QUESTION 1 **100 marks**

Foodage Ltd ('Foodage') is a company listed in the travel and leisure sector of the Johannesburg Securities Exchange (JSE). Foodage was founded in 1994 by Mr Sipho Sithole, when he opened the first 'Eat Some More' restaurant in White City, Soweto. The restaurant served traditional African fare and charged affordable prices, thus providing a wholesome family-centred value-for-money experience. Based on the success of this restaurant, Mr Sithole subsequently built up a franchise chain of Eat Some More ('ESM') restaurants which offers large servings of healthy inexpensive food. Today, there are over 250 franchised ESM restaurants spread throughout South Africa, all of them aimed at the lower income market.

When Foodage listed on the JSE in 2000, Mr Sithole assumed the role of Executive Chairman, while Mr Irvin Paddiachee became the Chief Executive Officer and Mr Fanie van der Merwe the Chief Financial Officer. Presently, Mr Sithole still holds the position of Executive Chairman but both Mr Paddiachee and Mr van der Merwe retired in January 2011 and now serve as non-executive directors of Foodage.

In the early years Foodage invested heavily in developing a number of its own-brand sauces for use in the preparation and serving of the various dishes offered in the ESM franchise restaurants. Over time Foodage began to sell these 'secret' sauces to the public through various ESM franchisees. This proved to be a success and in 2004 Foodage decided to commercialise the range of Eat Some More sauces by offering the products directly to the general public through large food retail chain stores.

In 2006, reasoning that further ESM franchise growth was limited and in a departure from the existing business model, the Board of Directors of Foodage approved the opening of the first Kolkata Night Biters ('KNB') restaurant, which was wholly owned and managed by Foodage. Foodage currently owns and manages 28 KNB restaurants, which offer authentic Indian cuisine, in South Africa. The KNB restaurant chain serves the higher income market and charges premium prices for the 'fine dining' experience it offers.

In early 2007 Foodage further broadened its business model and opened its first themed Popinas wine bar, again on a wholly-owned and managed basis, targeting customers under the age of 25 and serving inexpensive liquor and snacks. Foodage has since opened a number of Popinas wine bars and this brand is perceived to be the rising star in the group.

In June 2010, in an effort to expand its geographic footprint, the company incorporated Foodage International Plc ('FI'), with Mr Paddiachee's niece, Ms Samantha Paddiachee, as Managing Director. FI opened its first KNB restaurant in October 2010 in England. FI currently owns and manages six KNB restaurants throughout England. Although it is taking some time to establish the KNB brand offshore, the Board of Directors of Foodage remains convinced that international expansion in one form or another is going to be the key growth driver in the future.

The historical audited segmental data of the Foodage group is set out below:

FINANCIAL YEARS ENDED 30 SEPTEMBER					
	Notes	**2012**	**2011**	**2010**	**2009**
		R million	**R million**	**R million**	**R million**
ESM franchise operations					
Franchise licence fees	1	138,1	118,8	107,1	99,2
Marketing and procurement service fees	2	93,9	87,0	76,2	69,7
Total franchise revenues		232,0	205,8	183,3	168,9
Profit before tax from franchise operations		92,8	80,3	67,8	59,1
Products and merchandising	3				
Revenue		231,1	206,9	192,4	180,7
Profit before tax		23,2	20,6	19,3	18,0
KNB – South Africa only	4				
Revenue		78,3	61,6	55,1	48,0
Profit before tax		3,0	3,8	4,9	4,2
Popinas	5				
Revenue		284,2	180,4	64,6	15,5
Profit before tax		38,6	25,2	9,1	2,3
Total group domestic revenue		**825,6**	**654,7**	**495,4**	**413,1**
FI					
Revenue		28,9	21,6		
Loss before tax		(32,6)	(17,8)		
Total group revenue		**854,5**	**676,3**	**495,4**	**413,1**
Total group profit before tax		**125,0**	**112,1**	**101,1**	**83,6**

Notes

1 ESM franchise licence fees

Foodage grants operating licences to specifically selected franchisees. Each franchisee owns and manages his or her restaurant, which is branded as an ESM restaurant. Foodage provides each franchisee with upfront support on all aspects of locating, funding and physically setting up the restaurant and, once established, provides on-going business advice and training. In return for the Foodage support each franchisee pays annual licence fees to Foodage, which are based on a percentage of actual revenue. The percentage charge used to be negotiated annually, but after a particularly difficult round of negotiations in the 2009 financial year ('FY2009'), the parties entered into a four-year contract that stipulates the annual percentage of revenue charges.

Relevant details of the ESM franchise business are as follows:

	2012	**2011**	**2010**	**2009**
Weighted average number of ESM restaurants open during the year	251	264	255	248
Average annual franchisee restaurant revenue	R3,4 million	R3,2 million	R3,05 million	R2,95 million

2 Marketing and procurement service fees

In order to benefit from economies of scale and to leverage its core competencies, Foodage provides centralised marketing and procurement functions for both its franchise and retail operations.

Marketing services include managing and developing all aspects of the ESM, KNB and Popinas brands. This involves selecting the marketing campaigns and media delivery channels as well as dictating all facets of the dining experience, from the theme décor to menu offerings and prices, for each of the brands.

The Foodage procurement function has total control of the various supply chains and selects and manages suppliers based on agreed criteria, including BBBEE rating, cost, product quality and sustainability issues, and reliability of supply.

Foodage charges each ESM franchisee a percentage of the franchisee's turnover for the provision of marketing and procurement services. The annual percentage charges are governed by the four-year contract referred to in note 1.

3 Products and merchandising

This division houses the Eat Some More 'secret' sauce business. While Foodage retains ownership of the various Eat Some More sauce recipes, all manufacturing and distribution of the various products are outsourced, which allows Foodage to earn relatively consistent margins. Limited 'in store' brand support is offered for these products in food retail chain stores, with brand awareness mostly being generated from the ESM franchise marketing spend.

4 KNB – South Africa only

KNB has been a mixed success for Foodage. Initially the chain generated strong profits but margins have since come under pressure. In response Foodage has implemented a number of strategic changes, including eliminating a significant percentage of permanent jobs and replacing these persons with temporary workers, aggressively opening new restaurants, changing locations, and effecting on-going menu changes coupled with price 'specials' in order to increase revenues.

Other details of this business are as follows:

	2012	**2011**	**2010**	**2009**
Weighted average number of KNB restaurants open during the year	27	22	19	15
Annual average revenue per restaurant	R2,9 million	R2,8 million	R2,9 million	R3,2 million

5 Popinas

Modelled on the old Roman concept of 'decadent' wine bars, Popinas bars offer a range of inexpensive beers, wines, shooters and spirit coolers along with a limited selection of snacks, in an environment of loud electronic music and bold décor. Popinas bars have rapidly established a reputation among the younger generation as the 'in places' to be and have been an outstanding success, despite a number of clashes with local authorities relating to noise and nuisance complaints. Foodage is planning to open a further 20 Popinas wine bars in South Africa during FY2013.

Other details of the Popinas business are as follows:

	2012	2011	2010	2009
Weighted average number of wine bars open during the year	58	41	17	5
Annual average revenue per wine bar	R4,9 million	R4,4 million	R3,8 million	R3,1 million

Historical data regarding shares in issue and share prices

The Board of Directors of Foodage has always believed that the creation of shareholder value is of paramount importance and has consistently paid a great deal of attention to the Foodage share price. The number of shares in issue has remained unchanged since listing and all growth has been funded through a mix of retained profits and interest-bearing debt.

At 30 September	**2012**	**2011**	**2010**	**2009**	**2008**
	’000	**’000**	**’000**	**’000**	**’000**
Total shares in issue	90 000	90 000	90 000	90 000	90 000
Shares held by controlled company Own It (Pty) Ltd (see below)	(5 740)	(5 088)	(5 088)	(3 603)	(1 641)
	84 260	84 912	84 912	86 397	88 359
	R	**R**	**R**	**R**	**R**
Closing share price	12,90	11,35	8,40	7,15	12,80

Own It (Pty) Ltd

Own It (Pty) Ltd (‘Own It’), a 100% wholly-owned subsidiary of Foodage, was incorporated in 2007 for the purpose of effecting share buybacks if and when, in the view of the executive directors, the company had surplus cash and such acquisitions would create shareholder value.

Details of the share trading history of Own It are as follows;

	2012	**2011**	**2010**	**2009**	**2008**
	’000	**’000**	**’000**	**’000**	**’000**
Number of shares purchased on the open market	652	0	1 485	1 962	1 641
	R	**R**	**R**	**R**	**R**
Average buying price per share	12,45	n/a	7,80	13,05	16,50

Management incentive scheme

As an entrepreneurial group, Foodage strongly incentivises its leadership in such a way as to align the actions of those controlling the business with the needs of its shareholders.

In 2006 the shareholders of Foodage approved a cash or equity-settled management share incentive scheme, in terms of which the company was authorised to utilise a maximum of 10% (nine million shares) of the ordinary shares in issue for the purposes of the scheme.

Immediately after the 2006 shareholders’ meeting, Foodage awarded nine million standard share options to its senior management, executives and non-executive directors at an exercise price which was equal to the then prevailing share price, of R5,10 per share. All senior management and all directors earn in excess of R1 million per annum. The five-year vesting period of the options ended on 30 June 2011.

In 2011 the company elected to settle the nine million share options in cash, based on the prevailing share price of R10,50 per share. After paying transaction costs of R500 000 and deducting relevant taxes, Foodage paid the net amounts due to the option holders to them.

Extract from the 2012 Chairman's report on integrated sustainability

'Foodage is committed to becoming a better company by making sustainability a business imperative. To this end we have commissioned a number of initiatives which will result in our operations becoming more environmentally and socially sustainable. While we are confident we are at the forefront of social engagement, there is little doubt that our environmental impact needs to be reduced, and we intend to accomplish this by reducing our carbon footprint. I look forward to being able to provide concrete details of a number of successful reduction programmes in our next annual report.'

Extracts from the 2012 corporate governance reports

'The Board of Directors is chaired by Mr Sipho Sithole, an executive director. The *King Report on Governance for South Africa*, and the *King Code of Governance Principles* (known as King III) recommend that the chairman of the Board be independent. As the founder of the group Mr Sithole has a holistic understanding of the group's strategies and brands, and this deep understanding, coupled with his strong entrepreneurial flair, provides an invaluable service to the group which could not reasonably be expected of an independent person. Thus the group believes it is in the best interests of all stakeholders that Mr Sithole chairs the Board.'

'King III further recommends that the majority of the Board consists of non-executive directors, of whom the majority should be independent. Currently the Board comprises of five executive directors, two non-executive directors (Mr Paddiachee and Mr van der Merwe), and a single independent non-executive director. Given the intricacies of the group, it has not been possible to recruit suitably qualified independent directors and in any event the value added and collective wisdom brought to bear by the executive and non-executive directors at the Board level is such that the best interests of all stakeholders are well served by the current Board.'

'King III also recommends that the Remuneration Committee be chaired by an independent non-executive director and, further, that the majority of the Remuneration Committee members be independent non-executive directors. The Foodage group's Remuneration Committee is comprised of two non-executive directors who act independently, one of whom chairs the Committee, and three executive directors. Given the experience and knowledge necessary to appropriately remunerate entrepreneurial executives and senior management in a fast-changing environment, Foodage believes that the current committee composition is optimal. In addition, the integrity and objectivity of the non-executive directors is such that the interests of shareholders cannot be prejudiced. In this regard, it was somewhat surprising that at the 2011 annual general meeting, there was a non-binding vote against the proposed 2012 remuneration structures by 21% of the shareholders.'

REQUIRED

		Marks	
		Sub-total	**Total**
(a)	Evaluate the various growth strategies that Foodage has followed since listing on the JSE by − (i) analysing, and commenting on, the financial performance of the Foodage group and its various operating divisions and its international subsidiary for FY2009–2012 (your answer should include relevant ratios and calculations); and (ii) critically discussing the success of the various business strategies pursued by Foodage. *Communication skills – presentation and layout, appropriate style and logical argument*	 30 16 *3*	 49
(b)	Estimate the net cash received (i.e. after tax) by senior management, executives and non-executive directors in FY2011 with regard to the settlement of the share options by Foodage.	6	6
(c)	Critically discuss the effectiveness of Foodage's share buyback programme to date. Where relevant, support your answer with calculations.	16	16
(d)	Identify and describe ways in which Foodage could reduce its environmental impact in 2013.	12	12
(e)	Discuss and conclude whether you agree with Foodage's stated reasons for their non-compliance with the King III requirements, based on the extracts from the 2012 corporate governance report. *Communication skills – appropriate style and logical argument*	15 *2*	 17
Total			**100**