more recently we launched our gourmet burgers. Why didn't we do it 20 years ago? Because it is relevant today and it was not relevant 20 years ago. So, I feel that it has nothing to do with anybody else. The important thing is that as a protein chicken is an important protein. McDonald's has played a significant role from 1996 in this market, and we are continuing to expand this opportunity and continuing towards our chicken leadership. So, that is how, at least I see it. And like I said, the 50 and 75 lakhs that I am talking about has to do only with fried chicken. And by the way, irrespective of organized sector, there is a very-very large unorganized sector market of fried chicken that exists particularly in south India and east India. And we are sort of eyeing that as well, to bring all those customers into the organized sector board

Amnish Agarwal: So, if I go by what you are saying, then can you share with us what is the proportion of the non-veg to veg sales in our total food sales as of now?

Amit Jatia: We don't generally share the breakup, but just to give you a bit of a sense, it's normally 50:50. Different markets play a different role, so it’s not that easy an answer, but broadly.

Amnish Agarwal: And Amit, my second question is regarding our restaurant operating margin. So, what sort of a number should we look at in the medium term say if we are looking 1-2 years down the line particularly FY23 and beyond on a pre-IndAS basis?

Amit Jatia: Basically, we have said restaurant operating margin, we define our restaurant operating margin very clearly. And restaurant operating margin doesn't have any play with IndAS 116. So, at least at Westlife we have been consistent with it from 2013 since we listed. So, on restaurant operating margin, 16% to 18% is really what we are shooting for. And if we are able to get to that 16 to 18 range, we are talking of operating EBITDA between 13% to 15%. So, on FY23 onwards, I don't give guidance, but I am saying trend-wise, that's where we are heading.

Moderator: The next question is from the line of Vishal Punmiya from Nirmal Bang Institutional Equities.

Vishal Punmiya: My question is again on the margin front, the operating margin for the quarter. If I look at the cost items, and if I just compare it with 2Q FY21 where the topline was actually lower than what we did during this particular quarter, I understand that employee cost have slightly gone up as well as rental cost might have also gone up. But is there any other cost that you see for this quarter which might have not been there at a significant level in 2Q 3Q? Maybe in the terms of advertisement spends towards this new category or maybe doing some spends behind the stores, which are not operational for the quarter, but you might have spent during this particular quarter to open it in the next quarter? So, any thoughts on that front?

Amit Jatia: I'll let Pankaj take that question. But I will only give you one bit of information that I have gone by. Firstly, the second wave came pretty abruptly and suddenly. Secondly, it was more severe than the first wave. And thirdly to me, what was important was in June where still there were very severe restrictions, but our sales were better than November and our restaurant operating margin was at 16% and our operating EBITDA was at 10% in that month. And that clearly tells me the cost structure continued to stay where it needed to be. But obviously, there were no employee cutbacks this time, there was no salary impact. In fact, we rewarded our people to work with us through all of last year which was a very-very difficult year. But Pankaj might give you more specifics, if he has something to add.

Pankaj Roongta: Just to add, because of the high volatility in this quarter, so percentage to sales is not the right way to look at it. But if you see the growth of the P&L line items in operating cost, SG&As, food cost, etc., they have been significantly lower than the sales cost of 176%, which establishes the revised cost structures in place. And as Amit said with the June recovery, we were already at 16% restaurant operating margin and EBITDA touching 10%.

Vishal Punmiya: And secondly, when you talk about the fried chicken market and getting shares from the unorganized market, what I believe is the unorganized market is purely a fried chicken market and not a breaded fried chicken market. So, would it be easy to convert those consumers to a breaded fried chicken market?

Amit Jatia: I mean, from our point of view, we have seen in other markets like Malaysia, etc., where it happens over a period of time. So, for example, what happens is like I always say this, and I truly believe, I believe that the more burger players, advertising burgers, talking burgers and making burgers available increases the penetration of burgers in the country. And slowly I talked about how we will bring new users into the market. Similarly, I do believe that in the fried chicken market, the same thing is going to happen. As more and more people offer it, make it affordable, people do start moving up and as they move up the value chain, they start then coming towards breaded, etc. So, there are yet many examples of breaded like, if you go to Empire in Bangalore, which is one of the most popular fried chicken markets, it is all coated and the breading quality or type may be different, but it is still breaded. And in our case, we have created a unique coating, it's called the ghost chilli coating. And consumer feedback even before we launched it on a scale of 10, it was average 9.5. I mean, below 9 we did not get a single score. And now that is reflected in the sales that we are seeing in the market as after this time because of the pandemic, we could not advertise it, but as people are experimenting it, if we are continuously seeing a rise in sales in this particular product. So, we do believe that we will convert over time, bring new users into the McDonald's fold. And last point I want to make it's just like McCafe previously when you wanted to have coffee before McCafe, McDonald's was not in your consideration set to start with. Similarly, if you wanted to go for fried chicken, which has its own set of customers, McDonald's was never in the consideration set. With us having launched the fried chicken and as the awareness for that increases, as people try the product, we will come into the consideration set of the consumer. And that alone will give us a certain amount of business. And the rest of it will come through unorganized and through competition of organized sector.

Vishal Punmiya: Lastly, in the southern market where you have obviously started with the fried chicken portfolio, how many dips would a person buy to basically consume a particular bucket of fried chicken? And what are the margin benefits do you see, along with the fried chicken when they consume the dips?

Amit Jatia: It's too minor a point to be honest, Vishal. I mean, it's not going to change the game substantially. For us right now it's about people trying the product. The number two thing is to bring McDonald's in their consideration set when they think of fried chicken and it's a step towards what we call chicken leadership, that we have been able to achieve in many of the markets. So, that is currently what the focus is. We don't obviously discuss individual margins, but to me it's about taking average unit volume up and that in itself, in our opinion, will lead us to margin growth in terms of operating EBITDA and restaurant operating model.

Moderator: The next question is from the line of Jayesh Shah from OHM Portfolio Equi Research.

Jayesh Shah: I have two important questions. The first one is that when we hear about Jubilant and Burger King and the others looking at stores expansion or 75 to 100 per annum, Westlife at 25 to 35 range appears pretty modest and makes it look like a defensive stock in a hyper aggressive sector. How should we look at it? And what are the constraints that doesn't allow you to grow at this? And do you think these kind of growth rates are sustainable? Because we have seen the large, listed player add stores on their ways which is still so high? So, in one way, are they taking away the market potential from you and are you feeding potential market share to them?

Amit Jatia: So, we don't believe so. Firstly, it's about average unit volume as well, and rather than do 1000 square foot store that do 2 crores or 3 crores in average unit volume, just to show that we have 1000 stores is not our strategy. We have seen enough, very large players, many of whom you are talking about, just announcing that I will do 700 stores, I feel does not change the game. It is in Westlife that we consistently through the period of 2013, 2014, 2015, 2016, 2017, where everybody else was shutting stores, but we were adding 25 to 30 stores. And there is an example of some of our competition from whom we have learned. They were at 400 stores in 2014 and they are at 400 stores in 2019. Maybe today they are at 450 stores. So, my point is, just because you are opening 70 restaurants a year is not material. Let me put it differently. Suppose I can be 10 crores per restaurant and 300 stores to take me to 3000 crores right there. So, I feel that there's a balance between the two and I think the jury is still out there over time to tell us. It's about market share finally. It's not about number of stores. And currently in the markets we operate, we lead in market share. It's about penetration, it’s about the number of consumers that are using you per store. So, for example, in 100 stores in Mumbai, if I can do average unit volume of 9 crores per store, let's say I am making this up, the 9 crores means obviously I am serving a very large base of customers. So, why should I build 200 stores to serve the same 9 crores average unit volume? You understand what I mean? If the average unit volume of the 200 stores is 4.5 crores, why should I put another 200 crores of CAPEX? So, please first see the HRPL and Westlife performance over a 10-year horizon in terms of how we have grown our stores and how everybody else has. And I am not saying they are good or bad. I am just saying you see the difference. Finally, when you look at 35 stores, the 35 stores or 30 stores is for half the country as well. You have got to factor that in as well. So, I think I have made my point.

Pankaj Roongta: Just to add, there is a substantial difference in the AUV of McDonald's stores versus competition. So, when we open one store it is equal to almost two stores, so you can also compare like that. It's a national presence and plus the AUV difference.

Amit Jatia: Globally, when they were at some point more one other brand than McDonald's, so McDonald's has 32,000 restaurants and that other chain claimed that they had more restaurants than McDonald's, but McDonald's sales were 100 billion or that time maybe 70 billion. And this other chain was 15 billion. And McDonald's made, say $8 billion in profit and the other chain made no profit. My point is, it's not about number of stores, it's about the right quality of stores, the right average volume, the right location, real estate competitive advantage, like how we have got drive-thrus. It has made a significant difference. How we have been able to penetrate high street versus only being in mall, all that matters.

Jayesh Shah: Got it, that's a very useful insight. Just to follow up on this hypothetically what will make you look to stores expansion up to say 50 crores. What is the constraint here, if at all?

Amit Jatia: Constraint is the Indian market. Because one, the frequency of eating out is still the lowest in the world. Number two, the per capita income is lowest in the world, the ability of the consumer to spend money, as you can see in any category, forget QSR, is the lowest in the world. But yes, we have population. So, you can say we have a billion people and therefore we should have 10,000 restaurants. But I would love to see somebody build 10,000 restaurants. I gave the example earlier on the call, that while Ahmedabad, I am just using these numbers to make my point, the numbers have no relevance, let's say Ahmedabad you take 50 restaurants, and by the way you show me another brand that has 100 restaurants in Mumbai of our standing in our category. There is nobody that has 100 restaurants in Mumbai. And to make 100 restaurants in Mumbai and make money in the 100 restaurants in Mumbai, I think clearly reflects on what the brand is all about. Of course, we have chosen to go on an inside out strategy. And therefore, as we get into smaller cities, and by the way, we are in 40 small cities as well outside of the 6 core metros. But we own our 6 core metros and that's been our strategy. So, my closest competitor in Mumbai would have 30 restaurants. You understand? So, you have got to look at the quality of real estate, you have got to look at the diversification, but to answer your question, it's about growth in frequency of eating out, it's about the economy growing. Economy can't grow at 4% GDP and then you expect that we can grow faster than that. It is tough. For us it's about sustainable growth.

Jayesh Shah: That's very useful. My second question is that as shareholders, we have noticed that whenever the Westlife stock crosses 450, there is a little bit of regular promoter selling which ends up being overhigh. Now we have seen the practice in the other companies where the promoters have given an indication in terms of how much they want to sell, for whatever reason and up to what point. That gives us some kind of visibility as to what to expect. Can we expect something similar out of you?

Amit Jatia: Absolutely. And we have been saying this in all our calls, so there is a lot of pressure on us to increase liquidity and every time some very good global investors want to buy, we start getting calls and pressure from a lot of people to help with liquidity of the stock. So, we have made a stated goal that we are currently at, I think about 57% or so. We have said over the next three to five years we want to come down to about 53%. So, over time in the right manner with the right disclosures, we want to help get the stock to the liquidity that all our peers who have recently listed have got. So that's really what it is. And we are quite upfront that we want to get to about 53% over the next three to five years.

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

Amit Jatia: Thank you very much everybody for being on the call, appreciate your questions and patience to hear our answers. Have a lovely weekend and stay safe and we meet again in the next quarter.

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