MAY 2012

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The 2012 AlixPartners European Restaurant and Foodservice Outlook

AlixPartners
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The food may differ on the two sides of the Atlantic, but the dining trends are largely the same: in Western Europe, as in the U.S., consumers are hungry for value and convenience, and they are waiting for signs that economic conditions are stabilizing before returning to spending freely.

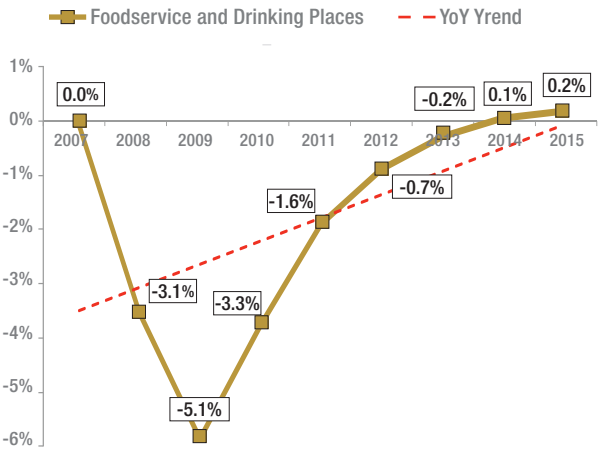
As restaurant sales seem to stabilize, the outlook for Western European dining appears positive—even as consumer confidence remains low, unemployment high, and considerable uncertainty surrounds the impact of austerity measures. In this environment, consumers across Europe say they plan to spend less per meal in the coming year. This makes it as important as ever for restaurant operators to focus on brand differentiation and consumer relevance to drive revenue growth. A clear understanding of consumer preferences, global and regional supply-chain execution, and the competitive landscape in each country will be critical in the contest for dining dollars across Western Europe.

SETTING THE TABLE: THE MARKET IN EUROPE

In Europe, socio-cultural trends, like dining more outside the home, appear to be offsetting economic pressures and even driving restaurant-sales growth in countries like France, the UK, Italy, and Germany. Consumer trends that swept the U.S.in 2008—such as interest in trading down from one restaurant segment to another (e.g., Casual Dining to Fast Casual, etc.), in discounts, and in health and wellness—appear to be reaching the mainstream in Western Europe.

Overall restaurant sales in Western Europe—which declined for four consecutive years—seem to be stabilizing, up 0.9% in the past year. While not as robust as the 1.8% sales surge in 2009-2010, growth continues at an incremental pace (figure 1). While the overall outlook is positive, European consumers have been spending

FIGURE 1: WESTERN EUROPE FOODSERVICE SALES



Source: Euromonitor 2011

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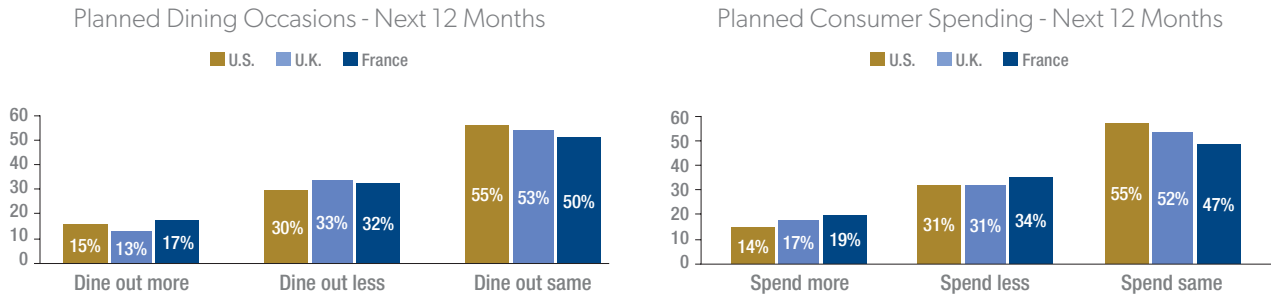
FIGURE 2: PLANNED DINING AND CONSUMER SPENDING IN THE U.S., U.K., AND FRANCE

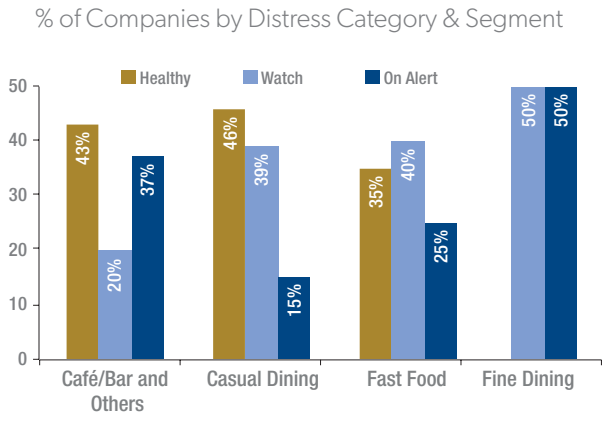


Source: U.S. Bureau of Labor Statistics, U.S. Bureau of Economic Analysis

cautiously and may continue to do so this year, as they look for stronger, more concrete signs of economic recovery, according to our survey[1]. Several factors appear to be contributing to consumer caution in Western Europe: declines in disposable income, looming tax increases, high rates of inflation and unemployment, and reduced access to credit. In this environment, consumer-dining intentions appear to be headed toward overall decline; we expect a 2% to 3% decline in spending-per-meal intentions in the UK and France, respectively (figure 2).

There are winners and losers in every segment, but the full-service segment has borne the brunt of the impact; declines began in 2007 and are likely to continue throughout 2012. Other segments are faring better: Quickservice (QSR) and Fast Casual continue to expand, drawing in customers with lower price points, speed, variety, convenience, and perceived value. Overall, however, the environment has forced companies to deleverage and conserve cash, and still, 35% of companies studied are in "fiscal danger" (figure 3). This, in part, has kept M&A activity focused on smaller-sized transactions (figure 4).

FIGURE 3: COMPANIES IN FISCAL DANGER



Source:Cap IQ, AlixPartners analysis of publicly available data, and Altman-Z analysis

[1] AlixPartners surveyed a demographically representative group of 2,000 adults in the United Kingdom and France (1,000 in each country) from March 17-23, 2012 about their dining habits and plans, with a focus on frequency, destination, spending, preference, trends, and marketing.

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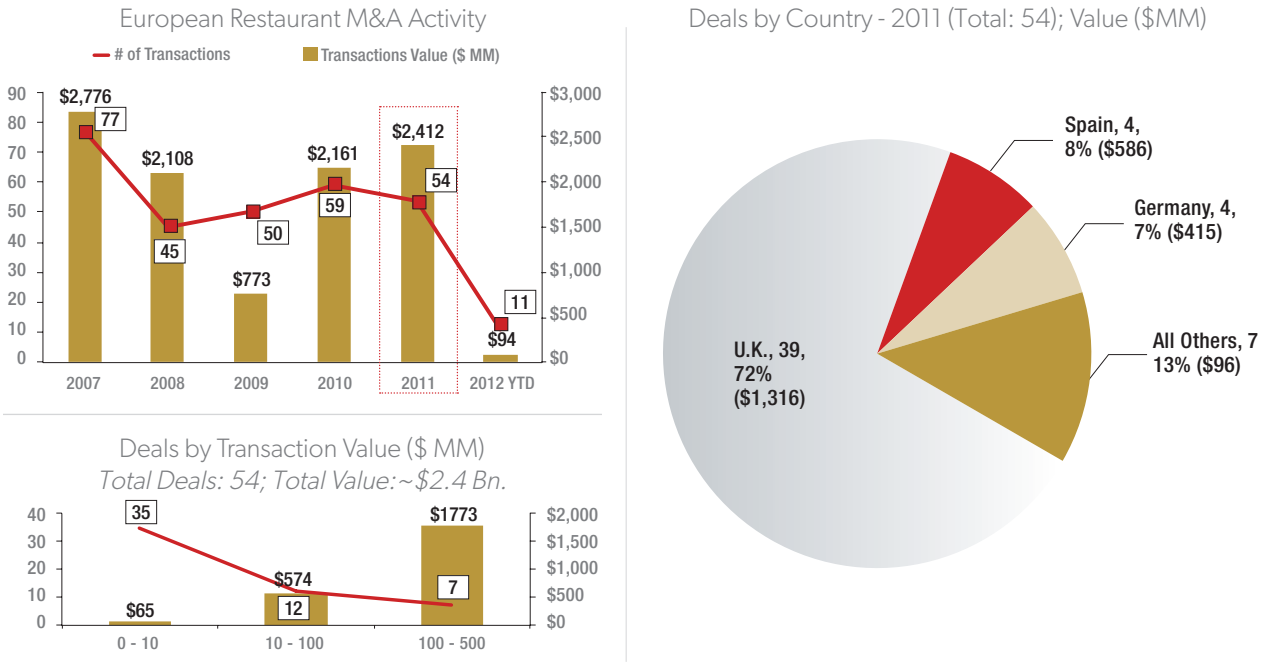
FIGURE 4: EUROPEAN RESTAURANT M&A ACTIVITY AND DEALS



Source: The Deal Pipeline, AlixPartners analysis (only transactions w/ reported value shown)

GROWING LOCAL: COUNTRY-BY-COUNTRY ANALYSIS

In general in Western Europe, as in the U.S., cautious spenders continue to respond to discounts and promotions. Independently owned restaurants have traditionally dominated Western European dining, but chain restaurants appear to enjoy the advantage in this environment, as they can leverage economies of scale on fixed costs and mass purchasing, have larger media budgets, and often have longer hours of operation than their independent counterparts. And, looking ahead, we expect this advantage only to increase amid heightened price competition and volatility in most major commodities.

Though food quality remains very important to customers, many appear willing to cede service and experience to save money. In addition to perceived value, the importance of health and wellness is growing, particularly in France.

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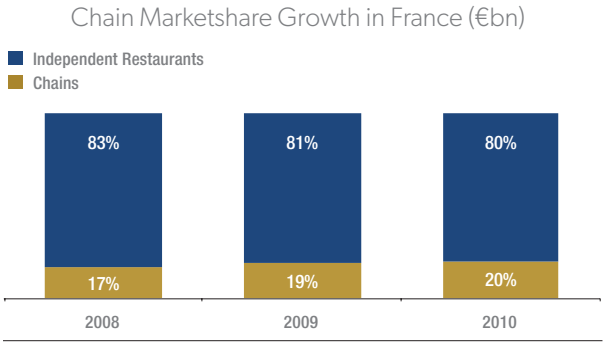
Diners also seem increasingly responsive to digital marketing tactics: more consumers overall are taking to the Internet and social media outlets to find dining-related deals and information. Digital media is especially impactful with younger consumers, and going forward, we expect mobile devices to present considerable opportunities for reaching customers.

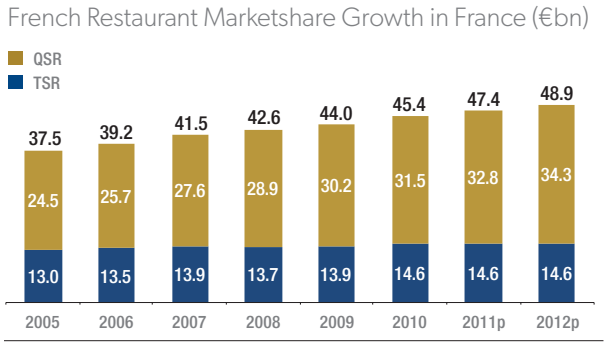
In France, as in the U.S., "eating away from home" has remained flat since 2007; however, restaurant spending has grown by some 9% (taking share from hotels, restaurants, supermarkets, and other channels). While the French market is still dominated by independent restaurants, chains are rapidly gaining ground (figure 5). Today, QSR represent 68% of the total market and continue to grow, making the segment particularly attractive to new entrants (Speed Burger, Jack's). Fast Causal has also emerged with strong growth, thanks in part to consumer interest in healthy fare.

Just 27% of French diners say they dined out at least weekly over the past 12 months; looking ahead over the next 12 months, they say they plan to reduce this frequency, as well as how much they spend per meal, slightly. Fast Casual and Fine Dining restaurants are exceptions to the rule: consumers expect to visit these restaurants slightly more frequently than they did in the last 12 months. Nevertheless, and somewhat surprisingly, French diners name Price as the most important factor when selecting a restaurant, followed closely by Food Quality. Menu Variety is a distant third. Accordingly, the top reasons French diners choose to stay home include the cost of restaurant meals, followed by concerns over their current financial situations and the future economy. Interestingly, some 60% of French diners view healthy menu options as Important or Extremely Important—far more than diners in the U.K. or the U.S. And in France, as in the U.S.

FIGURE 5: EVOLUTION OF FRANCE'S RESTAURANT MARKET



Source: Publicly available data, Gira Conseil, AlixPartners analysis



Source: Publicly available data, AlixPartners Analysis

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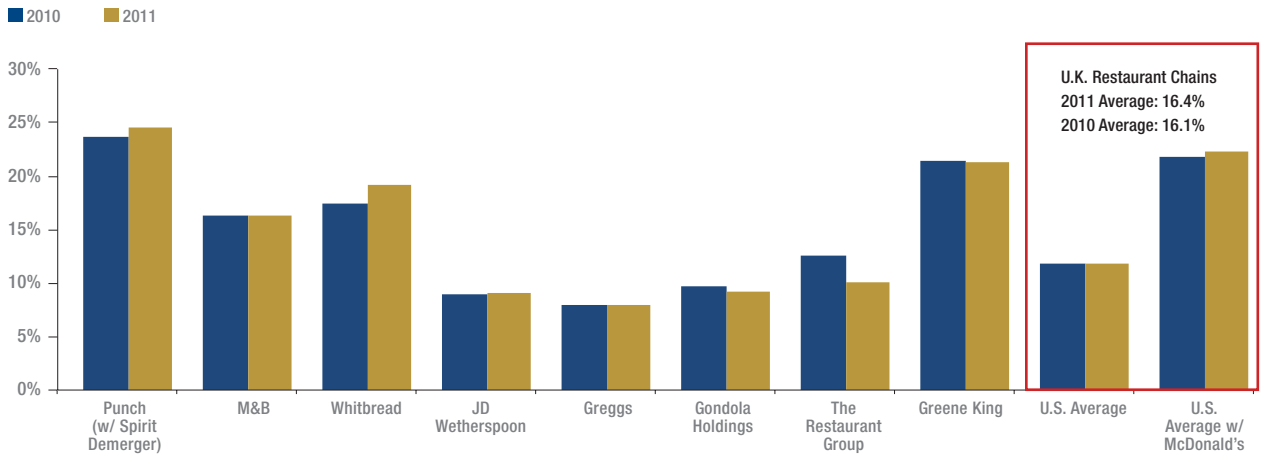
and the U.K., high-income single males between the ages of 18 and 24 dine out most frequently.

In the United Kingdom, 32% of respondents say they dined out at least weekly over the past 12 months; in the coming year, they, like their French counterparts, also expect to reduce slightly their frequency and per-meal spend. British diners cite a worsening of their current financial situations and the cost of meals out as the top reasons for staying home, along with concerns about the future economy and its potential impact. When they do dine out, British diners cite Food Quality, Overall Price, and Location as key decision drivers.

Despite consumers' gloomy outlooks, the restaurant industry in the U.K. has significantly outperformed the FTSE-100 since 2009. Average EBIT margins are better than those of U.S. peers (figure 6), and M&A activity in the U.K. has been and continues to be much higher than in the rest of Europe. However, P/E ratios for leading U.K. chains are lower than those in the U.S. The main reason for this is the rather dismal overall economic climate in Britain, which contributes to a challenging outlook for all restaurants there. Disposable income has declined; 2011 saw the steepest drop since 1977, and the year ahead looks tough. As in France, the Full Service segment may be hit hardest as consumers trade down to less expensive Fast Food options or simply eating at home. Still, not everyone is suffering: restaurant chains such as Wagamama and Nando's are growing significantly faster than the U.K. industry average.

FIGURE 6: U.K. RESTAURANT EBIT MARGINS COMPARED TO U.S. PEERS



Source: Publicly available company filings and annual reports

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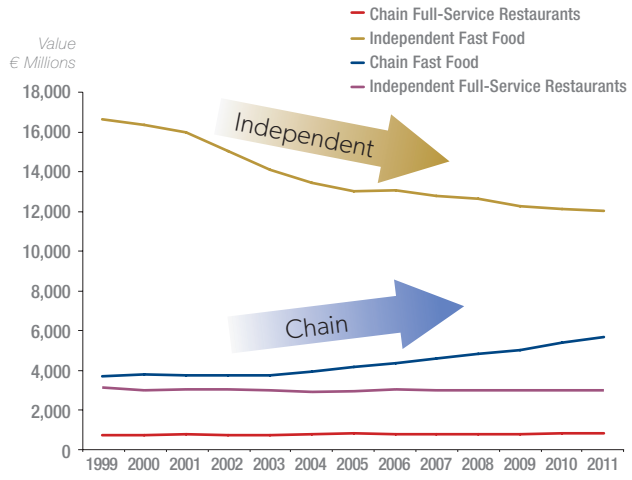
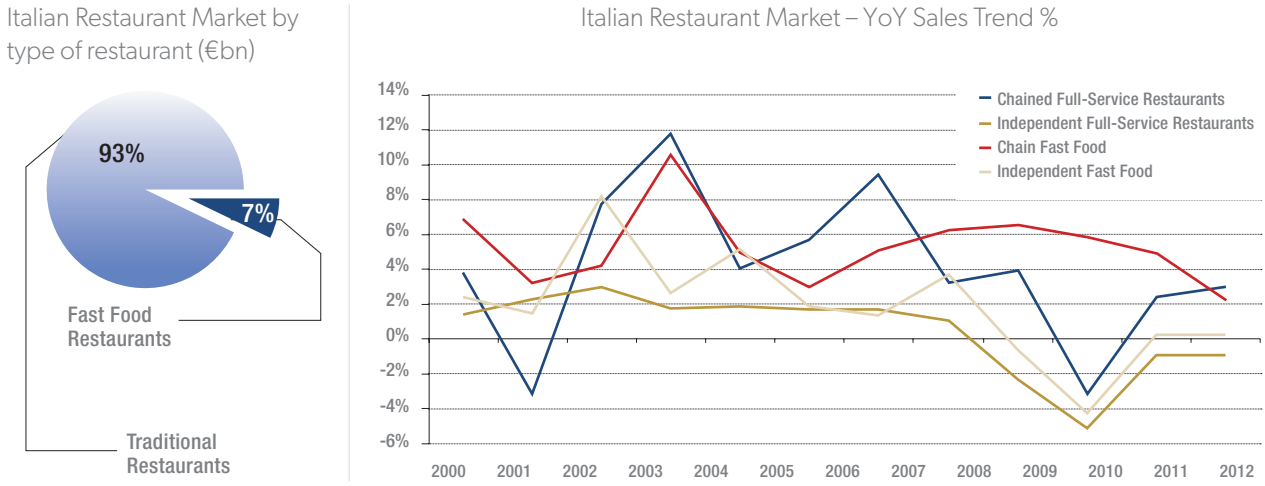
FIGURE 7: INDEPENDENT VS CHAIN RESTAURANTS IN GERMANY



Source: Euromonitor

In Germany, the good news is that, even though the number of units has declined, restaurant sales have increased. From 2011 to 2012, revenue in the restaurant industry increased by 2.9%. As in other parts of Western Europe, independent restaurants continue to dominate, but chains are growing at a faster rate; Independent Full-Service segment revenue has dropped by 27.8% since 1999, while chain restaurant revenue grew by 10.1% in the same period. Fast Food restaurants overall have seen increases in revenue since 2007, and chain restaurants in particular fared well with 23.7% revenue growth (figure 7). The top five restaurant chains in Germany in terms of sales include three U.S.-based and two European brands, namely, McDonald's, Burger King, LSG, Nordsee, and Subway.

FIGURE 8: ITALIAN RESTAURANT MARKET: TYPE AND SALES TRENDS



Source: Publically available information and AlixPartners analysis

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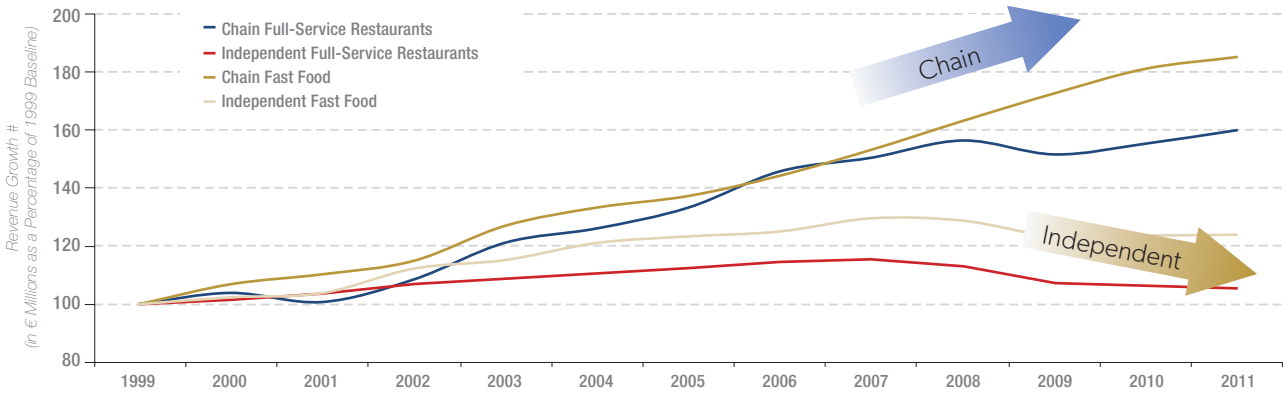
Italy remains a region linked to tradition and local gastronomy, especially in rural areas. As a result, traditional restaurants continue to be in high demand and dominate the €47.5 billion market (figure 8). Independents outnumber chains in all regions, but chains are growing fast, as in the rest of Western Europe (figure 9). In the Fast Food segment, chains have grown 30% over the past five years, while independents have grown just 3% in the same period. Across all segments, the average revenue per transaction at a chain restaurant is €32.2, compared to €33.9 for independent counterparts—a 4.3% difference.

FIGURE 9: CHAIN V INDEPENDENT RESTAURANTS IN ITALY



Source: Euromonitor

WRITING THE MENU: SATISFYING CONSUMER TASTES

In response to these consumer trends, we expect companies to continue mass localization—the customization of menus by country and by micro-segments of populations. Companies that develop products that support lifestyle changes will benefit; food trucks and pop-up dining are examples of successful industry responses to changing consumer demand. Similarly, North American Fast Casual concepts, such as Chipotle, Freshii, and Pinkberry, have succeeded in Europe by giving customers what they want: products that combine flavor and nutrition adapted to different times of day for both on-the-spot eating or to take away. Other reasons for success: flexible menus and a presence in bustling spaces (town centers,

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shopping malls, airports and train stations). Conversely, emerging European chains have opportunities in the U.S., where they are succeeding by placing ethnic themes and modern interiors in prime, proven, urban markets with limited advertising and media involvement.

Meanwhile, older brands in Europe will likely continue to modernize using a variety of tactics: conversions, re-imaging, and switches to modular concepts and new formats. Regulatory actions may drive nutritional transparency and a rise in healthy-choice options, particularly with obesity on the rise. Denmark, for example, passed a "fat tax" on companies, and in the UK, a ban on fast-food TV advertising that targets children may impact consumer choices.

PAYING THE CHECK: KEY TAKEAWAYS

Given the cautious consumer base across Western Europe, consumer relevance is critical. Restaurant operators must follow changing customer tastes closely and align their offerings with key emerging trends:

Convenience, Value, and Quality: Consumers are demanding high quality, on-the-go options along with easy ordering, value-pricing, speed, and variety. Those that offer it are already succeeding, and Fast Casual and QSR growth is likely to continue.

Modernization: Reinvention can mean relevance. To stay current, older brands should explore conversions, re-imaging, modular concepts, and new formats.

Social Networking: As consumers become more mobile—accessing the Internet via smartphones and engaging with social media outlets—restaurants need to follow suit. Digital and social media offer new opportunities for innovation in ordering, payments, and continuous communication with customers.

Despite continued, and in some cases heightened, economic uncertainty, restaurant operators can still grow market share. They just need to know how to do it. Do you?

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