

CHICKEN WINS

McDonald's broke with the past and stepped into KFC territory. Investors are lovin' it

McDonald's franchisee Westlife Foodworld's shares shot up 40% in 2022, far outperforming every peer. The addition of fried chicken to its menu is partly why

Seetharaman G, 6 Jan 2023

In 2022, shares of Westlife Foodworld saw their biggest spike in five years, with the company now worth \$1.4 billion

A key factor is the launch of fried chicken in the southern states in 2020, with the product now bringing in 10% of store sales

Also crucial have been the expansion of high-margin McCafe to four in five McDonald's outlets, and the increased share of delivery

Mutual funds have upped their stake in Westlife to close 20% from just over 11% in March 2020, but the stock remains relatively illiquid



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The year 2022 was sombre—even stormy in parts—for India's stock market. The Nifty 50, a key index, rose a mere 4%, following a 24% surge in 2021. But Westlife Foodworld Ltd couldn't have asked for a better year. The McDonald's India franchisee's shares shot up by 40% in 2022, far outperforming those of every other fast-food-chain operator.

It was Westlife's best year on the bourses since 2017, with its market capitalisation now at Rs 12,000 crore (~\$1.4 billion).

For years, rival Jubilant FoodWorks Ltd, which runs Domino's Pizza in India, was the go-to fast-food company for public market investors. But

India, was the go-to fast-food company for public-market investors. But that changed in 2022 when Jubilant's shares tanked by almost 30%, and Westlife became an investor favourite, even beating the two franchisees of Pizza Hut and KFC—Devyani International Ltd and Sapphire Foods India Ltd—that listed in 2021.

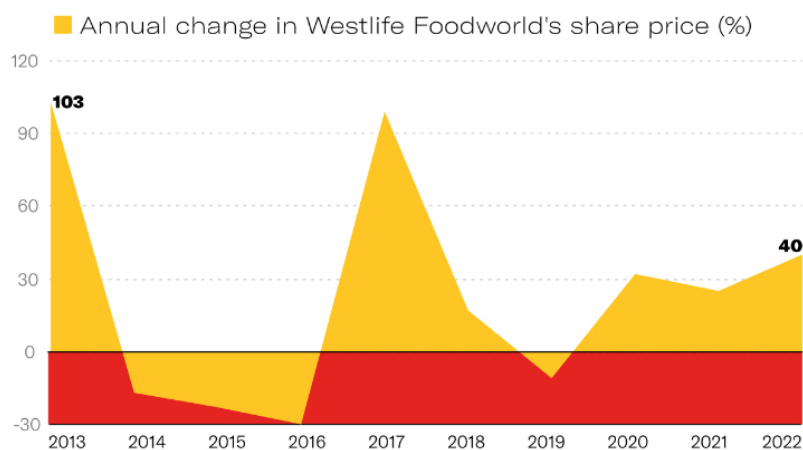
This rally is a result of multiple shifts in Westlife's business in recent years. First, its decision to expand its coffee-house-style kiosk McCafe to more than four in every five McDonald's stores from just one in every three in 2016. This is significant because McCafe beverages enjoy gross margins of over 80%, according to Preeyam Tolia, an analyst at brokerage Axis Securities Ltd. On the other hand, burgers—McDonald's mainstay—offer 60-70% gross margins depending on their prices.

Then, there were the fortuitous gains brought on by the pandemic. Unlike pizzas, burgers were not considered delivery-friendly. But that changed with the Covid-19-induced lockdowns. "Delivery was maybe 15% of their revenue three years ago. They wouldn't have thought it would go up to 35%," says a second analyst with a domestic brokerage. They and a few others *The Ken* spoke with for this story did not want to be named as they're not authorised to speak to the media.

The most fascinating, and perhaps even the most consequential in the long term, among the factors driving the rally was the addition of one item to the McDonald's menu—fried chicken. But it's not just fast food; it's a category in its own right in a country where chicken is the meat of choice.

Annus mirabilis

In 2022, Westlife investors saw their best returns in five years



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Graphic by Aishwarya V, 5 Jan '23

Source: Prime Database

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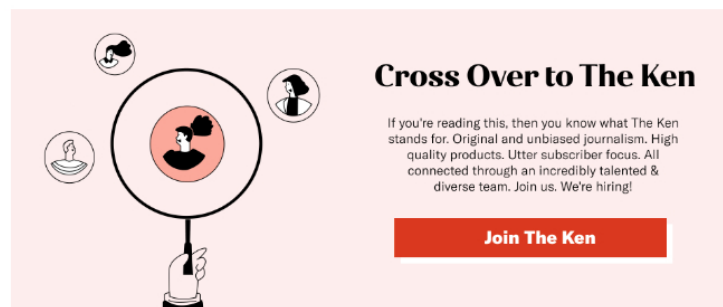
Westlife rolled out McSpicy Fried Chicken in the southern states in May 2020 and the diversification has since become a key point of discussion

2020, and the diversification has since become a key point of discussion during the company's quarterly earnings calls. While the food is now served in all the ~135 McDonald's stores in the south, it's still being trialled in five stores in the more vegetarian-friendly west, where Westlife runs over 200 stores. (A different franchisee has the rights to McDonald's in the north and east.)

Fried chicken brings in Rs 50-60 lakh (~\$60,390-72,500) in revenue per store per year, according to Tolia. And Westlife expects it to touch Rs 1 crore (~\$121,000), though it hasn't specified a timeline for the same. For context, Westlife's current annual per-store sales are Rs 6.3 crore (~\$762,760), which would mean fried chicken accounts for almost one-tenth of McDonald's sales in the south. Westlife's revenue in the year ended March 2022 was Rs 1,580 crore (~\$190 million).

In September, Smita Jatia, managing director of Westlife, said the company wanted to become the market leader in fried chicken, taking aim at KFC that's occupying the position right now. But KFC sees no reason to worry yet. "It works only when, say, three people want to have a burger and the fourth one wants to have fried chicken. They can then go to McDonald's," says a senior executive at KFC. "If your core is not chicken, then it's hard to compete."

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Fried and tested

Chicken, especially fried chicken, is one of the most sought-after segments of India's fast-food market. And Westlife is not the only one keen to take a big bite of it. In 2022, Jubilant brought the American fried-chicken chain Popeyes to India. That same year, Wow! Momo Foods, backed by the investment firm Tiger Global, launched its new chain Wow! Chicken.

There's good reason for all of them to gun for the same region. In all the southern states but Karnataka, over 90% of the population eats meat, according to a national government survey conducted in 2019-20. And even in Karnataka, the figure is close to 80%, while the national average is only 70%. Combine this with the relatively high incomes, and you get the country's largest catchment for fried-chicken chains.

South's up

Westlife's store addition will be biased towards the southern states, which are big on chicken



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So, Jubilant chose Karnataka's capital Bengaluru for its first eight Popeyes outlets. And 80% of Wow! Chicken's 37 stores are in the south and east, the second-largest market for fried chicken.

No wonder, then, Westlife preceded them by opting only for one of its two regions for the launch of fried chicken. The west is far more vegetarian than the south. For instance, less than 40% of the residents of the western Indian state of Gujarat consume meat.

Amit Jatia, vice chairman of Westlife, was not available for an interview, and questions sent to the company went unanswered.

Despite the geographical disadvantages, fried chicken is an attractive bet. It's a Rs 5,000-crore (\$604 million) market in the south alone, according to Westlife. And the product enjoys gross margins of 70% or so—nearly 10 percentage points higher than those of value burgers. “And it was only KFC ruling the market,” says Sagar Daryani, co-founder and chief executive of Wow! Momo Foods. Until the new players entered the picture, KFC's competition came solely from the unorganised sector, including many copycats with similar names.

But if the opportunity was so obvious, why did McDonald's wait so long to add fried chicken to its menu? Especially since the product has already been introduced in other parts of the world, including Asian markets like Indonesia and Malaysia.

“You've got to do the right thing at the right time. And the menu and

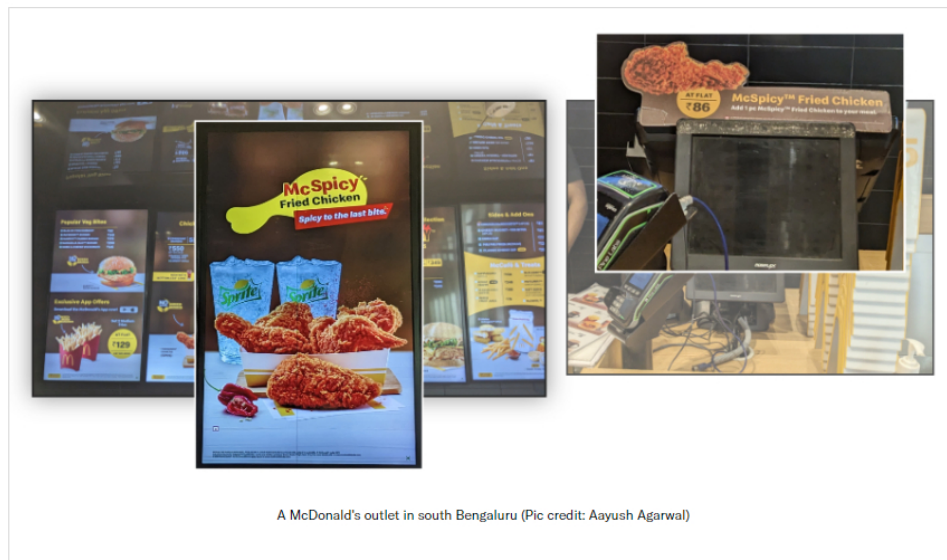
business evolve every day,” Amit Jatia, vice chairman of Westlife, said during an earnings call in August 2021. “You can’t put all the 1,000 products in one shot because consumers also get confused.”

While this may not be a compelling argument, it’s in line with McDonald’s track record in India. The chain launched Chicken McNuggets—a popular constant on McDonald’s menus around the world, in India only in 2009—a whole 13 years after it had opened its first outlet in the country.

But American fast-food chain Burger King’s entry into India, in 2014, may have set McDonald’s on the path to rethink its menu. “McDonald’s surrendered the premium segment to Burger King. They couldn’t compete with Burger King’s Whopper burger,” says the second analyst quoted earlier.

On top of that, Burger King offered more options on its menu, says Daryani. “It wasn’t just fries and Coke.”

If gourmet burgers—costing twice as much as their low-end variants—were one answer to the problem, fried chicken was another.



From sides to mains

Even if McDonald’s has a winner on its hands with fried chicken, there is one question that still remains: can this product drive footfall?

“KFC’s Zinger Burger was supposed to be an add-on. But now people go there just for that,” says Daryani. Fried chicken, not surprisingly, forms the lion’s share of KFC’s revenue—more than two-thirds, according to the global brokerage Jefferies—but burgers account for one-fifth.

Westlife is probably rooting for fried chicken to emulate the success for McDonald’s. If one visits a McDonald’s outlet in a mall in south Bengaluru, the promotions for fried chicken will be hard to miss. Right above the billing screen is an offer to add a piece of fried chicken to a meal at Rs 86 (~\$1).

Additions like fried chicken and other chicken-dish variants in its menu over the past five years have lifted the average daily sales of Westlife's southern stores 1.8X from 2016, compared to 1.5X in its western outlets.

Even if fried chicken becomes a big draw at McDonald's, a customer accustomed to it in Bengaluru or Chennai may not necessarily find it in Pune or Ahmedabad. During an earnings call in November, Saurabh Kalra, chief operating officer of Westlife, said that unless fried chicken is a big driver for customers, "it is not worth our while to add complication to operations in the west."

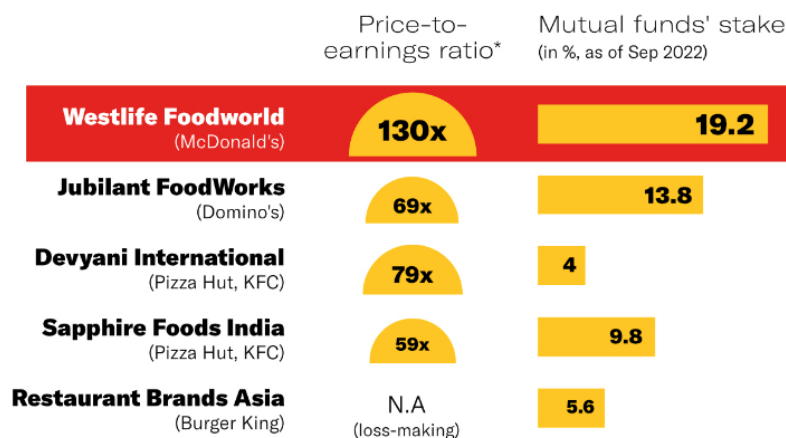
It's not just the western region; even stores in the north and east—run by a different, unlisted franchisee—don't serve fried chicken. "We see good potential in the fried-chicken segment and are keeping a close watch. We will enter at the right, opportune time when we are ready with a compelling offering in terms of food, taste, and value," says Rajeev Ranjan, MD of McDonald's – North and East.

McDonald's as a brand has struggled in these two regions owing to a long-drawn-out spat with its erstwhile franchisee, with which it ended its joint venture in 2019. As a result, McDonald's only has 160 stores in the north and east, less than half as many in the other two regions.

But this has little bearing on investors waiting to see if their bet on Westlife pays off.

Pricey and popular

Westlife is the most expensive of fast-food stocks, but it's also mutual funds' top choice



*Based on profits for the last 12 months

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Graphic by Aishwarya V, 5 Jan '23

Source: BSE, Value Research

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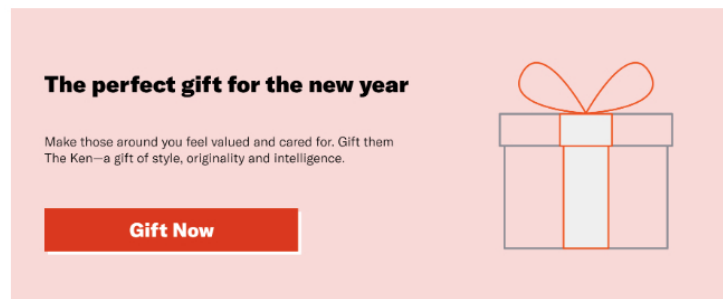
Small servings

Westlife's rally in 2022 certainly had a lot to do with, among other things, the rise of McCafe; the potential in fried chicken; and the company's commitment to open 40-55 new outlets every year until 2027—2X the addition in the past decade.

But Westlife shares likely had help on another front: there aren't too many of them up for grabs. Which, in the face of strong demand, drives up the price. In December, the average daily volume of Westlife shares traded—relative to the total number of shares available for trading—was 25% less than Jubilant's.

This is not because the promoters own a substantial portion of Westlife, for they hardly do. Of the 75% they are allowed to have in the company, they hold only 56%. Moreover, mutual funds own nearly 20% of Westlife, compared to over 11% at the start of the pandemic—a clear sign of growing appetite for the stock.


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But these investors must keep at it to build a decent position in companies like Westlife. “Buying an illiquid stock is a painful process. You have to buy them over a long period,” says a senior executive at a mutual-fund house that is among the largest investors in Westlife. Partly because of the prospects in India's fast-food market and partly because of the difficulty in owning a sizeable chunk of Westlife, institutional investors are not quick to sell the stock, which causes the shortage of shares.

Westlife is trading at almost 130X its previous year's profits, compared to Jubilant's ~70X. The gulf is also thanks to Jubilant's troubles in 2022, including the exit of its then-CEO Pratik Pota in March. And while in the pre-pandemic era, Domino's was the only fast-food chain with a significant delivery share in revenue, now most other brands have scaled up delivery, says Nihal Jham, an analyst at brokerage Edelweiss Financial Services. “This is due to their own initiatives post-COVID and the expansion of Zomato and Swiggy.”

There's also the fact that investors looking for a piece of the fast-food pie had to choose between Jubilant and Westlife. But since December 2020, in addition to the two Pizza Hut and KFC franchisees, the local operator of Burger King has gone public.

According to data platform Trendlyne, of the 16 analysts tracking Westlife, 15 have a 'buy' recommendation and one has a 'hold' rating. And

of the 30 analyst recommendations on Jubilant, 19 are 'buy', seven 'hold' and four 'sell'.

But given the premium the investors are paying for Westlife, a lot depends on whether its growth recipe is in line with its 2027 targets. And how many takers McSpicy Fried Chicken finds is a crucial ingredient in that.

Devyani International

Fast food

Fried chicken

Jubilant FoodWorks

KFC

mcdonald's

qsr

Sapphire Foods

Westlife Foodworld

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Starting out as a business journalist in 2008, Seetharaman has written about energy, climate change, retail, banking, and technology. He has worked with Business Today, a fortnightly, and the Sunday edition of The Economic Times.

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