Stock Market Review

Costa Coffee internationalisation strategy

Edward Rizzo

Edward Rizzo is a director at Rizzo, Farrugia & Co. (Stockbrokers) Ltd.

On February 19, Island Hotels Group Holdings plc announced that The Coffee Company Malta Ltd was recently awarded the Costa Coffee franchise in selected parts of Spain, namely the East Coast, the Balearic Islands and the Canary Islands. The Coffee Company Malta is a fully-owned subsidiary of Buttigieg Holdings Limited which in turn is 50 per cent owned by Island Hotels Group, 30 per cent by John Buttigieg, 13 per cent by Pierre Bartolo and 7 per cent by Mario Mifsud.

This may have been a surprising announcement to many, given that Island Hotels and Buttigieg Holdings have only been associated with Costa Coffee for less than two years. In fact, the franchise agreement between The Coffee Company Malta and Costa International granting it the exclusive development and operating rights for Costa Coffee shops in Malta was signed on May 16, 2012.

Over the past 21 months, The Coffee Company Malta converted five outlets from their 'unbranded' stores into Costa Coffee shops.

Island Hotels reported on February 19 that another two outlets will be opened in Malta by the end of 2014. Following the announcement of the award of the Costa Coffee franchise for selected regions in Spain, I met up with the CEO of Island Hotels Winston Zahra to delve deeper into the internationalisation strategy of the retail catering business unit.

Mr Zahra was visibly excited at the first opportunity for the Island Hotels Group to expand outside Malta. I started the interview by asking him to explain how this opportunity arose. The CEO disclosed that the parent company of Costa International, Whitbread plc which forms part of the FTSE 100, took a decision to expand across Spain and asked their top European franchisees to participate in a tender. Costa Coffee is currently only operational in the airports of Barcelona and Alicante.

The Buttigieg Holding's subsidiary, The Coffee Company Malta, was among the ones selected to participate "based on the immediate success of the Costa Coffee expansion in Malta".

Mr Zahra noted that Whitbread split the expansion strategy across three areas – Northern Spain, the central part of Spain and the East Coast. The CEO confirmed that a decision was taken by Island Hotels and Buttigieg Holdings to submit a tender only for the East Coast of Spain including the Balearic Islands and the Canary Islands given their dependency on tourism especially from the UK.

The agreement with The Coffee Company Malta Limited allows the company to open and develop 75 Costa Coffee shops in Spain over the next five years in an agreement which then spans 10 years.

Over recent years, the Spanish economy passed through very troubled times with record levels of unemployment leading to a severe economic contraction.

While the rate of unemployment is still among the highest in the eurozone at 26 per cent, recent statistics indicate that the economy has started to recover very slowly.

Despite signs of an improving economy, at first glance, many observers would rightly think that these conditions are hardly the right ingredients for a successful business venture. So I asked Mr Zahra why they decided to submit a tender for such an ambitious project.

The CEO quickly pointed out that a significant amount of research took place, which indicated that the Catalunya region, the main area covering the agreement with Costa International, is the most important contributor to the Spanish economy with per capita income above other regions and the rate of unemployment being lower than other parts of the country.

Mr Zahra substantiated his arguments with some interesting facts showing that Barcelona is the fourth most visited city in Europe after Paris, London and Rome.

Moreover, in 2010, Barcelona was the second most active city in the world for organised events.

In fact, the CEO confirmed that tourism figures for Spain remained very steady even during the crisis.

Mr Zahra made reference to data from the World Travel and Tourism Council which shows that in 2010, Spain's tourism industry directly contributed 6.4 per cent to GDP, equivalent to €62.1 billion.

The figures of the World Travel and Tourism Council place Spain in fifth place in terms of income from tourism after the US, Japan, China and France.

Mr Zahra explained that circa 57 million tourists visit Spain each year and the high incidence of British tourists (25 per cent) is an important ingredient for the Costa expansion given the wide penetration of Costa Coffee shops across the UK. Moreover, the most frequented region is Catalunya with 15 million visitors per annum, followed by the Balearic Islands with 10.2 million and the Canary Islands with 9.6 million.

The Coffee Company Malta will require a significant recruitment drive in the coming years to carry out this ambitious strategy. The CEO explained that Robert Buttigieg would continue to lead the Costa Coffee expansion in Malta while Raphael Cauchi will shortly be moving permanently to Spain to head the operation there.

Mr Zahra was full of praise for Dr Buttigieg, who has led the local expansion to date and been instrumental in winning the Spanish contract as well as for Mr Cauchi, who has been with the Island Hotels Group for 16 years and is someone "trustworthy who understands and practices the group's values".

The CEO stated that they are working towards a "well-defined recruitment plan" which will eventually lead to a full management team being based in Barcelona to oversee the various retail outlets.

Preparations to commence the store rollout are already very well advanced and Mr Zahra confirmed that a site in Barcelona is on the verge of being secured to enable the first Costa Coffee outlet to open during the third quarter of 2014. The CEO added that the first six outlets will all be located in Barcelona. The focus is currently on searching for the right locations which will provide the required footfall for successful outlets.

Mr Zahra claimed that these are critical factors together with attractive rental agreements with the landlords. The CEO is well aware of the challenges ahead and explained that Costa Coffee will be competing with a local brand ('Café & Te') and more importantly with Starbucks, which has a wide presence across the region.

"The figures of the World Travel and Tourism Council place Spain in fifth place in terms of income from tourism after the US, Japan, China and France"

Without delving into too much detail, Mr Zahra confirmed that the initial investment required to open the first few stores is not sizeable but this will naturally increase in the coming years as The Coffee Company Malta moves towards the complete execution of its business plan encompassing up to 75 outlets.

The CEO explained that the sale of the Coastline Hotel, which was also confirmed last week, barely 24 hours after the announcement on Costa Coffee Spain, together with other funding plans being worked upon, will enable the Island Hotels Group and Buttigieg Holdings to undertake the investment required for the internationalisation strategy in the years ahead.

Given the sensitivities involved, Mr Zahra did not wish to divulge any information on the expected revenue streams and margins being targeted from the outlets in Spain. However, he claims that the margins of Costa Coffee Spain should eventually exceed those in Malta due to the size of the market and the economies of scale once various outlets are operational in the years ahead.

During the interview, I also asked the CEO to provide information on the performance of the five Costa Coffee outlets in Malta which were opened in the past 21 months. Mr Zahra claimed that the general feedback was very good and the numbers are reflecting this positive perception.

Mr Zahra noted that The Coffee Company Malta registered significant revenue growth of between 35 per cent to 40 per cent compared to the unbranded outlets operational before the rebranding to Costa Coffee.

Margins are also "healthy and very much in line with the figures registered by other Costa Coffee outlets across the world".

This instigated Island Hotels and Buttigieg Holdings to open a further two outlets in Malta by the end of 2014 which the CEO confirmed will both be located in Valletta.

I was curious to know whether the listed status of Island Hotels Group assisted in the awarding of this prestigious tender amid stiff competition from other operators around the world.

Mr Zahra explained that the stock exchange listing was "important but not the determining factor". The CEO said that in his view, the most important factor was the way the brand in Malta was handled and the success achieved in such a short period of time.

However, the CEO confirmed that when dealing with international companies, the listing status proves to be very helpful given the corporate governance and transparency that is associated with a stock exchange listing.

Mr Zahra was clearly more upbeat when compared to our encounters in past years. There are many reasons for this increased optimism. He has managed to achieve a turnaround in the group's operational performance despite the continued difficulties in the international timeshare market.

Moreover, the CEO continued to achieve steady progress on some important strategic milestones, with the recent announcements of the Spanish franchise of Costa Coffee and the planned disposal of the Coastline Hotel.

Mr Zahra claims further initiatives are "being worked upon but still under wraps" to steer the Island Hotels Group to more rewarding times in the years ahead.