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GAIN Report

Global Agricultural Information Network

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Blossoming Coffee Culture Creates Opportunities for US Exporters

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Report Highlights:

Russia has historically been a tea drinking culture going back several generations. But in the last 20 years, the number of cafés in Russia has increased exponentially. The café market in just Moscow and its suburbs is currently estimated to be worth about \$2 billion. Chained cafés/bars recorded current value growth of 47 percent in 2013 with sales reaching 34 billion rubles, while the number of outlets grew by 17 percent to surpass 1,700. In 2013, 18.1 percent of Russians visited a cafés - making them second only to fast-food restaurants in popularity. Currently there are roughly 5,200 cafés in Russia.

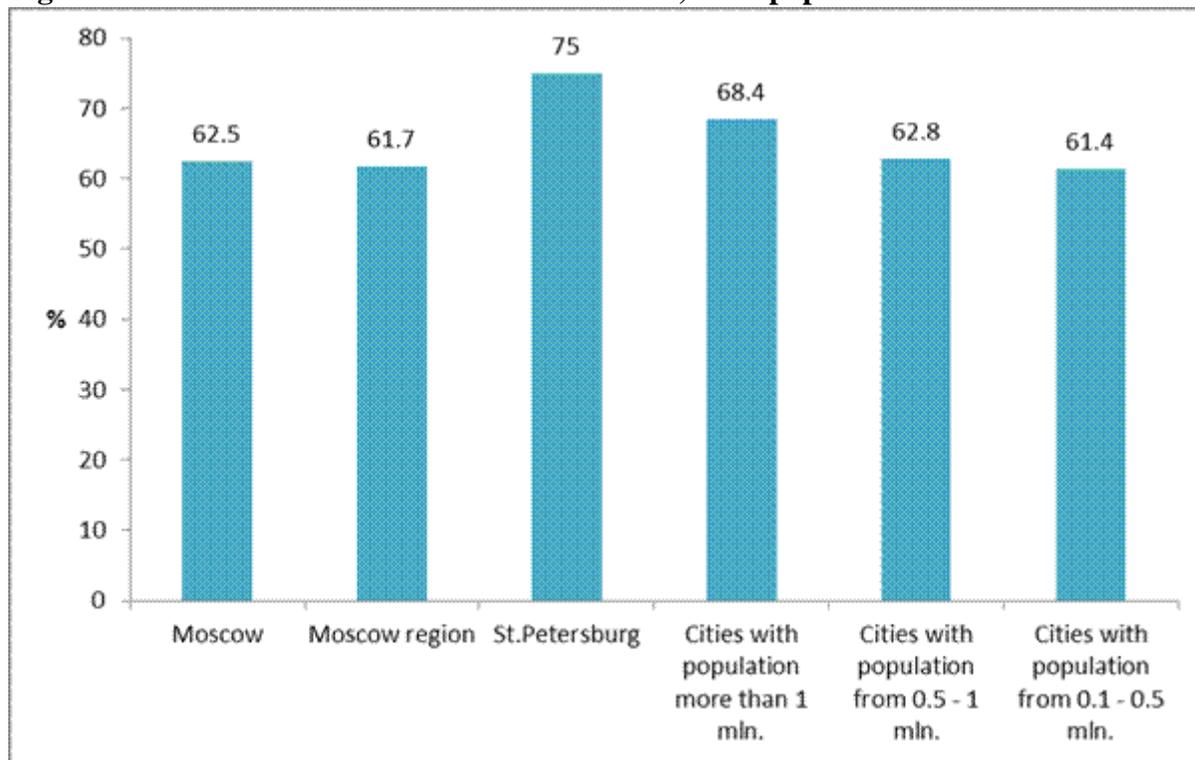
General Information:

Cafés Are Growing in Popularity

The café market in Moscow and its suburbs is currently estimated to be worth about \$2 billion. The popularity of cafés among urban consumers in the largest Russian cities is large and growing. According to InFOLIO Research Group, the value of the café market reached 6.73 billion rubles in 2012 (14 percent increase in comparison to 2011). In 2012, chained specialist cafes in Russia registered an impressive 26 percent current value growth and a 16 percent increase in the number of outlets, riding a wave of interest in coffee culture, particularly among the urban affluent consumer.

Chained cafés/bars recorded current value growth of 47 percent in 2013 with sales reaching 34 billion rubles, while the number of outlets grew by 17 percent to reach over 1,700. This growth reflects the sharp development of chained foodservice players, which are mainly expanding regionally. In 2013, 18.1 percent of Russians went to cafes - making them second only to fast-food restaurants in popularity. That figure dropped to 13 percent in the first quarter of 2014, which has seen it outflanked by sushi bars and pizzerias, according to Synovate Comcon consultancy. Market analysts have stated that 65 percent of residents from 18 to 54 years of age from cities with a population of more than 100 thousand visited cafés in 2013.

Figure 1. Russia: Visits to Cafes in Russian Cities, % of population



Source: RBC Research

Currently there are roughly 5,200 cafés in Russia and about 1,340 of them are managed by 80 chain

operators. Most cafés are concentrated in Moscow – about 670, and in St. Petersburg - about 470 coffeehouses. In Moscow each third café belongs to Shokoladnitsa and each fifth belongs to Coffee House. There is an increasingly high concentration of the leading chains, including Shokoladnitsa, Coffee House, Coffeeshop Company, Starbucks, McCafé, and Costa Coffee in these cities leading many of these chains to expand to the Russian regions. Non-chain cafés are significantly less common in the large cities. The rapid development of modern hypermarkets, trade centers, shopping malls, and business centers is helping leading chains, more so than independents, to enter regional markets.

Table 1. Russia: Market Share of Chained Café Leaders, in Percentage

Brand	Company name	2008	2009	2010	2011	2012	2013
Shokoladnitsa	Gallery Alex OOO	37.5	34.7	34.9	34.1	35.7	40.0
Coffee - House	Coffee House ZAO	33.3	31.7	29.3	26.7	25.2	23.6
Coffeeshop Company	Schärf Coffeeshop GmbH	0.9	2.5	4.0	8.8	10.8	12.5
Starbucks	Starbucks Corp	2.2	5.0	6.6	6.9	7.3	6.7
McCafe	McDonald's Corp	2.4	2.5	2.6	2.6	2.4	2.4
Costa Coffee	Whitbread Plc	1.6	2.2	2.8	2.8	2.3	2.2
Traveler's Coffee	Traveler's Coffee OOO	0.9	1.3	1.6	1.7	1.9	2.0
Others		22.2	20.1	18.2	16.4	14.4	10.6
Total		100	100	100	100	100	100

Source: Euromonitor

Regions are now becoming the main focus in expansion plans as Moscow and St. Petersburg are near the saturation levels of other major European cities in terms of chained cafés and independent cafés presence. Franchising is one of the main tools of coffee shops development, especially in the chained segment. The leading Russian café chain **Shokoladnitsa** has already opened outlets not only in Moscow (where there are around 250 establishments under the brand) and St. Petersburg, but also in Yekaterinburg, Volgograd, Kazan, Kemerovo, Novosibirsk, Sochi, Rostov-on-Don, Ufa, Tyumen and Chita, as well as abroad: in Yerevan, in Almaty and in three cities of Ukraine. Moreover, at the moment it focuses on regional expansion to the far eastern region of Russia. Shokoladnitsa brand chained outlets are franchised across Russia and have a strong brand identity with Russian consumers.

Two café chains leaders, Shokoladnitsa and Coffee House, together own about 600 outlets and have value shares of 7% and 5% respectively. Shokoladnitsa is closer to an Italian type café with a cozy interior while **Coffee House** is a more American-style coffee shop, with the décor being airy and uncomplicated. As a result, the clientele differs: Coffee House is preferred by consumers under 30 while Shokoladnitsa is favored by a more mature audience. Most of the Coffee House and Shokoladnitsa outlets are located in the food courts of new shopping malls and business centers. Prior to the acquisition Coffee House by Shokoladnitsa, Coffee House was investing heavily in chain development and incurring large debts. Shokoladnitsa's annual turnover is about \$300 million - excluding franchises. Approximate turnover of Coffee house is between \$160-170 million annually.

Locally-owned brand dominance is only likely to get stronger in the short-term as Shokoladnitsa's (Gallery Alex OOO) acquisition of number two player Coffee-House (Coffee House ZAO) this October. According to market analysts, estimated turnover of Shokoladnitsa may increase 1.5 times, exceeding \$450 million due to the merger. The owner of Shokoladnitsa, Russian restaurant mogul Alexander

Kolobov, whose portfolio includes sushi chain Vabi Sabi, Burger King Russia and Israeli confectioner Max Brenner, is planning to develop the Shokoladnitsa brand instead of Coffee House in the future.

In 1997 Christopher Tara Browne, a former music producer from America, opened in Siberia a café called **Traveler’s Coffee**, which began as a small counter inside of a pizza shop. Due to the popularity of its offerings, Traveler’s Coffee has expanded substantially. Currently the Traveler’s Coffee brand name is used in 67 cafés by franchises in different Russian cities including Moscow and St. Petersburg. The shop even has its own roaster in Novosibirsk, setting it apart from many coffee shops, by giving it a higher degree of customization and roast control.

Foreign coffee chains and other western franchises face an increasingly difficult operating environment for their brands and the franchise businesses of local players. In 2007, two leading multinational coffee shop chains appeared on the Russian market, adopting different development strategies. The world leader, **Starbucks** Coffee Company, opened its first outlet in Moscow in September 2007. In December 2012, Starbucks finally opened its first café in St. Petersburg and currently operates 75 coffee shops in Russia, 63 of which are in the capital. The company is planning to enter Yekaterinburg and Tyumen in 2015 seeking to expand Starbucks’ Russian footprint beyond major cosmopolitan centers. In October 2014, **Costa Coffee** (Whitbread Plc) chain in Russia - through local franchise partner Rosinter Restaurants Holding - announced plans to aggressively expand beyond the Moscow market. The company now plans to focus their Costa Coffee locations in alternative urban markets in Russia.

Austrian chain **Coffeeshop Company** has operated in Russia since 2008 and currently is number three by coffee sales after Shokoladnitsa and Coffee House. **Russia is among the company’s largest export markets and is growing rapidly. 82 coffee shops have been established in Russia with about half of them in St. Petersburg.** In 2014, the owner of the Austrian company Schärf Coffeeshop GmbH, owner of the Coffeeshop Company chain, became minority shareholder of a Russian company called "Coffee SET". The deal amounted to a 2 million euro investment which will be used to expand Coffeeshop Company cafés in Russia. For comparison, 293 outlets operate globally of which only 38 are located in Austria. The appearance of these leading multinational coffee chains in the Russian market has changed the position of the coffee shop segment.

Table 2. Russia: Leading Coffeehouse Chains in Russia

Chain Name	First Year of Operation	# Outlets July,2013	# Outlets July,2014	% Growth Year-on-Year
Shokoladnitsa	2001	361	403	11.6
Coffee House	1999	209	182	-13
Coffeeshop Company	2008	73	82	12.3

Traveler's Coffee	1997	67	77	14.9
Starbucks	2007	64	75	17.1
McCafe	2002	57	60	5.2
Costa Coffee	2007	28	30	7.1

Source: Restaurateur magazine, Foodservice magazine, trade press

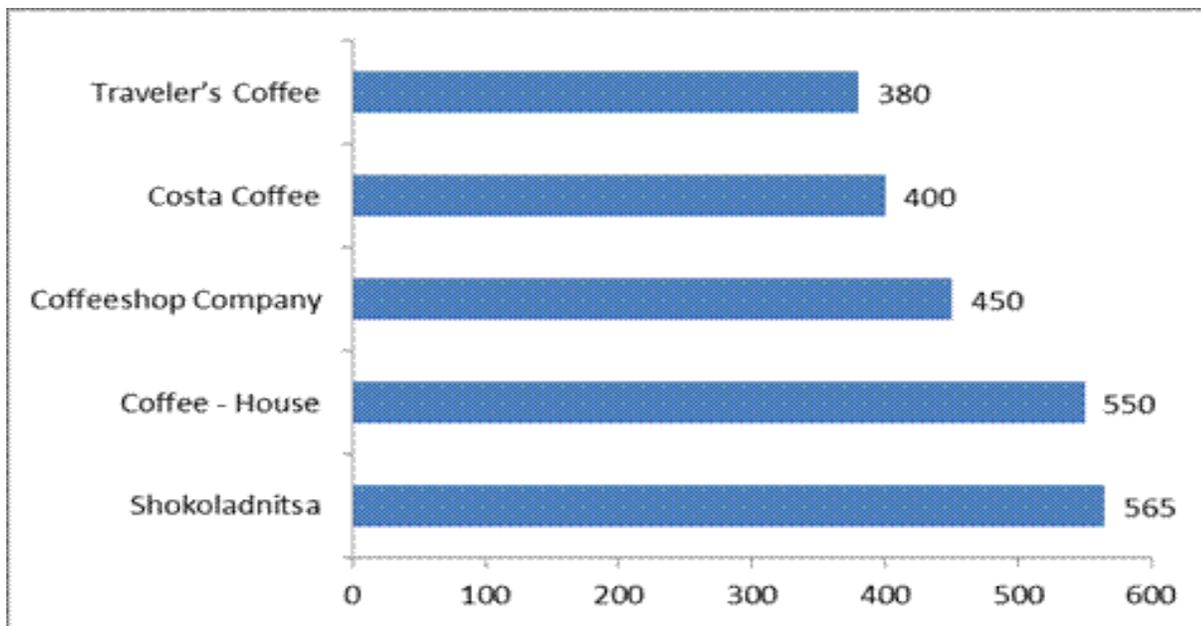
Table 3. Russia: Outlets of Leading Coffeehouses Chains in Moscow & St. Petersburg

Chain Name	Country of Origin	# Outlets in Moscow	# Outlets in St. Petersburg	Web-sites
Shokoladnitsa	Russia	257	31	www.shoko.ru
Coffee - House	Russia	108	65	www.coffeehouse.ru
Coffeeshop Company	Austria	19	37	www.coffeeshopcompany.ru
Traveler's Coffee	Russia	2	1	www.travelerscoffee.ru
Starbucks	USA	63	6	www.starbucks.com
McCafe	USA	28	11	www.mcdonalds.com
Costa Coffee	Great Britain	23	3	www.costa.co.uk

Source: Foodservice magazine July 2014, trade press

The typical Russian coffee shop format differs from western standards as Russian consumers prefer a larger assortment of drinks and food items. According to Foodservice magazine of 2014, drinks, including coffee, accounts for only 60 percent of sales at Coffee House, McCafe, Costa Coffee and Traveler's Coffee; 43 percent for Shokoladnitsa, and 40 percent for Coffeeshop Company. Cafés in Russia constantly increase their non-coffee selections to include alcoholic drinks, dairy cocktails, salads, hot dishes, desserts, and tea. The average bill at café in Russia is between \$15 and \$25.

Figure 2. Russia: Average Check in Cafés, in Rubles



Source: Foodservice magazine of 2014

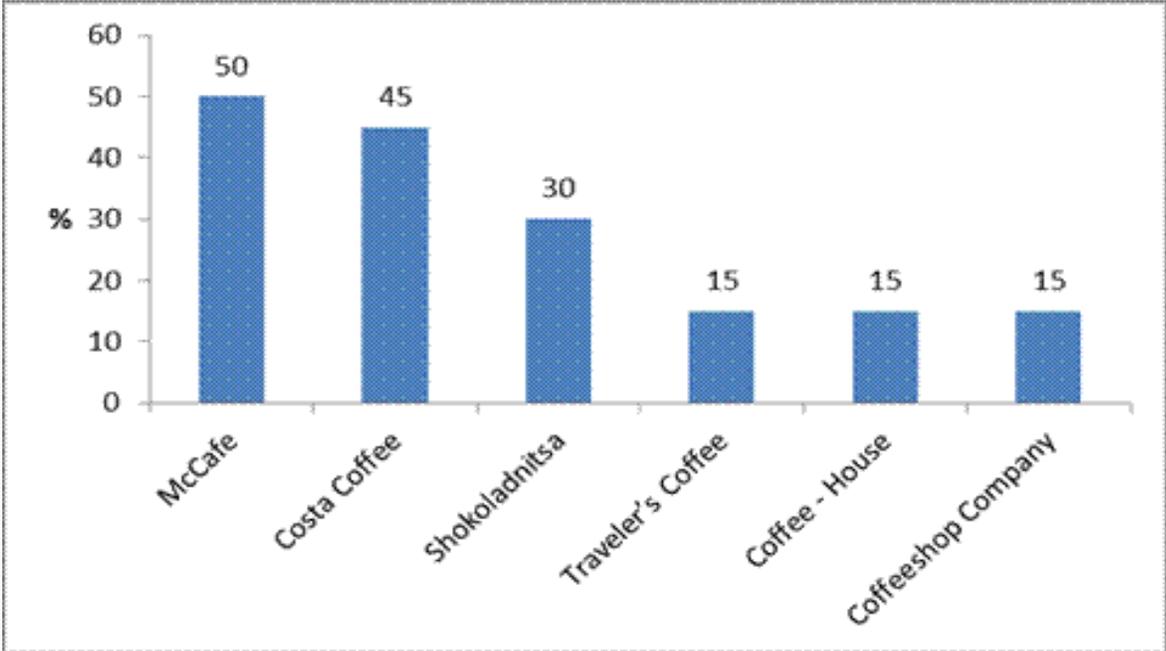
Russian coffee shops that sell a variety of desserts and confectionery products have created a new and interesting market for U.S. exporters of desserts, nuts, ingredients, and dried fruit. Traditionally, Russians have been large tea consumers that goes back generations. But in the last decade, per capita coffee consumption has rapidly increased – by 4 times in 2012 compared to the level of 2000, when only 68 million people in the country regularly consumed coffee. In 2014, this figure, according to numerous forecasts, will rise to 94 million people accounting for more than 60 percent of the Russian population.

Market analysts have noted that Russian coffee consumption is forecast to grow by 4 percent in volume terms in 2014 as its popularity continues to increase. Leading market players are actively marketing coffee to the under 30 age group and increasing the numbers of cafés in Russia while at the same time facilitating a growing “to go” coffee culture. Consumers are also becoming more aware and educated about the coffee they drink. They know that homemade coffee is considerably different (usually worse) from what cafes or restaurants serve. This depends not only on the barista’s skills but also on the variety of coffee being used.

Strengthening local brands are not the only problem for western coffee chains. As of September 2014, the Russian business confidence index remained near a one-year low as western sanctions on Russia further squeezed its struggling economy and consumer prospects. In addition to serious political tensions and economic hardship, chained coffee and independent cafes have also been forced to deal with a nationwide public smoking ban enacted in summer 2013. Smoking prevalence remains unusually high in Russia – 41.7 percent of the population in 2013 – and this could have a negative impact on coffee culture outside of the home.

Because of this policy change, take-away coffee transactions are a potential focus area for coffee chains in Russia although this requires changes in consumer behavior and preference. Currently all café leaders are selling take-away coffee.

Figure 3. Russia: Share of Sales of “To Go” Coffee by Major Cafés, in Percentage



Source: Foodservice magazine of 2014