



## **Costa Coffee: A Proposal to Build the Next Generation Self-Serve Espresso Bar**

The Victorian, yellow-bricked arches that framed Costa Coffee's Lambeth Roastery shook as a freight train rumbled across the tracks above. It was an unassuming home for a business with such promise. "It seems fitting", thought Jim Slater, Managing Director of Costa Enterprises, as he walked past the property's black iron gates, "that these old walls, where we still hand-roast 6,000 tonnes of coffee annually, could become the new home to what would be the most innovative project in Whitbread's 270 year history."

A year earlier, in December 2011, Whitbread PLC, a UK-based hotel, restaurant, and coffee shop chain, had split its Costa Coffee unit into four divisions, with teams focused on different aspects of the coffee business's growth initiatives. Among them, Costa Enterprises focused primarily on driving coffee sales through the UK corporate franchise business, "Proud To Serve" wholesale business, and newly acquired Coffee Nation, a fleet of fresh bean-to-cup self-service coffee vending machines ("concessions") founded by entrepreneur Scott Martin, 11 years earlier. The acquisition rationale was that Coffee Nation could access opportunities beyond the practical or economically attractive reach of Costa Coffee's premium high street cafés.

Slater had been handed the task, among other things, of expanding Costa Express across the UK and select European locations. The stated plan was to grow Costa Express to 3,000 sites, a seemingly realistic goal given that Costa Express dominated the UK forecourt market and that there were discussions underway with large partners –mostly forecourt operators—willing to operate several hundred machines each. "With the Express business model proven, the real challenge will be scalability", thought Slater. "If the product and supply chain allow, our near-term goals should be achievable".

Shortly after acquiring Coffee Nation, Costa had engaged Eric Achtmann, a seasoned private equity investor, aerospace product development expert and ex-McKinsey consultant, to perform post-acquisition due diligence. The exercise confirmed that Costa had made a wise investment, and the rebranding to Costa Express, recalibration and use of Costa's in-house "Mocha Italia" blend of coffee in each of the Coffee Nation machines had yielded an impressive uptick in sales. The due diligence also revealed that while the current concessions could suffice for Costa to meet the stated objectives of the acquisition, they would be challenging to scale beyond the original targets.

What intrigued Slater was an unsolicited proposal from Achtmann to build a next generation coffee system – to "provide scalability and to redefine both Costa Express and the industry." Achtmann proposed that a new system be built from scratch using aerospace technology, advanced product development techniques and manufacturing best

practices; a special development unit comprising leading international partners would be formed and would operate under special rules; and the market-ready product would be delivered into initial production within only six months and at a less than 30% of the cost of similar developments. Achtmann saw Costa Express as a private-equity style growth investment, offering the opportunity to “multiply Costa Express’ growth prospects and valuation manifold.” Looking at the numbers, it all sounded too good to be true.

The sceptic in Slater tallied up the risks, of which there were many. The fresh coffee vending business was more challenging than it appeared: unlike soda or candy vending, fresh coffee vending involved perishables (fresh milk, coffee beans), which created technical, logistical and regulatory challenges. Existing vending systems were basically “box-in-box” solutions - stock coffee machines encased in a large housing with a basic touch screen, if any. By virtue of their design, these systems presented challenges to install, operate and scale. Like others, Coffee Nation had already failed in developing a fully-integrated, next generation machine – its efforts with a top-tier engineering firm had resulted in a total write-off of three years effort and £5m investment.

While Slater had checked his credentials, Achtmann was still a relatively unknown quantity – he had been advising Costa for three months and Slater had only met him twice. Further, Achtmann was proposing to move development out of the organisation, where it had been since the company’s inception. He was also proposing a project management model more likely to be seen in the defence industry than in traditional vending, and an operating model more like an airline. “Basically, he is asking for ‘carte blanche’ to develop a new system – working outside of the organisation - which could have far reaching impact on the business”, Slater thought. “Even if successful, pursuing this proposal is fraught with both corporate and personal risks at a time when we believed we could meet our targets. If it can be pulled off, however, it could be a game changer for Costa Express – and for our parent company, Whitbread.”

It was January 16<sup>th</sup>, 2012, and Slater was almost ready to convene his regularly scheduled management meeting with his Costa Enterprises team. There were partnership proposals to assess and new market entry issues to debate. But, in the back of his mind was the seed of an idea for a game-changer. “There is no doubt that we would always want to reach for the sky if we know that, on balance, we would create a stronger strategic and commercial position for Express,” thought Slater. “There are many issues at play, and these must be carefully assessed.”

Opening his laptop computer, Slater glanced at an interview he had given to Marketing Week a few days ago. He was drawn to one of his own quotes, which seemed to sum up the dilemma he was facing:

It is important for an MD to have a strong understanding of his or her customers, as business strategy needs to be grounded in customer insight. However, without commercial acumen and a decent understanding of the financials, any MD is in for a rough - and potentially short - ride.<sup>1</sup>

## Whitbread PLC

In 1742, Samuel Whitbread and Thomas Shewell started a brewery in London. Two centuries later, in 1948, Whitbread, then Britain's third largest brewer, was listed on the London Stock Exchange. The firm built up its brewing business, licensing brands such as Heineken and Stella Artois, and purchasing brands such as Laphraoig whisky.

Whitbread branched out into restaurants, starting the Beefeater restaurant chain in 1974 and entering into joint ventures with PepsiCo to launch Pizza Hut. It entered the hotel industry with the 'Travel Inn' in 1987, and then the coffee market in 1995 with the purchase of the Costa Coffee business from Bruno and Sergio Costa. Moving away from its roots, Whitbread divested its brewery business in May 2000 to focus on building its hospitality and food service concepts. Whitbread's brands can be seen in Exhibit 1.

By 2011, Whitbread had 35,000 employees and was a FTSE 100 company. In 2011, it generated net profit of £222 million on revenues of £1.6 billion, and declared a dividend of £59 million. Whitbread's income statements and balance sheets can be found in Exhibits 2 and 3. Andy Harrison, Whitbread's chief executive, outlined the company's overall goal:

Whitbread is a hugely people-intensive, consumer-facing business, with a growing network of hotels, restaurants and coffee shops across the UK serving millions of customers every month. We also have exciting opportunities in our international business. Our strategy is to create substantial shareholder value through investing in the continued growth of our strong brands, with an ever-sharper focus on improving our returns on incremental capital.

The largest share of Whitbread's revenues came from its budget hotel chain, Premier Inn, which operated 600 hotels in the UK, the Republic of Ireland, Dubai and India, with a total of 44,295 rooms in its division. It had 379 restaurants under the Beefeater Grill, Brewers Fayre, Table Table and Taybarn's brands. Its Costa Coffee business had grown to over 1,000 outlets in the UK and was expanding internationally. The focus of the corporation was on rolling out a five-year growth plan that would see an expansion of its hotel, restaurant and coffee chain footprint globally, with a goal of 65,000 Premier Inn rooms in the UK, and 3,500 Costa Coffee stores worldwide. Financial information by division can be found in Exhibit 4.

## Hotels & Restaurants<sup>2</sup>

### Premier Inn

Whitbread's Premier Inn chain offered clean but simple accommodation at an affordable price, and competed directly against the Travelodge chain in the U.K. Premier Inn was the UK's largest hotel brand, with an estimated 40% share of the budget market. Its restaurant brands, co-located beside Premier Inns, were family-oriented pub restaurants.

Premier Inns appealed to the budget and corporate consumer: in a market where luxury room rates averaged £159 a night for a room, Premier Inn rates offered customers a value-oriented alternative at an average of £61 a night. Most Premier Inns, unlike its competitors, were built on company-owned land that had been purchased during a previous era when

Whitbread was the owner of hundreds of brewpubs across the country. Premier Inns were found mostly in secondary locations – away from expensive high street neighbourhoods – and alongside, the motorways and major roads that connected its cities. Rooms were small, about 38 m<sup>2</sup> in size compared to luxury competitors' at 60 m<sup>2</sup>, and there were few amenities.

But while the revenue per room was lower, Whitbread's corporate skill was in sticking to capital budgets and generating a high return on investment per room. The Whitbread organization was built on being able to standardize a design for cost effectiveness. Whereas luxury hotels had construction costs per room – excluding land – of between £135,000 and £375,000, the same figure for Premier Inn was in the £35,000 to £45,000 range.

Whitbread had an intense focus on efficiency. Most employees were customer service representatives. Whitbread's managers were rewarded – and promoted - on how effectively they managed their hourly workforce, and how well they controlled their costs of labour. One manager termed it: "getting extraordinary results from ordinary people". Some of the cost saving innovations that were developed included a faster way to clean a room; automated self-checkout; and lower procurement costs. Shaving five seconds off of a two-minute activity would result in thousands, if not millions of pounds of cost reduction if it could be studied, refined, and then implemented across the chain.

In a highly competitive hotel market, Whitbread's dedication to monitoring costs was essential to its bottom line. While luxury hotels generated average annual income before fixed costs per room of £30,100 and a return on investment of 8-22%, Premier Inn's comparative figures were £12,300 and 27-35%, respectively. The monitoring of the service experience and the control of costs was an on-going process and was key to Whitbread being able to deliver the smooth and growing earnings per share that its shareholders expected.

## **Restaurants**

Whitbread managed its restaurant holdings with the same focus on efficiency. Beefeater was a chain of pub restaurants featuring simple, pub food; Brewers Fayre served traditional British pub food; Table Table offered budget meals ("2 main meals for £11"); and Taybarn's was an "all-you-can-eat" restaurant chain with a 34-metre long food counter.

Profits from casual dining restaurants were generated by keeping utilization high and food and labour costs down. Whitbread's restaurant division had had the equivalent of a trial by fire as it tried to turn around its struggling business in the 1990s. Trying to overcome years of poor investment and intensifying competition, Beefeater units were re-launched as Grillbars and Out and Out casual dining restaurants.

When these changes did not work, the re-brandings were reversed, often to customers' confusion. Finally, in the 2000s, Whitbread initiated project "B2", spending millions to revamp all of its Beefeater restaurants, adding a prominent grill area in the front so that customers could see their steak being prepared. It cost Whitbread, on average £2 million to build – or rebuild – a restaurant from scratch.

Although the renovations were a success, Whitbread had an unsentimental approach to its restaurant portfolio. In 2006, Whitbread made the decision to divest a majority of the Beefeater and Brewers Fayre units not co-located with a Premier Inn. While co-located restaurants had, on average, earnings before interest and taxes of £225,000 per unit, standalone units had lower utilization rates and significantly lower profits.

## Costa Coffee

It was in the middle of the 1990s, when Whitbread was searching for high growth restaurant concepts, that they purchased a relatively small, 41-store coffee chain called Costa Coffee. In 1971, Bruno and Sergio Costa began roasting coffee to supply coffee shops and caterers with their special blend of slow-roasted beans. Their goal was to provide a premium alternative to the low-end instant coffee that was prevalent throughout the UK. Costa Coffee opened its first store in 1971, and the brothers sold their firm to Whitbread in 1995. Around this time, barista-made coffee using the higher quality Arabica beans was becoming more popular, prompted by the success of U.S.-based Starbucks and long-running television shows such as *Friends*, which had a coffee shop as part of its set. This new approach to coffee had a dramatic impact on UK consumers. "People here have put up with the same God-awful instant muck over the years, blissfully unaware of what they are putting up with," said one coffee importer in a BBC news report in 1998. "Now with the explosion in coffee shops and bars, they are getting wise<sup>3</sup>".

Starbucks' entry into the UK in 1998, through the acquisition of the Seattle Coffee Company, triggered a real estate rush, with both chains competing –alongside others such as Caffè Nero, Coffee Republic and Pret-a-Manger—for stores in prominent locations.

Backed by Whitbread, Costa became the third largest coffee chain by 2005, and the largest chain by 2011 with 1,500 units to Starbucks' 760 units and Caffè Nero's 530 units. Information on Costa can be found in Exhibit 5. Of the 1,500 locations, 900 were corporate owned stores and the remainder were franchised stores. Costa Coffee sold premium coffee, other drinks, and food; and could be found on high streets, in hotels, in grocery stores, along motorways, and in airports. Costa had 442 international locations in 28 countries, some of which came as a result of the acquisition, in 2009, of Coffee Heaven, a central and eastern European chain of 79 stores.

Typical corporate stores cost £230,000 to develop (Costa's stores, unlike its Premier Inn and Restaurant chains, was based on a leasehold operating model where rent was paid) and generated £85,000 per location in earnings before interest and taxes (EBIT). Costa's franchise stores had EBIT of about £30,000 per location per year. Costa's management team can be found in Exhibit 6. Costa's rapid growth within the Whitbread group meant that the coffee holdings were typically valued at a higher earnings multiple, sparking rumours that Costa might be spun off from Whitbread in the future.

As a premium brand, Costa advertised the fact that it had its own roastery, employed master roasters from Italy, and produced its own special blend of Arabica and Robusta coffee. Similar to Whitbread's hotel and restaurant operations, the cost of labour was the largest expense category. With the objective of delivering a great customer service

experience, a lot of attention was placed on recruiting, training and monitoring the hourly workforce, and ensuring that best practices were replicated throughout the Costa network.

In the retail industry, performance of a store network could be measured by the chain's ability to drive increasing "comparable store sales", or "like-for-like" sales. The comparisons usually included stores open for more than a year, then compared that store's sales growth (or decline), one year out. As Costa and its competitors expanded rapidly in the first decade of the 2000s, its comparable store sales growth seemed to slow down. "We expect Premier Inn to achieve ca. 5% like-for-like sales growth, Costa Coffee ca. 7%, and Restaurants at -1%", stated a research analyst, anticipating the comparable store sales growth in the fourth quarter of 2011. "We will be looking for any sign of a slowdown at Premier Inn and Costa"<sup>4</sup>. Costa's actual comparable store sales growth figure for that quarter was 3.8%.

In 2011, during the search for the next big growth idea, Costa's management team turned their attention to the growing coffee vending machine market.

## Coffee Nation

"I was working for Unilever in 1999 and doing a lot of travelling," recalled Scott Martin who, along with Martyn Dawes, was the co-founder of Coffee Nation. "We were travelling to the far corners of the world and nowhere could we get a decent coffee. On the high street, in contrast, people were rushing to buy high-end coffee. So we asked ourselves, why can't we do this, sell coffee from machines?" Martin spent the next year developing a prototype built in a factory in Manchester. Then, throwing caution to the wind, he quit his job to start Coffee Nation.

"We were used to the general view that vending machine coffee was always poor quality. The perception was that coffee from vending machines was never going to be a competitor to barista-made coffee," added Martin. "So we set out to change that perception." Coffee Nation's proposition, to operators of malls and convenience stores, was that they would earn them more money by swapping out a machine that sold coffee for £0.50 for a Coffee Nation machine that would sell premium coffee for £1.60. The founders made the first machines as large as they could, to ensure they were eye-catching. Texaco gave Coffee Nation two test sites at petrol stations.

"I would drive to the two test sites, clean the machines, continued on my way to the Coffee Nation office in London, then stop on my way back again to do a second cleaning," recalled Martin. After great difficulty – it was the aftermath of the dotcom bust after all – the founders raised £3 million in funding to roll out their concept. To make their money stretch even further, they convinced the bank to buy and lease back the coffee machines to Coffee Nation, arguing that since a machine generated £40,000 a year in revenues – and Coffee Nation kept half of it – the machines could be treated as an asset. Each Coffee Nation machine cost £15,000-£19,000 to build. Coffee Nation's machines can be found in Exhibit 7. Martin incorporated telemetry into Coffee Nation's machines, allowing the company to monitor the machines remotely:

“Websites like Facebook allow us to develop a one-to-one relationship with the customer. Think of a university for example, where people are occasionally sceptical of brands and conscious of quality. When we were going to a university, we would create a Facebook site for that machine, and surprise people by giving out messages on it. Things like ‘3 o’ clock in the library, free syrups on the machine.’ The telemetry allowed us to do this.”<sup>5</sup>

Having product development in-house was key for Coffee Nation’s success, as one commentator noted:

The business model evolved slightly. Having initially outsourced everything, the co-founders came to see the benefits of bringing more and more functions in-house – including the telemetry which allows Coffee Nation to monitor each of its machines in real-time. Yet the focus on key product development remained unchanged.<sup>6</sup>

In 2007, frustrated by the slow pace of growth, Martin engineering a management buyout of Coffee Nation, paying £23 million for the business. At that time, Coffee Nation had 550 outlets. At the close of the deal, Coffee Nation was valued at 3.5 to 4.0 times earnings before taxes, interest, depreciation and amortization (EBITDA). “Quite fortuitously, around this time, I met Howard Schultz, founder of Starbucks,” said Martin.

Schultz had wanted to expand Starbucks’ reach in the U.K. But after nine months of “conversations” nothing seemed to be happening. “So, in October 2010, I wrote a letter to John Derkach at Costa,” said Martin, who was looking for a brand alliance. Derkach was Managing Director of Costa Coffee at the time. Within 24 hours, Derkach was on the telephone with Martin. On February 28th, 2011, in a competitive bid against Starbucks, Whitbread purchased Coffee Nation for £59.5 million, looking to reignite growth in the Costa brand.

Industry observers were positive on the deal: “The decision to buy Coffee Nation, which has self-service machines in Moto and Welcome Break service stations and Tesco, could be an attempt to address Costa’s slowing growth. The price paid seems reasonable in light of this expansion potential.”<sup>7</sup>

Coffee Nation had 830 outlets in petrol stations, universities and hospitals. Coffee Nation was rebranded Costa Express, the machines recalibrated to deliver Costa brand standard coffee using their coffee shops’ “Mocha Italia” blend, and the change in brand immediately led to an uplift in sales of around 20%. A plan was put in place to rebrand all Coffee Nation machines within 90 days.

## Whitbread and Costa at the end of 2011

In December 2011, Whitbread was in position of strength. It was one year into a five year expansion plan that would see it achieve 65,000 hotel rooms and over 3,500 Costa stores worldwide by 2016. Whitbread had recently increased its dividend.

For Costa, store expansion in the UK was reaching its limits; analysts estimated that it would be difficult for Costa to expand beyond 2,000 domestic stores. Costa stores were already located close to each other: in London, 75% of Costa stores were within a quarter

mile of another Costa or a Starbucks or a Caffè Nero. Outside of London, 70% of stores from the top three chains were within one mile of each other. The threat of slowing comparable store sales at Costa was real, exacerbated by the fact that there were several new entrants – Lavazza, Tesco, and Greggs – looking to enter the UK coffee shop market in the next year.

International expansion beckoned, with prospects brightest in markets such as China, India and Western Europe. In an effort to quicken the pace of Costa's growth, on December 9th 2011 Whitbread restructured its Costa Coffee business into four divisions. One division would be focused on UK retail; a second was formed to target retail growth in China; the third division would work on its international franchise; and the fourth, Costa Enterprises, would focus on Costa Express, "Proud To Serve" wholesale proposition and Costa's corporate franchising business servicing large corporate customers.

Jim Slater, formerly Costa's marketing director, was promoted to the role of Managing Director for Costa Enterprises (see Exhibit 8). Slater was not a typical corporate executive – his early career was spent in FMCG—at Mars, Kraft and Diageo, and had been a key figure in the creation of brands, such as Bombay Sapphire Gin. He then became an executive director at Sunderland Football Club, helping them to reposition and commercialise his boyhood club during British soccer's renaissance years before becoming part of a successful Private Equity-backed management buy-out at Phones 4u. Slater was previously the Marketing Director for Costa and was credited with Costa's development into the top coffee chain brand in the UK. Slater was excited about growing Costa Enterprises, already a significant part of the Costa brand:

"Costa Enterprises currently represents over half the cups of Costa coffee sold in the UK - including Costa's corporate franchise stores, our "Proud To Serve Costa" proposition and Costa Express [the recently launched convenience vending brand]. The future will see Costa Enterprises pursuing our strategic goal of converting Costa from the UK's best-loved coffee shop into the world's best-loved coffee brand. To do this we must accelerate growth in new channels. About 25% of Costa's profit growth (before interest and taxes) is forecast to be delivered by Costa Enterprises. Costa has built incredible momentum, with total compound annual sales growth running at over 30% for each of the last three years. The time is right to capitalise on this momentum and transform Costa into a genuine global company. There are now four business units, each fully resourced with its own, focused, business objectives.<sup>8</sup>

One of the projects that Slater took over, as Costa Enterprises' new chief, was a due diligence project, initiated by John Derkach and Costa's Finance Director, Matthew Price, to review Coffee Nation's supply chain. Eric Achtmann, an advisor referred by Eden McCallum, a strategy boutique based in London, had been asked to review the robustness of Coffee Nation's supply chain, as Costa Express prepared to roll out the machines in the UK<sup>9</sup>. The longer-term goal, from Costa's perspective, was to have another 2,000 machines around the world in four years.

The initial evaluation came back "qualified": while very successful in current markets, there were a number of unresolved issues with Costa Express' current "Compact" machine (see



Exhibit 9), among them its scalability. Further, the Compact would not address untapped and potentially lucrative markets (e.g., corporate offices strategy boutique Eden McCallum, had been asked to review the robustness of Coffee Nation's supply chain, as Costa Express prepared to roll out the machines in the UK<sup>10</sup>. The longer-term goal, from Costa's perspective, was to have another 2,000 machines around the world in four years.

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In addition to performing the due diligence work outlined in the strategy brief, Achtmann proposed something else: Would Costa Express be interested in designing another machine, from the ground up, using a new management model based on his previous experience in special defence projects?

## **Achtmann's Proposal**

Eric Achtmann proposed to assemble and lead a product development team of his own choice – working outside of the confines of both Costa Express and Whitbread. He would select best-in-class partners and convince them to take entrepreneurial risk and co-invest in the development of a new coffee system for Costa Express, under the understanding that, if successful, they would be "designed-in" as part of the deal going forward. He expected that significant intellectual property could be created.

Achtmann was the founder of Global Capital Advisors, an investment advisory boutique focused on strategy, technology investment, mergers & acquisitions, and restructuring. He had experience as a venture capital investor, co-founding two European technology funds and investing in over 40 companies in the US, Europe and the Middle East. Achtmann had worked at McKinsey in their financial institutions and industrial practices, and had held a key role in the product development practice, acting as firm expert in matters relating to engineering, defence, aerospace, and the automobile industry. As part of a U.S. Congressional program, he had also worked in Boeing/McDonnell-Douglas's secretive "Phantom Works"<sup>11</sup> division, which focuses on "New Aircraft & Missile Products". A serial entrepreneur, Achtmann held an MBA in finance from the MIT Sloan School of Management and degrees in multiple engineering disciplines in Europe and the U.S., including MIT. He was also on the faculty at Switzerland's Federal Institute of Technology (ETH), an internationally reputed university. In 2011, Achtmann was introduced to John Derkach in September 2011 to evaluate the robustness of Coffee Nation's product and supply chain.

As the due diligence drew to a close in November, Achtmann approached Derkach, with Liann Eden of Eden McCallum, in November 2011 to outline his idea for a new system.

Shortly thereafter, Derkach left Whitbread to lead Tragus Group. Achtmann was contacted by Jim Slater, in late December 2011.

Slater told Achtmann he would consider the proposal. He could see that guiding Costa Express through its next phase of growth would require coordination with the Costa organisation. One of the outstanding issues was to what degree and under what circumstances could Costa Express's concessions – the self-service coffee bar concept as a whole – meet Costa Coffee's brand standard; some wondered if Costa Express would dilute the overall Costa brand. Another issue was the rapid pace of Costa Express's growth – at over 120% a year – and the concern expressed by some that this expansion could come at the expense of Costa's coffee shop business.

Slater had several options to consider. He could elect to proceed with no major changes, and he felt that the business' short to medium-term growth targets would be met without much difficulty. There would be a risk, however, that growth beyond the first couple of years could become difficult if they could not find a way to scale the existing system. Slater could also invest, immediately, to improve the existing system. £5 million had already been spent in the abandoned Gen3 project, so this approach would involve revisiting that project and taking a hard look at why it had failed.

A third option would be to start from scratch, with either Achtmann's proposal or through an internal effort that would start with no pre-conceived ideas. Slater did not think that it would be possible to enlist Achtmann's assistance to lead an internal team as Achtmann seemed insistent that his proposal needed to be carried out on specific terms.

Complicating matters further, the organisation was already stressed with the challenges of rapid growth. An additional challenge involved personalities. Scott Martin was a hard charging entrepreneur and now a valued change agent within Costa, often pushing the limits of corporate norms. Martin had achieved his earn-out from the sale of Coffee Nation, but was staying on to help build Costa Express. Slater knew that he had to find a way to work with Martin, who had been spearheading the effort on the Gen3 machine. If there were to be a new machine built, the new product –and the process for developing it– would have to have his buy-in. It was not clear how well Achtmann would get along with Martin and the rest of the Costa and Whitbread organisations.

Slater had just been promoted to Managing Director and was carefully considering the impact of his critical next move. As he thought about what he should do, the answer became clear to him. Slater picked up the telephone and dialled Achtmann's mobile number. He wondered how Achtmann would react to his response.

## Exhibit 1

### Whitbread plc - Brands

**WHITBREAD**

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ABOUT US | OUR BRANDS | INVESTORS | CAREERS | CORPORATE RESPONSIBILITY | MEDIA

PREMIER INN	COSTA	BEEFEATER GRILL	BREWERS FAYRE	TABLE TABLE	TAYBARNS
Whitbread's Premier Inn is the UK's biggest hotel brand, consistently rated the UK's Best Value Hotel Chain by YouGov. The only hotel chain to offer a 'Good Night Guarantee'.	Whitbread's Costa Coffee is the nation's favourite coffee shop and the largest and fastest growing coffee chain in the UK.	Whitbread's Beefeater Grill is one of the nation's much-loved restaurants, selling more than 3 million steaks every year in over 130 restaurants across the country.	Whitbread's Brewers Fayre is the perfect place to enjoy classic pub food, from a bar snack with friends to a Sunday roast with the whole family.	Whitbread's Table Table is a pub restaurant brand, serving great value, quality pub food with a modern twist in a relaxed and friendly atmosphere.	Whitbread's Taybarns offers customers seven different restaurants under one roof, with a 34 metre serving line, including pizza, Chinese dishes, carvery, salad and more.



Premier Inn



Beefeater Restaurant



Brewers Fayre co-located with Premier Inn

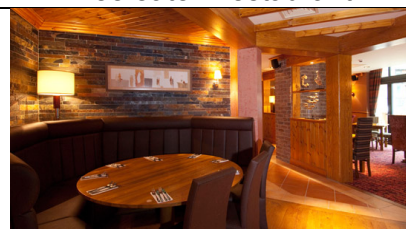


Table Table Restaurant



Taybarns Restaurant



Costa Coffee

Sources: <http://www.ehospitalitytimes.com/?p=5635>; [http://www.readingrestaurants.com/the\\_beefeater/](http://www.readingrestaurants.com/the_beefeater/); [http://www.tripadvisor.co.uk/Restaurant\\_Review-g186545-d2419974-Reviews-Brewers\\_Fayre\\_Loch\\_Lall-Fort\\_William\\_Lochaber\\_Scottish\\_Highlands\\_Scotland.html](http://www.tripadvisor.co.uk/Restaurant_Review-g186545-d2419974-Reviews-Brewers_Fayre_Loch_Lall-Fort_William_Lochaber_Scottish_Highlands_Scotland.html); <http://www.tabletable.co.uk/tabletable/our-pubs.html>; <http://www.roebuckproductions.com/projects/view/9>; <http://www.london-se1.co.uk/restaurants/info/496/costa-coffee>

## Exhibit 2

### Whitbread plc – Consolidated Income Statement

#### Consolidated income statement

Year ended 3 March 2011

	Notes	Year to 3 March 2011 £m	Year to 4 March 2010 £m
Revenue	3, 4	<b>1,599.6</b>	1,435.0
Cost of sales		<b>(237.1)</b>	(213.5)
Gross profit		<b>1,362.5</b>	1,221.5
Distribution costs		<b>(886.6)</b>	(830.3)
Administrative expenses		<b>(166.0)</b>	(138.0)
Operating profit	5	<b>309.9</b>	253.2
Share of loss from joint ventures	16	<b>(2.8)</b>	(3.1)
Share of profit from associate	17	<b>0.8</b>	0.7
Operating profit of the Group, joint ventures and associate	4	<b>307.9</b>	250.8
Finance costs	8	<b>(38.1)</b>	(43.9)
Finance revenue	8	<b>1.4</b>	1.1
Profit before tax		<b>271.2</b>	208.0
Analysed as:			
Underlying profit before tax		<b>287.1</b>	239.1
IAS 19 Income Statement charge for pension finance cost	6	<b>(11.5)</b>	(15.5)
Profit before tax and exceptional items		<b>275.6</b>	223.6
Exceptional items	6	<b>(4.4)</b>	(15.6)
Profit before tax		<b>271.2</b>	208.0
Underlying tax expense		<b>(83.7)</b>	(71.1)
Exceptional tax and tax on non GAAP adjustment	6	<b>34.6</b>	23.1
Tax expense	9	<b>(49.1)</b>	(48.0)
Profit for the year		<b>222.1</b>	160.0
Attributable to:			
Parent shareholders		<b>223.3</b>	161.0
Non-controlling interest		<b>(1.2)</b>	(1.0)
		<b>222.1</b>	160.0
Earnings per share (note 11)			
		Year to 3 March 2011 p	Year to 4 March 2010 p
Earnings per share			
Basic for profit for the year		<b>127.16</b>	92.37
Diluted for profit for the year		<b>126.73</b>	92.16
Earnings per share before exceptional items			
Basic for profit for the year		<b>111.79</b>	90.53
Diluted for profit for the year		<b>111.41</b>	90.33
Underlying earnings per share			
Basic for profit for the year		<b>116.52</b>	96.95
Diluted for profit for the year		<b>116.12</b>	96.74

## Exhibit 3

### Whitbread plc – Consolidated Balance Sheet

Consolidated balance sheet  
At 3 March 2011

	Notes	3 March 2011 £m	4 March 2010 £m
<b>Assets</b>			
Non-current assets			
Intangible assets	13	204.3	150.0
Property, plant and equipment	14	2,415.9	2,310.7
Investment in joint ventures	16	17.4	18.1
Investment in associate	17	1.4	1.2
Trade and other receivables	20	2.9	–
Other financial assets	18	0.9	0.9
		<b>2,642.8</b>	<b>2,480.9</b>
Current assets			
Inventories	19	18.4	17.0
Income tax recoverable	9	–	6.5
Trade and other receivables	20	84.3	93.9
Cash and cash equivalents	21	38.2	47.0
		<b>140.9</b>	<b>164.4</b>
Assets held for sale	14	4.0	2.3
<b>Total assets</b>		<b>2,787.7</b>	<b>2,647.6</b>
<b>Liabilities</b>			
Current liabilities			
Financial liabilities	22	4.2	31.4
Provisions	24	15.4	21.4
Derivative financial instruments	26	16.3	18.9
Income tax liabilities	9	15.4	–
Trade and other payables	27	280.2	286.3
		<b>331.5</b>	<b>358.0</b>
Non-current liabilities			
Financial liabilities	22	521.9	529.0
Provisions	24	29.8	32.4
Derivative financial instruments	26	16.6	17.2
Deferred income tax liabilities	9	142.7	160.8
Pension liability	32	488.0	434.0
Trade and other payables	27	15.2	8.2
		<b>1,214.2</b>	<b>1,181.6</b>
<b>Total liabilities</b>		<b>1,545.7</b>	<b>1,539.6</b>
<b>Net assets</b>		<b>1,242.0</b>	<b>1,108.0</b>
<b>Equity</b>			
Share capital	28	147.0	146.4
Share premium	29	50.8	49.1
Capital redemption reserve	29	12.3	12.3
Retained earnings	29	3,128.8	3,006.8
Currency translation reserve	29	4.3	5.1
Other reserves	29	(2,103.0)	(2,112.7)
Equity attributable to equity holders of the parent		<b>1,240.2</b>	<b>1,107.0</b>
Non-controlling interest		1.8	1.0
<b>Total equity</b>		<b>1,242.0</b>	<b>1,108.0</b>

Andrew Harrison  
Chief Executive

Christopher Rogers  
Finance Director

27 April 2011

## Exhibit 4

### Whitbread plc – Segment information, FY 2011

Year ended 3 March 2011	Hotels & Restaurants £m	Costa £m	Unallocated and elimination £m	Total operations £m
Revenue				
Revenue from external customers	1,177.3	422.3	–	1,599.6
Inter-segment revenue	–	2.7	(2.7)	–
Total revenue	1,177.3	425.0	(2.7)	1,599.6
Operating profit before exceptional items	283.4	50.1	(22.1)	311.4
Exceptional items:				
Refund of VAT on gaming machine income	4.6	–	–	4.6
Net loss on disposal of property, plant and equipment and property reversions	–	(0.4)	–	(0.4)
Impairment	(12.3)	(1.5)	–	(13.8)
Impairment reversal	7.9	1.3	–	9.2
Share of impairment of assets in joint ventures	–	(0.7)	–	(0.7)
Sale of business	–	(2.4)	–	(2.4)
Operating profit of the Group	283.6	46.4	(22.1)	307.9
Net finance costs				(36.7)
Profit before tax				271.2
Tax expense				(49.1)
Profit for the year				222.1
Assets and liabilities				
Segment assets	2,473.6	230.5	–	2,704.1
Unallocated assets	–	–	83.6	83.6
Total assets	2,473.6	230.5	83.6	2,787.7
Segment liabilities	(175.4)	(52.2)	–	(227.6)
Unallocated liabilities	–	–	(1,318.1)	(1,318.1)
Total liabilities	(175.4)	(52.2)	(1,318.1)	(1,545.7)
Net assets	2,298.2	178.3	(1,234.5)	1,242.0
Other segment information				
Income from associate	0.8	–	–	0.8
Loss from joint ventures	(0.5)	(2.3)	–	(2.8)
Capital expenditure:				
Property, plant and equipment – cash basis	168.6	31.0	–	199.6
Property, plant and equipment – accruals basis	177.4	30.2	–	207.6
Intangible assets	0.6	2.0	–	2.6
Depreciation	(77.9)	(20.3)	(0.1)	(98.3)
Amortisation	(1.8)	(1.1)	–	(2.9)

## Exhibit 4

### Whitbread plc – Segment information, FY 2010

Year ended 4 March 2010	Hotels & Restaurants £m	Costa £m	Unallocated and elimination £m	Total operations £m
<b>Revenue</b>				
Revenue from external customers	1,096.0	339.0	–	1,435.0
Inter-segment revenue	–	1.9	(1.9)	–
<b>Total revenue</b>	<b>1,096.0</b>	<b>340.9</b>	<b>(1.9)</b>	<b>1,435.0</b>
<b>Operating profit before exceptional items</b>	<b>247.0</b>	<b>36.2</b>	<b>(18.4)</b>	<b>264.8</b>
<b>Exceptional items:</b>				
Pension curtailment	–	–	4.0	4.0
Net gain/(loss) on disposal of property, plant and equipment and property reversions	14.5	(0.4)	(20.7)	(6.6)
Reorganisation	–	–	(9.9)	(9.9)
Impairment	(10.7)	(0.6)	–	(11.3)
Impairment reversal	9.1	0.7	–	9.8
<b>Operating profit of the Group</b>	<b>259.9</b>	<b>35.9</b>	<b>(45.0)</b>	<b>250.8</b>
Net finance costs				(42.8)
<b>Profit before tax</b>				<b>208.0</b>
Tax expense				(48.0)
<b>Profit for the year</b>				<b>160.0</b>
<b>Assets and liabilities</b>				
Segment assets	2,393.9	155.3	–	2,549.2
Unallocated assets	–	–	98.4	98.4
<b>Total assets</b>	<b>2,393.9</b>	<b>155.3</b>	<b>98.4</b>	<b>2,647.6</b>
Segment liabilities	(127.5)	(56.7)	–	(184.2)
Unallocated liabilities	–	–	(1,355.4)	(1,355.4)
<b>Total liabilities</b>	<b>(127.5)</b>	<b>(56.7)</b>	<b>(1,355.4)</b>	<b>(1,539.6)</b>
<b>Net assets</b>	<b>2,266.4</b>	<b>98.6</b>	<b>(1,257.0)</b>	<b>1,108.0</b>
<b>Other segment information</b>				
Income from associate	0.7	–	–	0.7
Loss from joint ventures	(2.2)	(0.9)	–	(3.1)
<b>Capital expenditure:</b>				
Property, plant and equipment – cash basis	111.6	15.2	0.3	127.1
Property, plant and equipment – accruals basis	106.6	17.3	0.1	124.0
Intangible assets	2.6	2.0	–	4.6
<b>Depreciation</b>	<b>(74.6)</b>	<b>(17.4)</b>	<b>–</b>	<b>(92.0)</b>
<b>Amortisation</b>	<b>(3.5)</b>	<b>(0.4)</b>	<b>–</b>	<b>(3.9)</b>



## Exhibit 5 Costa

### COSTA

#### THE NATION'S FAVOURITE COFFEE SHOP

Walk into a Costa and you'll notice it's a little different to other coffee shops. Firstly, there's the warm and welcoming atmosphere. Then there's the carefully chosen food and authentic coffee drinks. Next the Ferrari of coffee machines. And finally, the most passionate and well trained baristas around. That's why we're the nation's coffee shop of choice.



#### OUR COFFEE

Creating great coffee is an art that takes time and skill to perfect. And with 40 years of experience, we like to think that we've done just that. In that time we've discovered the finest beans, equipment and techniques to make sure that every cup makes the grade.

#### A DROP OF HISTORY IN EVERY CUP

On a grey day in London in 1971, an incredible thing happened: a cup of Costa coffee was poured for the very first time. Its creators, the brothers Sergio and Bruno Costa, first sold their coffee to a handful of local caterers. Then to some delicatessens. A few years later, they opened their first coffee shop.

Today Costa is the largest and fastest growing coffee shop chain in the UK. So while a lot may have changed since that first cup was savoured, our coffee certainly hasn't. We still slow-roast our beans in exactly the same way, and even in the same roasters, as Sergio did on that momentous morning 40 years ago. And as long as coffee lovers like it that way, we'll continue to do so.

#### THE HISTORY OF COSTA

- **1971:** Founded in London by Italian brothers, Sergio and Bruno Costa.
- **1978:** The first Costa coffee shop opens in London.
- **1995:** Whitbread PLC acquires Costa with 41 stores nationwide.
- **1999:** Costa opens its first international store in Dubai
- **2006:** Costa sets up the Costa Foundation – a registered charity that improves the lives of coffee-growing communities.
- **2007:** Costa overtakes Starbucks as the UK's largest coffee shop brand.
- **2010:** Costa is the first branded chain to nationally launch the Flat White
- **2011:** Costa acquires Coffee Nation and launches Costa Express. The first Costa Drive-Thru opens in Nottingham.



## Exhibit 5 (continued) Costa

[HOME](#)
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[WHAT'S NEW](#)
[COSTA FOUNDATION](#)
[COFFEE CLUB](#)
[CAREERS](#)

COSTA COFFEE > COSTA STORES

### COSTA STORES

#### COSTA

The nation's favourite coffee shop.

Walk into a Costa and you'll notice it's a little different to other coffee shops. Firstly, there's the warm and welcoming atmosphere. Then there's the carefully chosen food and authentic coffee drinks. Next the Ferrari of coffee machines. And finally, the most passionate and well trained baristas around. That's why we're the nation's coffee shop of choice.

#### COSTA METRO

Sips in the city.

Built for the city, our specially tailored metropolitan stores boast a sleek, contemporary feel. You'll find exposed brick walls, funky lighting and even more space to relax or work. Of course, being a Costa store, you'll also find our usual speedy service, warm friendly atmosphere and expert baristas too.

#### COSTA EXPRESS

More than just a quick coffee.

Quality coffee is now available wherever and whenever it's needed. You see, our Costa Express bars only ever use fresh milk and real Costa Mocha Italia beans. So if you fancy a latte, cappuccino or hot chocolate, you can now be sure of the freshest taste and finest ingredients, just the way it should be.

#### PROUD TO SERVE

Perfectly prepared.

Wondering why the coffee in your local pub suddenly tastes so good? Take a look at where it comes from. That's right, Costa now supplies pubs, bars, restaurants and caterers of all shapes and sizes with a range of coffee, all made with our very own Mocha Italia blend. So, just because you're not in a Costa coffee shop, doesn't mean you have to put up with mediocre coffee anymore.

#### FIND A COSTA

#### REGISTER TODAY

FOR OFFERS AS GOOD AS OUR COFFEE.

► [REGISTER NOW](#)









#### COSTA ICE

Click here to find out more








## Exhibit 6 Whitbread plc and Costa Management Team

Need 2011 version

### MANAGEMENT

Board	Executive Committee	Hotels and restaurants management board	Costa management board
			
<b>CHRISTOPHER ROGERS</b> Managing Director, Costa	<b>SIMON BARRATT</b> General Counsel	<b>PATRICK DEMPSEY</b> Managing Director, Whitbread Hotels & Restaurants	<b>LOUISE SMALLEY</b> Group HR Director
			
			<b>PAUL MACPHERSON</b> President & Managing Director, Whitbread Hotels & Restaurants International
			
			<b>PAUL FLAUM</b> MD Restaurants
			
<b>ANDY HARRISON</b> Chief Executive	<b>NICHOLAS CADBURY</b> Group Finance Director		

Need 2011 version

Board	Executive Committee	Hotels and restaurants management board	Costa management board
			
<b>CHRISTOPHER ROGERS</b> Managing Director, Costa	<b>JASON COTTA</b> Managing Director, UK Retail	<b>JIM SLATER</b> Managing Director, Enterprises	<b>ANDY MARSHALL</b> Managing Director, EMEI
			
			<b>HELEN HARDY</b> HR Director
			
			<b>CLIVE BENTLEY</b> Global Property & Commercial Director
			
<b>MATTHEW PRICE</b> Finance Director and Managing Director for Costa China			

## **Exhibit 7**

### **Coffee Nation Vending Machine**



Source: Costa Coffee

## Exhibit 8 Jim Slater

### COSTA MANAGEMENT BOARD

[INTRODUCING WHITBREAD](#) | [OUR STRATEGY](#) | [HISTORY OF WHITBREAD](#) | [AWARDS](#) | [MANAGEMENT](#) | [OUR STORIES](#)

## JIM SLATER

### JIM SLATER

Managing Director, Enterprises



**CHRISTOPHER ROGERS**  
Managing Director, Costa



**ANDY MARSHALL**  
Managing Director, EMEI



**JASON COTTA**  
Managing Director, UK Retail



**HELEN HARDY**  
HR Director

**JIM FULFILLED HIS BOYHOOD DREAM OF SIGNING FOR SUNDERLAND AFC –AS EXECUTIVE DIRECTOR**

**DATE OF APPOINTMENT TO WHITBREAD**  
2008

**CURRENT APPOINTMENTS**  
▪ Marketing Director

**PREVIOUS APPOINTMENTS**  
▪ Marketing Director at Phones 4u.

Born and raised on Tyneside, Jim graduated with honours from Aston University Business School.

He was then rapidly promoted through various commercial and marketing roles with Mars, Kraft and Diageo to establish a strong blue-chip career foundation.

In 1998, he fulfilled his boyhood dream by signing for Sunderland AFC, albeit in the role of executive director rather than wearing the famous red and white stripes.

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- [CORPORATE GOVERNANCE](#)

#### PRESS CENTRE

- [LATEST NEWS & PRESS RELEASES](#)

**Exhibit 9**  
**Costa Express “Compact” Machine**



Source: Costa Coffee

NOTES

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<sup>1</sup> <http://www.marketingweek.co.uk/costa-sets-out-a-new-marketing-strategy/3033212.article>

<sup>2</sup> Financial and operational data taken from the Jeffries Research report dated 6 December 2011

<sup>3</sup> BBC Website, March 12<sup>th</sup> 1998

<sup>4</sup> Jeffries Research, 6 December 2011, page 1.

<sup>5</sup> <http://www.growingbusiness.co.uk/UtilityPages/Print.aspx?nodeId=-6959143451460766591>

<sup>6</sup> <http://www.growingbusiness.co.uk/UtilityPages/Print.aspx?nodeId=-6959143451460766591>

<sup>7</sup> <http://www.guardian.co.uk/business/2011/mar/02/whitbread-fooddrinks>

<sup>8</sup> <http://www.marketingweek.co.uk/costa-sets-out-a-new-marketing-strategy/3033212.article>

<sup>9</sup> Liann Eden, Founder of EdenMcCallum (see case) originally introduced Eric Achtmann to Whitbread. The two were acquainted at McKinsey London, where Achtmann had led development of a new coffee machine concept for one of Europe's largest coffee machine manufacturers.

<sup>10</sup> Liann Eden, Founder of EdenMcCallum (see case) originally introduced Eric Achtmann to Whitbread. The two were acquainted at McKinsey London, where Achtmann had led development of a new coffee machine concept for one of Europe's largest coffee machine manufacturers.

<sup>11</sup> [http://de.wikipedia.org/wiki/Boeing\\_Phantom\\_Works](http://de.wikipedia.org/wiki/Boeing_Phantom_Works);  
[http://www.boeing.com/boeing/bds/phantom\\_works/index.page](http://www.boeing.com/boeing/bds/phantom_works/index.page)