Westlife Development

29 August, 2021

Management Meet Update

Reuters: WEST.BO; Bloomberg: WLDL IN

Should expect better operating performance going forward

We recently hosted the management of Westlife Development (WDL) for an interaction to get an update on the business and the overall operating environment. Key highlights from our discussion are as follows:

Business & demand environment:

- 1QFY22 was quite robust despite operating environment being difficult. All convenience channels saw growth on sequential as well as pre-covid basis. Delivery channel is touching new highs. On-the-Go channel continues to perform well month-on-month (MoM). In July'21, WDL's revenue recovered to ~100% of July'19 levels in all markets (except Maharashtra which continued to be under strict regulatory restrictions).
- While malls remain affected, drive-thru and high street stores have fully recovered.
- Going forward, expanding footprint, accelerating convenience channel and maintaining fiscal discipline remain key priorities for the company.

Store expansion:

- 'Potentialization' exercise is done regularly by the company. It is not that the entire increase of 150-200 stores (from 800-850 to 1,000 stores) is coming from smaller towns, but a huge growth potential exists in these markets. Earlier, *McDonald's* (WDL) was a brand which had 60-70% saliency of metros and the balance was coming from smaller cities. Going ahead, the company may open 40-50% new stores in smaller cities. Average Unit Value/sales per restaurant (AUV) will not decline if the location is right and all channels perform as expected. AUV of a new store is lower in Year 1 but reaches similar levels by Year 2.
- New store openings are focused on drive-thrus and high streets currently. Only once the malls and food courts are back to normalcy, the company will start opening stores in these formats.
- WDL's current store portfolio includes 60-70 *McDonald's* drive-thrus.

McCafé plans:

- Revenue from *McCafé* has been increasing QoQ from FY18 to FY20. The share of McCafé in the overall revenue is increasing and will continue to increase going forward as well. All new stores opened by WDL will be 'Experience of the future' (EOTF) stores and will have *McCafé* as well.
- Coffee is now a very big market in India. As competition increases, the management believes that consumers will have a wider choice. In the long term, players like *McDonald's,* who have been in the industry for a long period of time, will stand to benefit.

Delivery:

- Currently, McDonalds Delivery Service (MDS) hubs are not present in all the stores since the current demand from the addressable geographies are being catered to by existing hubs. The number of hubs can be increased as and when the company deems it to be necessary.
- WDL does not mind doing business with third party operators (3POs) as they believe that both require each other's support. There has been no undue demand for commissions and WDL maintains a healthy relationship with the top aggregators in the Indian market.
- Share of business from the company's own channel (self-channel) has been growing strongly in the last few years and will continue to do so even going forward.
- South Asian markets, including India are not comparable to a mature market like USA, where more than half the business is through drive-thrus and takeaways.

New launches and categories:

- The Spicy Chicken product is seeing tremendous response. Fried chicken (organized and unorganized) is a Rs50bn market in South India, of which WDL is targeting Rs5bn (10% market share) in the next few years. Even West India market looks as a decent opportunity where less non-veg consumption is compensated by higher absolute population. The company is looking to launch the product in West India soon. The company believes that the chicken opportunity can bring in incremental AUV of Rs5mn in the next 2 years.
- Gourmet collection is now available in all the outlets across 6 cities currently. The response has been very good so far. As the restrictions are getting lifted, incremental traction is coming for this range.

Key highlights on the costs going forward:

- Raw material (RM) environment is quite volatile, especially in palm oil and chicken prices, but no major impact on gross margin is expected. The company has not taken any pricing interventions of late. Price action from WDL is never a reactive approach. Every year the company does a meaningful pricing study with a global partner, taking into account factors like inflation, products, overall market, etc. On an average, the company takes a 2-3% price increase annually.
- Due to better liquidity in the market, there is a temporary disruption (competition) in the real estate space. However, WDL hasn't let go of any prominent opportunity. It always tries to keep a view of the next 60-70 stores that should come up and tries to secure those sites accordingly. WDL signs 20-22 years' lease (vs 10-15 years for competition), has variable/hybrid rent structure (as revenues increase even landlords benefit and the fixed component enables favorable leverage for WDL as volumes increase) and also ensures fairness in rents. With real estate expertise, the company is able to secure most sites it wants to be present in. Decline in the rentals for QSR players can't be compared since WDL's presence in mall vs no-mall format is very balanced. Further, negotiation is very different within different formats and regions. Going ahead, rental costs to sales ratio will remain at a similar level or may fall as volume grows over the medium term.
- Absolute ad spends had declined in FY21 due to shift to digital media. The company is focusing more on innovations for customer activations. Going ahead, it will try to maintain ad spends (%) at current levels.
- A large part of savings seen in recent quarters (sourcing, distribution, utilities, operating efficiencies) would sustain going ahead. Tactical savings like rebates or other fixed costs may come back. WDL has entered into a long-term rental arrangement for its head office. Hence, going ahead, as volume increases, the cost structure should optimize.
- In the last fiscal, the number of employees was low since operational hours were less. As operations normalize, the employee base should be back to pre-covid levels.

BUY

Sector: Quick Service Restaurant

CMP: Rs534

Target Price: Rs615

Upside: 15%

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Key Data

Current Shares O/S (mn)	155.6
Mkt Cap (Rsbn/US$bn)	83.2/1.1
52 Wk H / L (Rs)	577/330
Daily Vol. (3M NSE Avg.)	236,219

Price Performance (%)

	1 M	6 M	1 Yr
Westlife Development	(4.6)	6.5	42.6
Nifty Index	6.0	15.0	43.4

Source: Bloomberg

FY21 Annual Report

1QFY22 Investor Presentation

Valuation and View:

In the near term, we believe that the operating performance will improve with better volume. For FY23E, the company has maintained its guidance of achieving 13-15% EBITDA margin (excluding the impact of IND-AS 116). WDL's focus on consistent growth in its sales per restaurant/average unit volume (AUV) through an 'All Day' menu, value platform, brand extensions (McCafé, McDelivery & McBreakfast), continuous menu innovations (Fried chicken, Gourmet burgers, Dips, etc) and sharp focus on customer initiatives make us believe that the company can bounce back faster than peers and eventually achieving a sustainable high single digit SSSG in the medium term. Strong optimization of fixed costs supported margins in FY21. Going forward, in a normalized environment, improvement in gross margin (supported by a better mix) coupled with operating leverage should lead to a sharp improvement in operating margin, signs of which were already visible in 2HFY21 with a leaner cost structure. WDL eventually aims to get back to the previously guided trajectory of operating margin. The company took a pause in store expansion in FY21 to conserve cash and actually closed 14 restaurants on a net basis. While there were no store openings in 1QFY22, the company has 5 stores under ground-break and aims to open 20-25 stores in FY22. FY23 onwards, WDL has recently revised the guidance to 30-40 store additions on an annual basis from 25-30 stores earlier given the higher potential in tier-II cities. At the current market price (CMP), the stock is trading at 33.6x/21.9x FY22E/FY23E EBITDA (post IND-AS 116). Using the DCF-based valuation, we get a revised target price (TP) of Rs615 (Rs600 earlier), implying an EV/EBITDA multiple of ~25.2x on FY23E EBITDA. Maintain Buy.

Exhibit 1: Financial summary (includes impact of IND-AS 116)

Y/E March (Rsmn)	FY19	FY20	FY21	FY22E	FY23E
Net revenues	14,020	15,478	9,860	14,528	19,395
YoY growth (%)	*23.5*	*10.4*	*-36.3*	*47.3*	*33.5*
SSG (%)	17.5	4.0	-33.9	40.3	28.5
EBITDA	1,254	2,199	759	2,463	3,789
EBITDA margin (%)	*8.9*	*14.2*	*7.7*	*17.0*	*19.5*
Recurring PAT	214	93	-1,036	264	1,225
EPS (Rs)	1.4	0.6	-6.7	1.7	7.9
YoY growth (%)	*15.7*	*-56.6*	-	-	*364.7*
RoCE (%)	*6.9*	*11.2*	*-6.6*	*17.8*	*32.9*
RoE (%)	*3.8*	*1.6*	*-19.6*	*5.3*	*21.5*
RoIC (%)	*8.4*	*8.5*	*-6.2*	*6.5*	*15.4*
P/E (x)	388.6	895.7	-	315.8	68.0
P/BV (x)	14.3	14.4	17.3	16.4	13.2
EV/EBITDA (x)	67.2	37.9	109.7	33.6	21.9

Source: Company, Nirmal Bang Institutional Equities Research
Note: We have shifted to post INDAS 116 numbers from 3QFY21

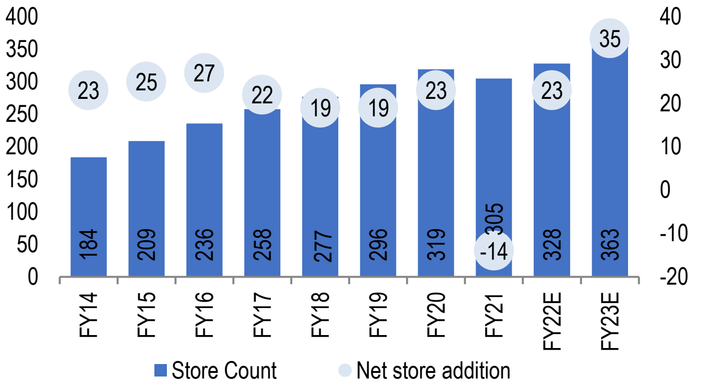
Exhibit 2: Change in our estimates (includes impact of IND-AS 116)

Y/E March	Earlier Estimates		New Estimates		*Change (%)*	
(Rs mn)	**FY22E**	**FY23E**	**FY22E**	**FY23E**	***FY22E***	***FY23E***
Net Sales	14,528	19,395	14,528	19,395	*0.0*	*0.0*
EBITDA	2,528	3,842	2,463	3,789	*-2.6*	*-1.4*
EBITDA margin (%)	*17.4*	*19.8*	*17.0*	*19.5*	*-0.4*	*-0.3*
Net Income	310	1,259	264	1,225	*-14.9*	*-2.7*

Source: Company, Nirmal Bang Institutional Equities Research

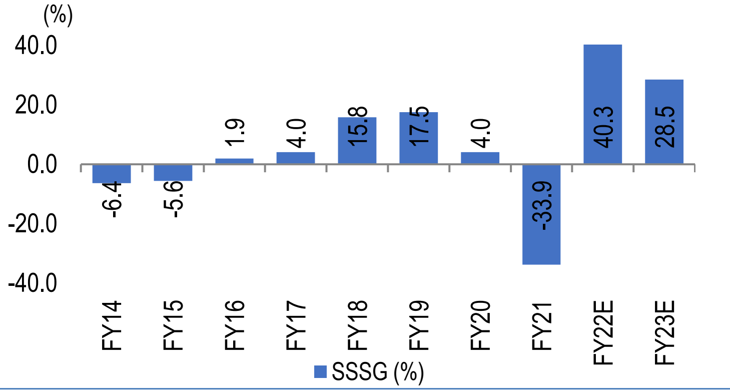
FINANCIAL STORY IN CHARTS

Exhibit 3: WDL has upped its store expansion strategy which will materialize from FY23



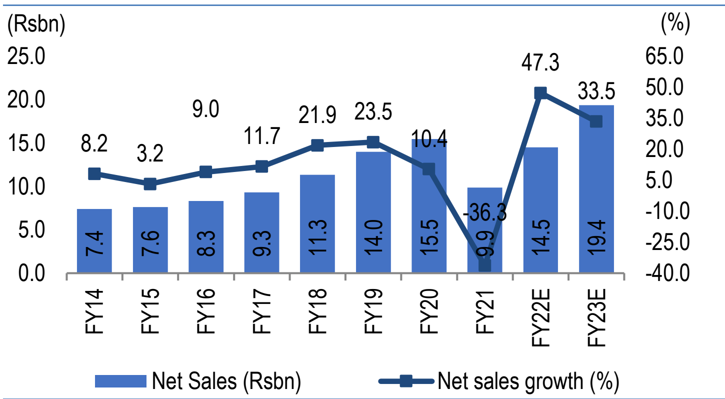
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 4: SSSG will see improvement in FY22 on account of a negative base



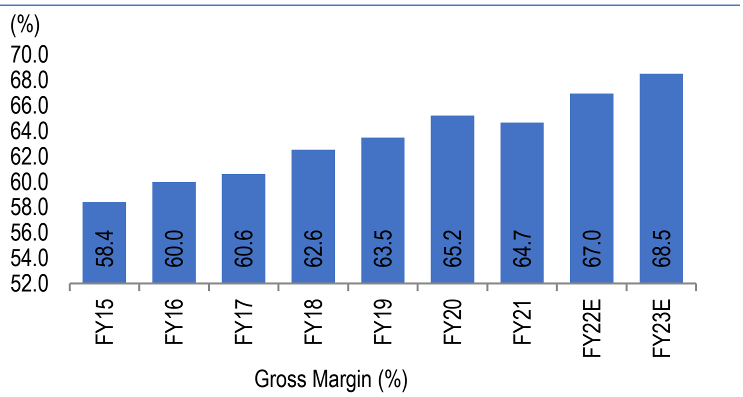
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 5: We build consolidated net revenue growth of 40.2% over FY21-FY23E (~8% over FY20-23E)



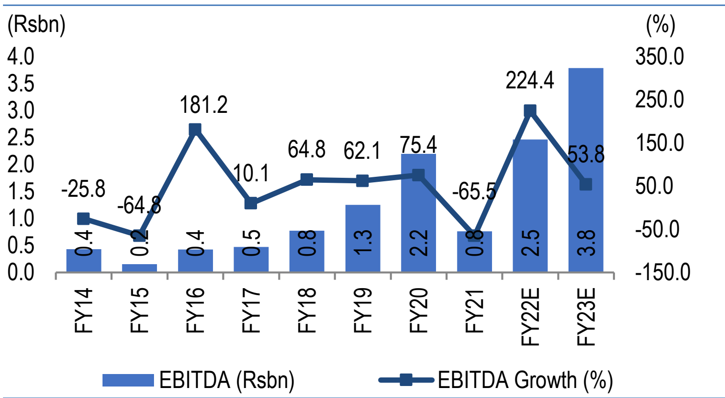
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 6: Gross margin likely to expand by ~380bps YoY over FY21-23E



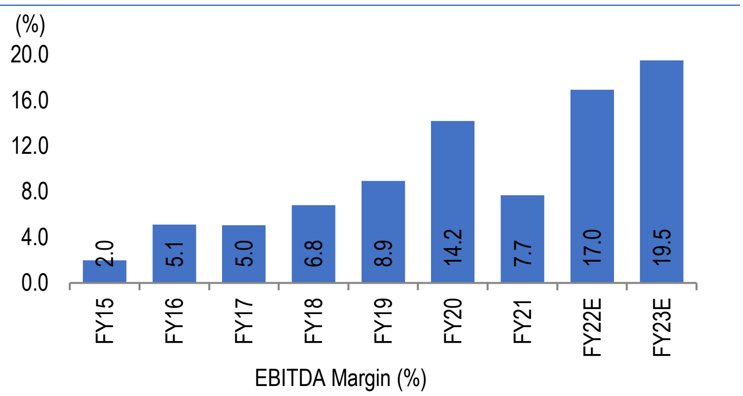
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 7: We build EBITDA growth of 123.4% over FY21-FY23E



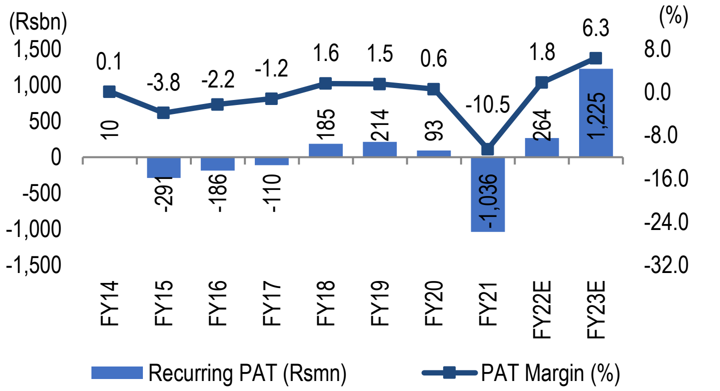
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 8: EBITDA margin likely to expand by ~1180bps YoY over FY21-23E



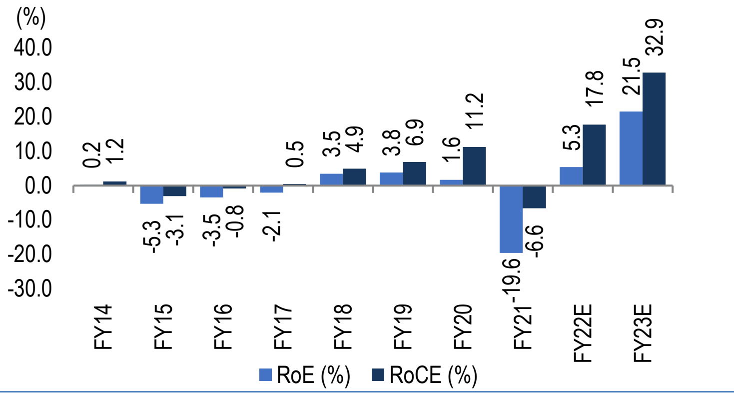
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 9: WDL likley to clock positive adjusted PAT & margin FY22E onwards



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 10: Return ratios to substantially improve going ahead



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 11: DCF valuation (includes IND-AS 116 impact)

Particulars (Rsmn)	FY21	FY22E	FY23E	FY24E	FY25E	FY26E	FY27E	FY28E	FY29E	FY30E	FY31E	FY32E
Profit/(loss) before Tax	-1,287	352	1,637	2,061	2,608	3,215	3,003	3,652	4,280	4,920	5,650	6,418
Depreciation	1,537	1,682	1,822	1,981	2,144	2,307	2,453	2,585	2,718	2,851	2,986	3,116
Net interest	845	890	840	836	838	841	843	846	849	851	854	857
Others	-294	-461	-511	-316	-333	-306	-398	-537	-625	-812	-1,044	-1,301
Direct Taxes Paid	293	-89	-412	-519	-657	-809	-756	-919	-1,077	-1,238	-1,422	-1,615
Change in WC	444	146	-84	219	32	312	100	326	159	365	195	394
Cash flow from Operations	**1,538**	**2,521**	**3,293**	**4,262**	**4,634**	**5,559**	**5,245**	**5,953**	**6,302**	**6,937**	**7,219**	**7,868**
Less: Capex	-813	-1,204	-2,283	-2,322	-2,268	-2,266	-1,866	-1,876	-1,894	-1,916	-1,943	-1,795
Free cash flow	**725**	**1,317**	**1,009**	**1,940**	**2,366**	**3,293**	**3,379**	**4,076**	**4,408**	**5,020**	**5,276**	**6,073**
Discounting Period		0	1	2	3	4	5	6	7	8	9	10
Discounting Factor		1.00	0.92	0.84	0.77	0.70	0.65	0.59	0.54	0.50	0.45	0.42
PV of Free cash flow		**1,317**	**925**	**1,629**	**1,819**	**2,321**	**2,181**	**2,411**	**2,389**	**2,493**	**2,400**	**2,531**

DCF Valuation	Rsmn
PV of explicit cash flows	22,408
PV of terminal cash flows	73,235
Total Enterprise value	95,642
Net debt / (cash)	57
Equity value	95,585
No. of o/s shares	156
Value per share (Rs)	**615**
CMP (Rs)	534
Upside (%)	**15.1**

Cost of equity (%)	11.2
Cost of debt (%)	4.6
WACC (%)	**9.1**
Terminal growth rate (%)	**5.5**

Implied multiple (FY23E)	x
EV/EBITDA	25.2
EV/Sales	4.9
P/E	78.2
P/CEPS	31.4

FV sensitivity to change in WACC and terminal growth rate

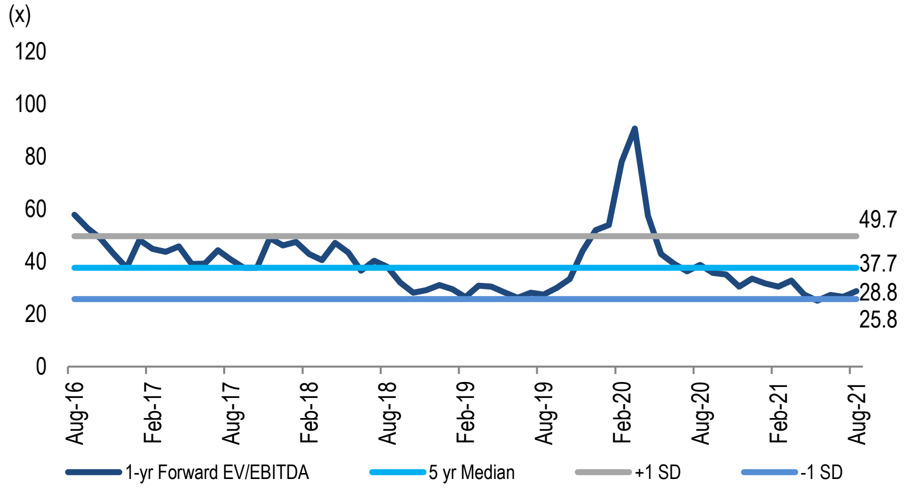
%		Terminal Growth Rate						
		5.2	5.3	5.4	5.5	5.6	5.7	5.8
WACC	8.5	689	706	724	743	763	784	808
	8.7	648	662	678	694	712	730	750
	8.9	611	624	637	651	667	683	700
	9.1	578	589	601	**613**	627	641	656
	9.3	548	558	568	579	591	603	616
	9.5	521	530	539	549	559	570	582
	9.7	496	504	512	521	530	540	550

Upside/downside

%		Terminal Growth Rate						
		5.2	5.3	5.4	5.5	5.6	5.7	5.8
WACC	8.5	29.0	32.1	35.4	39.0	42.8	46.8	51.1
	8.7	21.3	24.0	26.9	29.9	33.2	36.7	40.4
	8.9	14.3	16.7	19.3	21.9	24.8	27.8	31.0
	9.1	8.1	10.2	12.5	**14.8**	17.3	19.9	22.7
	9.3	2.5	4.4	6.4	8.5	10.6	12.9	15.4
	9.5	-2.6	-0.9	0.9	2.7	4.7	6.7	8.8
	9.7	-7.2	-5.7	-4.1	-2.5	-0.7	1.1	3.0

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 12: 1-year forward EV/EBITDA



Source: Company, Nirmal Bang Institutional Equities Research

Financials (Consolidated; Includes impact of IND-AS 116)

Exhibit 13: Income statement

Y/E March (Rsmn)	FY19	FY20	FY21	FY22E	FY23E
Net sales	**14,020**	**15,478**	**9,860**	**14,528**	**19,395**
% Growth	***23.5***	***10.4***	***-36.3***	***47.3***	***33.5***
SSG %	***17.5***	***4.0***	***-33.9***	***40.3***	***28.5***
COGS	5,116	5,382	3,483	4,799	6,105
Staff costs	1,975	2,192	1,782	1,959	2,325
Other expenses	5,676	5,704	3,836	5,307	7,176
Total expenses	12,767	13,279	9,101	12,065	15,606
EBITDA	**1,254**	**2,199**	**759**	**2,463**	**3,789**
% growth	***62.1***	***75.4***	***-65.5***	***224.4***	***53.8***
EBITDA margin (%)	***8.9***	***14.2***	***7.7***	***17.0***	***19.5***
Other income	73	71	294	461	511
Interest costs	177	808	845	890	840
Depreciation	797	1,384	1,537	1,682	1,822
PBT (before exceptional items)	353	79	-1,329	352	1,637
Exceptional items	0	-166	42	0	0
Tax	139	-14	-293	89	412
PAT (before exceptional items)	**214**	**93**	**-1,036**	**264**	**1,225**
PAT	**214**	**-73**	**-994**	**264**	**1,225**
PAT margin (%)	***1.5***	***0.6***	***-10.5***	***1.8***	***6.3***
% Growth	***15.7***	***(56.6)***	***NA***	***NA***	***364.7***

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 14: Cash flow

Y/E March (Rsmn)	FY19	FY20	FY21	FY22E	FY23E
PAT	214	93	-1,036	264	1,225
Depreciation	797	1,384	1,537	1,682	1,822
Other income	-73	-71	-294	-461	-511
(Inc.)/dec. in working capital	-79	108	444	146	-84
Cash flow from operations	**858**	**1,513**	**651**	**1,631**	**2,452**
Capital expenditure (-)	-1,364	-10,071	-813	-1,204	-2,283
Net cash after capex	**-506**	**-8,558**	**-162**	**427**	**169**
Inc./(dec.) in invest. & other ass.	-290	856	-48	363	350
Cash from invest. activities	**-1,654**	**-9,215**	**-861**	**-841**	**-1,934**
Dividends paid (-)	504	-502	315	-200	-200
Inc./(dec.) in total borrowings	13	7,677	-586	591	81
Cash from financial activities	**517**	**7,175**	**-271**	**391**	**-119**
Others	261	458	308	-706	-624
Opening cash balance	109	92	30	110	317
Closing cash balance	92	30	110	317	101
Change in cash balance	-17	-69	-174	475	-224

Source: Company, Nirmal Bang Institutional Equities Research
** Capex includes change in right of use assets*

Exhibit 15: Balance sheet

Y/E March (Rsmn)	FY19	FY20	FY21	FY22E	FY23E
Share capital	311	311	312	312	312
Reserves	5,519	5,459	4,501	4,764	5,989
Net worth	5,830	5,770	4,812	5,076	6,301
Total debt	2,339	1,837	2,152	1,952	1,752
Other long-term liabilities	31	7,922	7,632	7,713	7,794
Deferred tax liability	0	-214	-510	0	0
Total liabilities	**8,201**	**15,316**	**14,086**	**14,740**	**15,847**
Gross block	10,753	12,542	13,596	14,786	16,139
Depreciation	5,727	7,110	8,647	9,641	10,742
Net block	5,026	5,431	4,949	5,146	5,397
Right of use assets	0	7,714	7,008	7,312	8,068
CWIP & Intangibles	1,210	1,161	1,141	1,137	1,207
Investments	2,024	1,576	1,984	2,004	2,104
Inventories	410	411	465	534	537
Debtors	98	47	88	103	141
Cash	92	30	110	317	101
Loans & advances	1,278	865	904	975	1,035
Other current assets	105	181	75	83	84
Total current assets	1,982	1,535	1,643	2,012	1,897
Creditors	1,178	1,280	1,851	2,041	1,940
Other current liabilities & provisions	864	822	789	829	887
Total current liabilities	2,042	2,101	2,640	2,870	2,827
Total assets	**8,201**	**15,316**	**14,086**	**14,740**	**15,847**

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 16: Key ratios

Y/E March	FY19	FY20	FY21	FY22E	FY23E
Per share (Rs)					
EPS	1.4	0.6	(6.7)	1.7	7.9
Book value	37.5	37.1	30.9	32.6	40.4
Valuation (x)					
P/Sales	5.9	5.4	8.4	5.7	4.3
EV/sales	6.0	5.4	8.4	5.7	4.3
EV/EBITDA	67.2	37.9	109.7	33.6	21.9
P/E	388.6	895.7	(80.3)	315.8	68.0
P/BV	14.3	14.4	17.3	16.4	13.2
Return ratios (%)					
RoCE	6.9	11.2	(6.6)	17.8	32.9
RoE	3.8	1.6	(19.6)	5.3	21.5
RoIC	8.4	8.5	(6.2)	6.5	15.4
Profitability ratios (%)					
Gross margin	63.5	65.2	64.7	67.0	68.5
EBITDA margin	8.9	14.2	7.7	17.0	19.5
EBIT margin	3.3	5.3	(7.9)	5.4	10.1
PAT margin	1.5	0.6	(10.5)	1.8	6.3
Liquidity ratios (%)					
Current ratio	0.4	0.6	0.7	0.7	0.7
Quick ratio	0.3	0.5	0.6	0.6	0.6
Solvency ratio (%)					
Debt-to-equity ratio	0.4	0.3	0.4	0.4	0.3
Turnover ratios					
Total asset turnover ratio (x)	1.7	2.1	1.5	2.1	2.4
Fixed asset turnover ratio (x)	2.8	2.8	2.0	2.8	3.6
Inventory days	26.6	27.8	45.9	38.0	32.0
Debtor days	2.1	1.7	2.5	2.4	2.3
Creditor days	80.7	83.3	164.0	148.0	119.0

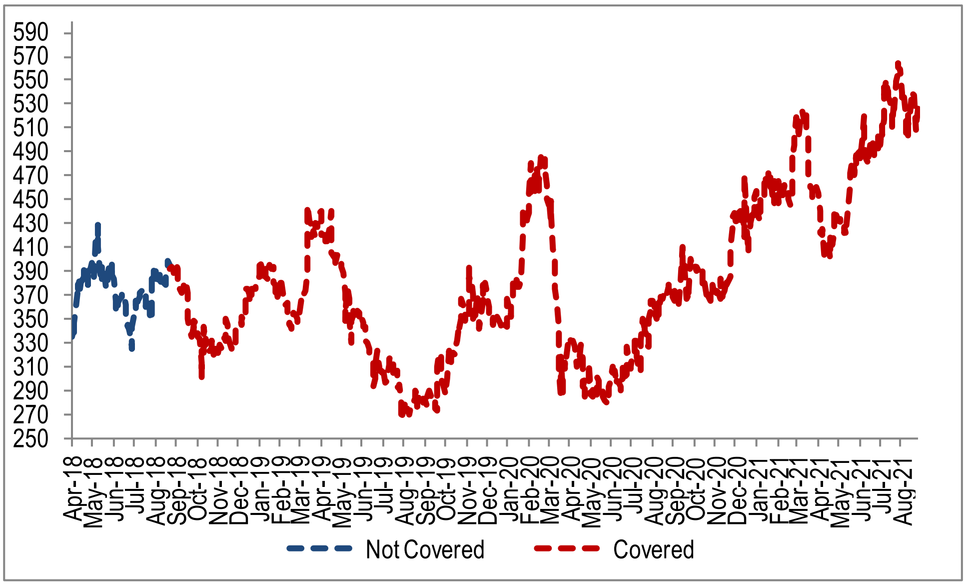
Source: Company, Nirmal Bang Institutional Equities Research

Rating track

Date	Rating	Market price (Rs)	Target price (Rs)
6 May 2015	Buy	296	403
11 May 2015	Buy	293	403
5 June 2015	Buy	280	403
10 August 2015	Buy	295	356
9 November 2015	Buy	238	335
8 February 2016	Buy	222	280
9 May 2016	Buy	202	282
9 June 2016	Accumulate	237	246
8 August 2016	Accumulate	214	219
24 August 2018	Buy	395	485
29 October 2018	Buy	320	420
4 February 2019	Buy	380	440
4 April 2019	Buy	420	490
15 May 2019	Buy	349	450
26 July 2019	Buy	291	370
25 Oct 2019*	Buy	347	425
01 Nov 2019	Buy	350	425
24 Jan 2020	Buy	421	485
20 April 2020	Buy	326	375
13 June 2020	Buy	297	350
31 July 2020	Accumulate	354	360
23 September 2020	Accumulate	366	410
9 November 2020	Accumulate	372	410
8 January 2021	Accumulate	445	485
22 January 2021	Accumulate	452	495
9 April 2021	Accumulate	420	480
14 May 2021	Buy	420	490
7 June 2021	Buy	485	560
14 August 2021	Buy	512	600
29 August 2021	Buy	534	615

Coverage transferred to Vishal Punmiya w.e.f. 19th August 2019

Rating track graph



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Stock Ratings Absolute Returns

BUY > 15%

ACCUMULATE -5% to15%

SELL < -5%

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