

Marketing Trends and their Implications

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Overview of Presentation

- Industry size and structure
- Retail consolidation and changing procurement patterns
- Major challenges and future trends

TOTAL 2002 U.S. FOOD SYSTEM*: \$900.109 BILLION

◆ *\$485.152 billion food retailing (excluding non food grocery store sales)*

- 54% of total
- 32,981 supermarkets
- 127,000 total stores selling food including 83,500 convenience stores; 1148 membership club stores; and 1777 Supercenters
- Supercenters contributed 11% of retail food sales

◆ *\$414.957 billion food service*

- 46% of total
- 844,000 outlets

***Excludes alcoholic beverages
Sources: ERS/USDA and The Food
Institute**

The Revealing Percentages

	<u>Conven'l Grocery</u>	<u>Super Center</u>	<u>Disc. Drug</u>	<u>Club Store</u>
Gross	25.3	25.0	20.0	11.0
Oper Exp	21.8	17.5	16.0	7.5
Net Margin	3.5	7.5	4.0	3.5
(Before taxes)				

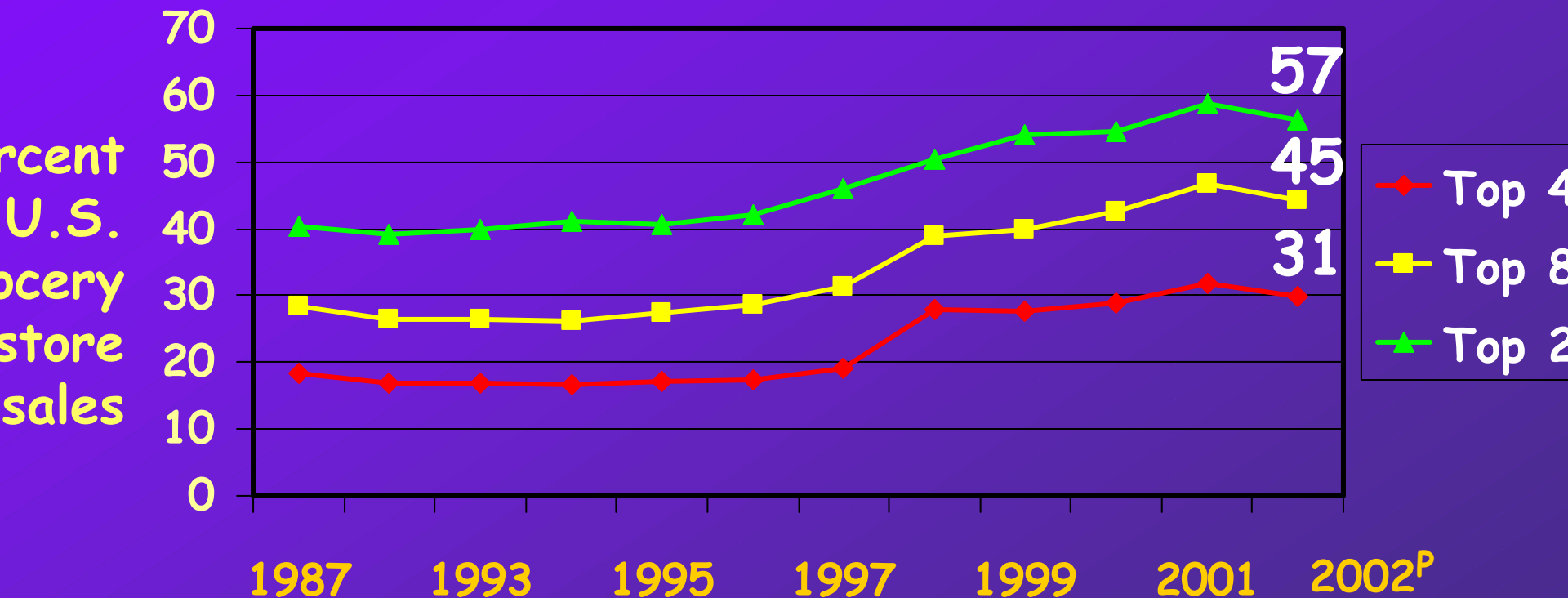
Source: Glen Terbeek

New players playing by new rules drove retail acquisition trend

- *Mass Merchandisers, especially Supercenters, led by Wal-Mart:*
Driving non-value-adding costs out of the system
Contracting with preferred suppliers
Co-Vendor-managed Automatic Inventory Replenishment - shared responsibility for growing the category

U.S. Food Retail Concentration

Twenty largest food retailers captured 57% of total grocery store sales in 2002^P



^P Preliminary

Source: ERS/USDA and Census, modified by Cook

LARGEST U.S. FOOD RETAILERS, 2002

<u>rank</u>	<u>company</u>	<u># stores</u>	<u>sales (\$B)</u>
1	Kroger Co.	2,461	\$51.8
2	Albertson's	1,346	\$35.7
3	Safeway	1,793	\$32.4
4	Wal-Mart Supercenters	1,243	\$29.3 ¹
5	<i>Ahold USA</i>	1,633	\$25.1
6	Publix	739	\$15.9

Groceries only; Italics=foreign-owned

Source: Supermarket News, March 2003

LARGEST U.S. FOOD RETAILERS, 2002

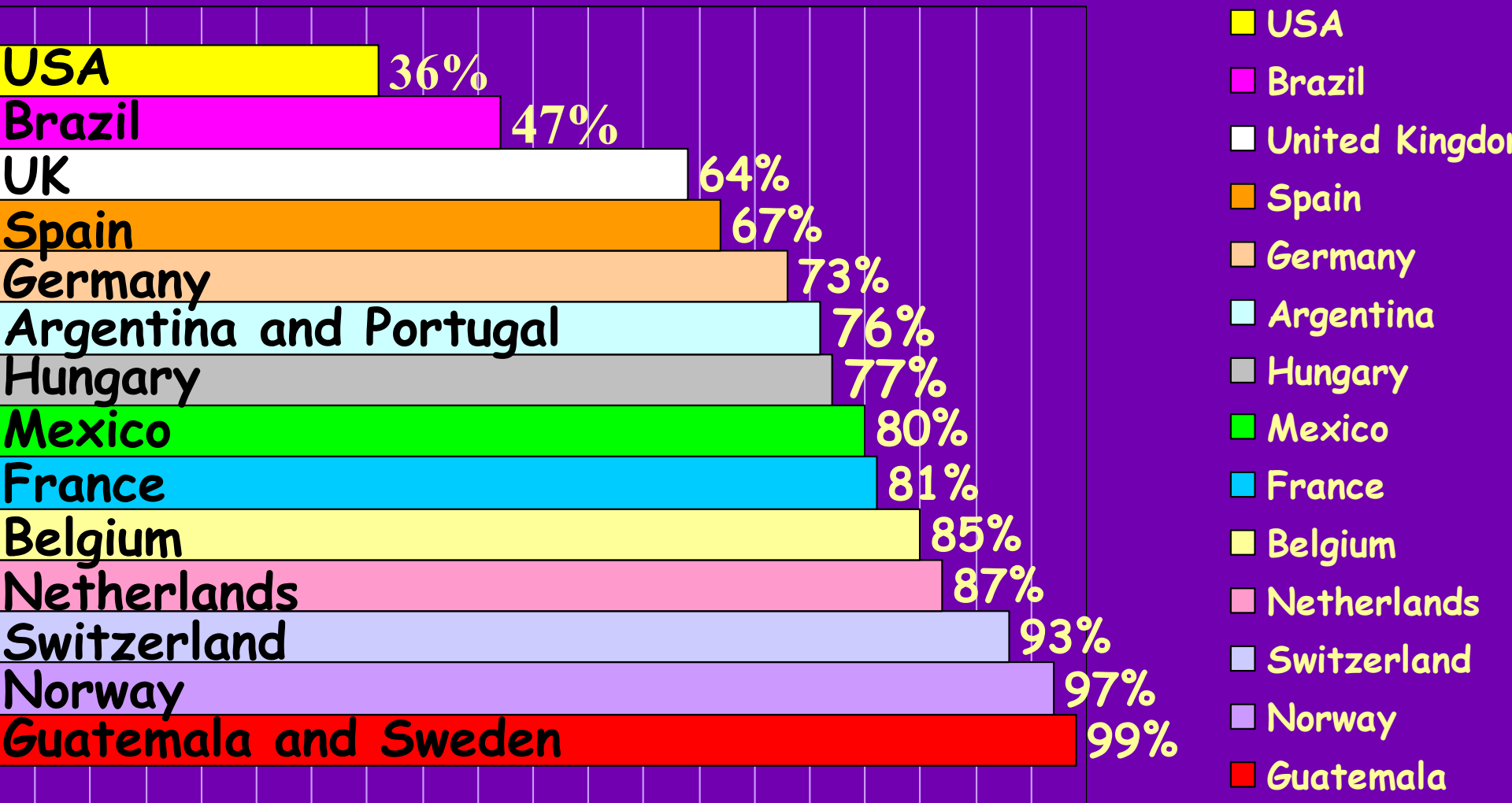
<u>rank</u>	<u>company</u>	<u># stores</u>	<u>sales (\$ B)</u>
7	<i>Del Haize America</i>	1,485	\$15.0
8	Winn-Dixie	1,073	\$12.2
9	Supervalu ¹	1,395	\$9.8 ¹
10	<i>Great A & P²</i>	626	\$8.3
11	H.E. Butt ²	284	\$9.0
12	Meijer ³	156	\$5.0

corporate and licensed stores only; italics=foreign-owned

excludes Canada or Mexico ³Groceries only

Source: Supermarket News, March 2003

2002 Market Share of the Top 5 Retail Chains Per Selected Country, % of Supermarket Sales



Source: M+M
PlanetRetail and
Reardon

Top 20 Europe-wide share about 60% in 2002

Wal-Mart plays a Dominant Role in Global Grocery Industry

- Operates in 10 countries, largest retailer in world, \$244.5 billion in 2002 sales
- Wal-Mart has 75% share of US 2002 supercenter sales
- Over 1333 supercenters in US in 2003
- Opening 200/yr supercenters.; projected to reach 2000 by 2006 in the US
- Plus 52 neighborhood markets
- Opening 40 supercenters in Ca. over the next 4 to 6 years

Bottom Line

Wal-Mart will dominate mainstream retailing for years to come, but new formats will emerge and compete successfully. Successful formats will define their opportunities in contrast to Wal-Mart, finding “white space” where they can out-price or out-differentiate it.

Wal-Mart Effects

- **On the up-side:**
 - **Many suppliers have seen profitable volume growth working with Wal-Mart, making it their most profitable customer.**
 - **They have developed supply chain best practices that have been leveraged across many other customers.**
 - **They've created blueprints for customer business team success.**

Wal-Mart Effects

- **On the down-side:**
- **Some suppliers have come to rely heavily on this massive customer, generating financial risk. Many large CPG manufacturers sell Wal-Mart 25% or more of their total volume.**
- **Plus, many of Wal-Mart's major retail competitors are struggling, placing volume and margin pressures on CPG suppliers who depend on other customers thriving over the long-term.**

Source: Bishop Consulting

Future Winners

Limited assortment stores (LAS) are totally integrated from procurement through merchandising. They are optimized for lowest cost, and can offer consumer prices 10-15% below Wal-Mart's. They have effectively competed because they maintain total control over every operational aspect, relying very little on suppliers in direct contrast to Wal-Mart.

Source: Bishop Consulting

Future Winners

Dollar stores also compete effectively with Wal-Mart on price. In an effort to generate trip frequency, expect to see more regularly-stocked items, especially food, and likely eventually fresh produce. Also expect suppliers to create product specifically to meet dollar store price points. Recognizing, then investing in growth formats is critical to CPG manufacturer share positions.

Source: Bishop Consulting

Future Winners

Trader Joe's creates unique food products under their own brand. The combination of convenient, high-quality, great-tasting products with outstanding value results in a highly differentiated offering with broad consumer appeal: upscale and down.

Future Winners

Whole Foods features organics including fresh produce and meat and poultry that appeals to health-conscious consumers. They combine “natural” with premium, differentiated offerings in all categories.

Consumers

Independent
Restaurants

Chain
Restaurants

Convenience
Stores

Retail
Stores

Export
Market

Foodservice
Distrib. Warehouses

Retail
Distrib. Warehouses

Freight/Shipping
Agents

Brokers

Terminal Markets

Sales and Marketing

Warehouses and Docks

Harvesting
Crews

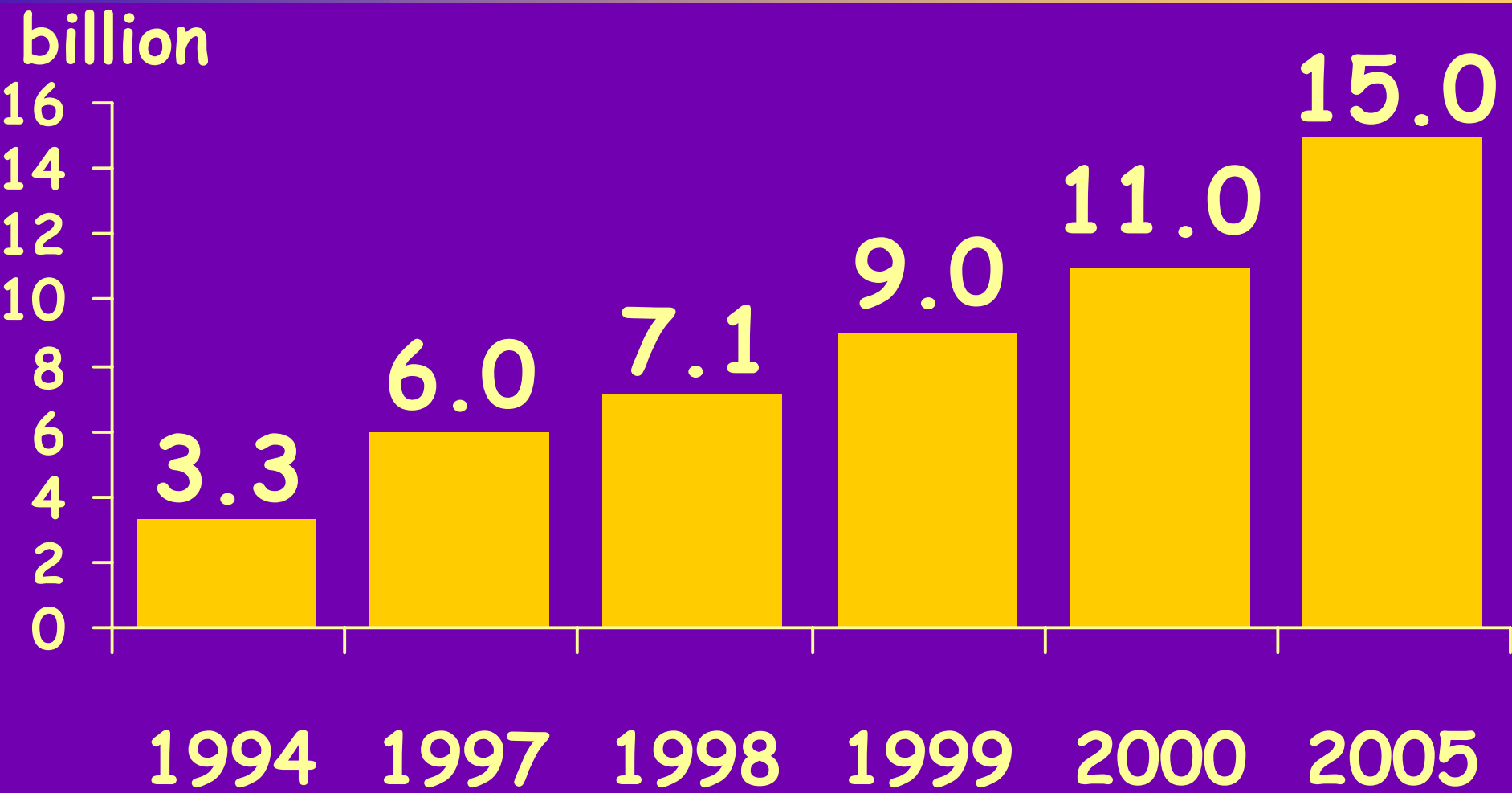
Affiliated
Growers

Outside
Growers

**Grower / Shipper
Organizations**



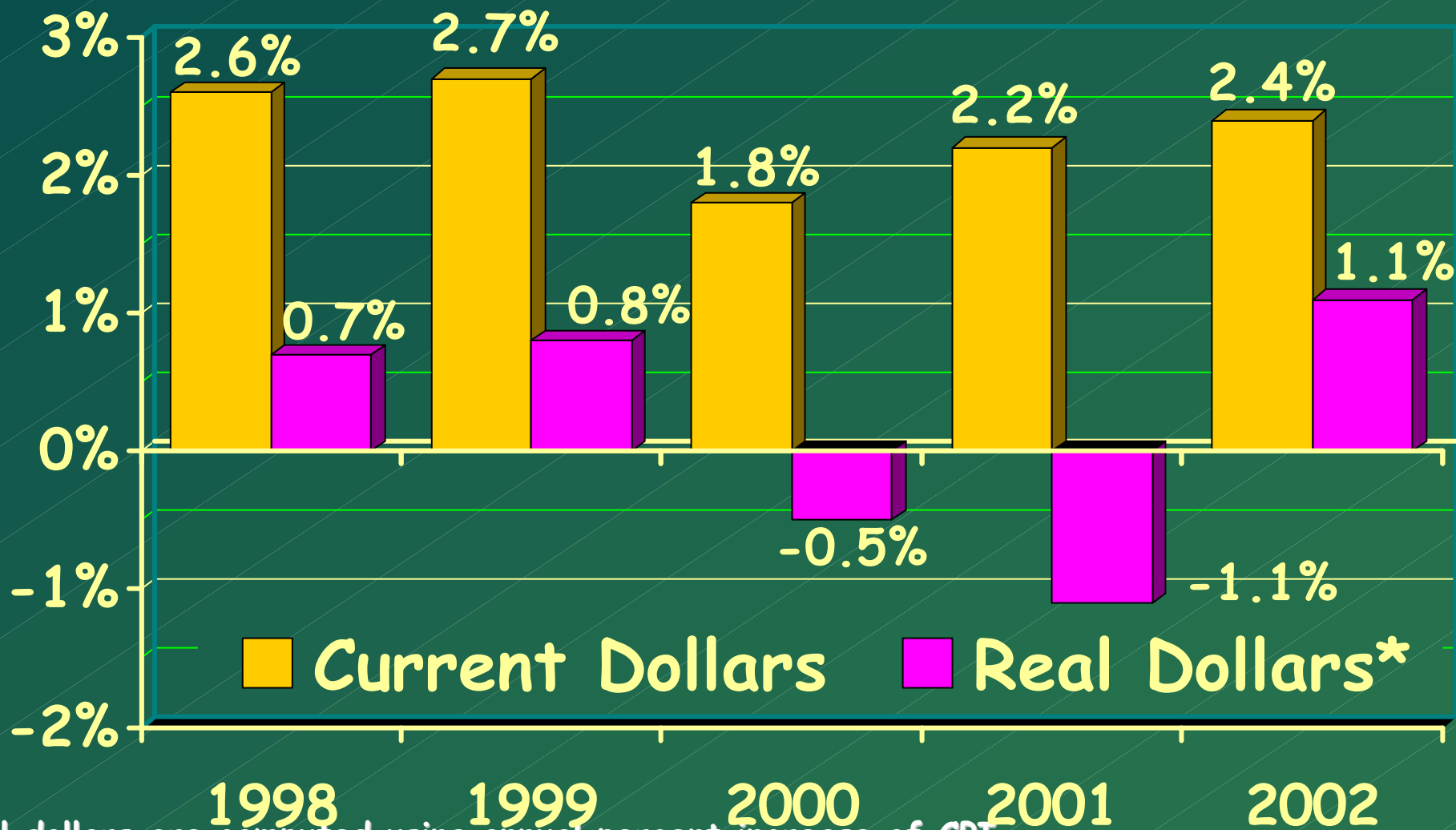
US Fresh-cut Produce Sales Trend, All Marketing Channels, \$ Billion



% sold via foodservice channels vs. 40% via retail

Source: IFPA

Median Company Identical Store Sales Growth (Food Marketing Institute Speaks 2003)



Real dollars are computed using annual percent increase of CPI for food-at-home.

The consumer shift to value

- **Consumers no longer view supermarkets as the “One Stop Shopping” outlet for groceries.**
- **Now even Value Retailers like club stores and supercenters have become frequented as more than stock-up shopping opportunities.**

The consumer shift to value

- Value retailers have out-executed their competition and moved beyond price as the sole point of differentiation.
- Value retailers (including dollar stores) now represent 17% of the entire US retailing sector, excluding autos, the fastest growing part of all retailing.

Competing in a Value-Driven Market

- **Channel blurring has caused the retail landscape to be overstored.**
- **Plus, foodservice channels compete with all forms of food retailing which tend to offer ingredients to prepare instead of meals to eat.**
- **Retail Home Meal Replacement helping somewhat and fresh produce value-added products benefiting.**

Competing in a Value-Driven Market

- **Grocery retailers have been losing share to foodservice for decades, now to value retailers**
- **Conventional grocery retailers must identify value propositions they can own if they are to remain competitive! (fresh produce can be a point of differentiation)**
- **Bottom line: more structural change expected in the US grocery industry and more pressure on suppliers!**

US Chains: Impact of Retail Consolidation on The Buying Process

- Multiple buying offices now merging into fewer or one
 - Purchase from shipper without seeing the product
 - More emphasis on standards, less on price
 - Synergy contract buying
 - More emphasis on forward planning
 - Buy more directly from shippers

Sources: PMA Fresh Track 2001; Cook and misc.

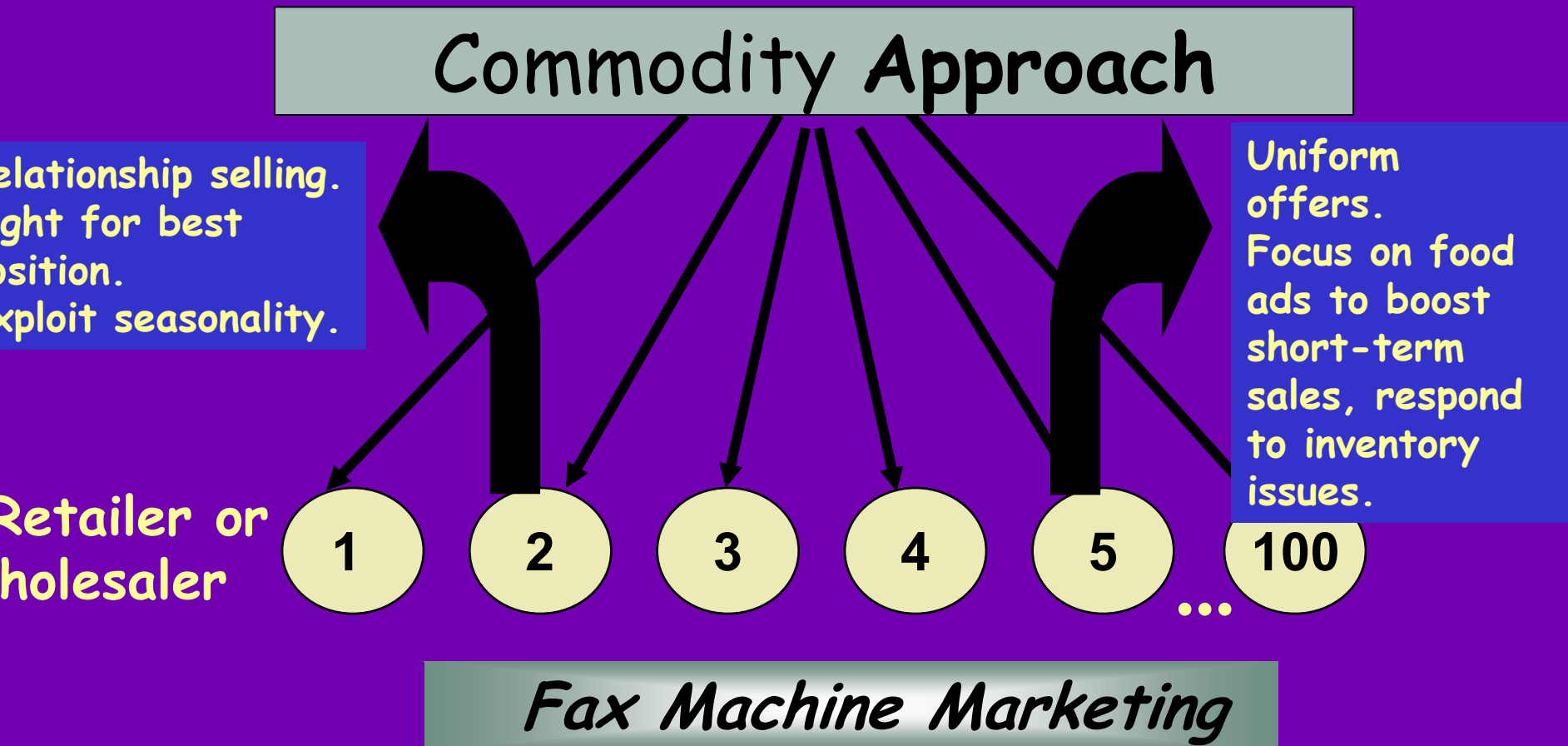
US Chains: Impact of Retail Consolidation on The Buying Process

- Ahold - ending Division buying, centralizing to 2 or 3 preferred suppliers chain wide
- Safeway - centralized merchandising to Pleasanton, Ca., buying to Phoenix
- Kroger - consolidating divisions and centralizing buying to Cincinnati

Key Trends in the Fresh Produce Industry

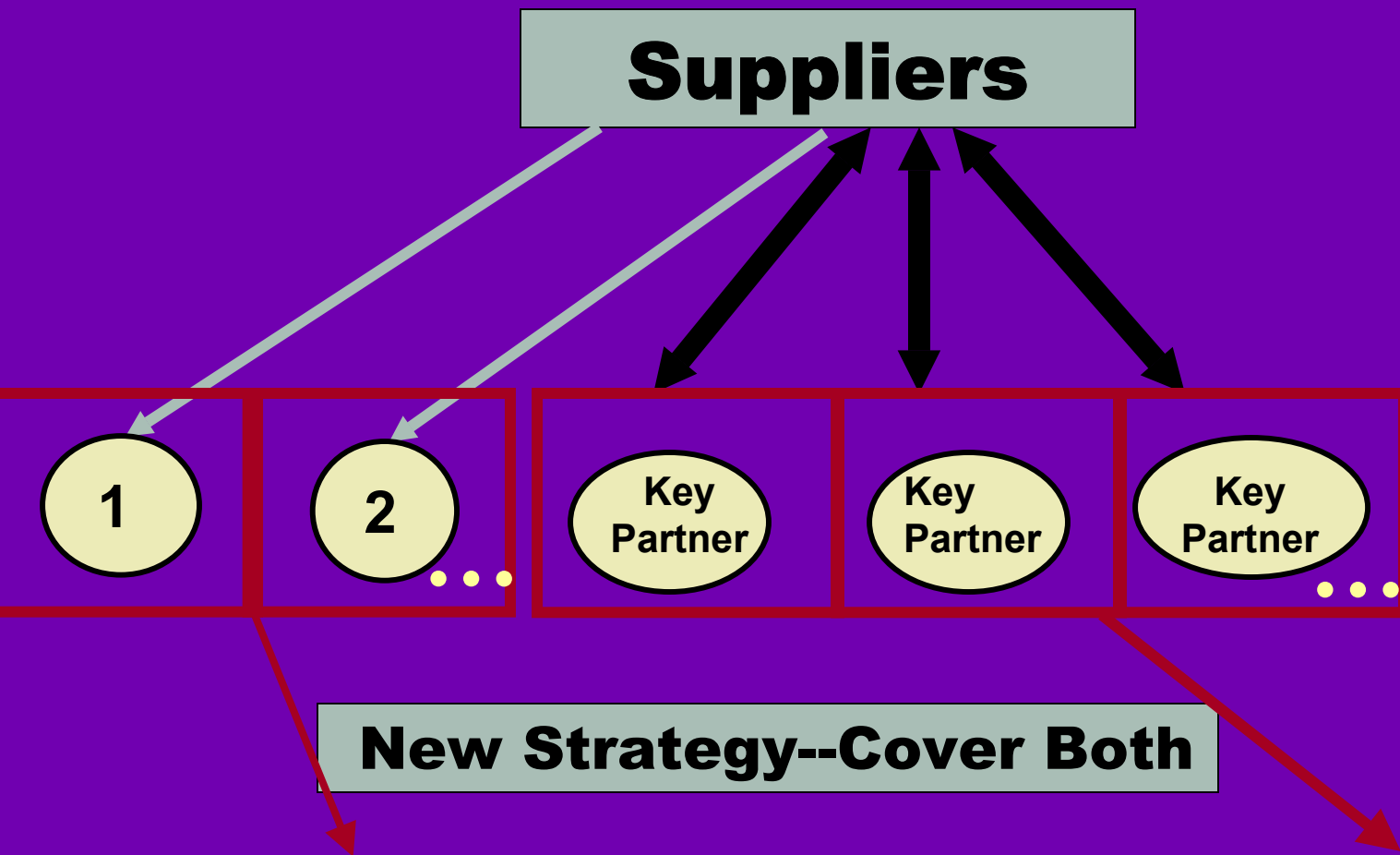
- Supply chain management (SCM) is beginning to replace the traditional, fragmented, daily sales orientation of the fresh produce business with partnerships focusing on year-end net results

Produce Business Model 1960 to mid-90s: "Distribution-Based Strategy"



Source: Adapted from The Perishables Group

New Produce Business Model, 1998...



Retailers know the value of ads, space location, etc.

Expect suppliers to know consumer

- Right product
- Right stores
- Right time
- Right price

TRADITIONAL "A" RETAILERS

Bid for orders.
Buy ads, fight for space.
Tactical approach.

NEW MODEL "B" RETAILERS

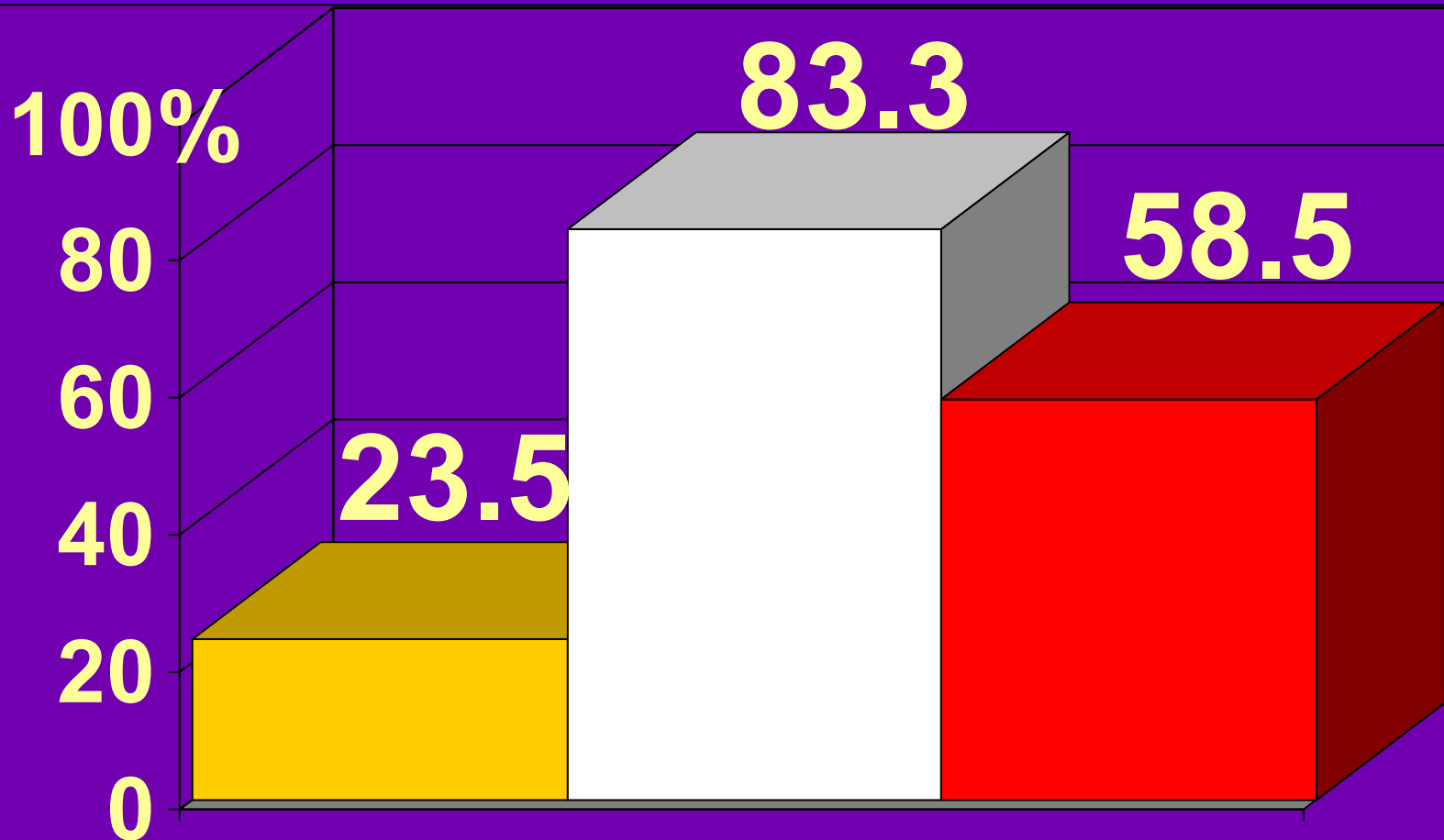
Consumer Information.
Category Expertise.
Category Development.

Shippers becoming the buying agents for retailers

- Offering year-round supply, including via direct imports where necessary.**
- This is posing new competitive challenges to growers and shippers in smaller early season areas, like the case of the California apple and pear industries. Small volume late season suppliers may become even more redundant – unless they add value!**
- May also affect conventional importers.**

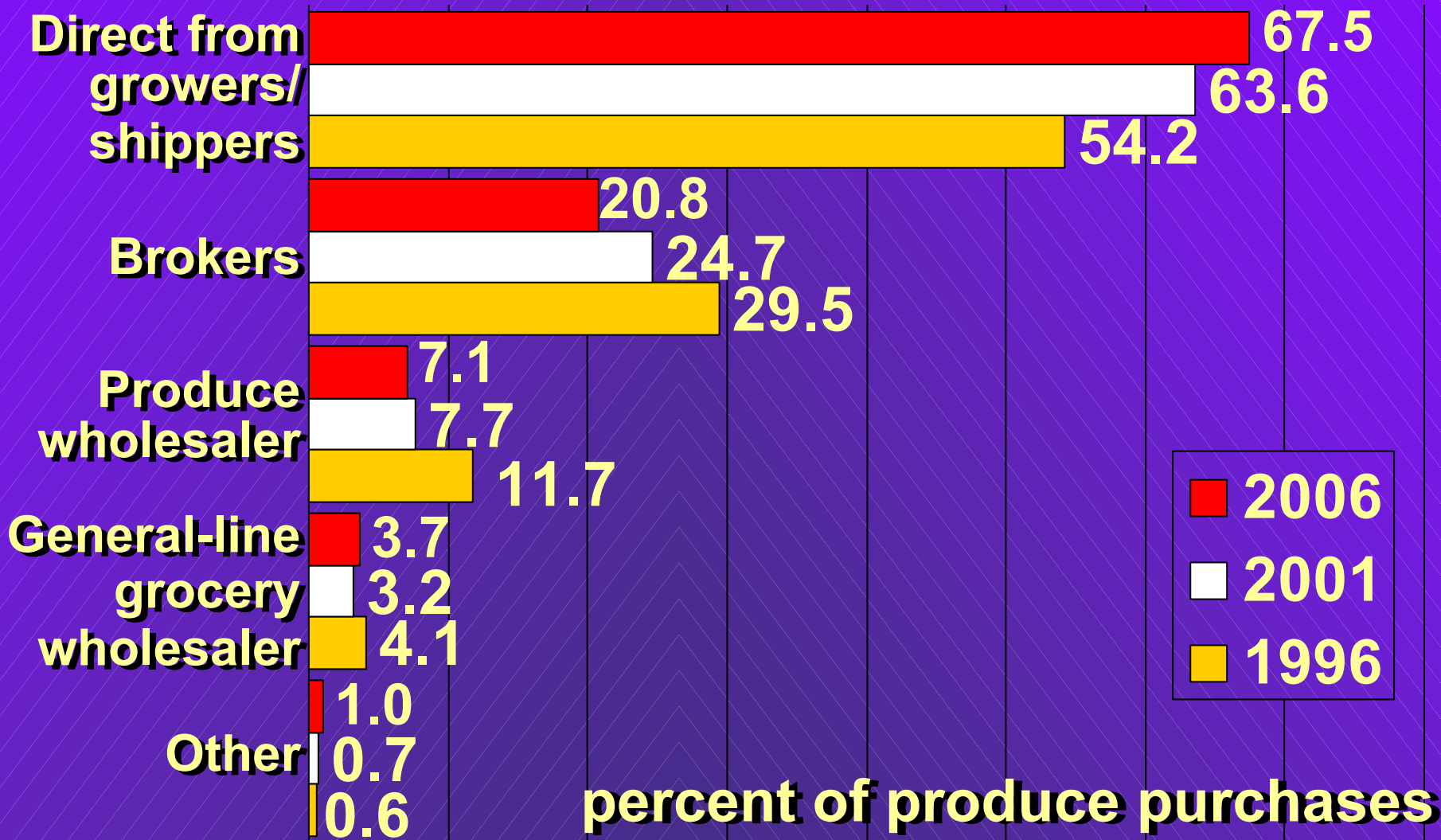
Percent of US Retailers with Produce Category Managers by Firm Size

■ up to \$1.5 B ■ > \$1.5 B ■ all retailers

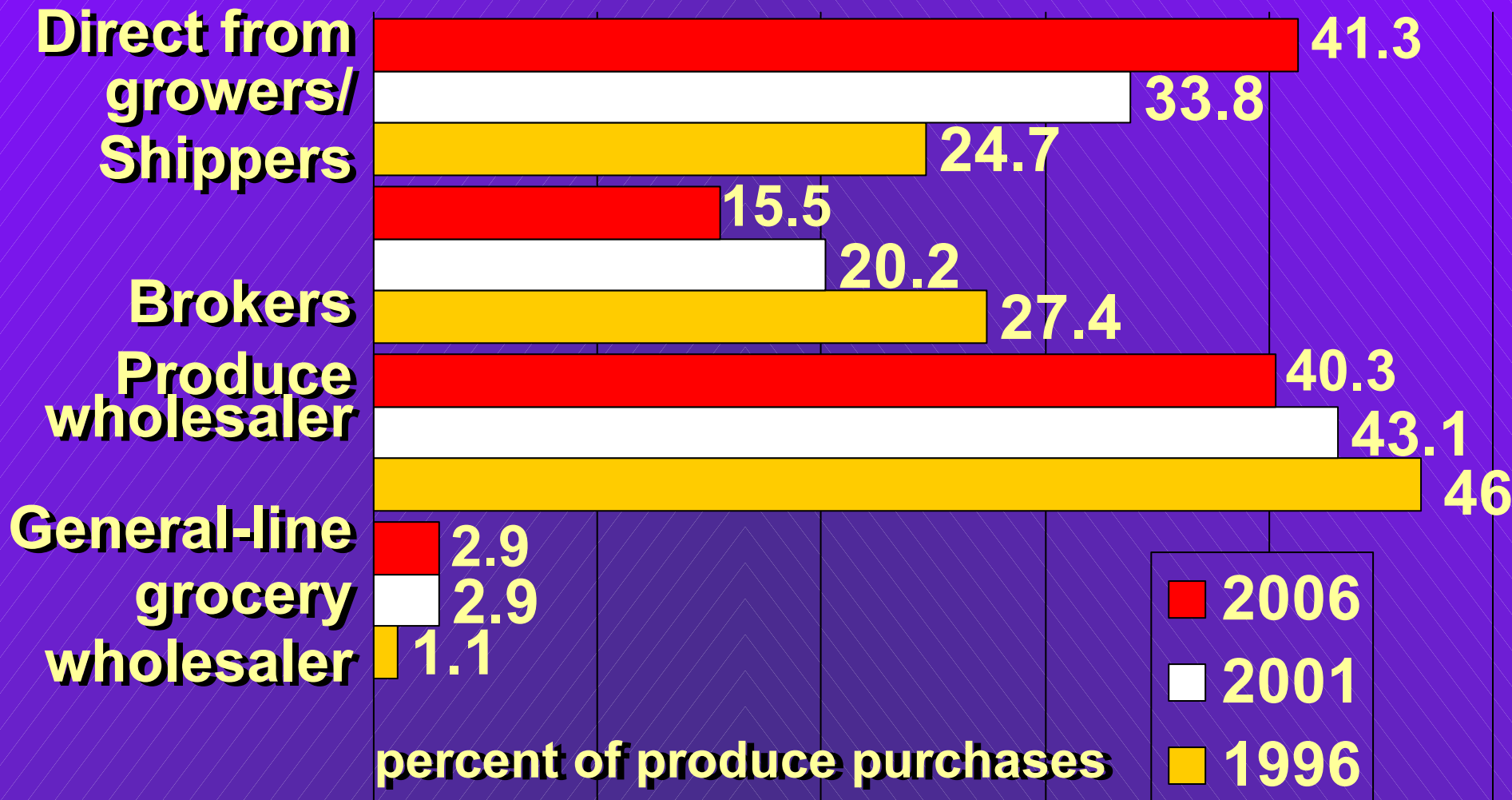


Source: PMA Fresh Track 2001

Sources of Produce (% of purchases), US retailers with Sales over \$1.5 billion



Sources of Produce (% of purchases), US Retailers with Sales up to \$1.5 Billion



Sales mechanisms for each marketing channel -1994 & 1999 - %

Grapes, oranges, grapefruit and CA/FL tomatoes

Sale Type	All 1994	All 1999	Retail 1994	Retail 1999	Mass Merch 1994	Mass Merch 1999
Daily Sales	72	58	57	43	20	7
Advance Sale	19	24	30	42	19	23
Shrt-t. Contract	7	11	12	11	48	41
Lng-t. Contract	2	7	1	4	13	29

Source: Economic Research Service, Produce Marketing Study Interviews 1999-2000

Supply Chain of the Future: Benefits of Scan-Based Trading in Produce

For Retailers

- smaller inventory
- fewer invoice disputes
- reduced transaction costs
- better delivery scheduling
- more targeted customer promotions

For Suppliers

- smaller inventory
- fewer disputes, quicker payment
- reduced transaction costs

How to handle shrink?

Demand Based Management (DBM)

- Understanding consumer demand is the only untapped resource left
- DBM is enabling retailers to tap this resource
- The rate of adoption of DBM is predicted to be rapid, however, as always, produce will lag its introduction in the rest of the store
- random weight remains a barrier

Types of Fees & Services Requested

Slotting

Volume Rebates

Non-volume Rebates

Promotional Ads

E-commerce fees

Capital Improvements

Certification

EDI

Displays

Private Labels

Returnable Containers

Special Packs

Food Safety

Fees are increasing for all fresh produce but commodities are still different

Commodities

- No slotting fees
- Other fees well under 2 percent of sales
- Volume incentives, promotional allowances and rebates

Fresh-Cut

- All fees approximately 1 to 8 percent of sales
- Slotting fees, promotional allowances, volume incentives, and rebates - firms offer options
- Can cost up to \$2 million to acquire the business of a national chain; \$500,000/division

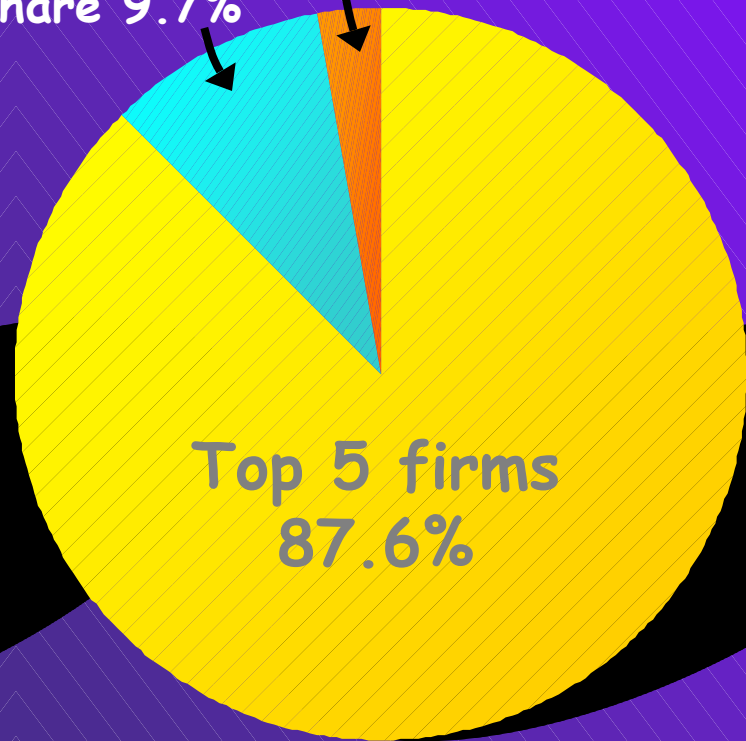
U.S. Market Shares of Fresh Cut Salad Firms, Dollar Sales

Private label share 2.4%
Other share 6.4%



1994

Private label share 9.7%
Other share 2.7%



1999

*Private label share ranked third in 1999 vs. 6th in 1994.

Source: IRI

SHELF CAPTAINS

- Leading, technologically savvy vendors—sometimes brokers
- Take category interface responsibility for section
- May work in retailers' headquarters
- Recommend shelf sets, product placement
- Very influential to category management



Building Retail Partnerships

• Roles and Responsibilities



Source: Adapted from The Perishables Group

Two Basic Strategies

- **Low-cost producer/shipper**
- **Differentiated producer/shipper marketing a premium product or product with identifiable preferred characteristics that are commercially perceived and valued**
- **First strategy increasingly difficult as buyers push more demands and services upstream to suppliers**

Conclusions

- Adoption of SCM is not uniform across the vertical fresh produce distribution system: Both the new and old business models exist side-by-side with many firms in-transition
- So mixed short-term signals but clear long-term trends!
- Smaller seasonal players will need to find niche markets.
- Strategic alliances and joint ventures are being explored as alternatives

CONCLUSIONS: The Future?

- Supply side consolidation and year-round marketing presence may make large shippers more susceptible to fees, including slotting fees. This will depend in part on shipper strategies, which are influenced by inter-firm rivalry and market share issues. It also depends on whether the Wal-Mart procurement model becomes the norm.