

Changing consumer lifestyles and growing wealth are driving healthy gains in the consumer foodservices industry

International Trends

A culture of eating out has emerged strongly in developed nations, with developed countries such as the United States (US) and the United Kingdom (UK) having shown an escalating affinity for eating out in recent years.

Table 1: Growth in UK Eating Out and Drinking Expenditure (1982 – 2007)

	Eating Out	Drinking	Total
Nominal	9.0%	5.0%	6.9%
Real	3.8%	0.0%	1.8%

Source: www.mbplc.com, ONS

Today, over 30% of food spend in the UK is out of home compared with 20% 15 years ago. In the US it currently exceeds 50%, having risen from 39% in 1977¹.

Consumer spending in the UK foodservice industry totalled almost £13 billion in 2007². According to market researcher Datamonitor, Britons continue to dine out more, buying an average of 633 meals outside the home a year, and spending an average £1 224 per head. Some market commentators in the UK believe that by 2050, half of all household food spending will be eating out³. The combined value of foodservice in Europe and the US is forecast to exceed \$700 billion by 2009⁴. The eating out phenomenon has evolved from being a luxury spend item to one of ever increasing necessity. Within the global context,

the eating out culture has been characterised by being less planned, leading to more irregular eating times and reinforcing the trend for more quick snacking or quick and easy meals. A few structural changes have led to the persistence of this trend: the fact that more women work; and the existence of more single households. Simply put, the consumer is time impoverished. The demand for healthy products and changing lifestyles are driving out of home consumption.

Local Trends

The trend in South Africa (SA) is no different, albeit off a low base. Over the last 8 years, a favourable economic climate, including continued growth in personal disposable income and a comfortable level of inflation, provided the key underpin to growth in the restaurant and fast food industries respectively. Changing population demographics and consumer profiles and lifestyles, as well as the emergence of the black middle class, has spearheaded extraordinary growth within the South African consumer foodservice industry.

Growth in average household income per LSM category can be seen in Figure 1 below:

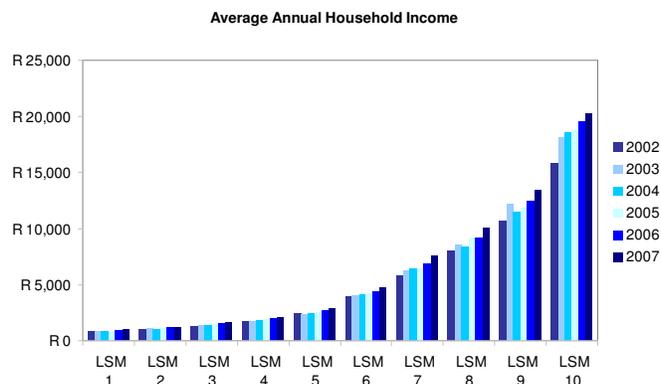


Figure 1: Average Household Income (2002-2007)
Source: SAARF AMPS Industry Presentation

Average household income has grown from R2 435 in 1994 to R5 319 in 2007. Between 2005 and 2007, average household income of black groups grew 15%, whilst the aggregate white, coloured and Indian group averaged 5%. Over the same period, the largest growth has been in LSM's 5-7⁵. This is indicative of the increased buying power of the emerged black middle class.

The resulting growth has led to a mushrooming consumer foodservice industry - cafés, bars, full-service restaurants, fast food, home delivery and street stalls provide consumers with plenty variety and create the platform for aggressive competition and market share rivalry. Independent, franchised and gourmet restaurants are thriving. The growth in retail space, particularly malls, has increased accessibility and distribution; and fashioned growth in the industry. Extended shopping hours at the super regional malls have provided additional growth opportunities.

Figure 2 below illustrates the annual growth in SA retail space since 2000.

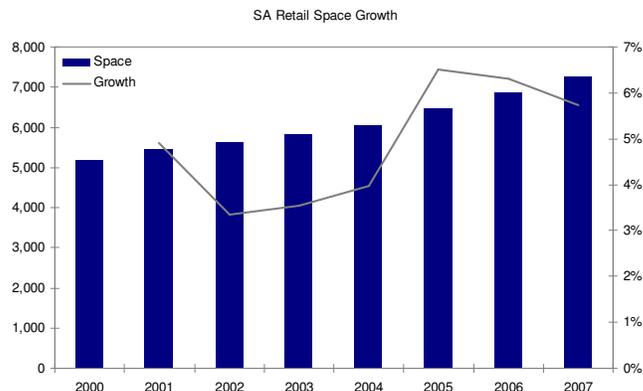


Figure 2: Growth in SA Retail Space (2000-2007)
Source: BJM, Renaissance

SA has seen its retail exposure grow from 1.2 million m² in 1970 to over 7.2 million m² in 2007; this represents a compound annual growth rate of 5% per annum. The entry into previously uncharted territory has therefore created fresh growth avenues – Maponya and Jabulani Malls in Soweto, Vangate Mall in Athlone, and Trade Route Mall in Lenasia, to mention a few. Indications are that trading densities in these areas have surpassed company expectations.

The SA Foodservice Industry

Brand equity is the key to creating sustainable growth, with the franchising model enabling the establishment and continued expansion of trademarks. Franchising is seen as a blueprint to business success - the franchisor provides the concept, supplies corporate power and know-how, whilst expanding his network cost-effectively. The franchisee receives hand-on assistance with all aspects of setting up the business, whilst trading under an established name.

The franchising model has been a global success story – franchisor and franchisee failure rates at

5.3% are extremely low compared to normal business where the failure rate is in excess of 80%⁶. Not surprisingly, in the US, over 50% of total retail market GDP arises out of franchises⁷. With regard to contemporary franchise chains, McDonald's is unquestionably one of the most successful worldwide, with more restaurant units than any other franchise network.

In SA, the franchising concept is relatively young. In 2006, total turnover of the franchising market (excluding petroleum sales) estimated by Franchise Directions exceeded R100 billion, contributing approximately 7% to SA GDP.

Key players in our foodservice franchise industry are listed below:

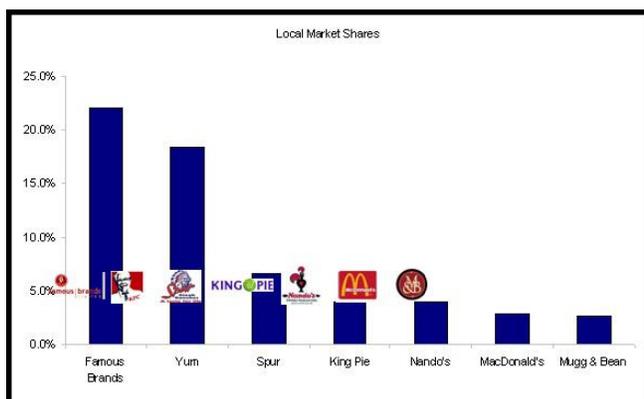


Figure 3: Market Shares

Source: Famous Brands Presentation, Euromonitor, Company Websites

The estimated composition of the quick service restaurant (QSR) franchising market can be seen in Figure 4 alongside.

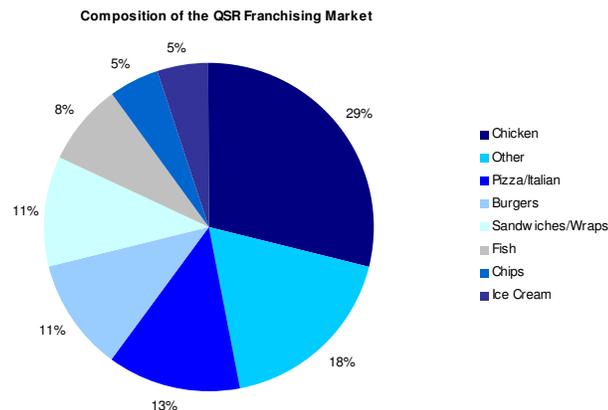


Figure 4: Composition of the QSR Franchising Market
Source: JPM, Franchise Directions, Renaissance

Chicken is by far the most popular QSR segment. KFC, which is housed under the Yum brand, has the lion's share of the chicken QSR industry, followed by Chicken Licken.

It is estimated that the foodservice industry share of chicken consumption is approximately R3.2bn, or 19% (see Figure 5 below). This means that about 1 in 5 chickens consumed, is bought via restaurants and take-out outlets.

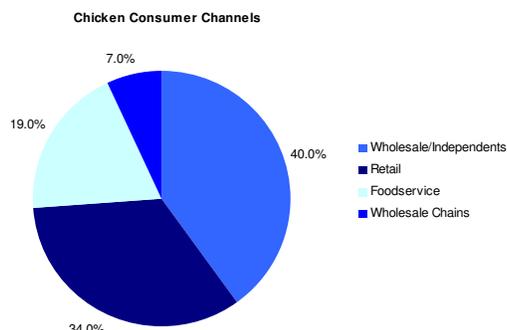


Figure 5: Chicken Consumption Channels
Source: Sovereign Foods Presentation

Chicken consumption is the fastest growing protein source in SA, with per capita consumption having grown from 16kg in 1994 to almost 30kg today. This trend is expected to continue into the medium term – an increase of 900g per annum is expected, which should bring the domestic consumption of chicken to approximately 1.65 million tons in 2014⁸.

Table 2 below illustrates the per capita consumption in other regions of the world.

Table 2: Per capita Poultry Meat Consumption (kg per person per year)

	2003	2004	2005	2006	2007*	2008**
Argentina	18.6	21.6	24.0	28.1	28.6	30.7
Australia	30.6	31.9	34.3	35.0	34.9	35.2
Brazil	31.5	32.5	35.5	36.4	37.9	38.8
Canada	29.2	29.6	29.4	29.7	30.2	30.1
China	7.7	7.6	7.7	7.9	8.3	8
Hong Kong	31.1	37.6	38.8	38.8	38.7	36
India	1.4	1.5	1.7	1.8	1.9	2
Mexico	25.3	25.8	27.0	28.1	28.2	28
Russian Federation	11.6	11.7	15.0	16.7	18.0	19
Saudi Arabia	35.7	34.3	38.1	35.4	35.7	35
USA	43.2	44.6	45.4	46.2	45.4	46

* preliminary

** forecast

Source: USDA Foreign Agricultural Service

Aside from China and India, which have low per capita consumption due to cultural and religious reasons, SA's consumption is largely in line with some of its emerging market peers.

Local Tastes and Preferences

The dining experience locally tends to be more family-orientated. Quality and affordability are key considerations for the aspirational consumer. These attributes form the cornerstone of the local franchising industry.

Spur has entrenched itself as SA's leading family sit-down restaurant group with its value-based offerings, including Spur Steak Ranches, Panarotti's Pizza Pasta and John Dory's Fish and Grill. The Famous Brands stable, including Steers, Wimpy, Debonairs Pizza, FishAways, House of Coffees and Brazilian Café, is SA's leading QSR and casual dining franchisor. The newly listed Taste Holdings, also targets the middle-income, more cost conscious consumer with its Maxi's and Scooter's brands.

Both Spur and Famous Brands have shown consistent growth over time, strengthened by their ability to generate free cash flow and adjust to changing consumer trends.



Another interesting trend is the growth in “coffee-themed” restaurants. The coffee culture pioneered in the TV series ‘Friends’ has permeated South Africa, with the growing social appeal undeniable.

Specialist coffee shops, such as our own home grown Vida e Caffé and international brands such as Seattle have become household names.



Current Challenges

Notwithstanding the upsurge in eating out over the last few years, like many other consumer sectors of the market, the food industry has not escaped the economic slowdown unscathed. Pressures in the current environment have led to a temporary compression of recent growth trends – unprecedented food inflation, energy and labour costs, the rising interest burden on first time home and car owners and power supply challenges have caused commensurate pressure on margins, turnover and profits. For the twelve months ending June 2008, food inflation exceeded 17% with some inputs such as maize, having more than doubled⁹. Over and above rising fuel costs, delivery services are also facing the increasing

challenges of growing traffic congestion and poor calibre drivers.

Many industry participants, including both listed property and logistics companies, have cited increased debtor costs stemming from the consumer foodservice industry. There have been a number of failures in smaller franchised operations and independent marginal restaurateurs, with their plight having been exacerbated by the power outages experienced at the beginning of the year. Even up-market restaurants have seen closures due to unmanageably high debt levels. Like-for-like sales have slowed, as consumers tighten their belts, opting to eat out less, or trade down.

But it's not all doom and gloom. Famous Brands reported healthy growth of 26% in headline earnings per share earlier this year, and Spur too has weathered the storm. Within the Spur offering, restaurant turnover showed respectable growth of 11% for the twelve months ended June 2008, with Spur Steak Ranches having grown adequately despite the consumer slowdown – testament to the strength of their brand equity and ability to adjust to changing market conditions. Their continued focus on value-for-money offerings through menu re-engineering has led to limited price increases, thereby curbing volume declines. Furthermore, scale allows them to more efficiently procure inputs within their wholesale and manufacturing divisions. Declining franchisee profitability has been limited due to absorption of costs at the franchisor level – evidence of building a sustainable business model.

Other restaurateurs are said to have decreased portion sizes or switched to cheaper ingredients in an attempt to prevent thinning margins.

As consumers scale back spending, the key focus in the current environment is the maintenance of a value perception, without compromising quality – attributes that Spur has upheld.

Future Trends

Analogous to the awareness of health and wellness globally, SA consumer foodservice outlets should continue to ensure that their menu offerings are diverse and appeal to the more discerning consumer. The move from red meat to white meat means that restaurant operators need to continually assess and rejuvenate their product set. An emphasis on fresh ingredients may place increasing pressure on margins. Increased innovation and segmentation will become necessary to grow and maintain market share, particularly within more commoditised offerings, such as pizza. Further growth of themed restaurants (Thai, Indian, Mexican, Italian) is likely as the SA consumer develops changing tastes and preferences. Another important consideration is the growing competition from food retailers, in the form of ready-to-eat packaged convenience meals and in-store restaurants and cafés.

Conclusion

Despite the recent slowdown, the long term fundamentals remain firmly in tact. Convergence in incomes suggests that the burgeoning foodservice industry in SA should continue posting healthy gains. A recipe for success includes a sustained focus on convenience, value, quality,

differentiation and product relevance. Moreover, brand equity will be strengthened through continuous evaluation of consumer tastes and preferences; and changing market conditions. SA definitely has the appetite for continued growth and development of more than just a bite-sized industry.

Sources:

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Picture source: Famous Brands presentation

¹ www.mbplc.com; www.findarticles.com

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⁸ BFAP

⁹ I-net, Renaissance

ⁱ The article was written when **Afena Capital** was still operating under the name **Renaissance Specialist Fund Managers**