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Growth Opportunities in China for Chain Restaurants and their Suppliers

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April 2006

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Agenda

- Why China?
- Key Country Characteristics—economic development, business environment, demographics
- Important Regional Differences
- Chinese Diet
- China's Restaurant Market—comparisons to U.S.
- Eating Out Habits
- Popular local and foreign chains
- Briefing on Technomic's China Restaurant multi-client program
- Contact Information
- Q & A

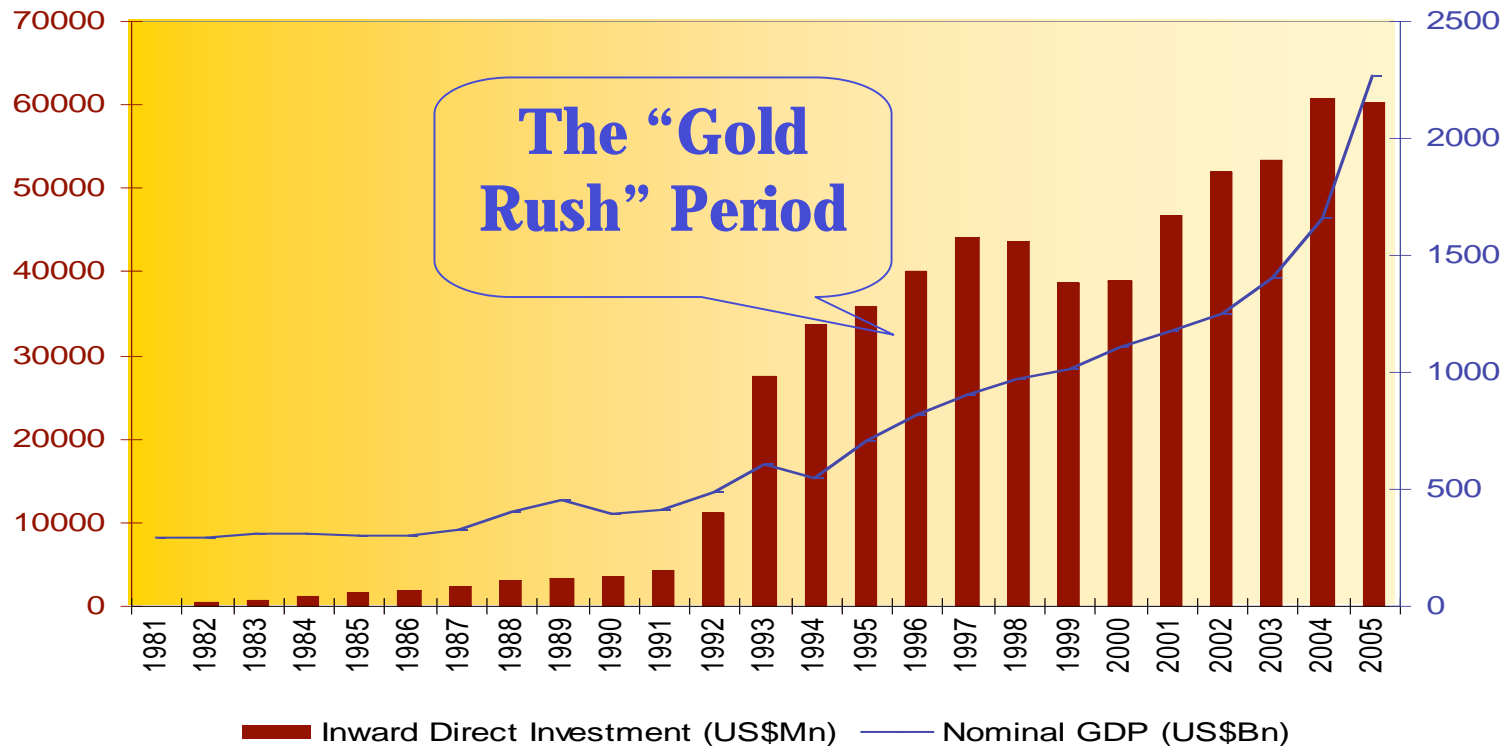
Why China?

China remains the most dynamic economy in the world...

- **Population:** #1 in the world at 1.3 billion
- **Urbanization:** there are more than 170 cities with over 1 million population
- **Trade:** 3rd in the world in total trade ->\$1 trillion annually
- **Growth:** Since 1993, GDP has increased more than 600%
- **Web users:** #2 behind the US in internet subscribers
- **B-School Grads:** 86 in 1991 up to 10,000 in 2004
- **MNC participation:** Of the global top 500 multinational companies, about 450 have invested in China, with some setting up regional headquarters in China;
- **Cell phones:** More than 300 million subscribers
- **Autos:** In the last four years, annual car production has increased from 230,000 to almost 3 million
- **Economic Impact:** China's economy has grown ~9 percent a year for more than 25 years
 - The fastest growth rate for a major economy in recorded history.
 - Moved 300 million people out of poverty and quadrupled the average Chinese person's income.

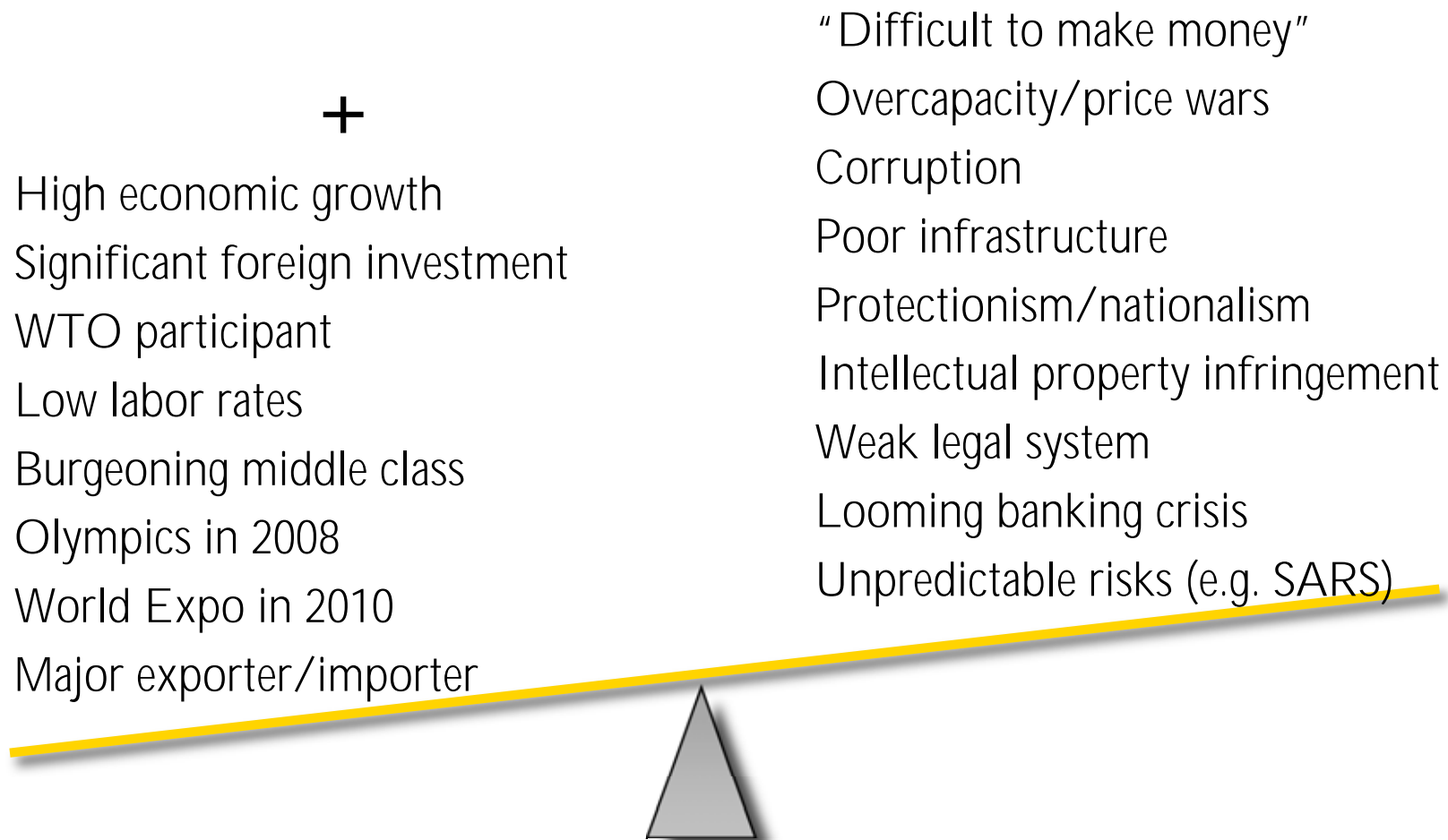
China's Economic Development

From a business standpoint, China is a newcomer to the world market and is still in an early and dynamic state of evolution.

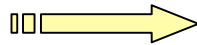
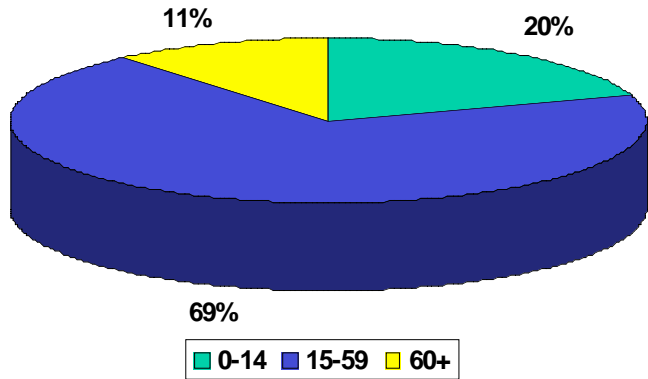


China's Schizophrenic Profile

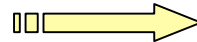
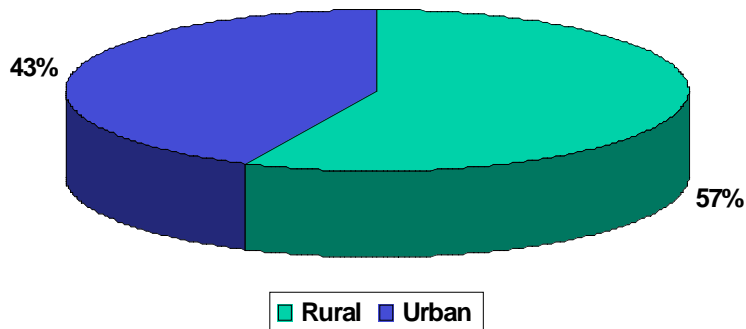
China's opportunity-risk scale



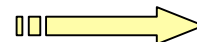
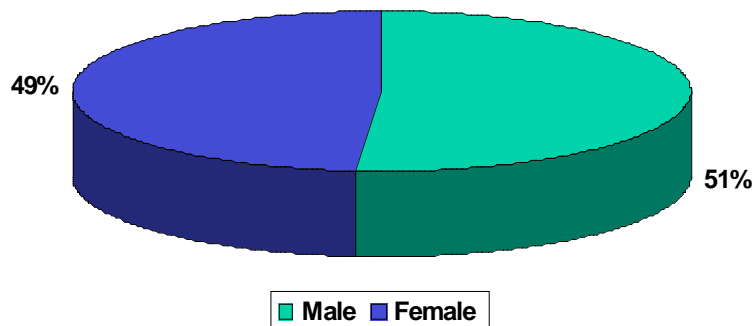
Key Demographics



- Since 1978 China has adopted a one-child family planning policy –in the coming years, the proportion of people over 60 will go up sharply.



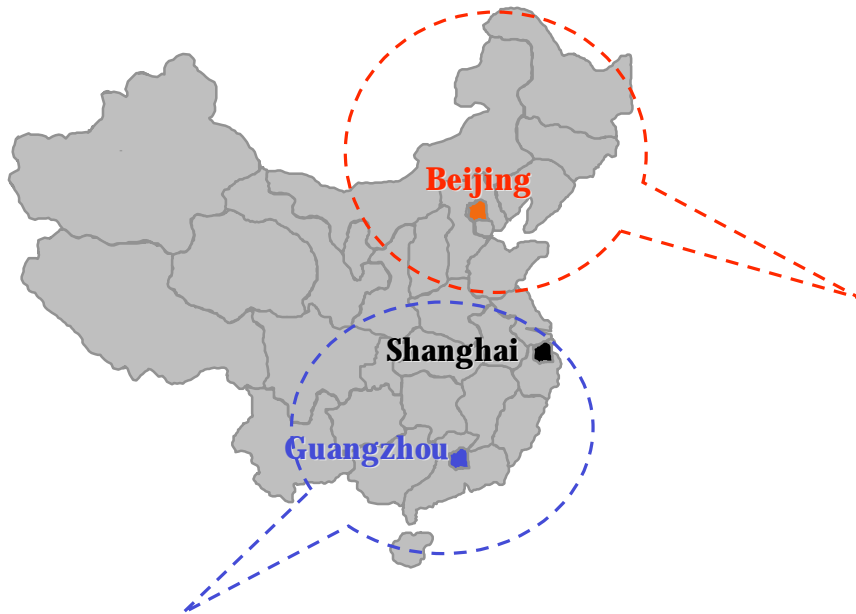
- Rural residents have been migrating to urban areas to find jobs while more and more rural areas are being developed into industrial areas—spurring continued urbanization.



- Rural Chinese tend to prefer male babies who are expected to support the family when grown-up.

Regional Difference

Wide differences in terms of culture -- North and South divide by Yangtze River:



- **Language:** Mandarin dominated
- **Personality:** Extroverted, less entrepreneurial
- **Climate:** 3 seasons, dry (North Eastern USA)
- **Food:** Flour-based food, like noodles, dumplings, buns, etc; Limited variety of cuisines

- **Language:** Thousands of dialects -- some major like Cantonese, Shanghainese, etc.
- **Personality:** Introverted, hard-working, entrepreneurial
- **Climate:** Wet, tropical in South (South Eastern USA)
- **Food:** Rice-based; more variety of cuisine: South-western food is known for spicy; Shanghai food tends to be sweet; Cantonese food highly varied (eat anything).

China's Diet (basic profile of urban resident)

- **Typically 3 meals a day**
- **Daily visit to farmers' market to buy fresh vegetables and meat**
- **Salty food more popular than sweet**
- **More chicken/pork than beef and fish**
- **Preference for food with good taste, smell and color instead of nutrition**
- **More emphasis on dinner and least about breakfast -- employees usually have fast food for lunch**



Breakfast



Lunch

China's Diet

Breakfast

In South (Canton area), people tend to spend hours for breakfast in nice restaurants with reasonable prices.

In other markets, young people tend to skip breakfast.

White-collar employees buy breakfast from dirty street stands as well, though some prefer to eat at home.



Typical Breakfast Menu for Urban Residents

Fried Braided-Bread (油条 You Tiao)



Wet Bread w/ Fillings (包子 Bao Zi)



Congee (粥 Zhou)



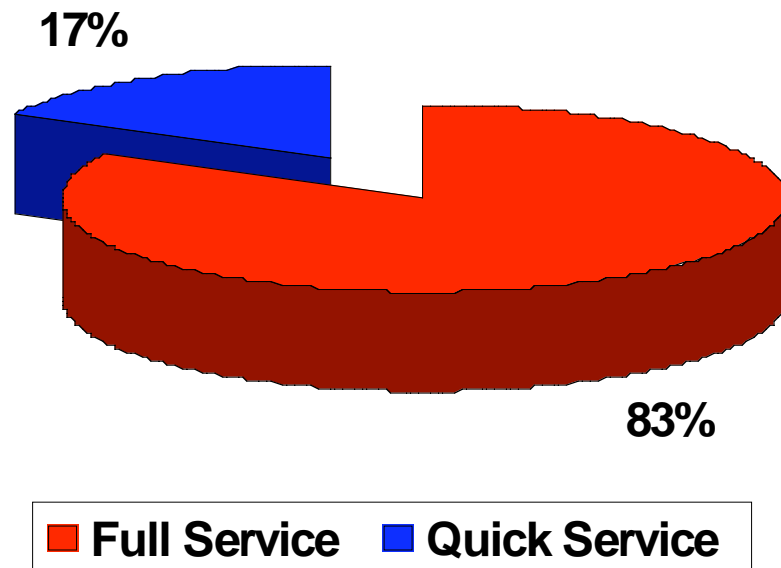
Combo Meal (烧饼油条 Shaobing Youtiao)



- A meal costs around 0.25-0.60 U.S. cents
- The menu tends to be high in calories (~950)
- Now some young families begin to include milk and bread in their menu

China's Restaurant Market

China's restaurant market* reached an estimated US\$110 billion in 2005 and is expected to maintain double digit growth through the end of the decade.



- **Key drivers...**
 - **General economic growth**
 - **Increasing disposable income**
 - **Continued urbanization**
 - **Changing consumer habits**
- **Quick service restaurants showing 20% per year growth as both local and foreign chains expand**

**Basically full and limited service restaurants*

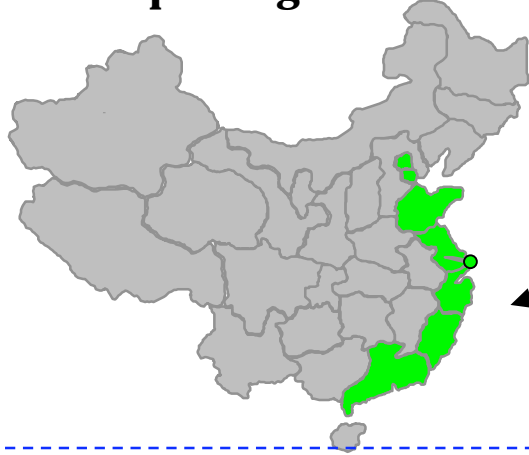
China's vs. U.S. Restaurant Markets

(2004 data)	China	USA
Total Revenues (US\$bn)	\$110	\$314
Growth Vector	15-20%	~7%
Total Restaurant Outlets	~3.5 million (>4 mm in 2005)	529,000
Average Revenue per Outlet	\$33,000	\$594,000
Number of Chain Restaurant Outlets	~7,000	184,000 (top 500 only)
McDonald's • Outlets • Revenue • Rank	600 \$454mm (E) #3	13,673 \$24.4 bn #1
KFC • Outlets • Revenue • Rank	1,200 \$1.2bn (E) #1	5,525 \$5 bn #7

Note: Full and limited service outlets--apples-to-apples comparisons are "rough" estimates

Overview of China's Chain Restaurants

Developed Regions in China



- **The average growth rate of chain restaurant industry in recent years is ~20%**
- **About 70% of the chain restaurants are located in the developed regions on the East Coast**

- Largest chains are foreign – KFC and McDonalds have 25-30% of all chain outlets
 - 75-80% of chain restaurants are local -- but their average number of outlets is much less
- Famous local chain brands include:
 - 小肥羊 (Little Sheep/Xiao Fei Yang, #1 local brand, established in 1999 in Inner Mongolia, specialized in Hot Pot self-cooking mutton food, over 700 outlets, annual sales of US\$ 541 mm in 2004)
 - 北京小土豆 (Xiao Tu Dou/Little Potato, established in 1989 in Shenyang, Liaoning, specialized in noodles as well as sea food restaurants, totaling over 170 outlets, with annual sales of US\$ 230 mm in 2004)
 - 马兰拉面 (Ma Lan La Mian, Chinese fast food restaurant, established in 1995 in Beijing, specialized in noodles, over 440 outlets, with annual sales of US\$ 60 mm in 2004)
 - 江苏大娘水饺 (Da Niang Shui Jiao – established in 1996 in Changzhou, specialized in dumplings, over 200 outlets, with annual sales of US\$ 33 mm in 2004)

Typical Quick Serve Restaurants



Typical Quick Serve Restaurants



Eating Out Habits

About 70-80% of people eat out for work lunch -- typical price around 1 US dollar.

- 80% of eating out occasions are for dinner--budget typically...
 - <3 US dollars per person for low-end restaurant
 - 3-5 US dollars per person for mid-end restaurant
 - 5 - 12 US dollars per person for high-end restaurant
 - 12 US dollars or above for superior/5 star.

Typical mid end urban quick service restaurants



Note: Based on Technomic survey of 100 mid-higher income residents in Shanghai

Popular Local Chains



Rice noodle for lunch-dinner



Milk tea -- mid-high end

Famous bean curd soup/fried bread



Noodle lunch

Eating Out Habits—Chain Restaurants

- Social gathering and convenience are the top reasons for people to eat out
- Food type/taste is the dominant restaurant selection criterion (50%)
 - Cost, convenience and safety are highly considered as well
- Over 80% learn of the desired restaurants through word-of-mouth.
- Over half the respondents expect to eat out more in the future due to higher disposable income, desire to socialize and “get out of the house”.
 - Underlying desire for more enjoyment out of life
- Consumers tend to be conservative in trying out a new restaurant
 - Friend's recommendation has a lot of weight
 - And curiosity

Note: Based on Technomic survey of 100 mid-higher income residents in Shanghai

Western Chains

For the quick service restaurants, over 50 % go to western chains-- KFC, Mc Donald's and Pizza Hut were by far the top chains mentioned by consumers.

Positives

- Good hygiene
- Atmosphere
- Convenience
- Good taste



Negatives

- Simple menu
- Expensive



Western Chains

KFC's congee



Western Chains

Full service western restaurant chains are limited to date in China...



- The reason to go to a full service restaurant is to try new food types and is due to its reliable, clean & hygienic environment. Many people would love to try but their concern is the expensive price.
- Among the western cuisines, French and Italian are well known and very attractive.
- Atmosphere was valued most in selecting a western full service restaurant.

Note: Based on Technomic survey of 100 mid-higher income residents in Shanghai

Entry Considerations

- Timing—not too early or too late
- Addressable/target market
- Value proposition versus cost
- Scale of operation
- Localization of supply chain/management
- Protection of brand/IP
- Value of local partnership
- Owned versus franchise
- Geographic coverage/pace of rollout

Technomic's Multi-Client Program

The overall objective of this common sponsor program is to present a detailed and strategic view of China's chain restaurant market. The overall goals of the program cover the following main areas:

- Overview of the scope and nature of China's economic development
- Characterization and present structure of China's restaurant industry
- Position and activity of major chain restaurants
- Presence and position of foreign chain restaurants
- Characterization of consumer eating out behavior and interest in Western chain restaurants
- Industry supply structure (food, disposables and equipment)
- Regulatory environment and major constraints
- Key success factors
- Overview of entry/expansion considerations
- Proprietary China management workshop (China Readiness Assessment)

Technomic's Multi-Client Program

The deliverables of this report will provide the foundation on which a China entry or expansion strategy can be built.

Each sponsor will participate in a workshop to take the next step in processing the market findings and leading to a tangible response.

- Review of the sponsoring company's *China Readiness Profile* (see www.chinareadycompany.com)
- Discussion of potential opportunities in China
- Identification of possible strategic responses
- Review of next step initiatives for consideration

Charter sponsors will also be able to contribute to the research's design and list of issues (including the consumer research module)

Technomic's Multi-Client Program

The core methodology will be a series of in-depth, face-to-face interviews with major players in the restaurant value chain. Effective interviews of this type in China are done personally and in a probing, open-ended manner.

Research Target and Type	Number of Completes	Description
Probing Operator Interviews	50	<ul style="list-style-type: none">▪ Focus on major chains, both local and foreign, including headquarter/ China management
Probing Channel Interviews	50	<ul style="list-style-type: none">▪ Includes interviews with distributors and product suppliers
In-depth, personal interviews with consumers	1500	<ul style="list-style-type: none">▪ A cross section of consumers in 7 key cities
<i>TOTAL</i>	<i>1600</i>	

Technomic's Multi-Client Program

For a complete proposal, please contact:

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THANK YOU!