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Q1 FY23 Earnings Conference Call Transcript
August 3, 2022

Moderator: Ladies and gentlemen, good day and welcome to Devyani International's earnings conference call. Please note, that this conference is being recorded.

I would now like to hand the conference over to Mr. Anoop Poojari from CDR India. Thank you and over to you, sir.

Anoop Poojari: Thank you. Good afternoon everyone and thank you for joining us on Devyani International's Q1 FY23 earnings conference call. We have with us Mr. Ravi Jaipuria, Chairman of the Company; Mr. Raj Gandhi, Non-Executive Director; Mr. Virag Joshi, CEO and Whole-time Director; and Mr. Manish Dawar, CFO and Whole-time Director of the Company. We will initiate the call with opening remarks from the management following which we will have the forum open for a question-and-answer session.

Before we begin, I would like to point out that some statements made in today's call, maybe forward-looking in nature and a detailed statement in this regard is available in the results presentation shared with you earlier.

I would now request Mr. Ravi Jaipuria to make his opening remarks.

Ravi Jaipuria: Good afternoon, everyone. I warmly welcome you all to our earnings conference call to discuss the business performance for the quarter ended June 30, 2022.

We reached an important milestone of 1,000 stores this quarter. It took us 25 years to get to this important landmark. We believe this is just the beginning of our exciting journey and hope to cross many more such milestones in the coming year. The 1000th store that we opened is a Pizza Hut store at a prime location at Sion, Mumbai. With this we continue our efforts to grow the Pizza Hut brand across the country. This opening was also very special for us as we could host nearly 25 especially abled children from a Mumbai based NGO to share our happiness and celebrate an important milestone in the journey of your Company.

On the economic front, we are seeing early signs of recovery in consumer sentiment. Sectors like FMCG and retail are likely to report marginal volume growth over the next few quarters. While input prices have remained elevated, well-established businesses with scale have been able to navigate the same with some pricing initiatives and protect margins, this bodes well for organized players across industries.

We had a strong start to FY23 by way of adding 70 new stores in this quarter, led by 27 stores in KFC, 23 stores in Pizza Hut and 14 stores in Costa Coffee. Our Pan India reach has expanded further, and we are now present in 215 cities. The non-metro store contribution within our Core Brands has gone up to 52% now. Our total system store count stood at 1008 stores as of June 30, 2022.

We ended Q1 FY23 with growth across all our brands. As a result, we witnessed good recovery in overall sales in the quarter with strong traction in the dining channel. This helped us post consolidated revenue of INR 705 crore nearly 2 times the corresponding figure for the last year. KFC contributed INR 425 crore and Pizza Hut contributed INR 165 crore.

We also saw some new product launches from KFC and Pizza Hut. KFC launched the popcorn nachos an innovative blend of tender chicken popcorns served on a bed of crunchy nachos. Pizza Hut launched the flavor fun pizza range just last week. We are excited about this launch since it addresses a significant gap in our portfolio. Our innovation engine remains robust as we continue to expand our business. Notwithstanding the current economic situation, we remain excited about the long-term potential of our brands and the food services sector in India.

Existing urban centers and the upcoming ones are expected to be the consumption hotspots, supported by increasing urbanization of our population and the growth in disposable income. Changing lifestyles should also provide strong tailwind for an increase in the frequency of non-home cooked food consumed by families. The combination of growth in the relevant market and order frequencies gives us the confidence to continue with our expansion momentum. We believe we are well positioned and capitalized to leverage this opportunity.

With this, I would like to conclude my address and now hand over to Manish for his comments. Thank you.

Manish Dawar: Thank you, Mr. Jaipuria. Good evening, everyone. A warm welcome to all of you for your valuable time and presence on our Q1 FY22-23 earnings conference call, our fourth results call since the listing.

Our revenues for the quarter stood at INR 705 crore versus INR 591 crore in the previous quarter, a quarter-on-quarter growth of 19%. On a year-on-year basis revenues have nearly doubled. It is pertinent to note that Q1 FY22 was seriously impacted by COVID wave two and hence not strictly comparable. It is also important to note that the overall quarter 1 revenue surpassed the quarter 3 FY22 revenues which is normally a high season quarter.

On the profitability front, timely price hikes and strict cost management helped us to maintain gross margins at 71.1%, despite multiyear high inflation across the raw materials and packing material basket. Brand contribution has been constrained at 20.5% due to increase in utilities and logistics charges versus 21.2% in the previous quarter. This was offset by a leverage benefit on higher revenues leading to pre-IndAS EBITDA at INR 114 crore during the quarter, the highest in our history with EBITDA margin at 16.1% versus 16.5% in the previous quarter. Reported EBITDA which is post index was INR 164 crore with margins at 23.3% versus INR 62 crore a year ago. Accordingly profit before tax for the quarter stood at INR 77 crore versus a loss a year ago and INR 42 crore in the previous quarter.

Our Core Brands continue to perform well. KFC with 27 new additions reached 391 store count at the end of the quarter. Average Daily Sales grew 127,000 with an SSG of 63.6%. ADS for the quarter for KFC surpassed pre pandemic levels and drove revenues for INR 425 crore. Timely price hikes helped us contain the impact

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of unprecedented increase in input costs, with gross margins coming in at 69%. Brand contribution margin helped by leverage on higher sales improved sequentially to 22.4% from 21.8% in Q4 FY22. With COVID restrictions receding, on-premise consumption has further increased to 65%.

Coming to Pizza Hut, the brand added 23 new source to reach a store count of 436. ADS has also improved sequentially to reach 44,000 with SSSG at 31.5%. On-premise consumption inched higher to 46% for Pizza Hut also. Revenues came in at INR 165 crore with stable gross margins and brand contribution margins at 17.5%.

Costa Coffee added 14 stores to reach a total of 69, revenues grew to INR 18 crore in the quarter, with stable gross margins and brand contribution margin profile. Brand contribution stood at INR 5 crore with a margin at 30.5%. The ADS for the grand improved to INR 36,000 in the current quarter versus INR 30,000 in the previous quarter.

Overall consumption demand is holding reasonably well at present. The full impact of input costs will be fully evident in the current quarter. However, we expect that input prices should stabilize in the coming quarters. With normal monsoon forecasted, we expect better demand and softer raw material prices towards the latter half of the year, which would help in better top line momentum as well as margin for DIL.

On that note, I would like to request the moderator to open the forum for any questions or suggestions that you may have. Thank you very much.

Moderator: Thank you very much. The first question is from the line of Abneesh Roy from Edelweiss.

Abneesh Roy: Congrats on the numbers. I have three questions. So first, is there any seasonality in the KFC business? Could you tell us in terms of average daily sales Q1 to Q2 to Q3, is there a significant difference and if possible, in terms of numbers?

Ravi Jaipuria: Okay. I think the key difference you find is that quarter 3 is always the best quarter because of Christmas, New Year and the holidays coming in. Quarter 4 is also a good quarter because of the holidays just getting over and the winter season. But there are no major seasonal differences.

Manish Dawar: So, Abneesh, let's look at your other part of the question, which is what the ADS in the previous three quarters was. So, quarter 4, if you remember, we were at about 113,000. Quarter 3, it was our best ever quarter until that time was 124,000 and the previous quarter was 116,000. Therefore, from that point of view, we are very encouraged with the numbers in quarter 1. And I think KFC is doing extremely well as far as the consumers are concerned.

Abneesh Roy: Sir, thanks that was very helpful. My second question is on KFC. Did the price hikes have any impact on demand in your view? And have we covered the entire current raw material inflation impact already? I am not asking about the view on RM because that is difficult to give. But based on the current RM scenario, have you already taken the price hikes?

Manish Dawar: Abneesh, as we kind of talked about it in the last quarter call, we have not managed to cover the full input inflation in KFC. However, we are largely covered because, if you remember, we took an almost 9% price hike in KFC and therefore the margins, the gross margins in the current quarter, they are a little diluted versus the previous quarter. But at the same time, we have also seen that the edible oil prices have started to come down. The chicken prices have started to stabilize. We are seeing some bit of inflation on the flour prices currently, but we expect in the next couple of quarters, it should stabilize. So, therefore, in hindsight, I think we took a very balanced view as far as the price hikes was concerned and we are very glad that things are panning out the way we had anticipated.

Abneesh Roy: My last question is on your store expansion mix. So, you plan to have 1000 store over the next four years. I want to understand if the KFC-PH mix be similar and you expect other brands to ramp up over the 4-year timeframe, in terms of the mix?

Manish Dawar: So, Abneesh if you remember we have talked about opening 100 stores for KFC every year. Another 100 stores for Pizza Hut every year and the remainder 40-50 stores will be Costa and some Vaango stores. So, that is what basically constitutes a 1000-store break up that we have talked about earlier. So obviously Costa in the mix is improving. Vaango in the mix is improving, but again, compared to the overall business that we have, these are still relatively smaller brands, and we continue to see their share increase in the mix. You also need to understand that even with 100 stores for KFC and 100 for Pizza Hut, the business is gravitating more towards KFC. The capex per store for KFC is higher than the capex per store for Pizza Hut. The ADS for KFC is almost 2.5 to 3 times the ADS of Pizza Hut. The return on investment is also better for KFC versus Pizza Hut. So, while let us say on our headline number the additions looks similar, KFC as a brand is kind of becoming stronger in the overall portfolio that we have.

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

Vivek Maheshwari: A few questions. First is on the gross margins, Manish. If you look at KFC margins, they are more or less stable but in case of Pizza Hut margins are actually moving up. I know there has been different level of price hikes that you took between KFC and Pizza Hut but just curious that you know, given that you still have some ground to cover in case of Pizza Hut, why go for margin at this stage or is there something that I am missing in this math?

Manish Dawar: No, there is nothing you are missing. It is just that in Pizza Hut, we took the price hike a little ahead of the input inflation. KFC input inflation had started hitting us earlier. For Pizza Hut we were covered as far as the forward contracts were concerned. We took the Pizza Hut pricing much earlier. However, you will now see that in the current quarter, the margins will come back to the normal level. So, it was only just a timing piece, and we got some advantage out of it.

Vivek Maheshwari: Okay. Got it. And any further price hike that you have taken in either of the formats in this quarter, as in June quarter or until now in July.

Manish Dawar: No. Nothing as of now.

Vivek Maheshwari: The other question is on Flavor Fun pizzas that you have launched. So, for a long time you stayed away from the value side of offerings in Pizza Hut, and now you have entered with Flavor Fun pizzas. Right? So, two parts - one is, what gives you the confidence that you should be launching it now or what has changed that you have launched it now? And second is what is your expectation from this important offering given that it is reasonable for the competition?

Manish Dawar: Vivek, as we talked about earlier, our priority as far as Pizza Hut as a brand was concerned was to restructure the brand and to turn it around and then to start growing the brand. And that is what we have done over the last few years. And we've kind of talked at the IPO stage that we closed large format stores. We started replacing the large format with smaller format which worked very well for us, basis that we kind of tested the entire Pizza Hut smaller format at scale, and therefore we opened a lot of stores, and they are doing well. And while all of this was on, there was COVID so we were a little slow as far as the menu innovation was concerned. And now having got full confidence in the business model - the brand has turned around and it's doing well for us, we've introduced this innovation. Fun Flavor pizzas are starting at INR 79. Obviously, we've had this gap in our portfolio; we've tried to address that. It's too early to kind of gauge as to what is happening in the market because it is not even a week. But otherwise in the test market, we've seen some encouraging response, but let's see how it goes.

Vivek Maheshwari: Okay. Sure. And last question Manish, I mean the ADS disparity between KFC and Pizza Hut. So, KFC being ahead of pre pandemic levels whereas Pizza Hut is not, what will it take given that competition is also significantly ahead? And we have discussed this in the past also but any new thoughts? Do you think that Flavor Fun will be a driver for this ADS to move up from this level? Because you are still trailing behind quite a bit on Pizza Hut.

Manish Dawar: So, Vivek if you look at strictly pre pandemic level, and I would not like to just isolate one or two years we used to operate large stores, right? It was a heavily dine-in focused business. We've kind of managed to turn it around and have managed to change the profile of the business to delivery and that is the reason we are gaining momentum from there. We think that Flavor Fun pizza will be able to address that gap and we will be able to attract new consumers, we will be able to attract price conscious consumers, we will be able to attract let us say youngsters, college-going kids, who currently think and perceive Pizza Hut to be more expensive brand. So, this is what we are trying to address through this launch.

Vivek Maheshwari: And just a follow up so, what are the thoughts on let us say, advertising & media spends behind this new launch? Is that going to be an important push from your side?

Virag Joshi: So, we are promoting it through the digital platforms and mass media during this quarter. We will continue the marketing push and see how it pans out across the country.

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

Percy Panthaki: My first question is on the capex. As you are well aware there is a difference in the capex per store for what you do versus the other franchisee. And basically, they say that there is a renovation capex which pushes up the number and it is probably not that the store opening capex is so high. So, I just wanted to understand you are doing about INR 1.25, 1.3 capex per store. Is there any material renovation capex in this number? And if not, is it just that the phasing of the renovation is different for you maybe for them it is coming up now, maybe for you it will come up 2, 4 years down the line? So, any kind of thoughts on that?

Ravi Jaipuria: Well, our capex includes renovation spends as well, I do not know what they are including and what they are not including so I do not want to comment on their costs. But our renovation costs are included in the capex that we are telling you.

Percy Panthaki: So, you will believe that apart from a normal sort of inflation, this INR 1.25 - 1.30 is the number to go with for the next 3 - 4 years, apart from let us say 5% - 7% inflation everywhere in capex?

Ravi Jaipuria: I cannot talk about inflation, but otherwise, yes.

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Percy Panthaki: Okay. Understood. Secondly, just wanted to spend some time on Costa. You have added quite a lot of stores this quarter, 14 stores. That is a fairly decent number. So, just wanted to understand two things: one is what according to you is the market opportunity here? And secondly, how are you positioned in this space versus, let us say a Starbucks and versus McDonald's? Especially in the coffee and beverages space, both in terms of what the brand stands for, as well as in terms of relative pricing to these competitor brands?

Ravi Jaipuria: Well, I think we are competitively positioned as far as Starbucks is concerned and our coffee is loved by everybody in the country. It is just that we were waiting for the final agreements which we closed late last year, and that is why we have started our expansion from this quarter. We see a huge opportunity in the coffee segment, and I think we will scale it up reasonably fast. You may see this in the coming quarters. And the opportunity for coffee is very large - it is huge.

Percy Panthaki: In terms of pricing of like for like products compared to Starbucks and compared to McDonald's, where would your pricing be, just on a relative percentage premium or discount?

Ravi Jaipuria: We are comparable to Starbucks. Our pricing is similar to Starbucks.

Manish Dawar: We will be at about 90% index Percy, to Starbucks.

Percy Panthaki: Okay. Understood. And secondly, for these Flavor Fun pizzas, I understand you have been test-marketing them for a few months now in one or two states. So, in that test market, what kind of percentage increase in ADS did this result in for those stores in which these products were tested?

Ravi Jaipuria: Well, we got a reasonably good response and exact numbers was different in each state, but we got a reasonably good response, and that was without large scale advertising. So, hopefully with the advertising this should give us enough headway in our numbers of consumers coming in.

Percy Panthaki: And one last question, if I may on Vaango. What is the reason that we are not going sort of more aggressive on this just like we are now on Costa Coffee? And is this mainly a food court type of format or is it amenable to other types of formats? I mean, I just wanted to understand, are you still a little unsure about the store economics and therefore you are not going for a much larger rollout or what is the reason that you are not doing that?

Ravi Jaipuria: No. We are quite sure of the product and where it works. So, we are now scaling it up slowly and we are only putting Vaango where we have seen success and where it works for us. But there will be enough stores of Vaango coming in the right location so that we do not have to shut the stores after opening. We are making sure that we have analyzed over the last few years where Vaango is more successful. And that is where we are opening the stores and the speed of opening will be much faster than what we have been doing.

Percy Panthaki: So, this is state wise when you say where it is working, where it is doing well, do you mean state wise?

Ravi Jaipuria: Location wise, I mean if it works in shopping malls or it works in airports or it works in hospitals, where there is a captive consumption, this works very well.

Moderator: The next question is from the line of Tejas Shah from Spark Capital.

Tejas Shah: Couple of questions from my side. First one pertains to ADS. So, on value terms, ADS is actually tracking very well, and we are pre COVID level in KFC and then on Pizza Hut we are showing very good recovery. But in terms of volume of transactions, are we seeing similar recovery and then volume of transactions as well?

Manish Dawar: Tejas, we do not disclose the transactions separately, but we are seeing a good traction on transactions as well. So, they are stable and doing well.

Tejas Shah: Okay. I do not want the number but point to point the gap or the recovery won't be totally price led, it will be volume led as well, that is what that was my question?

Manish Dawar: So, let us say if you look at the current quarter, it is more of pricing. If you look at let us, say the previous quarters, it is more of transactions, every quarter things could be different depending on what the situation is. But overall, we keep a good eye on both transactions as well as the value and we ensure that we can kind of drive forth.

Tejas Shah: Second, pertains to gross margin and we have done a very good job to contain the pressure over here. Just wanted to understand our GM philosophy. Is it a goal seek number, which we actually work with backwards on taking price hike decision? Or other factors like competitive price points and even our ability to make other interventions also come into picture? And along with that, in an inflationary environment, how do you measure net promoter score or competitive value standing when we take such price decision versus the rest of the competition?

Manish Dawar: Sure. So, Tejas, basically the philosophy that we follow on gross margin, is that we need to kind of stabilize. We do not have to exploit the pricing to be able to drive the volumes. At the same time, all of the innovation normally gets introduced at a margin accretive basis. So, that is where the accretion in gross margin comes. Because our basic philosophy, where we come from, is that QSR as a category is highly under penetrated in the country. And if you have to really cover the population and we have to grow the store count and we have to kind of, take the industry to a different level, then we have to be kind of reasonable in terms of our gross margin expectations, and yet ensure that it gives us a good ROI and return on equity for the investors.

Moderator: The next question is from the line of Chirag Shah from CLSA.

Chirag Shah: Congrats on a very good set of numbers. My question is on Pizza Hut. Obviously, over the last few years, there are a lot of things that have worked. But on the point of ADS, I understand that there is a mix change that has happened, and which is why the headline ADS numbers have not changed much. But without giving or sharing numbers with us, can you help us understand that on large format to smaller format stores with the ADS numbers for the 3 or 4 years, what kind of CAGR you would have achieved?

Manish Dawar: Chirag, we don't have like to like data available because over the last, let's say, about 2.5 to 3 years' time, we've changed the format for Pizza Hut very, very dramatically. It used to be large format stores we've converted all of that into smaller format. While we were doing that conversion, COVID hit us and therefore we are not able to measure as to what were the normalized numbers around the COVID time. But having said that, if you look at, let us say, on a per square feet efficiency basis, Pizza Hut is in a far better shape compared to what it used to be earlier. Because on lower ADS numbers, the store formats were much larger whereas with smaller formats, we have managed to kind of improve the topline as well and that is where you are seeing that Pizza Hut as a brand has turned around and become much more efficient versus what it used to be.

Chirag Shah: That really helps. So, on a revenue per square feet basis, what kind of CAGR growth that you would have achieved over the last 3, 4 years or for the last, whatever measure you wany to put in because I think that umber is pretty important and when people look art ADS headline numbers that is where think the confusion sets in, right?

Manish Dawar: Yes. So, let me just work out on a per square foot basis the question that you have, and we can come back to you on that.

Chirag Shah: Sure. And secondly, when I look at the Pizza Hut sales mix, of course the same point around how the mix is changed has also impacted the sales mix and obviously there are other factors as well, but where do you think the sales mix now is trending, now that I think the mix change issue should now be behind us going forward I would assume I mean, you know, incrementally we've not added larger format stores. So, as far as the mix is concerned, how would you look at the sales mix going forward?

Manish Dawar: So, if you look at, let us say our large format, dine-in stores would be roughly about 10% of the total store count. And going forward, I mean, seeing how Pizza hut has turned round, we could open a few larger format stores, but let us say what we used to open earlier would remain only, I would say less than 5% to 10%. And that would be more like a flagship if you are going to new location or something like that. But broadly, we are going to be operating in the same range. So, let us say if we are currently at about 1100, It could well be called 1200 to 1300.

Virag Joshi: Is it to do with channel mix or sales mix, you are asking?

Chirag Shah: Actually, my question was on channel mix, yes.

Virag Joshi: Okay. So, in channel mix we stood at about 55% on our delivery in Pizza Hut in the quarter. And about 45% on dine-in and takeaway. So, that is where it stands today and that is why the format of 1000 to 1100 square feet suits the mix very clearly and we will stick with that format completely.

Chirag Shah: Sure. So, what you are trying to say is that the 55 - 45 would stick here going forward?

Manish Dawar: Chirag, look it is evolving, because right now if you see, people are coming out of pandemic, they are working from home. Obviously, people tend to come out for eating, but we have seen that pizza market longtime back has moved towards home consumption. Even while, let us say, we are coming out of pandemic, the situation is still not fully normal. It could be 5% here and there, but we will be in the same range.

Chirag Shah: Understand. And my last question is on Vaango. You know, from what Mr. Jaipuria said it appears that you know, you are now far more confident on the format than what it was a couple of quarters back. Earlier we were struggling with the fact that while there is a very large opportunity for Indian menu, how the price points can be set, etcetera, but now what you are saying is that the unit economics are right, are established. It is a question of now what format we plan to roll this out, is that understanding correct that you know versus a couple of quarters back the visibility on Vaango rollout is much better?

Ravi Jaipuria: No, the visibility was there at that time also. I think our bigger focus was on KFC and Pizza Hut as we were opening lot of stores. We know where Vaango works and where it is successful. So, we are focusing on that with the expansion and Vaango is giving us good margins. We will be focusing and opening all the new Vaangos in the territories and locations where it works for us. So, we are going to accelerate the growth in this.

Moderator: The next question is from the line of Priyam Khimawat from Ask Investment Managers.

Priyam Khimawat: Good evening, team two questions from my end. Firstly, on Pizza Hut, our brand margins have been on an upward trajectory for the last seven quarters now and it is reached 17.5% in the current quarter. While this has absolutely been in line with what you had stated in your pre-IPO meetings, and I want to congratulate for you for it. I wanted to understand from you, what trajectory can we expect on this going ahead? Considering that we are targeting high single digit SSSG on Pizza Hut and also with these new budget pizza launches, which could improve throughput per store. Should we see further improvement in margins from here on or 17% to 18% margin is what we will be comfortable with currently?

Manish Dawar: Look our aspiration will be to kind of get to the KFC margin, but that is a long haul. As of now I think we have kind of picked all the low hanging fruits and we would like to stabilize at the current level of margins. Having said that, there are some small opportunities which are still available. One is, obviously as I said, all of the innovation comes in at accretive margins but again, innovation contributes a small percentage to begin with. And secondly, the property portfolio is very different compared to what it used to be. So therefore, we have seen that our rent to revenue ratio is better compared to the deals that we used to get earlier which is pre-pandemic. So, these are marginal initiatives. So, therefore you can assume that we will be more or less at the same level.

Priyam Khimawat: Okay. Secondly, just wanted some insights on competitive intensity in the pizza space currently, because with most of the free dollars which were being spent on incubating new brands not being available so easily anymore, are we seeing reduced competitive intensity than say what we have seen four, six quarters back especially from cloud kitchens, like say Ovenstory, etcetera?

Manish Dawar: Look, pizza is a large market, and it is a growing market. So, while let us say the large competitive intensity may not be visible to us, but at the local level, there are a lot of local city-based brands which are there. So, while let us say on a national level, there are very few brands but every large city if you look at would have at least 15 to 20 local pizza brands. These are not so visible, both from Share of Voice and whatever they are doing, but the competitive intensity remains strong.

Priyam Khimawat: Okay. And if I may squeeze one more. When I try and look at our corporate expenses, which is nothing but the difference between our Pre-IndAS brand contribution and EBITDA. It has stabilized at around INR 30 crore per quarter for the last four or five quarters. So, going ahead when we try and double our revenues and store count, will it be safe to assume that this corporate expense line item will grow at a substantially lower rate than revenues and there will be operating leverage playing out here?

Manish Dawar: Yes, you can assume that. So, let us say, you can assume that corporate overhead will grow more or less in line with inflation. At the same time, we are trying to build the organization because we have had some skill gaps as we are kind of growing and expanding but that will have a marginal impact on the overall basis.

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

Jaykumar Doshi: Congrats on a very good set of numbers. Can you share some light on how have you progressed on delivery time? So, I think the market leader recently called out that about 70% of the deliveries are done at an average of 20 minutes. So, what has been the progress for you over the past 2 years in terms of delivery? And what are the conversations you are having with Swiggy and Zomato to improve that further? I am sure they are pushing you to increase take rates that is what we gathered from Zomato's call yesterday, but what is your demand from them, and you know, how should we think about this?

Manish Dawar: Again, we continue to engage with the food aggregator platforms. Obviously, they push us to kind of increase the take rates, we push them to reduce the take rate. The balance always lies in the middle. We are one of the largest business partners for them. And therefore, as of now, we have not seen a huge impact on us. We are where we were. So, let us see how the entire situation pans out. We have our own delivery infrastructure as well as we kind of alluded to earlier. So, from an insurance policy, we are well prepared. I do not see there could be a big issue as far as take rates are concerned. So therefore, that is how we are looking at it.

Jaykumar Doshi: And the second part of question in terms of you know, your delivery timing, how has it improved over the past four to six quarters? What are you averaging today, or what percentage of your orders are delivered in the 30 minute?

Manish Dawar: So, in fact, 70% to 80% of our orders are delivered within 30 minutes, which if you remember, let us say when we talked about the same around the IPO time, it was closer to 35 to 40 minutes. So, we have managed to improve the delivery timelines. Obviously, the competition is doing a great job and therefore we are not in the zone of 20 minutes. But we are kind of following our own trajectory, we have managed to improve from 40 to 30 now. So, therefore, with higher penetration as we are opening the stores, our delivery times automatically are becoming better.

Jaykumar Doshi: 70% of the orders in about 30 minutes or within 30 minutes, is this across the network all India?

Manish Dawar: On an average basis, yes. Because there could be some pockets where the store penetration is still lower. There could be pockets where it is much more efficient depending on where we are catering it, whether we are catering it from our high street store, or a mall store or we are catering to a housing society or multistoried. So, there are multiple things and therefore within the region also it could vary a little bit.

Moderator: The next question is from the line of Vicky Punjabi from UTI Mutual Fund.

Vicky Punjabi: I just had one clarification. If I look at Pizza Hut, one thing that I observed was that if I just take a difference between the gross profit and brand contribution, and basically you know, driving the SG&A overhead on a store per store basis. I am comparing this to 2Q FY22 last year, it is kind of being flattish, I mean, it works out to some something around INR 24 lakhs for 2Q FY22 versus INR 20 lakhs for 1Q FY23. Wanted to understand this, the assumption was that as we move to a complete unlock period, we will see some of the cost, which is the rent and stuff come back, but it seems that there has been no additional cost that has come back in fact, we've actually improved cost on a per store basis. Can you help me understand what really changed here, because in KFC, I think this is not the phenomenon, KFC is quite different where we have seen the cost actually increase and in line what the thought process was?

Manish Dawar: So, Vicky if you remember during the IPO time, we did mention that we have to look at the normalized quarters because we did get the credit as far as the rentals were concerned during wave one and wave two of those quarters and we isolated those quarters. And we focused on the normalized quarters because normalized quarters did not have such credits. And that is how we've kind of managed to build and it has remained the same. And obviously with some leverage coming in, it is kind of helping us. At the same time, I did also say that while let us say the metro areas prime property would always be in demand. But there is some bit of expectation change from the landlords rent also now, because earlier it used to be the highest rental payer will get the property, whereas whatever the landlords have experienced during the COVID times, they've kind of managed to respect the brands much more and we are seeing a little better environment. Non-metro continues to be favorable as far as the rent to revenue ratio is concerned. So therefore, on an overall basis, it is a better property market also that we are seeing so.

Vicky Punjabi: Okay. And just one more question was on again on the sales mix of Pizza Hut. I mean, we have seen off-premise coming off and on premise is increasing. I mean, of course a part of it is because of the unlocking period, but just wanted to understand your thoughts because you know, the thought process was going more to delivery with the larger part of revenues coming out of delivery but out here we are seeing delivery revenue shrink to, I think possibly 60% plus in Q3 FY22 to around 54% now?

Manish Dawar: I thought we have seen some exceptional delivery performance during COVID time because people used to kind of, they were restricted from going out and so forth. So, it's more of a normalization which is kind of in the balancing, which is happening because if you see, prior to COVID, everybody kind of used to come out for work and people used to order at home, whereas now, post COVID, we've seen that a lot of people are still working from home, work from home has become a norm rather than has become a choice rather than a norm. And therefore, to that extent, I mean you need some bit of environment change, you need to have some bit of balance between staying at home and coming out. So, I think that is what is panning out. But we are pretty confident that the overall delivery versus the instore consumption would probably settle at the pre pandemic levels in the next few quarters.

Vicky Punjabi: And what would be expectations of those levels?

Manish Dawar: So, let us say your off premise would be anywhere close to 60% for Pizza Hut, and for KFC, it will be between 35%, 40%.

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

Devanshu Bansal: Congratulations on a strong execution. Sir, you indicated new innovations generally come at a higher gross margin. So, does that apply to our new launch of Flavor Fun as well?

Manish Dawar: No, it does not apply to flavor fun because obviously it is a very, very strategically placed pricing that we have done and therefore it is marginally dilutive. But within Flavor Fun, there are higher priced categories which kind of compensate for the margins which are at a lower price point.

Devanshu Bansal: Okay. So, the operating leverage that you will be gaining to ADS increase that may sort of compensate for some loss in the gross margin, is that right?

Manish Dawar: Yes.

Ravi Jaipuria: Yes, absolutely.

Devanshu Bansal: And secondly, our repair and maintenance expense are sort of relatively higher at about 4% versus Sapphire's is at about 2%. So, do we also expense a part of our maintenance capex in the P&L?

Manish Dawar: Devanshu, we will have to understand what the exact mix and breakup of repairs and maintenance, I will not be able to comment on their numbers. It will not be because of the maintenance capex. Refurbishment capex that we do normally gets capitalized. But otherwise, the repairs and maintenance is not so high.

Virag Joshi: Capex may be little bit higher because of the seasonality of April, May, June, but that should not affect repair & maintenance spends.

Manish Dawar: That'll be electricity.

Virag Joshi: I do not know what's Sapphire is, we do not know about that.

Manish Dawar: Devanshu, we can check this out and come back to you.

Devanshu Bansal: Sure. And you mentioned about some inflation in the capex. So, if you can give me, I missed that number. So, what is the capex inflation that you are seeing currently?

Manish Dawar: Overall, about 8% to 9%. Within that we have seen higher inflation for air conditioning equipment, we have seen higher inflation on imported equipment. But overall would be about 8% to 9%.

Devanshu Bansal: Okay. And lastly, what is the reason for sequential drop in depreciation? So, we added about 70 stores, but depreciation amount has gone up sequentially.

Manish Dawar: Devanshu, there was a small impairment charge that we have taken towards the end of the year. And that is the reason the depreciation was a little higher towards the year end. That is the reason you are seeing a little drop in the current quarter.

Devanshu Bansal: Okay. And the reason for higher other incomes sir, you have reported about INR 9 crore of other income?

Manish Dawar: That is mainly to do with IndAS adjustments.

Moderator: The next question is from the line of Sandeep Bansal from ASK Investment Managers.

Sandeep Bansal: Congratulations on a great set of numbers. Just two questions from my side. Firstly, any thoughts on what could be the potential number of KFC stores that we could be looking at?

Manish Dawar: We are looking at about 100 stores every year.

Sandeep Bansal: Right. But let us say this run rate we expect to continue over the next 3, 5 years, 2 years?

Manish Dawar: If you look at it from a macro perspective, India as a market is under penetrated as far as our category is concerned. There is a mismatch in terms of non-vegetarian offering versus the consumption patterns of the population and so, keeping that in mind we think we can go with 100 for the reasonable future.

Sandeep Bansal: Sure, great. My next question was, if you could highlight some of the key risks or challenges that you are facing in executing your expansion strategy, margin strategy, anything that you can share in you know, on the ground, you know, stuff like commodity costs, food inflation, all that is, we get that, other than that, any specific issues?

Manish Dawar: So, Sandeep, if you see this is a retail business. So, the most important piece is you need to have the right location. And while we've kind of evolved this like a science, and subscribe to multiple databases to ensure that we do not have errors and we do not face problems because of the property locations. But the location risk is something you have to live with. And at times, we are kind of stuck with a situation whereby despite all the efforts, we do have to take a call on closing down the store. So, this is I think one big risk which is there. We have tried to minimize this over time, but it continues to remain an important risk. And otherwise you have the normal input inflation, the commodity prices, the geopolitical situations, I mean, the exchange risk and so on, so forth. So those are kind of normal.

Moderator: The next question is from the line of Shirish Pardeshi from Centrum Broking.

Shirish Pardeshi: My first question is a fundamental question. In your experience when we have launched INR 79 pizza, I am sure you would have factored in some cannibalization. But obviously that will also draw lot of footfall to the store. So, I just wanted to understand in your experience, such interventions, though, as a Company it might be a better thing to do, but what kind of cannibalization you would have expected or maybe you can use any past example?

Manish Dawar: Look, in the past, we have not had this kind of experience. But you are right in saying that there would be cannibalization and we factored that when we planned for this launch. How it pans out, let us see. It is too early. Cannibalization will happen, but as you also said, it is good for the brand, it is good for the Company. It will help us draw in newer consumers. It will help us to kind of draw in younger crowd, which is very important for this category because it is a very young category and that is what we are trying to correct.

Shirish Pardeshi: Manish, I got that, but a little deeper insight, if you can provide. Will it be more than 10%, less than 10%, or would it be 5% or marginal?

Manish Dawar: Look, I think given that the launch is only a week old, we will be in a position to talk about it in detail, maybe in the next call, when we will have some data available, and we can kind of then take it up.

Shirish Pardeshi: Sure. My second question is on Slide 15, where you have given ADS for KFC at 127 and humongous same store sales growth. Just wanted to understand in your experience in any normalized quarter, it is not a correct way to look at because still ITES companies are not working to the full bench. So, in that context, is there a room for growth since you have taken 9% price increase? This 127, directionally will it look up or will it remain at the same level? How should one model your same store sales growth in a normalized period?

Manish Dawar: On KFC, we are looking at about 3% to 4% SSSG numbers on a year-to-year basis. And we do hope that we will be in a position to meet that. Obviously, in the current year because of the input inflation, we have taken a price hike, but you also need to remember that the current quarter SSSG numbers are getting compared to the quarter where we had COVID wave two and that is the reason those numbers are looking a little elevated.

Shirish Pardeshi: I got that. But just touch a little more on ADS. You did not comment on ADS.

Manish Dawar: Yes, because for example, ADS is a blend of our existing stores and the new stores. And obviously the new stores start at a lower level. It takes almost about 15 to 18 months to reach a maturity level for a newer store. Therefore, we need to measure the new store separately and the SSSG numbers for the existing store separately. And that is how you need to kind of build up your model in terms of the existing and the new stores.

Moderator: Ladies and gentlemen, this would be the last question for today, which is from the line of Sanjaya Satapathy from Ampersand.

Sanjaya Satapathy: Sir, my question was the explanation that you gave on other expenses increase, I could not really get that clearly. Can you please clarify again?

Manish Dawar: On other expenses, basically, there are a couple of items, which I kind of talked earlier. We have seen not just the input inflation on the raw material and packing material. We have seen the inflation on the logistics, on utilities and on electricity, which kind of sits as far as the other expenses are concerned. So, that is the reason. At the same time, quarter 1 typically is a very high season summer quarter therefore the air conditioning costs are the highest in this quarter. That also impacts and kind of contributes to the to the other expenses.

Sanjaya Satapathy: My last question is that within KFC, you of course have multiple products and you have been doing a lot of innovation. But the key categories they are seeing are, let us say, Biryani and the other one would be Burger. Do you kind of look at how each sub-categories are doing in terms of growth and within that as we know that Biryani per se is such a big category, how are you really looking at that?

Manish Dawar: Sanjay from a KFC menu mix perspective, our biggest item that we sell is basically chicken on the bone and that is what we are known for. In terms of the other sides or let us say biryani, those are small contributors. Burgers, I would say would be the second biggest contributor after the chicken on the bone and they are growing well.

Sanjaya Satapathy: And that is continuing to be the trend and you are not really seeing much of a change.

Manish Dawar: Yes, absolutely.

Moderator: Thank you. That was the last question for today. I would now like to hand the conference over to the management for closing comments.

Raj Gandhi: Thank you, Mr. Chairman and all the participants, analysts who have been on the call. I do hope that we have managed to respond to your questions satisfactorily. Should you need any further clarifications, or would you like to know more about the Company feel free to contact our Investor Relations team. Thank you once again for your time today to join us on this call and participate in our group chat. Thank you very much.

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