

# The Restaurant Revolution in Emerging Markets

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**Consumers in emerging economies, driven by rising disposable incomes, are the most likely to increase their dining out habits.**

— *Euromonitor*

Out-of-home dining represents a key theme in emerging markets (EM) that captures opportunities driven by a growing middle class, greater consumer brand and health awareness, and increasing technology adoption. We see EM countries benefitting from favorable demographics and significant catch-up opportunities, which should translate into industrialization, urbanization, job creation, wage growth, disposable income growth, and ultimately, consumption. We believe rising consumption will be an important driver of sustainable high growth within the EM asset class. Furthermore, the combination of a higher level of multi-national interconnectivity, greater disposable income levels, stronger employment (leading to less free time), and customers being more brand and health conscious should translate into a significant opportunity for the food industry.

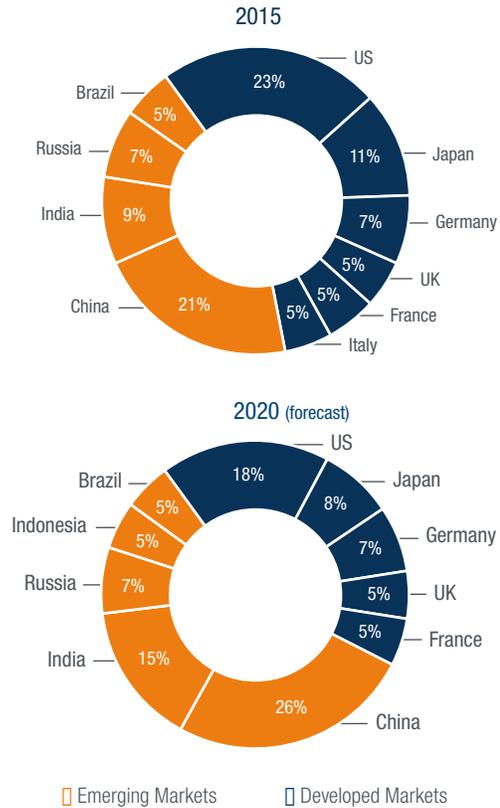
## Shifting Demographics Impact Consumption

The number of middle class consumers in the emerging markets will reach 2.3 billion by 2020.<sup>1</sup> Just as important as its substantial size, EM consumers are young. 44% of EM citizens are under 25 years old, compared to 28% in the developed markets (DM).<sup>2</sup> When considering that younger consumers are more concerned about brand recognition and perception than their older peers, we believe this translates into a strong opportunity for discretionary spending. Global consumption is forecast to reach \$62 trillion by 2025, twice its 2013 level, with half of this increase coming from EM countries.<sup>3</sup> The global distribution of consumption is already tilting towards EM, with consumers living in emerging market cities contributing 56% (or \$14.1 trillion) to global consumption growth, compared to 35% (or \$8.8 trillion) for consumers in developed market cities.<sup>4</sup> Income levels in EM have grown at an average annual rate of 5.9% from 2006 to 2015, significantly above 2015's global average of 1.7%.<sup>5</sup> As seen in DM, an increase in disposable income often comes from job creation, which correlates with an increase in spending and a decrease in excess time. With that in mind, we believe that leading companies in the out-of-home dining segment are well positioned to capitalize on these fast growing trends in EM.

\*Scaled to 100%.

Source: The Brookings Institution, "The Unprecedented Expansion of the Global Middle Class," 2017. Totals may not equal 100% due to rounding. Any forecast is for information purposes only and is not guaranteed in any way.

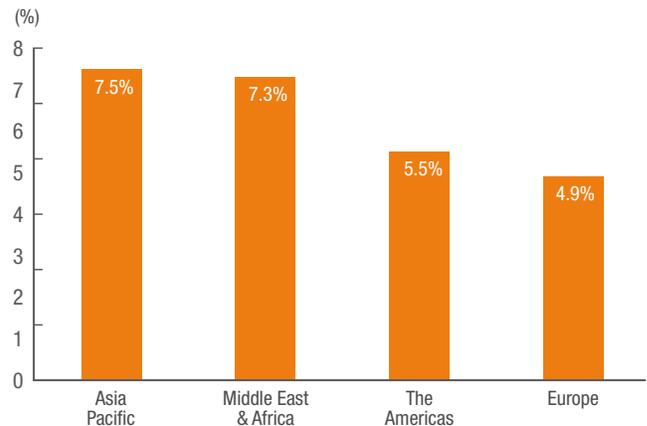
### MIDDLE CLASS CONSUMPTION: TOP 10 COUNTRIES\*



## Branding and Aspirational Opportunities

Though affordable and often considered a defensive sector, we consider the EM dining segment to be a semi-luxury category. As the US market saturates, Western brands, such as Domino's Pizza, Starbucks, and Chilli's are growing rapidly across EM countries. Today's EM consumers have grown up familiar with these brands through television, movies, and social media. As a new member of the middle class, eating branded food can be seen as aspirational. In fact, we had one Starbucks manager in Mexico City tell us that it is not uncommon to see customers buy a coffee on Monday, and then keep the branded cup on his/her desk for the remainder of the week as a status symbol. As income levels continue to grow, we see opportunities like this translate into increased volumes and higher priced items. Spending on eating out is forecast to grow at a faster rate in EM than in DM. The important thing is that these companies have already won half the battle with their brands. The leading companies are able to enhance their brand by improving the customer experience, convenience or both. Furthermore, companies with a strong social media presence have an advantage in maintaining brand awareness and loyalty.

### "EATING OUT" EXPENDITURE GROWTH FORECAST (2017-2026)



Source: Oxford Economics, Cushman & Wakefield "The Global Food & Beverage Market."

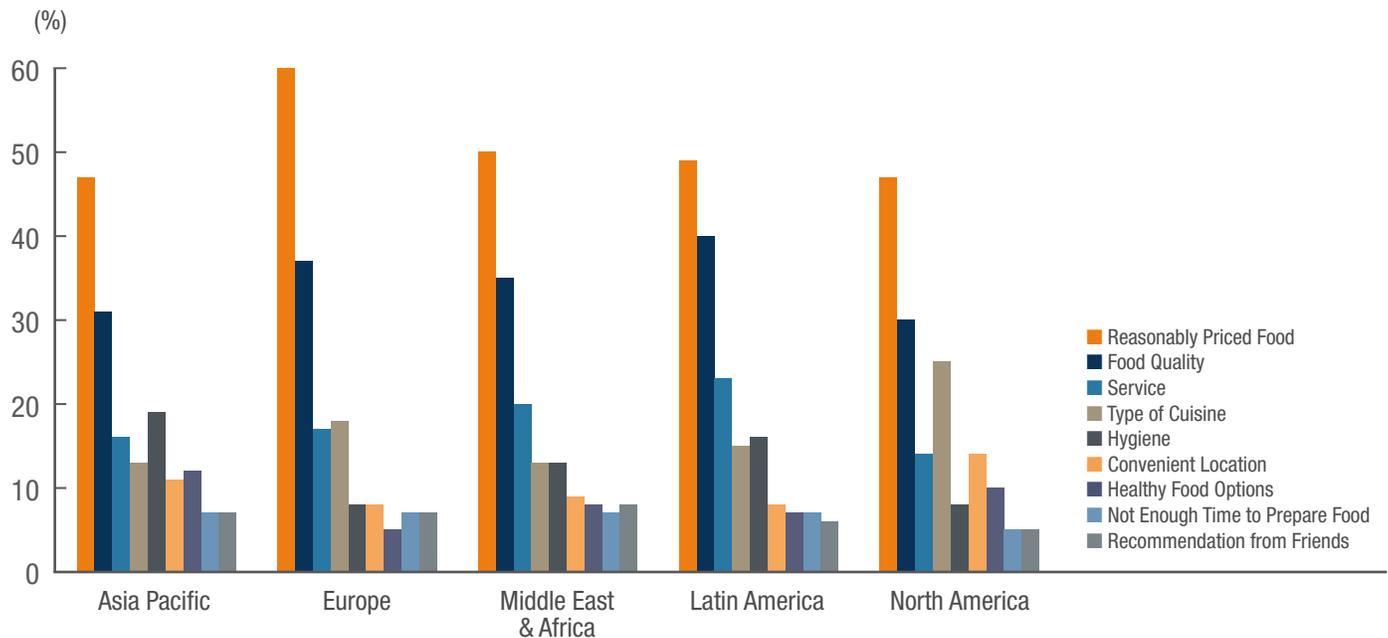
Estimates and forecasts are only projections and not guarantees.

## A Healthier Consumer

Counter to the US market, dining out in EM isn't only seen as chic, but it can also be a healthy alternative. As the world's population is aging and living longer, the World Health Organization estimates 73% of all deaths by 2020 will be driven by preventable diseases such as diabetes, stroke and heart attacks, with the majority occurring in low-income and other EM countries. As a result, EM consumers have taken a more active role with their health and eating habits, which includes following proper nutritional guidelines. A 2016 Nielsen study found that

after price, food quality and hygiene are two of the most influential factors for diners when making purchasing and eating decisions. While DM consumers may consider fast food unhealthy, EM consumers view it as a better alternative to street vendors offering uninspected meat that may have been in the sun for several days. International chain restaurants in EM countries provide health inspections and transparent calorie counting coupled with fresh product offerings.

### MOST IMPORTANT FACTORS FOR DINERS' PURCHASING/EATING DECISIONS



Source: Nielson

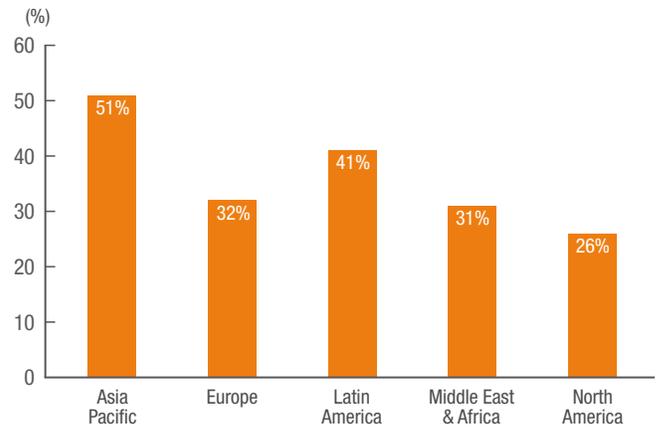
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## An Increasingly Tech Driven Industry

Restaurant operators are leveraging rapidly changing technology to help grow their same-store sales and margins, while consumers benefit from increased convenience and choice. Increasing competition has led restaurant operators to focus on technologies that will help them boost traffic and control costs, driving a digital transformation within the sector. Companies are collecting more consumer data and growing their loyalty programs in an effort to drive repeat business with larger average ticket sizes. Mobile usage is allowing companies to reach new customers and better understand their existing customers. As mobile penetration in EM continues to grow, consumers are placing greater value on convenience, which has permanently changed consumer expectations in the out-of-home dining segment. We expect options like online ordering and delivery to become the standard in EM as logistics networks grow. EM consumers are already using mobile payments to order fast food more often than their DM counterparts. Companies are also increasing their capabilities to track and analyze customer data in an effort to better segment their customers for more effective email targeting and text promotional campaigns. Finally, automation and robotics will continue to be tested in different areas within the supply chain to better control food and labor costs.

### FAST FOOD EATERS USING MOBILE PAYMENTS\*

% of Fast Food Eaters across the following regions who have used their phone to pay for an item/service in the past month



\*Fast Food Eaters are defined as internet users aged 16-64 who eat fast food at least once a week.

Source: GlobalWebIndex Q2 2017.

### COMPANY SPOTLIGHT

## DP Eurasia

DP Eurasia is the master franchise agreement holder for the Domino's Pizza brand in Turkey, Russia, Azerbaijan and Georgia. They have taken the successful Domino's Pizza model and leveraged the parent company's technological capabilities and branding, while focusing on local flavors. The company's strategy is focused on four main pillars: (1) focus on innovation and online ordering to drive like-for-like (LFL) growth, (2) store network growth, (3) leveraging scale advantage to further improve profitability, and (4) potential for further international expansion. Expanding upon the first pillar, online ordering at DP Eurasia is currently around 52% of system sales, compared to their long-term target of 70%. Online ordering provides better margins, resulting in larger sized orders and more frequent re-orders, which helps drive positive LFL growth. DP Eurasia uses Domino's proprietary PULSE (point-of-sales) system for online ordering, while also leveraging its own technology for their loyalty program and partnerships with companies such as DeliveryHero.

By leveraging both the parent company's technology and their own, they have more operational flexibility in their domestic markets and in the region. DP Eurasia has also been successful in introducing the Domino's Pizza brand to Turkey and Russia via a combination of marketing and adapting to the local palate. For example, all of the food in Turkey is Halal while offering several unique items that are popular with locals such as the soufflé (the chocolate lava cake recipe has since been exported to other Domino's markets) and Sosyal Pizza (developed by customers voting through Facebook). In Russia, their 30 minute delivery promise is another key differentiator relative to their competitors. By successfully implementing their technology, branding, and knowledge of local markets, the company has been able to exceed their operational targets for 2017 with LFL growth of 10% in Turkey and 28.9% in Russia in 2017 (versus targets of 6-9% and 13-17%, respectively) all while continuing to expand rapidly.

## COMPANY SPOTLIGHT

## Alsea



Alsea is a Mexican-based food operator with the master franchise agreement rights to numerous well-known brands such as Starbucks, Chili's and Burger King. Alsea has been successful in leveraging technology and strong branding to grow their footprint. Alsea's multi-branded loyalty program, WoW, which launched just last year, already boasts over 1 million users and represents roughly 17% of total transactions. The loyalty program has helped grow ticket sizes (35% on average) and drive repeat visits, while keeping customers within the Alsea ecosystem. Given the company's strong assortment of brands, Alsea has been focused on improving their customer relationship management capabilities to better understand their customers, and eventually help drive growth across the different brands. For example, if Alsea launches a

new Chili's in a specific neighborhood in Mexico City they would be able to send push notifications to customers of their other brands in the area to alert them of the new opening. Alsea has also used technology to increase operational efficiency. Last year, the company introduced Enlace, a paperless solution for store supervision. Enlace tracks all key performance indicators along with important supervisor data (e.g. number of visits, food safety, maintenance data) to help increase store efficiency while providing better brand oversight and reducing management turnover. Alsea's ability to leverage technology, branding, and customer preferences have been rewarded by the market with an incredible share-price growth of 566% since 2009.<sup>6</sup>

## Conclusions

Casual out-of-home dining presents a large investment opportunity in EM countries. As EM consumers benefit from the high growth structural stories in their respective economies, they will likely see further formal employment prospects and benefit from higher levels of disposable income. This usually translates into

less time preparing food at home, but more opportunities for health conscious consumers to spend on out-of-home dining experiences. Discretionary spending today does not necessarily mean buying an item. More often than not, it is also an experience. In the case of casual dining, it is both.

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