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Long-term Growth versus Short-term Pain

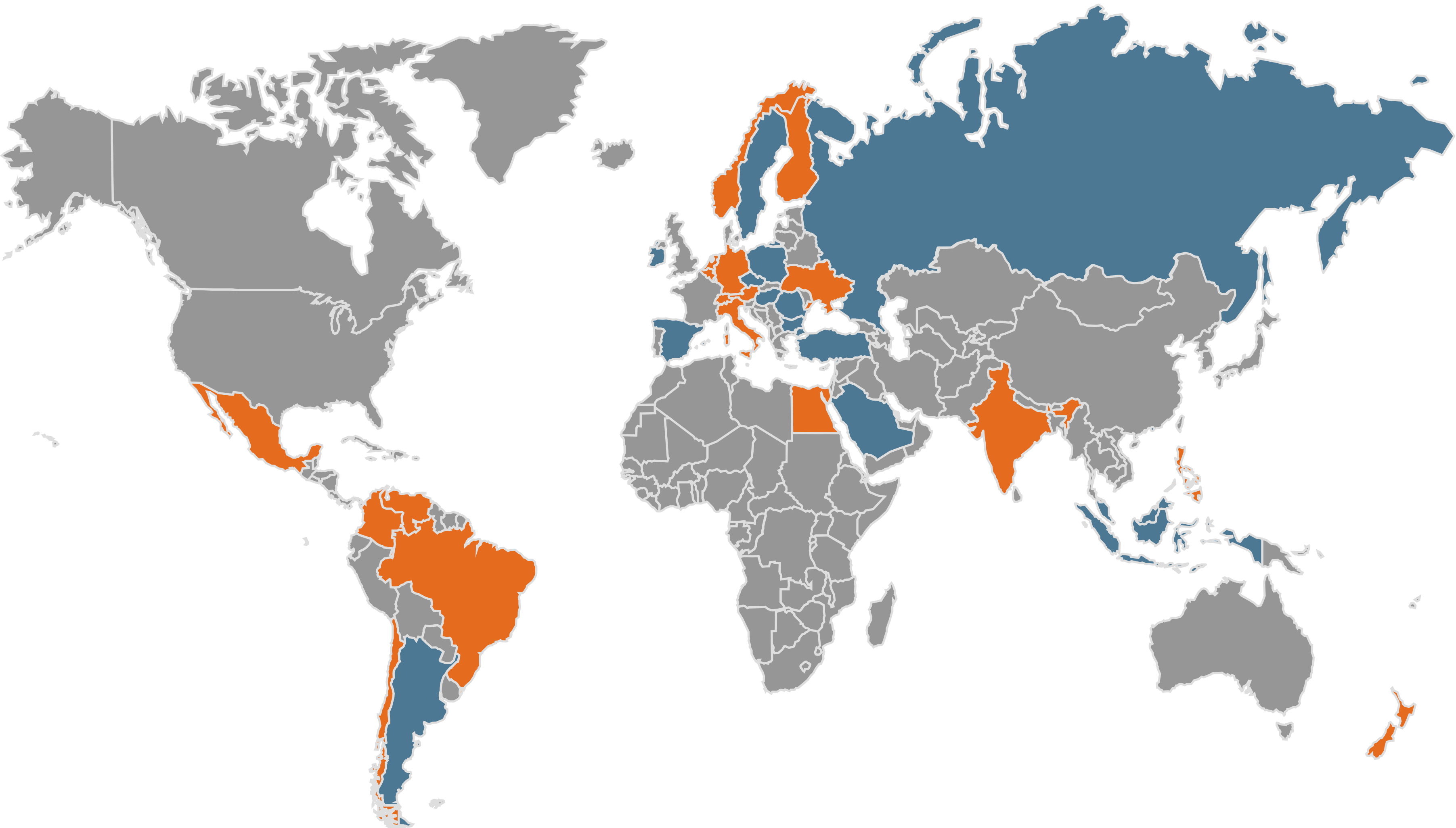
- Strong growth in cafés/bars over the last five years was followed by flagging on-trade demand for both alcoholic drinks and hot drinks in 2009, as cash-strapped consumers the world over made fewer trips out and spent less when they did go out, often drinking more at home while trading down to cheaper items, from spirits to beer, or from imported beers to local brews.
- Thus, as of late 2009, cafés/bars stood at the crossroads of two intersecting trends – premiumisation on the one hand, as consumers looked for higher quality items, be it premium coffee or high-end spirits, with the more immediate need to conserve cash as economies struggled to grow. A search for luxury has combined with a desire for value to create a complicated consumer environment. Even in a time of economic hardship, signs persist that consumers continue to value "affordable luxuries," combining premium indulgence with attractive price points.
- With 2009 coming to a close, signs of a recovery continue to appear. Company results indicate that real consumer demand still persists. Costa Coffee, for instance, has continued to expand, posting strong profit and outlet growth figures throughout the year, while even struggling Starbucks has indicated its sales situation is stabilising. In alcoholic drinks, both beer and spirits posted on-trade volume gains in 2009, bolstered by continuing strong demand from Asia Pacific, while beer demand remained resilient in North America, expanding slightly while wine and spirits volumes declined in the on-trade, suggesting that even hard-hit developed market consumers continue to go out, though they often choose to economise when they do.
- Over the next one or two years, the most successful operators will be those able to adapt to a new consumer mindset, while keeping an eye on a continuing, long-term process of consumer evolution. Emerging market consumers continue to seek out global brands, whether high-end spirits or premium coffee, while developed market demand for certain items, such as premium coffee, has proven surprisingly resilient, for example in the UK, where specialist coffee shops continue to expand.
- Diversity and experience are the buzzwords going forward, with operators offering a diverse range of products, reaching out to those consumers seeking affordable value as well as those looking for the occasional luxury (two groups which overlap to a substantial degree). Along with full-service restaurants, no sector is more reliant on experience to drive sales than cafés/bars, particularly as competition continues to heat up from other sectors, notably fast food.

Largest Coffee Shop Markets Lag Behind Fastest Growing

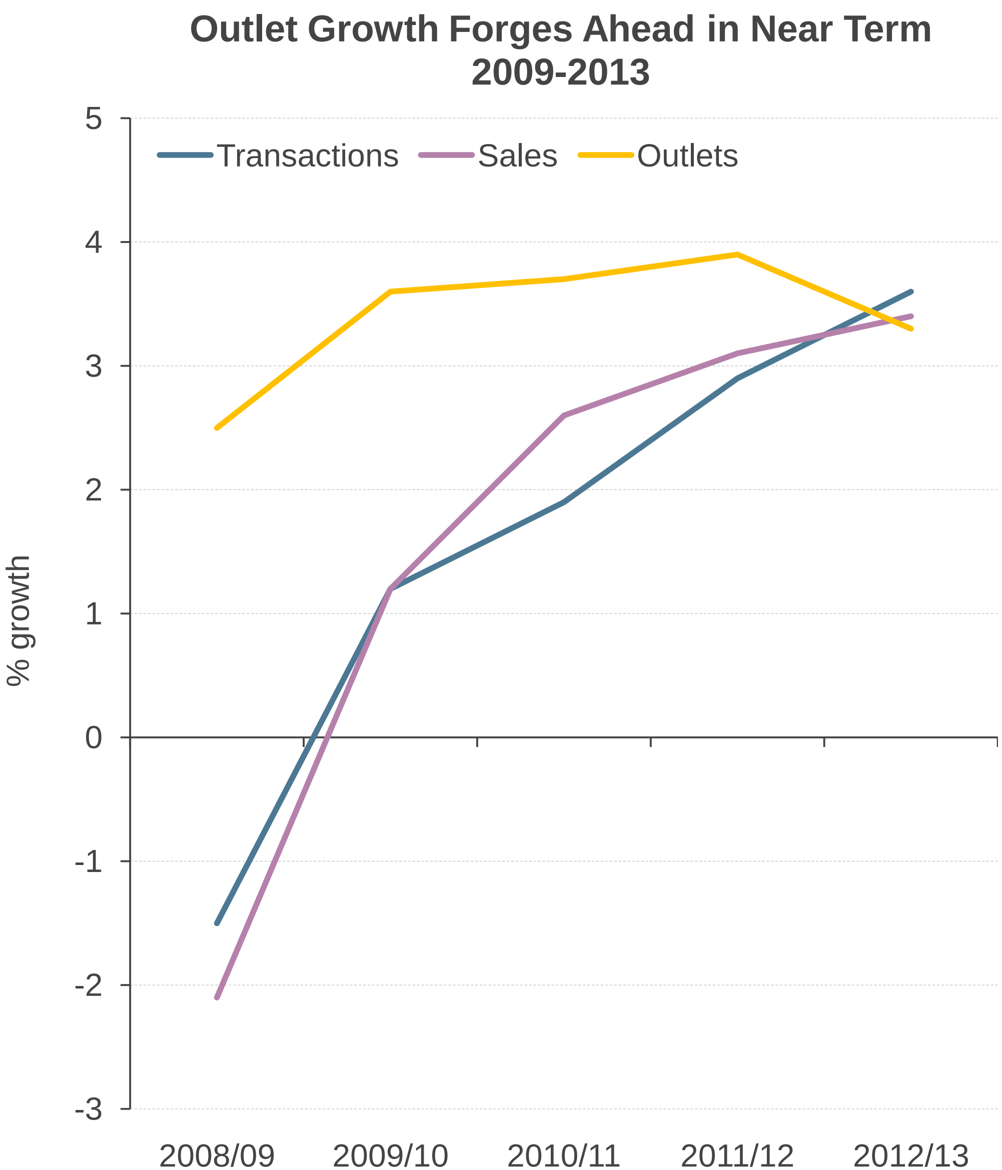
- While the US remains the world's leading market for specialist coffee shops by a huge margin (2008 sales more than three times those of second-place Japan), it was also the world's slowest growing market in 2008, with sales contracting by nearly 4%, due in large part to a serious drop-off in traffic through market leader Starbucks' shops. Sales were also disappointed in other top 10 markets, with sales in Japan up by just 0.6%, while number four Canada grew by less than 2%.
- Given the pace of expansion in the sector and the magnitude of the economic downturn in key markets, a slowdown was to be expected. Starbucks, above all, has pursued an extremely aggressive expansion strategy over the last 10 years, particularly in the US, with the reduction in consumer spending calling the viability of a portion of these outlets into question. Likewise, the undeniable popularity of premium coffee in many markets has led to a surge in competition, both from other specialist coffee shops and from other quick-service operators, such as burger chains, convenience stores, and even bars and taverns, many of which have upgraded their coffee offerings in recent years.
- Despite this, hot drinks consumption has continued to grow. While growth was slower than in 2008, volumes expanded in every region in 2009, indicating continued strong demand for coffee, while chains such as Costa Coffee have continued to post strong sales in the teeth of a major recession, indicating real resiliency of demand even in hard-hit developed markets. Growth will return to the largest coffee shop markets – in many, it never left – but competition will remain fierce, with weaker operators likely to fall over the next two or three years, while more established brands upgrade both their food and their outlets to compete better with ambitious fast food chains.
- In more nascent markets, 2008 remained rosy. In both Romania and Venezuela, specialist coffee shop sales expanded by more than 50%, albeit from relatively small bases, while in India sales grew by more than 40%, as home-grown chains Café Coffee Day and Barista continued to take share and broaden their product lines, with both operators adding upscale brand extensions over the last two years, reaching out to a growing population of both middle-class Indians and more affluent urban professionals.
- For global operators, the ongoing challenge remains to take advantage of surging sales and strong potential in emerging markets, while adapting to a changing competitive environment in places like the US and the UK. While developed market consumers' passion for coffee is here to stay, maturing markets will force many operators used to double-digit expansion to examine seriously every aspect of their operations, as same-store sales become the new focus.

Specialist Coffee Shops Lead Growth Worldwide

- Specialist coffee shops lead growth in a number of major markets (shown in **orange**), and occupy one of the top five growth positions in many more (shown in **blue**).



Expansion in Coffee Shops Set to Continue



- Following a difficult 2009, specialist coffee shops are expected to see a recovery in sales and transactions growth in 2010, buoyed by strong demand from Western Europe and Asia Pacific, as returning disposable income growth and (eventually) falling unemployment help boost consumer spending.
- Outlet numbers are likewise expected to rise, although it should be noted that outlet growth has remained strong throughout both 2008 and into 2009. While Starbucks' retrenchment in the US has generated headlines, outlet construction has continued apace in markets like India, Vietnam and parts of Western Europe, while even in markets hard-hit by the recession there has been no large-scale wave of outlet closures.
- The steady acceleration in both transactions and sales growth throughout the next five years reflects two factors. In more developed markets, the largest coffee shop chains have continued to upgrade and expand their food offerings, which, over the long term, has helped raise average transaction values. At the same time, transaction growth in emerging markets has been very strong and is expected to remain so, eventually pushing global transactions growth past sales growth by 2012.

Looking Ahead

Categories Continue to Blur:

The lines between specialist coffee shops, bars, taverns, pubs and traditional cafés and teahouses will continue to blur, as all operators look to drive traffic.

Bars will continue to invest in their food and coffee offerings, specialist coffee shops will continue to position themselves as legitimate food destinations, while "experience" has become the buzzword for the entire cafés/bars sector.

The number of specialist coffee shops with credible alcoholic drinks selections is expected to grow, as operators look to develop sales beyond the morning rush/afternoon periods, while more bars are expected to move towards high quality food offerings as a means of increasing repeat business.

Coffee Competition will Intensify:

Surging global demand and the potential for high-margin coffee sales should fuel steadily increasing competition for specialist coffee shops, both within the sector and without.

The growing maturity of the sector will lead to greater segmentation in many markets, with a clear demarcation between high-end and value operators.

At the low end, competition is projected to grow from fast food operators, convenience store chains and other retailers, as all look to add profitable coffee sales. Among higher end chains, food and ambience is expected to become paramount, as chains like Starbucks look to retain their edge as desirable places to work, study or socialise.

Definitions

All values expressed in this report are in US dollar terms, using a fixed exchange rate (2008).

All forecast data are expressed in constant value terms; inflationary effects are discounted. Conversely, all historical data are expressed in current value terms; inflationary effects are taken into account.

Cafés/bars

- This sector encompasses all establishments where the focus is on drinking either alcoholic or non-alcoholic beverages and where food is also served. Establishments serving beverages only are excluded. However, while a wide variety of snacks and full meals are offered, it is not uncommon for consumers to only order a drink. Cafés/bars comprises "specialist coffee shops" and "other cafés/bars". Juice bars, such as energy drink bars and fruit juice bars, have been excluded from this sector. They have instead been included in the "ice cream fast food" sector.

Specialist coffee shops

- Specialist coffee shops are "coffee-themed" outlets, which focus primarily on serving coffee: coffee is the main item on the menu, with a large variety of different coffee types and coffee-related products. Such drinks are sold on their own or with pastries, biscuits, cakes and sandwiches for consumption either on or off the premises. However, these outlets are currently developing a wider range of food items, such as salads and other light snacks. They usually offer take-away, and present a modern environment and designer décor. The concept includes both coffee-to-go chains and independent coffee houses. Outlets may also sell coffee beans, such as the Lavazza chain.

Other cafés/bars

- "Other cafés/bars" includes the following establishments: bars, lounge bars, and wine bars which are characterised by the sale primarily of alcoholic beverages, offering limited simple dishes; beer halls, branded or theme pubs, and traditional pubs, where beer is the main alcoholic drink consumed; cafés, traditional tearooms and tea bars, where non-alcoholic drinks are the main focus. Also included are outlets serving French or Italian patisseries and other similar products which have a sit down area, where people consume tea or coffee in addition to a light meal or snack.

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