Q3 FY2021 Earnings Call Transcript – Jan 21, 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 Westlife Development Limited Q3 FY21 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 phone. Please note that this conference is being recorded. I now hand the conference over to Ms. Devanshi Dhruva from Investor Relations. Thank you and over to you ma'am.

Devanshi Dhruva: Thanks Nirav. Welcome everyone and thank you for joining us on Westlife Development Limited Earnings conference call for the quarter ended 31st December, 2020. We are joined here today by Mr. Amit Jatia – Vice Chairman, Ms. Smita Jatia – Director, and Mr. Pankaj Roongta – CFO and VP Finance and Accounts for Westlife Development Limited.

Please note that our financial results and investor presentation have 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 to COVID-19 and the strategic imperatives that lie ahead. 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 disruption due to COVID-19, 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 may be 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 turn the call to Amit to share his views. Thank you and over to you, Amit

Amit Jatia: Thank you, Devanshi. Good evening all and thank you for joining the call today. At the outset I wish you all a very happy 2021, and both you and your families are safe and healthy. The year 2020 was unlike any other. It brought with it unprecedented challenges and anxieties. But at Westlife we have always been guided by the philosophy that in every adversity lies an opportunity. So we took this crisis as an opportunity to test our collective resilience, strength and agility. As a result we have not just recovered well but we have also recovered strong with the business that is even more robust and shock resistant.

Over the last 25 years we have mindfully built a strong and more importantly sustainable business on the back of a solid foundation. This has insulated us against many crises such as the one we just faced. We believe that we have been running a marathon, pacing ourselves well and further strengthening our business every step of the way. It is our strong foundation that truly brought forth the key competitive advantages that helped us overcome the crisis and will continue to propel our growth in the new normal.

First and foremost, it is our commitment to ensuring exceptional customer experience, Westlife has always taken bold initiatives to meet the ever evolving consumer needs in a very fast paced business environment. Be it our Experience of the Future restaurants or acceleration of omni-channel strategies with the launch of two completely new channels - digitally enabled take-out and on the go within a matter of weeks. We have always been at the forefront of delighting customers.

Second is our unique supply chain and our innovative menu offerings. We are one of the only QSR with a strong closed loop supply chain backward integrated to the farms. Our strong partnerships with our vendors ensure that we offer the best quality ingredients and keep pushing the envelope on menu innovation. A sheer testimony of our supply chain strength is that during the pandemic when most players were operating on limited menu we were actually able to launch two new products.

Third is our real estate portfolio. Our diversified portfolio of real estate with 20% drive-thrus has been phenomenal for our business in the last year. Our foresight to have designated takeaway windows to support capacity and scale has also been key to our quick recovery. Our unique revenue linked real estate deals ensured that we come out of this crisis unscathed.

These factors along with our strong balance sheet and cost leadership enabled us to pivot in the face of this crisis. Today even at 20% lesser revenue we are delivering the pre-COVID level of margins. Our new convenience channel are thriving and driving incremental revenue growth even as the situation is normalizing. At the same time SOPs for contactless operations are helping in-store dineing build strongly, which is set to further accelerate as regulatory restrictions ease up. With this, we believe we are accelerating fast towards exceeding pre-COVID levels and reclaiming our growth trajectory.

I now hand it over to Smita to take us through the highlights of our Quarter 3 FY21 results.

Smita Jatia: Thank you Amit. Good evening to all and I wish you all a very happy and healthy new year.

I'm elated to share that in Quarter 3 FY21, we charted robust recovery across all business parameters. With our convenience channel showing consistent growth, and dine-in building up fast and strong, our revenues accelerated to 85% to 90% of pre-COVID levels. We also got back on our growth path and opened three new restaurants and three McCafé.

As I mentioned last quarter, we have reengineered our business to create a new framework. What is really great is that we have been able to lower our breakeven point even as the business has come back to near normalcy.

We have also improved the margins significantly and cost efficiency. As a result of our operating EBITDA for the quarter jumped to 10.2% from negative 4.9% in Quarter 2 FY21. In fact for the month of December we reported an operating EBITDA of 13.1%, which is similar to YOY basis despite 20% lower sales. I'm also proud to share that we have delivered a profitable quarter. In fact cash profits from this quarter have wiped off half the losses that we incurred in the first half of FY21.

As seen on Slide #6, we started our recovery journey in October, when our biggest market Maharashtra finally opened up for dine-in. We saw the momentum build up rapidly through November, buoyed by the festive cheer. And in December, despite substantial regulatory restrictions in several of our markets we saw a phenomenal uptake in sales with revenues coming back to 97% to pre-COVID levels. Dine-in the month recovered 75% - 80%, even with night curfews and the 50% capacity constraint. Even McCafé recovered over 80% vis-à-vis pre-COVID levels. At the same time, sales from convenience channels accelerated to 120% of pre-COVID levels in the month again notwithstanding the night curfews in some of our key markets. This gives us confidence that once these restrictions are lifted, our business including dine-in will bounce back stronger than pre-COVID also.

Our sales continue to be driven by higher volumes at our drive-thrus that have been our biggest success during these times and small town stores that have shown remarkable resilience. As of today, almost all our highways stores are doing even better than pre-COVID sales and the trend is similar for our stores in smaller cities such as Bharuch, Kolhapur, Nellore and Tirupati. In fact, if we exclude restaurants which are closer to colleges and some mall stores where movie theaters are key generators, we are now close to full recovery.

As seen on Slide #7, what has been especially heartening to see is that even as our dine-in has come back strong; our convenience channels continue to grow at a healthy rate. During the month of December, McDelivery revenues exceeded pre-COVID levels, while our drive thru revenues doubled over pre-COVID period. Our innovative on the go platform is also seeing healthy growth month-on-month. We believe that our omni channel strategy is working quite well and that it will continue to play a critical role in driving incremental business post COVID as well.

Moving to Slide #13, Assurance, Convenience and Access continue to be key pillars of our strategy in the quarter. We restored full operations and launched new stores with the promise of Golden Guarantee. We also celebrated the occasions such as chicken day and children's month to add some extra cheer to the customer sentiments. In the last fortnight of December we launched an integral campaign 'Sprint to Success' to motivate employees and maximize sales. I believe we have been able to leverage our technology backbone quite effectively to build a strong omni channel presence. With this we have been able to create more opportunities for people to consume us - whenever, however and wherever. We now have three thriving convenience channels. Delivery and drive thru are beating their pre-COVID levels while on the go is building up fast and strong. We are also seeing a very encouraging trend in terms of average check for these platforms that have exceeded pre-COVID levels as well as YOY Quarter 3 FY20 level. On the go that was launched just about 5 months back, is now operational across 255 stores. This unique service is converting all our stores into digital drive thrus and creating completely new used cases for the brand and serving us a strong competitive advantage.

Technology is also helping us build back dine-in. While contactless ordering and payment is enabling customers to enjoy safe dining, our unique McDonalds app with compelling offers across menu options is helping us build frequency. The app saw a 20% surge in activity users this quarter as compared to Quarter 3 FY20 and its contribution to GCs zoomed by 80% as compared to Quarter 2 FY21.

This quarter also marks an important milestone in our journey towards being an even more inclusive brand. We launched a special pack Eatqual for our customers with limited upper limb mobility. I'm glad to share that this has been very well received by our customers and people at large.

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

Pankaj Roongta: Thank you Smita. Good evening ladies and gentlemen, wishing you all a very happy and healthy new year. I am very happy to report that we have delivered a rock solid Quarter 3. We have been able to successfully build on the momentum that we saw in the Quarter 2 and accelerated sales when Maharashtra opened up in October. At the same time, we continue to rationalize costs on the back of operational efficiency and lowered our breakeven point. I'm happy to share that among all the challenges, we have delivered a positive quarter for PAT with sales almost recovered to pre-COVID levels at the exit of the quarter.

As Smita mentioned, our omni-channel focus has been a key pillar of growth and will continue to play an important role in driving incremental business post-COVID as well. Our drive thrus have been one of our biggest areas of strength. Our drive thru sales peaked during the second quarter and remain elevated when compared historically. Our long-term principles of deploying capital remained unchanged as we continue to grow steadily. We are proud to announce that we opened 3 new stores with McCafés during this quarter. We are now also present at the Mumbai airport and maybe some of you can visit us there in your upcoming trips.

We clocked an overall sales of Rs 325 crores for this quarter, a strong sequential growth of 55% over Quarter 2 and we exited the quarter with 97% sales recovery versus the pre-COVID level (i.e. February) despite the capacity constraints and night curfews in many place.

Our gross margin improved by 220 bps on quarter-on-quarter basis and landed at 65.7%, which is almost back to YOY level on the back of volume recovery, product and channel optimization and cost leadership.

During these past months our goal has been to restructure and reduce our operating costs, both on short-term and long-term perspective. I'm happy to share that we have consistently reduced our average fixed cost by 25% to 30% of the pre-COVID levels which helped us achieve our ROM of 15.4% for the quarter, a great 1200 bps jump on a sequential basis.

These fixed cost reductions coupled with judicious control on the discretionary expenses resulted in a substantial reduction in our cash loss**.** As a result our operating EBITDA landed at the Rs 331 million or 33 crores versus a loss of Rs 10 crores in the previous quarter. The company achieved an operating EBITDA of 10.2% for the quarter and 13.1% in December'20, which is almost similar to December '19 margins - a trend we are confident of sustaining as we move towards achieving and even exceeding the pre-COVID levels of profitability in the coming quarters. Hence on an overall basis our Quarter 3 registered a profit of Rs 82 million on profit after tax level versus Rs 27 crores loss in Quarter 2. The cash profits for the quarter at Rs 35 crores have wiped off ~60% of H1 loss of Rs 64 crores.

Our focus during these months has been to maintain robust liquidity, contain debt and build a stronger balance sheet and hence, I am very happy to share that we were able to optimize our treasury in working capital arrangements thereby exiting the quarter with almost zero net debt for the company. The company maintains healthy cash reserves at the end of Q3 on its balance sheet.

For Quarter 4, our priority is continued to be around driving affordability and convenience and increasing trust complemented with strong fiscal leadership. With the business environment getting closer to normalcy, our business performance has also stabilized to a large extent. With this the utilization levels have crept up, as we exited the quarter, we are getting closer to normalcy across all our markets. We will continue to strategically deploy our funds to ensure that we continue growing our business and that our stakeholders are duly rewarded. With that said, I will now hand it back to Amit, would take you through the outlook for the coming quarter.

Amit Jatia: Thank you Pankaj. We are entering 2021 with renewed hope and zest but not without the learning of 2020. As consumer paranoia turns into caution, we believe that in 2021, we are looking at the biggest ever opportunity for the QSR segment to explore and McDonald's to reinforce its market leadership.

Assurance, convenience and access will continue to be the key levers of our strategy, of course with financial prudence giving us the added firepower.

One of the most critical take away from the pandemic has been that we are capable of doing more with much less. Even with a major cost rationalization program, we were able to innovate and grow very well.

Going forward we will continue to invest in cutting edge technologies that enhance customer experience and convenience. We will simultaneously be taking all redundant cost out of the system on an ongoing basis ensuring our balance sheet remains robust and future-proof. Starting this year, we will also resume store expansion, much in line with our earlier guidance of adding 25 to 30 stores every year.

As another major learning, we will continue to look beyond short term tactics, towards the longer-term view. We will do what is right for the business in the long run rather than take a myopic view of the business as it stands today. We have a war chest and we will continue to invest in the business to achieve our long-term vision and create value for all our stakeholders. Thank you. I now open it up for Q&A.

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 Group.

Avi Mehta: I had a clarification, while we have seen you have given the performance versus pre-COVID, could you share how dine-in and delivery are doing on a YOY basis? And linked to that first be it for pre-COVID if we look at the Feb as the benchmark, has that strength even continued as we go forward because seasonally as well Jan-Feb are typically weaker months than December. So just those two questions please if you could.

Smita Jatia: Just a clarification in your first question when you asked, you asked about delivery and what other thing?

Avin Mehta: Dine-in.

Smita Jatia: So we also mentioned some statistics in December wherein our convenience channels have zoomed up by (+125%) and at the same time dine-in sequentially has moved up from 75% to about 80%. So as I again mentioned that both are growing sequentially and completely the convenience channels are giving us incremental growth and the dine-in is not eating up into the convenience channel. So this is pretty much answer to question one. Second to me in COVID times I don’t know if there is too much seasonality because dine-in is growing month-on-month here as the regulatory restriction of capacity and curfew are going to come out. So still we haven’t reached 100% of our pre-COVID levels and comparable sales. So we are not looking at the business at this point seasonally how Jan-Feb-March is going to do. We are quite confident that in the Quarter 4 we will also show sequential growth.

Amit Jatia: Just to add to Smita's points, I think the vaccine changes consumer confidence quite substantially and I think that also helps us with the sequential growth.

Avi Mehta: I think Smita covered some part of it but the delivery portion or the convenience portion is not getting impacted, did I hear that correctly despite the dine-in coming back?

Smita Jatia: Yes, absolutely.

Avi Mehta: If there is mix difference that is happening in delivery that own versus third-party apps or no, convenience continues?

Smita Jatia: Nothing like that. I think both are growing steadily and as you have seen in Slide #7, you can see the trend of both growing very well.

Avi Mehta: I thought that it is versus pre-COVID, so we kind of take it in just Feb, it was not YOY which is why I thought I will kind of reconfirm.

Smita Jatia: No, it's also month-on-month. You can see the sequential growth.

Avi Mehta: The second question was on the margin front, you have done a very commendable performance over here. This gross margin if I look at it has happened despite the mix in particular share of McCafé and high value products being below pre-COVID levels. Is that understanding correct and if it is would it be fair to say that as scale kind of comes in because historically we have seen scale also helps us deliver or drive some bit of gross margin expansion. So would that be a fair expectation to also build in gross margin in addition to the operating leverage gains that would naturally accrue as we move closer and closer to normalization?

Smita Jatia: Absolutely, so one is the operating leverage which is linked to your product mix. Pre-COVID our growth in McCafé sales added to the gross margins as well as our promotions and product interventions, so that's definitely going to continue and we are very happy to say that even with lower sales we are pretty much back to our pre-COVID gross margins and as scale increases of course gross margins will increase.

Moderator: The next question is from the line of Latika Chopra from JP Morgan.

Latika Chopra: My question was there are reports of bird flu, so did that affect your operations in any manner over the last few weeks?

Smita Jatia: So that's the only question, I thought….

Latika Chopra: No, there are other questions as well. If you could take this up then I can ask the next question.

Smita Jatia: We are just monitoring it. Currently we have not seen any appreciable impact of bird flu. But I think in the coming weeks depending on its intensity we will be knowing more. But even moving forward, even last time when it had come, customer do substitute and therefore it's not a major impact or major derailer which we will see which could come with month on month growth of our business.

Amit Jatia: You know we have a very strong fish platform as well and consumers normally switch from chicken to fish or to sometimes vegetarian as well.

Latika Chopra: My second question was on your revenue mix, if you could just help us understand how the revenue mix stood between convenience and dine-in prior to COVID, where we have reached in journey today and now with all the push and technology from your side and obviously the changed consumer behavior, how do you see this share settling down and within this new platform of on the go how meaningful this could be, any color compared to whatever your experience — I know it's really few months so far — but in some of the stores may you have seen a good pickup on this particular format if you could give some color?

Smita Jatia: Just to give you a little context, globally McDonalds has always been a convenience brand and it has always led to the growth and if you see in US 70% of the business of McDonalds come through drive-thru. Now in India pre-COVID obviously there was a healthy mix between dine-in and convenience channel because we were still an occasions led brand. Now what's happening during COVID and we really don't know where it's going to settle, used cases are changing. What do I mean by used cases and I will give you an example taking your on the go comment, is that when people are traveling point A to point B, they are oaky just picking up a cup of coffee or picking up a snack. which is just giving a new used case for on the go channel. So all I can say, it's very early to say where the convenience channels are going to settle down. But, the only thing I can definitely say it's not going to completely substitute dine-in. The celebration occasion or the dine-in occasions will always be here to stay, at least in India for the next couple of years and there will always be a healthy mix between the two.

Amit Jatia: Just to add to Smita's point, Latika I feel that the convenience channels are here to stay because the consumers have tasted convenience and because it is convenient they will now continue to use the channel. So if I'm going to look at our dine-in sales in similar restaurant in September and as the dine-in sales have increased we see no sort of reduction in the convenience channel sales. So I feel that as things stabilize the dine-in business will at least be back between 90% to in my view even 100% and the convenience channels are going to stay. So I feel we are going to get decent same-store sales growth because of this reason as well.

Latika Chopra: Just last bit I wanted to check, you operate across multiple cities, do you maintain the price parity on your portfolio, and I mean like the end consumer price between your own app versus the aggregators or are there more benefits or promotions or discounts which are available on McDelivery app?

Amit Jatia: We maintain what is called demand based pricing and even in the city of Mumbai prices might not be the same. So it's all done with a lot of consumer data depending on the market we are in, it depends on whether we want to grow that market. So typically, when we enter a new city, if you take smaller city particularly, the purchasing power parity is quite different from Mumbai.

Latika Chopra: No, Amit that I understand. I was just taking on a specific pin-code or a particular catchment area, is the pricing on your own apps and on the aggregator app like a Swiggy or a Zomato, is this same, the end consumer?

Amit Jatia: It's same.

Latika Chopra: So, there are no extra discounts or promotions which consumer can get on your own app?

Amit Jatia: Yes the offers are different.

Smita Jatia: The offers will be different on our app and the offers are different on the Swiggy or Zomato app because those are offers which Swiggy and Zomato also give to push their own business over and above our offers. So, you may see a better offer on a Swiggy or you may also see a better offer on our app depending on what the customer wants.

Latika Chopra: So it's fairly dynamic that way.

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

Percy Panthaki: My question is on the margins only and you mentioned that for the month of December you have come to about 13% kind of EBITDA margin despite sales being low by 20% YOY. So just wanted to understand one thing because of COVID there are certain cost saving which are going on, be it your travel cost or be it certain rental concessions etc. Ofcourse some part of these cost savings may be permanent in nature but some part of it is definitely temporary. So could you give an idea if I remove this temporary part of cost saving as in if I add it back to your overall cost on a hypothetical basis then what would the margin come to?

Pankaj Roongta: I will answer this in the following manner, as we relooked at the new cost base and started correcting the cost structurally, some part of it was definitely tactical which kind of has come back in Q3 with higher volumes and example being utilities or some sort of other operating items. But, on a long-term basis we are saying that the costs, basically on the commercial structure that we have created is going to give a long-term optimization of about 20% to 25% on pre-COVID level. So there is an element of tactical increase that has come back but a large part of it is here to stay.

Percy Panthaki: So basically, you're saying this 13.1% or whatever that margin you have clocked in December that margin doesn't have any cost savings which are temporary in nature?

Smita Jatia: Yeah, so I would add to what Pankaj is saying. Amit has always maintained that our vision 2022 is to be able to get through a mid to high teen operating EBITDA. So I think we are still on that journey and this year obviously has been a blip where we have actually been able to structurally change a lot and this is not going to take away from our margins going back to pre-COVID levels and improving on top of that.

Percy Panthaki: The reason I am spending a little more time on this is if with a 20% lower sales growth you are doing a 13% margin and in this 13% margin all the cost savings which you have done are sustainable and permanent in nature, then once this (-20) goes to a (+5) or a (+10) then the margins could be much higher than this 13% number. Is that interpretation correct?

Pankaj Roongta: Yes, very correct. What we are seeing is that on the volumes coming back to pre-COVID levels or even higher the cost optimizations that we are driving will lead to higher margins.

Percy Panthaki: Could you give a little more granularity on what these cost optimizations are, the ones which are permanent in nature and will not come back even after lifestyles normalize, COVID impact is completely gone etc. Permanent cost savings, can you give some examples or some granularity of what you have done on that?

Pankaj Roongta: I can give you some key pointers there, starting from supply chain where we have relooked at our cost structures not only internally but also challenging the cost structures of the suppliers because with most of the suppliers we have an open book model. We have relooked at our distribution cost but also the cost of operating the store. We have relooked at our all-fixed cost structures not only at a store level but at a head office level and therefore the cost optimization is not limited to any particular line item in P&L. It starts from FPD, which is our Food, Paper and Distribution right till the fixed cost at a head office level. The cost optimization across the P&L line, such that when we are back to recovery, the tactical stuff will come back but lot of it will stay back.

Percy Panthaki: Do you see any risk on gross margin from food inflation?

Pankaj Roongta: There are bits and parts that we are keeping our eyes on to monitor, for example on oil prices etc., temporary disruption in chicken prices but since we are a forward-looking company and the supplier relationship is great, we always plan for such contingencies and demand planning from a medium to long-term perspective. At this point in time, we do not see a lot of the cost inflation hitting our financials in the next quarters.

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

Anand Shah: On the gross margin again despite the lower scale and lower contribution of McCafé already back to your pre-COVID gross margin. Is there an element of much superior mix here or have you tweaked any pricing especially in terms of your combos or offers or you give some discounts are on which is driving this?

Pankaj Roongta: To give you a perspective historically also Westlife has increased gross margin about 100-150 basis points year-on-year. Therefore, in pandemic what we have done is, is really an incremental to the effort that we always do year-on-year basis because the design principle of higher profitability is increase in sales while showing us 100-200 basis points on the cost every year from the P&L. Now when you talk about gross margin improvement it is volume recovery, it is product mix, channel mix but also cost optimization. We never say that we have reached to a maturity or that there is no potential to increase gross margins further. Even going forward in further quarters and for FY23 vision statement, the gross margin will continuously improve as we move forward.

Anand Shah: There is no reduction in promotions or discounts or so or any price hikes which is driving us?

Smita Jatia: As you always know that we have never worked on discounting and BOGOs. It's always value pricing, so our value offers have always been there and they have come back after our dine-in has come in or it's on MDS value offers which are there. They continue and we will keep on optimizing that. If you remember for us gross margin is three levers, raw cost, the product mix and third is the pricing and these are levers which we will continuously use to be able to grow gross margins.

Anand Shah: On the cost again especially manpower we have still seen a 30% odd reduction YOY and you are sort of 80%-85% recovery. Is there any permanent reductions you have done in the number of manpower or any efficiencies here? This kind of run rate is sustainable even when we go back to (+100%)?

Pankaj Roongta: Absolutely, this comes back from the previous question on the cost optimization of how much of it is tactical and how much of it is long-term and what we commented is that there are lot of efficiencies and cost optimization that we have added to the store operations, such that like Quarter 3, Quarter 4 when we had 100% operational quarters, how can we make more profit or similar profit compared to pre-COVID levels and there is a lot of efficiency measures that we are adding on store operations. So you are right, it is around utilities, it is around crew labors, it is around all the key levers of store's profit.

Anand Shah: Does your revenue mix also drive this manpower reduction as in more convenience less of dine-in currently, so is that also driving this sort of reduced manpower?

Pankaj Roongta: Convenience versus dine in it's all about volumes. When the volumes are increasing and the cost is optimizing it leads to high profitability. We are not saying that the change in the channel mix will lead to a lower or higher manpower. Change in channel mix leads to a volume recovery, lead to better profitability because of better efficiencies at the store level.

Amit Jatia: Channel mix will not lead to labor reduction.

Anand Shah: You did indicate that on a net debt basis that Q3 end you have become neutral to positive?

Amit Jatia: What was the question?

Anand Shah: Net debt level in Q3 end it's become neutral to positive now?

Pankaj Roongta: Yes, so net debt has become neutral at the exit of Q3 with the measures of working capital optimization and treasury performance. That's something we could achieve coming from where we entered this year and through where we are existing Quarter 3 and we are hopeful to be at those kind of levels even for Quarter 4.

Anand Shah: Amit would you like to revise your vision '22-23 guidance, margins you are already back to 13%, your gross margin should recover, you have 20% cost reduction. You should be able to achieve the target at the current levels.

Amit Jatia: I won't revise it down and I won't revise it up but we will hopefully beat it if everything goes well because you never know when things go wrong in this difficult world. We don't like to revise it down; we don't like to revise it up but will be delighted if we can beat it. That is how we will stay.

Moderator: The next question is from the line of Nihal Jham from Edelweiss

Nihal Jham: On the recovery part, I think on a yearly basis we have reached an 80% kind of recovery by December at this point. I just wanted to get a sense that to come back to say 100% of last year and may be higher on pre-COVID levels, is it that it's contingent on the multiplexes mainly opening up and the footfalls in malls coming back to normal or would that be the incremental driver as per you?

Amit Jatia: I don't think that there is only one. I will tell you for example in Mumbai, trains are still not running. So our transit stores definitely are not where they need to be, so multiplexes are an important aspect, colleges is the second and the third would be transit. If these three things come back together, we will pretty much be there.

Nihal Jham: Amit you have mentioned that 20% of our stores are drive thru, just a sense that approximately what portion is located in malls?

Amit Jatia: We normally don't even share how many drive-thrus but currently it was convenience so we did but we don't share but I can tell you that we have a very strongly diversified portfolio. As you can see in Mumbai and other market, we have very strong high street presence. We have very good highway presence and we are pretty much present in malls as well. I feel it's a pretty balanced portfolio.

Nihal Jham: Pankaj just on the cost part, you did detail in terms of the various initiatives that you plan to take. If I look at our cost breakup for FY20, if I exclude our marketing and royalty, on an average including the rent we had cost of around 750 crores. Are we saying that structurally we have taken away 150 crores of cost via the various initiatives? Would that be the right number to put approximately for the savings we are targeting?

Pankaj Roongta: Difficult to put a substantiated number because it's a very different year. It's not like-for-like that we can compare this year versus last year, right. But all I can say is that on percentage basis and driven by our cost initiatives, our profitability at a reduced level even for this year will be equal or better than last year and also for going forward for the future years it should be going in a north direction. It is linked to both cost optimization and better efficiency.

Nihal Jham: In the last call you mentioned and this was driven by what even Zomato had said that approximately 25% to 30% of restaurants are currently closed, that was in November but just a sense; currently is it that you think the same number is not operational or that number is significantly reduced it?

Amit Jatia: It's a gut feeling because there are so many unorganized restaurants that it's hard to say. What I am reading and hearing and what I am seeing on the ground, I would put it at about 25% to 30% of restaurants are either not operating at all or sub-optimally there. So that is my take, but it's a rough number.

Moderator: The next question is from the line of Sabyasachi from Centrum Broking Limited.

Sabyasachi Mukerji: I have question regarding your closure. Would we close down around ten stores this quarter? Last quarter also you had closure of nines stores. How many store closures are we looking forward, are we planning any further store closure?

Pankaj Roongta: Sabya none for the Quarter 4 and going forward. This quarter has seen ten and last quarter was nine and this was part of our network optimization exercise more than anything else. Going forward there are no closures that we are seem to do.

Sabyasachi Mukerji: These are closures or relocations?

Amit Jatia: These have been closures but we may re-enter some markets as we get better deals in some of these markets.

Sabyasachi Mukerji: On the store expansion, you opened three stores in Q3. Going ahead do you still stick to that 25 to 30 stores or will we be aggressive going ahead?

Amit Jatia: That's what I said in my outlook that that we intend to get back to the 25 to 30 openings from FY22.

Moderator: The next question is from the line of Mayur from OHM Portfolio.

Mayur Gathani: I just want to continue from the previous gentleman's question. Why are we still looking at only 25-30 stores? Shouldn't you be more optimistic, we have seen through COVID more or less and we are back to pre-COVID levels probably Quarter 4 we will beat it? Why are we still looking at 25 or 30 stores expansion only? Why don't we speed up and do more expansion? We have had competition talking about double the number or more than that.

Amit Jatia: We have been around for 25 years and we have seen the absorption of the market, our philosophy as I have maintained for the last 10 years, since we have been listed that there has to be a sustainable level of growth. We have seen enough brands, competitors who talk of becoming a billion-dollar business and let's say in 2014 if they had 100 stores, in 2018 they had 60. My point is that from our point of view our real estate, diversified portfolio; the deal structure of 20 years, 5-year rent increases, the quality of the real estate is all extremely important to us. Secondly, the absorption in the Indian market with only 12 frequency of eating out even in a city like Mumbai does not justify that and we don't want to stretch our network into sort of a restaurants in the middle of nowhere just to meet numbers. As you heard, when I talked about my comments in the beginning; sustainable growth is what is important and we have learnt with our experience that we have found that at every points in time over a 5-year horizon we are ahead of most of our competitors. Secondly, you got to look at our, we operate in West and South and when you look at us in West and South, like take Mumbai. If Mumbai I have 100 restaurants my closest competitors will have 25 to 30 restaurants and these are competitors and who have been around for a long time. It's a much longer question and it's more a one-on-one that we can separately explain to you our philosophy. Another point is that every single restaurant that we have opened, we do something called a trading area survey and we know precisely in detail when we build a new restaurant as to what the impact on adjusting restaurants and we are able to predict our sales with quiet accuracy and we know the impact of opening in the wrong location as well. Like I said it's a longer conversation and in our view until the per capita income does not change, until GDP growth in India does not change, we feel this is the sustainable level at this point in time. Five stores here and there.

Moderator: The next question is from the line of Manish Poddar from Nippon India Mutual Fund.

Manish Poddar: On the CAPEX part so these new stores which you have opened; is the construct or CAPEX per store relatively different now?

Amit Jatia: The CAPEX per store is the same. Rs. 25-30 million.

Pankaj Roongta: The average CAPEX per store is between 25 to 35 million.

Manish Poddar: This is what we intend to go for the new stores which we will roll out? This is the same number or the size of stores will remain largely similar?

Amit Jatia: Absolutely, we believe so. As I have maintained earlier 2,700 sq ft to 3,000 sq ft and the investment varies from 25 to 35 million depending on EOTF, McCafé and things like that.

Moderator: The next question is from the line of Siddharth Bhattacharya from Anvil Wealth.

Siddharth Bhattacharya: I just wanted to understand how do you measure capacity and capacity utilization at a store level?

Amit Jatia: I have said this before that our kitchens are designed for very large capacity so there could be a restaurant doing 15 crores a year and there could be a restaurant doing 3 crores a year and essentially that does not change the kitchen layout much. In terms of seating its typically like 80 to 100 because of all the channels we have. I talked about kitchen capacity, the same kitchen can do 15 crores and it could do 3 to 4 crores. So we don't think capacity is a constraint as of today. Secondly, in the dine-in areas I have said typically we like 80 to 100 seats and because of all the convenience channels again restaurants with the same size who do 10 to 15 crores versus 3 to 4 crores. So we don't think that there is a definite capacity. Like a store of 1,100 in a food court could also do 12-15 crores average value. So, that is how McDonald's design is.

Siddharth Bhattacharya: Effectively we are nowhere near your peak capacity utilization in most of your stores, right?

Amit Jatia: It depends again, so yes. So, what we do is we keep the debottlenecking and like I said, there are stores we have that do 15 crores and more. And essentially all these cities sometimes there is a balancing equipment like maybe it needs two coffee machines, if the coffee demand is very high. So it is very minor, it's not a big deal.

Siddharth Bhattacharya: My second point is on your raw material sourcing. So some of the benefits that you get from time to time are actually based on the raw material prices and some of them are based on your sourcing capabilities which are longer term in nature. So in terms of your sourcing capabilities what kind of benefits have you witnessed during COVID and going forward, if you can guide in terms of that.

Amit Jatia: In India, we have created a supply chain that is backward integrated to farms and these are all long-term contracts and as Pankaj mentioned earlier many of them are open book and what I mean, what we mean by open book is that we are able to see the entire cost structure and we are able to work with them. So as Pankaj mentioned, we went into the cost structure of the supplier in a lot more detail and not only bring efficiency at our end but we were able to work with the supplier to bring efficiencies there. That is how we got the gross margin to where it is. This process is ongoing while I cannot give you a rupee number or a percentage number but we do expect gains to continue over the next 1 to 2 years.

Moderator: The next question is from the line of Devanshu Bansal from Emkay Global Financial Services.

Devanshu Bansal: I have two questions. Number one, delivery on a YOY basis has recovered to only 90% YOY. So what is leading to a slightly slower recovery in this channel and if you can just highlight what has been the trend through the quarter.

Smita Jatia: I don't think we've mentioned delivery alone anywhere has recovered to only 90%. We've mentioned that our convenience channels and our convenience channels is a culmination of delivery, on the go and drive-thrus and that has grown to 127% of pre-COVID levels. If you take drive-thrus, our drive-thrus have grown 200% YOY. Even our delivery has surpassed YOY growth. So we don't really give break up.

Devanshu Bansal: Actually, I was looking at your presentation itself, where you mentioned the December '20 sales recovered to 110% of pre-COVID levels for delivery and 90% YOY recovery.

Smita Jatia: Its December to December and in that in October-November-December, if I take the full quarter, the convenience channels have grown 127% of pre-COVID levels, which is February. So, I would say delivery has come up pretty much as per our pre-COVID levels. And in fact, if I take all the convenience channels, they have surpassed pre-COVID levels and our whole narrative is that it's not only about delivery, it is about convenience channels and McDonalds has always been a convenience brand and with our drive-thru portfolio, with delivery, all these are all businesses which used to exist even pre-COVID levels. And with COVID these channels all have grown and new channels like on the go have come into play.

Devanshu Bansal: Just lastly, if you could highlight what are the key initiatives that we are taking to increase traction on our own app versus the third party aggregators.

Smita Jatia: See there are a multiple levers which we are using whether it's SCO, SCM, CRM so I can't say any particular one, but there is a healthy growth of our own channels because I think brands which the consumer trusts, these are brands which are being used and whenever the consumer is searching for brands or a burger brand, definitely McDonalds comes on top and as a result we have seen a very healthy growth of our own channels during the COVID time. And Swiggy and Zomato obviously through their own efforts are also growing, which is giving us organic growth on their channels also.

Moderator: Thank you very much, ladies and gentlemen, due to the time constraints. That was the last question for today. I now hand the conference over to Amit Jatia for closing comments.

Amit Jatia: Thank you very much. I really appreciate everybody joining the call today. If you have any more questions, please reach out to Devanshi in Investor Relations. Thank you. Have a good weekend.

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