

Indian Restaurant & Food Service Industry – Structure & Prospects

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Overview

The Indian Restaurants and Food Services Industry has continued to expand at a healthy pace, aided by y-o-y growth in the incomes and largely unaffected by the prevalent economic scenario that has slowed growth in sectors like manufacturing and infrastructure. The market size of the Indian restaurants and food services industry stands at Rs 3.7 trillion as of 2018 registering a y-o-y growth of about 10% and a CAGR growth of 8.4% between 2013 and 2018.

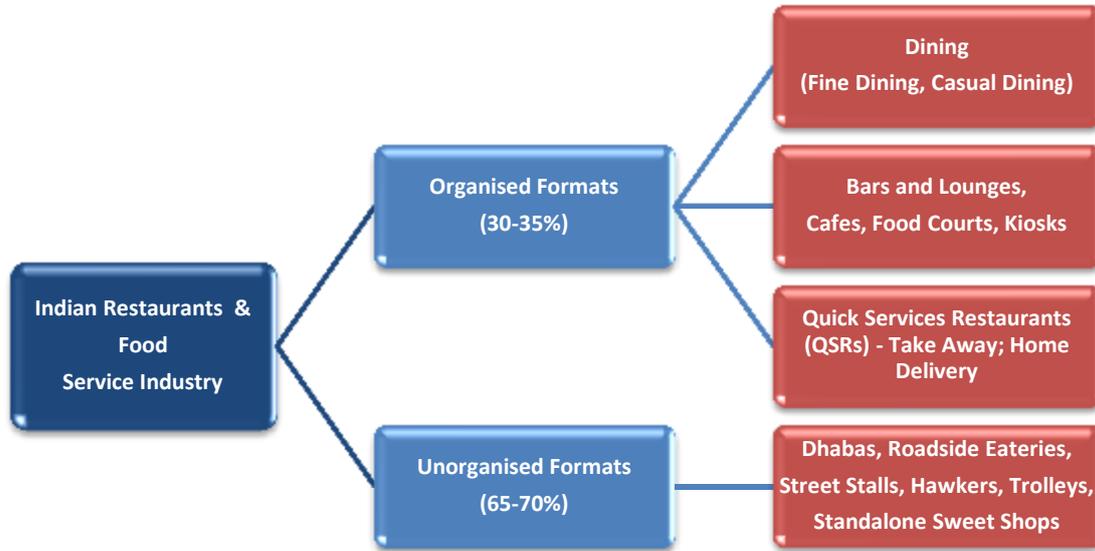
The Indian restaurant and food service industry comprises two distinct segments: **organised and unorganised**. The organised segment accounts for about 30-35% of the industry, while the unorganized segment accounts for the remaining 65-70%. The organised segment is characterised by an organised supply chain with quality control and sourcing norms with multiple outlets having standardised designs. The unorganised segment lacks technical standardisation and a structured supply system or business practices.

The unorganised segment of the industry consists of individuals or families selling ready to eat food through roadside vendors, dhabas, food carts, street stalls, etc. However in line with the evolving consumer preferences and increasing innovation by the organized formats, the industry has experienced a rapid shift towards the organised segment in the recent past. The shift is further fuelled by the foray of large global international brands into the organised food service sector.

Quick services restaurants (QSRs) and casual and fine dining restaurants account for about 75-80% of the organised segment, followed by cafes & bakery and pubs, clubs, bars, and lounge (PBCL) accounting for about 8-10% and institutional catering and kiosks with 13-15% share in the organised market.

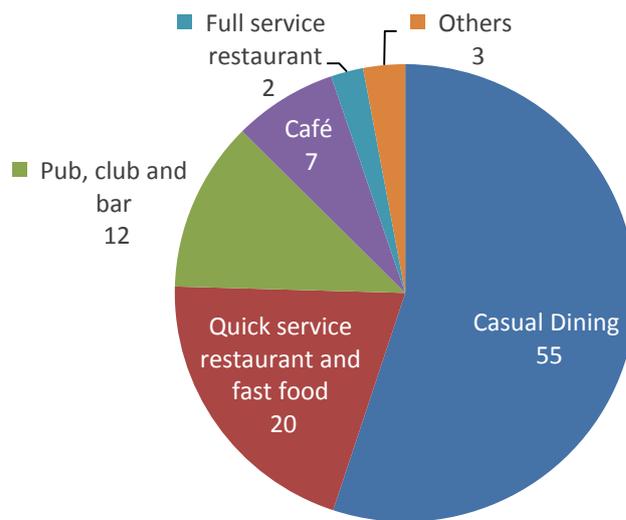
Going forward, CARE Ratings expects **the restaurant and food service industry to register a growth of about 10.4% CAGR for the next 5 years between 2018 and 2022 to reach Rs 5.5 trillion by 2022**. The growth will be supported by long term healthy demand outlook backed by higher disposable income, favorable demographics and rising aspirations of the burgeoning middle class, increasing internet penetration, increasing number of women joining the workforce, increasing focus on health and wellness, technological advancements and growing urbanization.

Chart 1: Indian Restaurant & Food Service Industry



Source: Company presentations, Industry

Chart 2: Indian Organised Food market segmentation – FY19 (%)



Source: FICCI, Company presentations

Quick service Restaurants (QSRs) forms an integral part of the Indian Food industry. The QSRs have both fast food cuisines as well as minimal table services and majorly cater to the millennial and working professionals usually in the age bracket 15 – 40 years. The USP of QSRs is quick deliveries and competitive pricing that attract consumers.

Major drivers of Indian food industry

1. Favourable demographics

- The growing Indian population has also led to increase in the 'earning population' (age group 15-60) of the country. The proportion of Indian populace in the age group of 15-60 years increased from 62.5% in 1991 to 66.2% in 2016.
- Considering the huge size of the Indian population, the lower median age implies a higher number of working people thereby clearly outlining the immense earning as well as spending potential of the Indian populace.
- Taking into account the age group below 25 years being one of the highest spending age group, the current age dynamics are expected to boost the retail sales in India. The median age of India is 26.7 years, one of the lowest globally in comparison to 37.2 years in the US, 45.8 years in Japan and 36.3 years in China.

2. Economic growth

- GDP registered an average growth of over 7.5% in the last 5 years, i.e. between FY15 and FY19
- Per capita GDP witnessed a growth of over 10% y-o-y and per capita Private Final Consumption Expenditure (PFCE) registered growth of over 11% on y-o-y basis during FY19
- With International Monetary Fund (IMF) and Organisation for Economic Co-operation & Development (OECD) estimations of India becoming one of the fastest growing large economies in the world, the consumer sentiments remained quite positive in FY19 in terms of spending on services registering a growth of about 7.4% y-o-y in FY19. However, the growth was marginally slower compared with previous years on back of uneven monsoon that led to lacklustre agricultural growth and subdued consumption demand.

3. Rising income levels & growing per capita expenditure

- In the last decade, Indian economy has progressed rapidly. Correspondingly, India's per capita GDP has gone up from Rs 98,405 in FY15 to Rs. 143,048 in FY19 at a CAGR of 9.8% fuelling a consumption boom in the country.
- Correspondingly, the per capita personal disposable income surged from Rs 100,439 in FY15 to Rs 144,758 in FY19 at a CAGR of 9.6%. Also, the per capita private final consumption expenditure too rose from Rs 57,201 in FY15 to Rs 85,086 in FY19 at a CAGR of 10.4%. The growth in country's per capita GDP in turn has increased the disposable income of the populace ultimately driving the country's consumption.

4. Growing spread of plastic money & easy availability of credit

- The growing use of 'plastic money' i.e. credit and debit cards has resulted in an increased spending amongst the consumers thereby fuelling the demand in the service sector. With the acceptance of plastic money by almost all the service providers in the organised segment, the number of outstanding plastic cards in the country is on a rise. The incentives such as cash-back offer or discounts on selected sales linked to the plastic money have lured the Indian consumer to experience the pleasure of 'cashless spending'.

Chart 3: Credit card transactions (000 Nos)

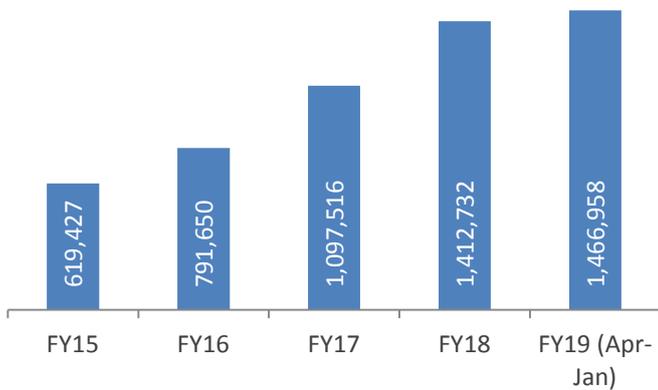
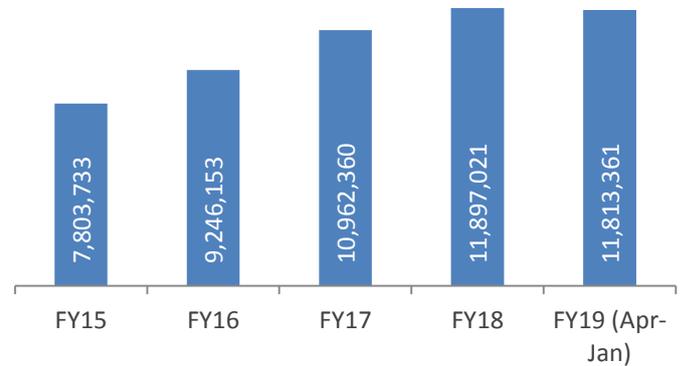


Chart 4: Debit card transactions (000 Nos)



Source: RBI, CMIE

5. Internet penetration & technological advancements

- As of June 2018, India's internet penetration in the urban areas stood at 82.1% and 19.5% in the rural areas
- Number of active internet users in the country is the second highest globally and data usage of 8 GB per subscriber per month is comparable to developed countries
- With the increasing number of internet users in the country, the food industry in India has seen a sharp growth in demand. As per Telecom Regulatory Authority of India (Trai), broadband subscribers increased from 99.2 million in March 2015 to 550.2 million users in February 2019 registering a sharp CAGR growth of over 53% during the 5 year period.
- Also, with emergence of many online food aggregators such as Zomato, Uber Eats, Swiggy, etc, a substantial part of the unorganised market has come under the purview of the organised segment and availability of restaurants options for consumers has increased considerably thereby driving the demand. Deals, discounts and convenience offered by these aggregators also add to driving demand for the restaurants and QSRs.

6. Growing female working population

- On the backdrop of growing Indian economy during the recent years, the participation of female workforce in the country's economic activities has increased considerably. The proportion of the female workforce which accounted for 26% of the country's workforce during 1971 has scaled to 31% during 2011. Notably, the percentage of working women involved in the organised industrial activities too has gone up from 27% in 1981 to 47% in 2011 (As per Indian census).
- The higher purchasing power in the hands of 'working-women class' compared to the housewives enhances the ability of the former to spend much more comparatively.
- Further the 'time constraint' factor also needs to be accounted for by the working women while making purchases of various day-to-day requirements. Capitalizing on the same, the organised industry have increasingly emphasized on the 'order online' concept.

Major Challenges faced by the industry:**1. Input risks**

- A. **Raw material** – With agriculture being the dominant sector of the Indian economy contributing ~14% of GDP in FY18, the availability of raw materials such as vegetables, grains, etc is high. The government has mandated the payments of Minimum Support Price (MSP) for food grains, while the sale of vegetables and fruits happens through Agricultural Produce Marketing Committee (APMC). Hence, there is minimal control or bargaining power with the supplier of raw materials. However food inflation impacts the restaurant industry by increasing the input cost for various food ingredients, which forces restaurateurs to hike the menu price. The price hike becomes difficult during economic slowdown and high inflation scenario which impacts consumers' discretionary spending and consumption patterns.
- B. **Land** - Land for restaurant is difficult to acquire due to different requirements of outlets as compared to other entities. Hence, the trend of restaurants coming up in malls has been picking up in recent times. Also the real estate rentals of prime location have increased in the past years, contributing a significant percentage to the total costs incurred during operations
- C. **Manpower** - The Fine Dining segment of the Indian restaurant industry requires employees with specific skill sets such as fluency in English, training in etiquette and basic knowledge of the workings of the sector. The current system of training in hotel management does not produce enough graduates and getting English speaking staff with basic service skills is proving to be a challenge for the industry. The segment also faces high levels of attrition of 40-50%. The similar issue is also witnessed by other segments like QSRs, where availability of trained and professional chefs and waiters is scarce.
- D. **Technology** - The technology is slow moving in the Indian restaurant and QSR industry. However increasing number of organized players are adopting online and mobile ordering systems to increase their sales.
- E. **Capital** - The restaurant and fast food industry is not highly capital intensive in nature. However, due to the low cash turnaround time, it needs high working capital. Due to assured margins, banks and financial institutions willing lend to restaurants and fast food chains.

2. Penetration levels & substitutes

- The industry is largely unorganized; however there has been increasing shift towards organized market in the recent past owing to many international and organised players entering the Indian market. Organised players have presence in urban and semi-urban areas of the country, limiting the penetration. Packaged and Ready-To-Eat foods are significant competitors to the Indian restaurant industry.

3. Entry barriers

- India's organised restaurant segment is witnessing intense competition, with a large number of international players keen to enter the industry. The industry has regulatory entry barriers in the form of 10-12 licenses, documentations and permits, permitting easy scalability. The industry is not highly dependent on technology, limiting the need for high capital requirements. However, players have to invest in setting up robust supply chains. A strong distribution network in the form of increasing number of outlets is a critical factor for setting up a restaurant business in the country. The restaurateurs continue to focus on creating a strong brand value and are growing their marketing strategy.

Financials

CARE has analysed the revenue and cost structure of the organised restaurant & food service industry in India. Net sales have continued to register double digit growth of over 17% y-o-y during 9M FY19, comparatively higher than 16.1% registered during 9M FY18.

Table 1: Industry Sales and Margins (9M)

(Rs crore)	9M			Growth (%)	
	FY17	FY18	FY19	FY18	FY19
Net Sales	5,096	5,914	6,946	16.1	17.4
Expenditure	4,488	5,090	5,927	13.4	16.5
Cost of services & raw materials	1,261	1,462	1,589	15.9	8.7
Operating & Manufacturing cost	1,973	2,248	2,841	13.9	26.4
Employee cost	907	1,000	1,116	10.3	11.5
Other Expenditure	347	379	382	9.2	0.6
Operating Profit	702	903	1,158	28.7	28.2
Operating Profit Margin (%)	13.8	15.3	16.7	-	-
Interest	243	267	324	9.5	21.6
Tax	70	127	189	81.7	49.1
Profit after Tax	41	170	307	316.8	81.2
Net Profit Margin (%)	0.8	2.9	4.4	-	-

Note: 1. The industry margins are based on the financial results of 4 listed restaurant players

2. of these, results considered for 2 players is on standalone basis, while consolidated results have been considered for 2 companies

3. 1 company with consolidated results has over 50% revenue share from restaurant and hospitality business and the other company has only one business segment as 'QSR' as primary business

Source: AceEquity, company reports

- Prior to FY18, a lot of factors such as demonetization, liquor bans in various states along the highways, introduction of goods and service tax (GST), reckless expansions of outlets weighed down on the overall performance of the QSRs and food service industry. However, post FY18, players focus on same store growth, streamlining of processes post GST, food innovations, etc have supported the revenues of the industry. Also, with GST coming in effect, the rate of tax came down significantly from 18% to 5% thereby reducing the total cost for consumers.
- Operating profit margin also continued to witness an expansion of about 140 basis points during FY18 and FY19 on back of higher revenues despite increased expenditure. Interest cost for players increased by over 21% during 9M FY19 vis-à-vis a growth of about 9.5% during the corresponding period previous year while tax expense significantly declined during the same period. Therefore, the net profit margin during FY19 (Apr-Dec) registered an expansion of about 150 basis points.
- Interest cover (ratio of PBDIT/interest) for the set improved marginally to 3.6 times in 9M FY19 compared with 3.4 times in 9M FY18

Government regulations

The Indian Hotels & Restaurant Industry's contribution together to GDP and exchequer continues to remain negligible at below 1% till FY18. The industry provides employment opportunities for kitchen staff, waiters, chefs, etc.

Duty Structure

With introduction of the Goods and Service Tax (GST) from July 1, 2017, service tax and Value Added Tax (VAT) have been done away with.

GST rates (applicable from July 1, 2017)

	Pre GST Regime		Post GST Regime	
	Central Taxes	State Taxes	Central Taxes	State Taxes
Restaurant (without air conditioning)	-	-	2.5%^	2.5%^
Restaurant (with air conditioning)	15% on service component^^	12.5% of food bill 20.0% for alcohol bill	2.5%^	2.5%^
A/c restaurant in 5 star or above rated hotel	15% on service component^^	12.5% for food bill 20.0% for alcohol bill	9.0%^^	9.0%^^

Note: ^ With no input tax credit

^^ with input tax credit

- Liquor however continues to attract state levies like VAT as its kept outside of GST regime
- Restaurants inside Hotels will also levy 5% GST, except for starred hotels with tariffs over Rs 7,500

Source: CBEC

The Government of India allowed 100% FDI in single brand retail under the government approval route and relaxed the 30% sourcing of products clause (for FDI above 51%), proactively contributing to the growth of the restaurant Industry in the country. However, the number of licenses required to set up a restaurant in India continues to be bit challenging for players wanting to set up operations in the country. There are at least 10 to 12 different basic licenses required to set up a restaurant business, although seeking these licenses is not very difficult. Once, obtained the business can be easily scaled up.

Investments

The Indian restaurant and food service industry has been attracting significant investments both from domestic as well as international private equity and venture capitalists lately. Various factors such as macroeconomic factors, ease of doing business, changing consumer preferences, etc. has led to a surge in investments in the Indian restaurant and food industry majorly in the **QSR segment**. The food tech space alone witnessed a growth of close to 400% in investments during FY18 crossing US \$370 million.

Some of the major investments in recent years:

- The investment arm of French luxury goods conglomerate LVMH, L Catterton Asia, acquired a controlling stake in Impresario Entertainment & Hospitality, which owns fine dining restaurant brands Smoke House Deli and Social at about Rs 400-450 crore

- Massive Restaurants Pvt. Ltd (MasalaBar, Pa Pa Ya, Farzi Café) raised about Rs 100 crore in FY18 from private equity fund Gaja Capital to fund expansion
- Sapphire Foods raised Rs 225 crore of equity investment led by Edelweiss Private Equity and its existing investor Goldman Sachs for funding its expansion plans in India in December 2018
- Swiggy, online food delivery startup raised \$1 billion from existing investor Naspers Ltd and China's Tencent Holdings Ltd in December 2018, making it the biggest ever funding in the country's booming food-tech sector
- Alibaba's payment affiliate Ant Financial invested \$210 million in restaurant discovery and food-delivery platform Zomato in October 2018
- Zomato, to promote cloud-based kitchen, has committed to investing US\$15 million in Bengaluru-based Loyal Hospitality
- Hardcastle restaurants, owner and operator of McDonald's restaurants in west and south India, plans to invest Rs 800 - 1,000 crore over the next 3 year period to introduce healthier options (low-calorie, low-fat alternatives) and digitise its stores to attract millennial.

Outlook

- Going forward, CARE Ratings expects **the restaurant and food service industry to register a growth of about 10.4% CAGR for the next 5 years between 2018 and 2022 to reach Rs 5.5 trillion by 2022.**
- The growth will be supported by long term healthy demand outlook backed by higher disposable income, favorable demographics and rising aspirations of the burgeoning middle class, increasing internet penetration, increasing number of women joining the workforce, increasing focus on health and wellness, technological advancements, and growing urbanization
- With the surge in investments in the online food ordering business, the industry is expected to witness substantial growth and operations of large segment of the unorganized market are expected to get streamlined into organized market
- Also, in the years to come, premium dining and QSRs are expected to expand their presence in multiple non-metro towns across country.

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