Tomorrow's Trends Delivered Today

Food Retailing 2013

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Topics for Today's Discussion

- **Introduction and Objectives**
- The Challenges of Capacity and Demand
- Consumer Trends That Will Reshape the Industry
- Merchandising/Marketing Capabilities Driving Growth
- Technology as a Differentiator
- Capabilities Needed to Win in Tomorrow's Market

Our research triangulates data from multiple industry and consumer sources

Primary Customer Research
- Custom survey of over 1500 shoppers
- Deep dives into key areas
  - Consumer Attitudes and Preferences

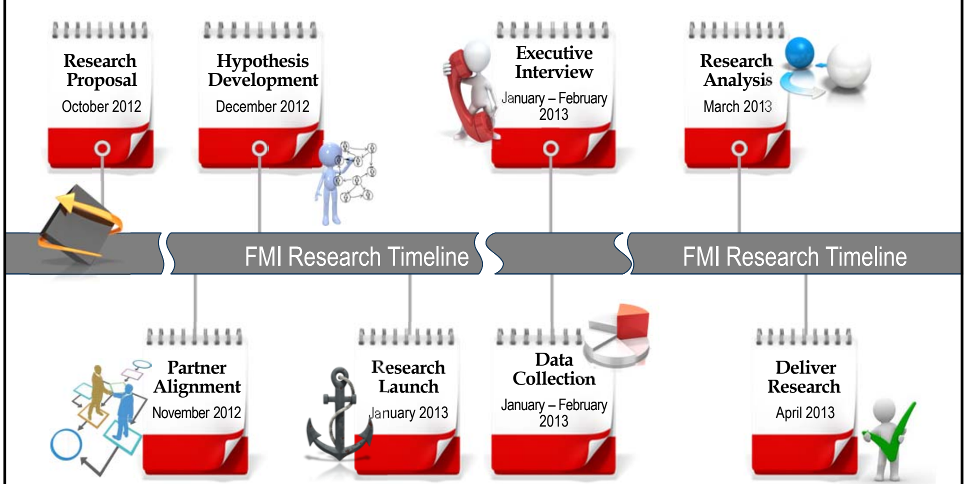
Industry Data
- Partnerships with key industry data providers

nielsen CATALINA CROSSMARK The Way To Market

Food Retailing 2013
Tomorrow's Trends Delivered Today

Interviews with Industry Experts
- Interviews with 25 C-level retail executives
- Interviews with Booz & Company retail experts across several geographies

Our research effort began in January 2013 and was highlighted at FMI Future Connect April 30th, 2013.



Our conversation today centers on exploring three critical future growth issues at retail

Key Industry Questions

- *"Is the grocery industry in the midst of a structural transformation driven by major consumer, competitive, and economic forces?"*
- *"How will the changing shopper landscape alter food retailer strategies and tactics?"*
- *"What are the new capabilities (merchandising, marketing, technology) which will drive lasting differentiation?"*

5

Retailer and CPG Manufacturer C-Level Perspectives On Current and Emerging Industry Challenges

- Growing **concern about capacity** across all channels for grocery retailing
- Continued acceleration of **industry consolidation**
- Changing **dynamics of consumer behaviors** including ethnic differentiation
- Absolute need for **understanding the shopper**
- Impact of **price vs. value creation positioning** strategies (across merchandising and marketing)
- Acknowledged potential **impact of digital** technologies
- Growing need for a more seamless retail environment supporting competitive differentiation
- Intensified need for **shopper-centric collaboration** capabilities
- Creation of effective **cost-to-serve new operating models**

6

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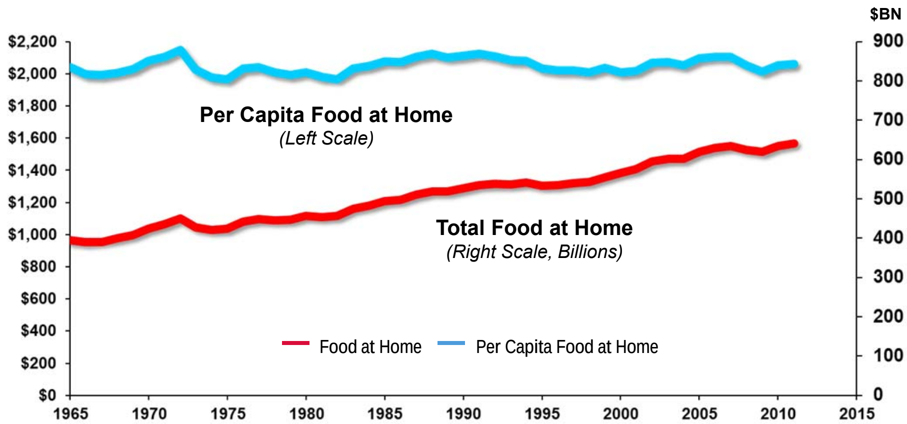
Overall Grocery Demand/ Capacity dynamics imply intense competition in the years ahead

- **Overall demand for groceries grows with population** – in recessionary periods, demand ticks down by ~5% to 7% on a per capita basis
- Looking forward we see **key uncertainties**:
  - Projected flat level of per capita demand
  - Continued grocery capacity additions by both traditional grocery retailers and new channels
- Accelerated encroachment from **internet and mobile**
- **By 2025**, we expect:
  - **Supercenters** to have reached saturation in all but the most urban markets
  - **Dollar stores to be approaching saturation** at about ~36,000 stores
  - **Online grocers** to command **~10% of the market**
  - Overall industry to have added **~290 million square feet**

Food for consumption at home – the core of the grocery market – grows steadily in line with population

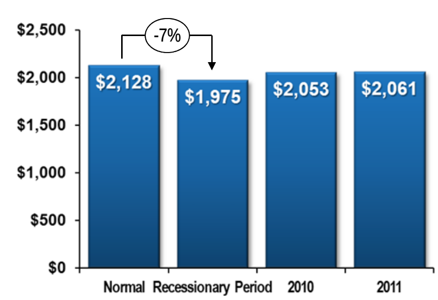


In recessions, per capita demand ticks down by perhaps 5%-7% as consumers "trade down"

Trading Down Behavior

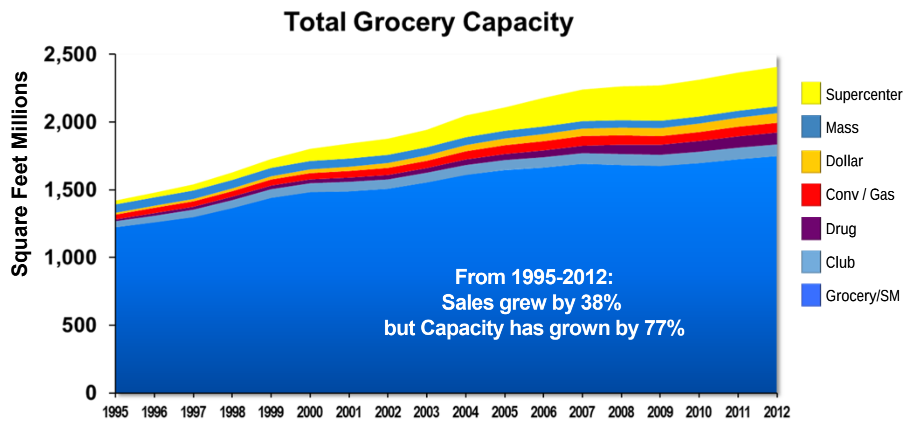
- Switch to lower priced stores (SuperCenter, Dollar, Hard Discount, etc.)
- Buy private label rather than national brand
- Buy more on deal
- Cheaper cuts of meat, more ground beef, less steak, etc.
- Draw down pantry inventory
- etc

Food at Home
(Per Capita Demand, $2010)

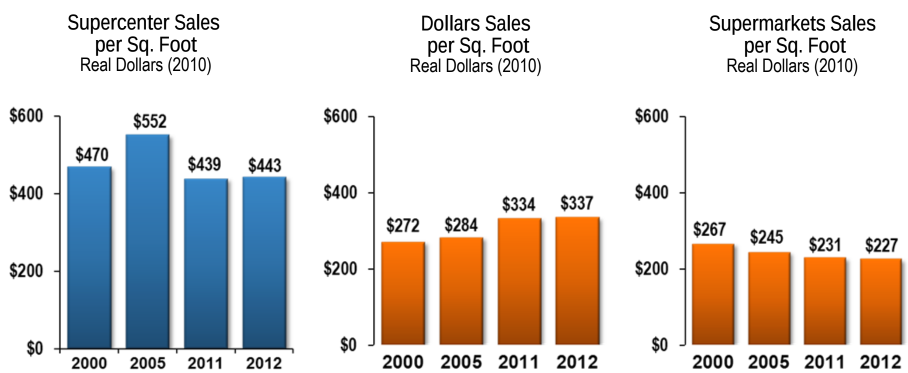


Today, per capita demand is still ~4% below "normal" levels

Over time, the broad industry adds capacity to meet the expanding demand – but at a faster rate



New entrants maintained their space productivity but supermarkets have seen a steady decline…



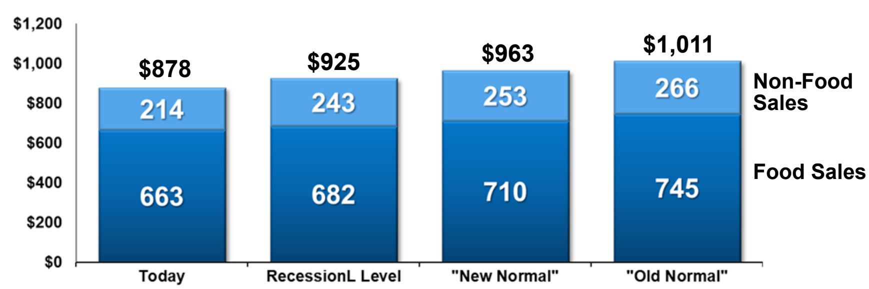
…eroding profitability for the traditional industry

Key Issue Facing the Industry: *How will capacity and demand evolve in the years ahead?*

Demand	• Grows with population	• "New normal" level of demand or recover to historic non-recession levels
Supercenters	• Saturation analysis MSA by MSA	• Demonstrated ability to enter markets already saturated with supermarkets • Main uncertainty is level of saturation of major conurbations (NYC, LA, SF etc.)
Dollar	• Saturation analysis by MSA	• Grocery category penetration of dollar stores (increasing all the time)
Drug	• Growth in line with Rx volume • Adjust for volume captured by other channels	• Mail order/online penetration of core Rx businesses
Online	• Occasion/category view	• Highly uncertain • "Suspend disbelief"

Overall demand for will grow with population with grocery sales reaching $900B to $1+T by 2025

Projected US Retail Grocery Sales: 2025
$Billion, Real Dollars ($2010 = Base Year)



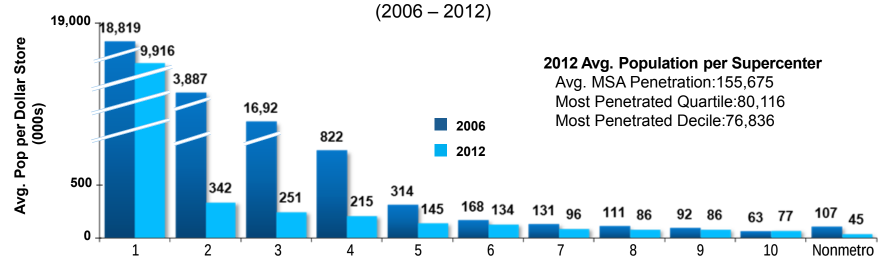
	Today	RecessionL Level	"New Normal"	"Old Normal"
Per Capita Grocery Spend	$2,795	$2,672	$2,780	$2,919
Per Capita Food Spend	$2,113	$1,969	$2,049	$2,151
Per Capita Non-Food Spend	$682	$703	$730	$768

Source: Catalina Marketing, US Census Bureau; Booz & Company Analysis

Challenges of Capacity and Demand

Supercenter build out has continued steadily – saturation is likely approaching in all but the most urban markets

Supercenter Penetration by Deciles
(2006 – 2012)



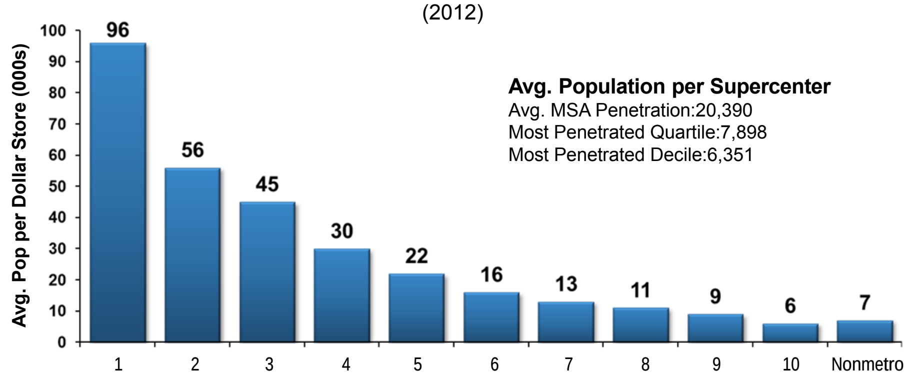
	1	2	3	4	5	6	7	8	9	10	Nonmetro
Total 2012 MSA Pop.	19.8M	22.0 M	21.1M	17.6M	23.9M	21.2M	16.6M	25.7M	21.2M	21.1	46.3M
# MSAs	1	4	4	13	29	21	35	28	36	135	NA
# Stores	2	67	93	90	183	223	185	288	271	287	1,039

Source: Catalina Marketing, US Census Bureau; Booz & Company Analysis

Challenges of Capacity and Demand

Dollar Store build out is still very much in progress and will likely continue at a rapid pace

Dollar Penetration by Deciles
(2012)



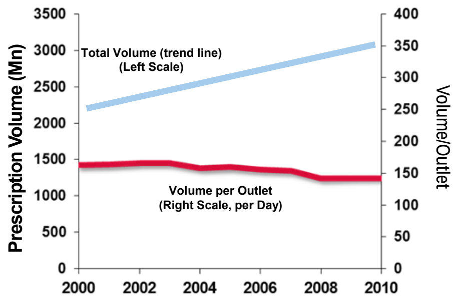
	1	2	3	4	5	6	7	8	9	10	Nonmetro
Total 2012 MSA Pop.	18.1M	35.8M	22.5M	29.8M	24.7M	28.4M	26.4M	26.7M	26.6M	26.7M	46.3M
# MSAs	19	7	24	31	31	36	19	35	60	101	NA
# Stores	197	611	558	1,023	1,134	1,734	1,969	2,301	2,846	4,076	7,077

Source: Catalina Marketing, US Census Bureau; Booz & Company Analysis

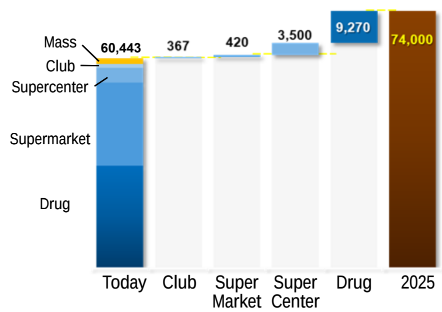
Challenges of Capacity and Demand

Pharmacies expand capacity to serve the market for prescriptions – for drug stores grocery sales are "come along business"

Prescription Volume
(Retail only)



Pharmacy Growth
# of Outlets



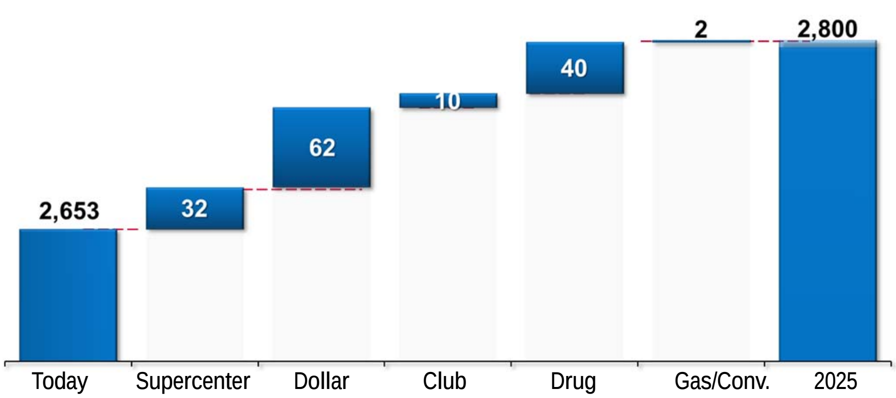
Source: AIS Health; Booz & Company Analysis

17

Challenges of Capacity and Demand

Taken together, non-supermarket channels will add ~145 million square feet by 2025

Grocery Capacity Additions by Format
(Supercenters, Neighborhood Markets, Dollar, Club, Drug & Convenience)
Today to 2025, Millions of Square Feet



Source: Booz & Company Analysis

18

Key Issue Facing the Industry: *What level of penetration might online groceries achieve by say, 2025?*

Perishable
- Produce, meat etc. requires personal inspection
- Includes packaged chilled products

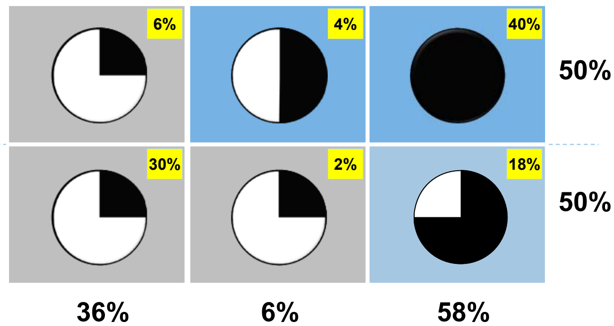
Frozen
- Mostly consistent quality packaged goods
- Requires specialist transport and storage

Ambient
- Mostly consistent quality packaged goods
- Includes non-food

Stock Up
- Fairly perishable demand: food and non-food consumables
- Price sensitive
- Once per week or less
- Lists

~$65 per Trip

Fill In
- Near-term/immediate need: "tonight's dinner"
- Shopping lists less prevalent
- Lower price sensitivity

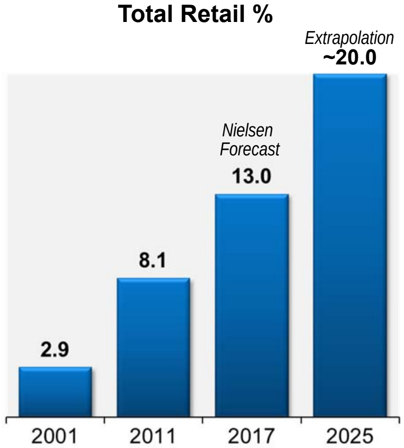


Hypothesis: Non-perishable, stock-up occasions are most likely to migrate online

Source: Booz & Company Analysis

On this basis, a reasonable estimate might be ~10% of grocery retail is online by 2025, mostly non-perishable

E-Commerce Penetration: Total Retail %



Online Penetration of Grocery: 2025

Perishable Stock-Up: ~2%	Frozen Stock-Up: ~5%	Ambient Stock-Up: ~20%
Perishable Fill In: ~1%	Frozen Fill In: ~1%	Ambient Fill In: ~10%

10.4% Overall

Source: Nielsen 2017 Retail Update, Booz & Company Analysis

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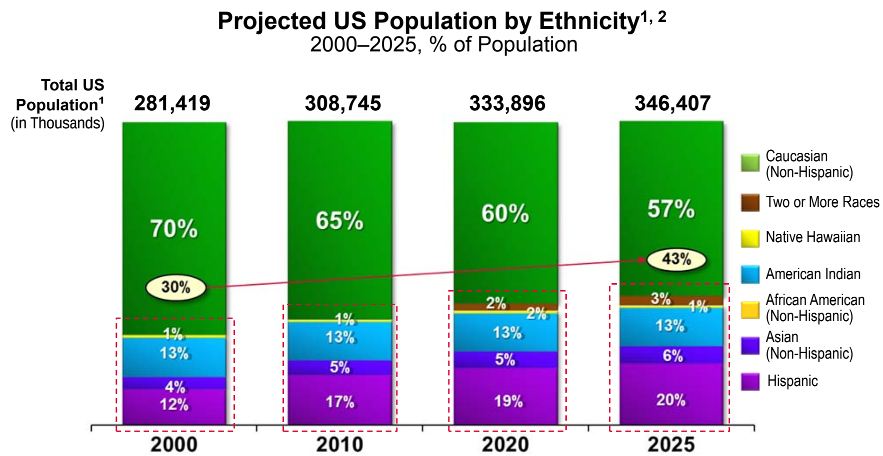
21

Shifting Consumer Demographics are going to create new competitive challenges for both retailers and manufacturers

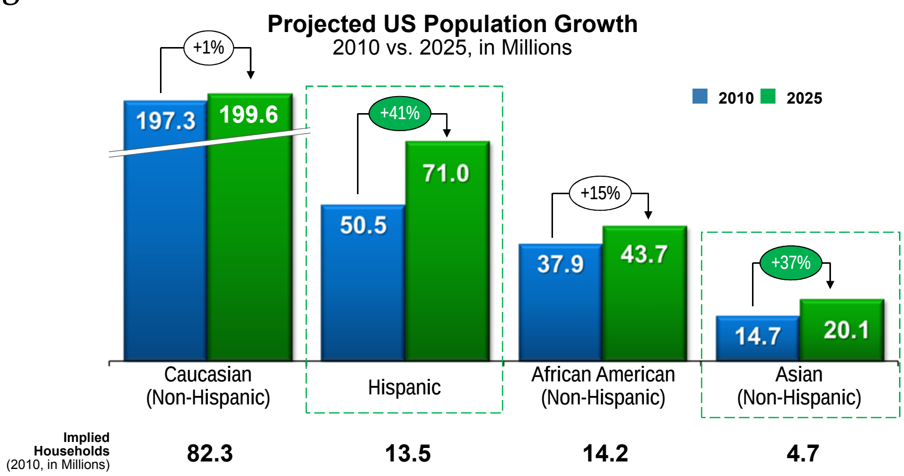
- US Ethnic population share **will increase to 47% of the US** consumer base
  - Represents a 13% increase in the next ten years
- **Hispanics and Asian populations** are forecast to grow the most
  - 41% and 37% respectively, in the period 2010 to 2025
- Ethnic-based **marketing and merchandising will increasingly present a growth opportunity** for grocers
- In addition, the opportunity to **carefully architect an Ethnic store strategy** is significant
  - Ranging from dedicated full ethnic stores to "bodega like" store-in-store formats
- In parallel, **age-based shifts will need to be dealt** with competitively
  - The 65+ year old segment will increase 7% (as % of total US population),
  - Both the 18, and under and 25-44 year old segments will decrease
  - All other age segments will remain relatively flat

22

Ethnic groups are growing steadily as a proportion of the overall population – though Caucasian remains the largest single group



The shift is driven by much more rapid ethnic population growth versus Caucasian



The Hispanic market in particular is set to expand dramatically

Key Issue Facing the Industry: *What about ethnic stores?*

Ethnic Stores – From Strategies to Tactics

- As ethnic populations expand, the **demand for ethnic products increases**, retailers will increasingly need to reflect this in their assortments and merchandising
- By 2025 Hispanic grocery spend will be ~$200bn in aggregate
- However, **building a dedicated ethnic store** is another matter:
  - Supermarket economics require **~$300k+ per week sales volume** to spread store's fixed cost
  - A successful ethnic store requires both a **concentration of an ethnicity in a local area, and a high share of wallet** among that population for success
- We see the following **ethnic store landscape evolving**:
  - High ethnic concentration – opportunity for a **number of market specific dedicated** ethnic stores
  - Diverse ethnic neighborhoods – potential for a l**arge number of very small traditional grocery stores (bodegas)** and/or dedicated ethnic store-in-store departments
- However, for success both retailers and manufacturers **must clearly "institutionalize and integrate" ethnic understanding** in the delivered shopping experience

For Hispanics, we assessed the distribution of the population, zip code by zip code

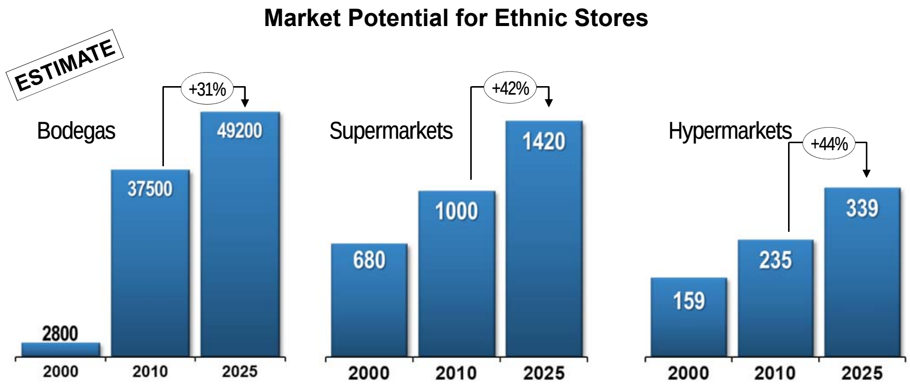
U.S. Hispanic Market Potential: Number of Stores
(2010 Census Data)

Store Size ($K/week)	Local Market Share Among Hispanics				Total Dollar Spend ($ Billion)	
	40%	50%	60%	100%	50%	100%
$20K	29,227	37,504	45,875	79,512	39.0	82.7
$50K	10,890	14,239	17,677	31,701	37.0	82.4
$100K	4,482	6,061	7,660	14,239	31.5	74.0
$200K	1,820	2,520	3,289	6,519	26.2	67.8
$350K	674	997	1,322	2,870	18.1	52.2
$500K	346	536	743	1,723	13.9	44.8
$750K	151	235	346	891	9.2	34.8

We estimate the total market for Hispanic supermarkets at about $18B, but much more for bodegas

Source: 2010 Census Data; Booz & Company Analysis

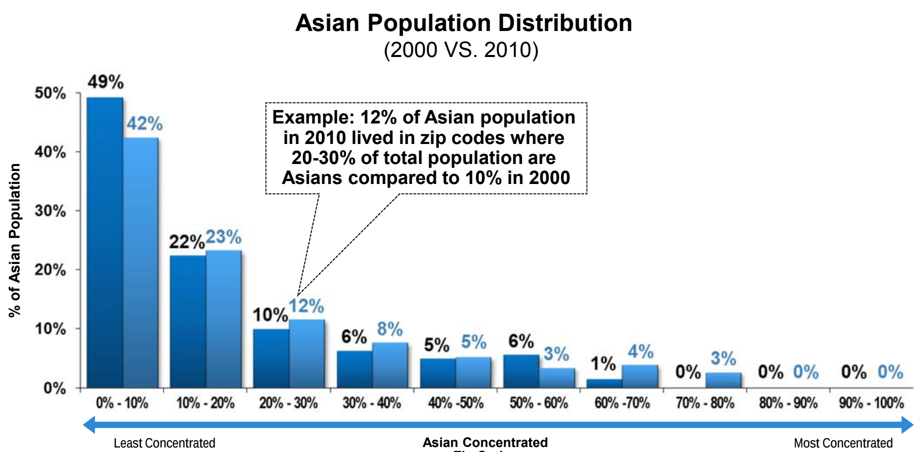
As a result, the market for Hispanic stores grows somewhat unevenly



Note: 2000 market potential represents modeled potential, NOT actual stores. Assumes 50% share of wallet. Excludes Puerto Rico

Source: US Census data; Booz & Company Analysis

Asian population is much less concentrated, and more varied – unlikely to support very many specialty ethnic supermarkets

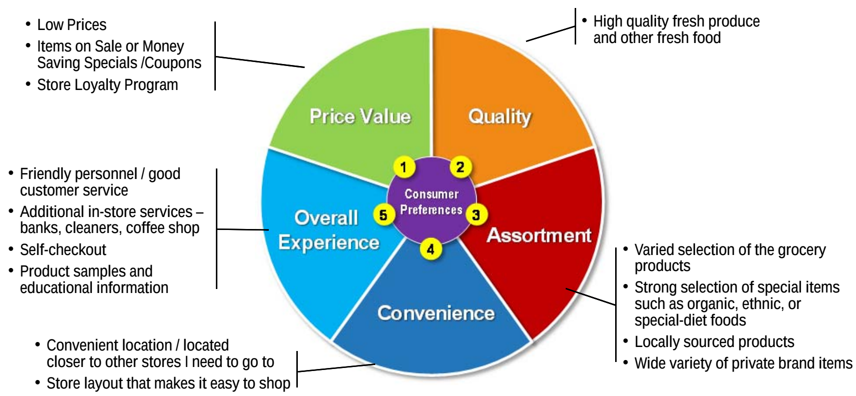


Note: Includes all Asian ethnicities

Source: 2000 & 2010 US Census Data, Booz & Company Analysis

Our research identified a number of consumer choices and tradeoffs that are today driving shopper decision making

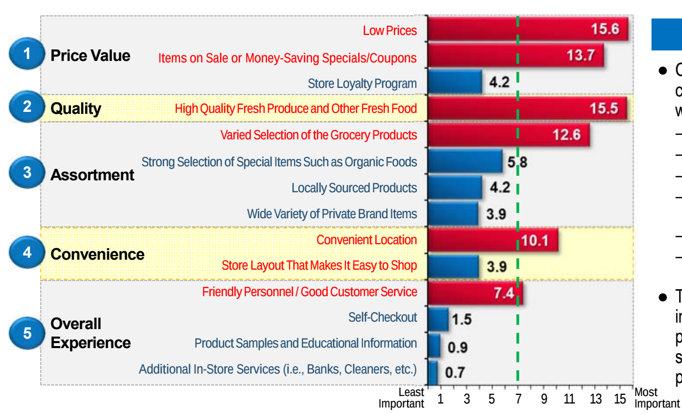
Consumer Choices and Trade-offs [1]
(Most important attribute categories when deciding where to purchase groceries



1) Q16: Below are some things people say are most important to them when selecting a store to purchase groceries. Please indicate what is the most and least important to you. (Based on MaxDiff scaling)

Grocery retailers must address these choices and tradeoffs to remain relevant

Consumer Choices and Trade-offs – Overall Importance Index [1]



Perspective

- Core value proposition for consumer choices and tradeoffs when selecting a store are:
  - Low prices
  - Sale items or money saving specials
  - High quality fresh produce and foods
  - Varied grocery selection of grocery products
  - Convenient location
  - Friendly personnel/good customer service
- These preferences are 2-3x more important than the next set of preferences such as special food selections and store loyalty programs

1) Q16: Below are some things people say are most important to them when selecting a store to purchase groceries. Please indicate what is the most and least important to you. (Based on MaxDiff scaling)

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What is the single most important capability needed for both differentiation/growth? – *shopping experience coherence*

booz&co. Retailer Coherence Index

Source: Booz & Company

Different trip types require unique "value positioning"

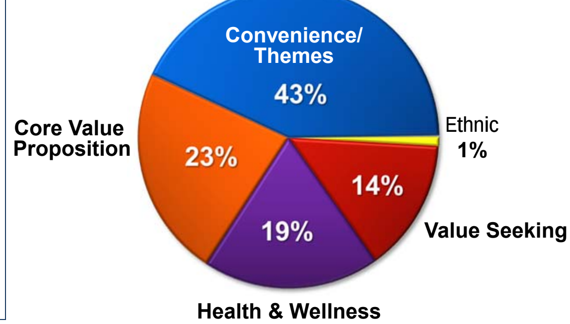
Source: Booz & Company

Merchandising displays are also a proven capability to drive growth – however improved strategy/execution is needed

Overview

- **Understanding the current merchandising landscape**
  - 510 Stores across five key channels
  - Supermarket, Mass/Supercenter, Drug, Club, and Dollar
- **In-store audit of 27,000+ unique displays**
  - ~22,000 of these are grocery category displays
- **Grouping of these displays into five unique merchandising platforms**
- **Determining Center Store, Perimeter, and Rest of Store locations**
- **Understanding Private Brands penetration**

Types of Grocery Category Displays[1]
Across All Channels
N = 21,898



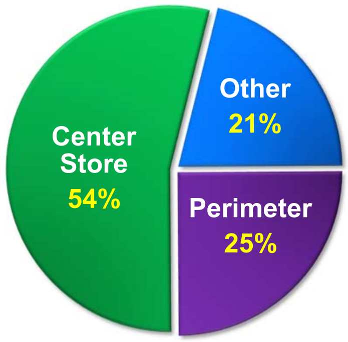
1) "Primary" theme displays.

Note: Convenience/themes include snack & meal solutions; Health and wellness includes eco friendly, health & wellness and organics; Ethnic includes Asian, Hispanic and other ethnic.

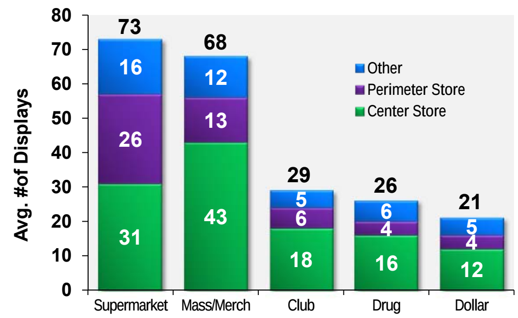
Source: 2013 CROSSMARK In-Store Marketing and Merchandising Assessment; Booz & Company Analysis

Supermarkets concentrate display activity in the perimeter while other channels focus on center store

% of Grocery Category Displays by Store Location[1]
Across All Channels
N = 21,898



Average # of Grocery Category Displays by Store Location & Channel
N = 21,898

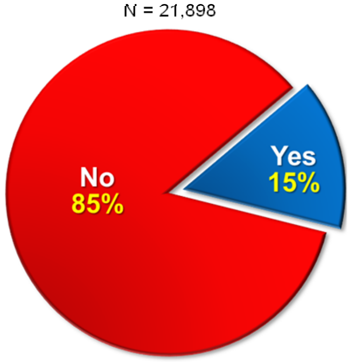


1) Center store includes the following departments: Pharmacy, Frozen, Alcohol, HBC, and All Other Center Store. Perimeter store includes: Bakery, Meat/Seafood/Poultry, Dairy, Deli, Produce, and All other Perimeter Store. Other includes: Outside of Store and Front/Lobby/Checkouts.

Source: 2013 CROSSMARK In-Store Marketing and Merchandising Assessment; Booz & Company Analysis

Private Brand display strategies are clearly being used by retailers to develop and deliver merchandising innovation

Private Brand vs. National Brand Grocery Category Displays[1]
Across All Channels
N = 21,898



Perspective from the C-Suite

"We will continue to develop our private brands as a strategy to continue to improve our margins. We believe a powerful differentiator for us will be how we capitalize on private brands with our shoppers and markets"

– CEO, Regional Retailer

"We are increasingly promoting private brands with national brands. What we are finding is that these multi-brand promotions are working. Recently we began offering private band only promotions and they have been very successful – we expect to do more

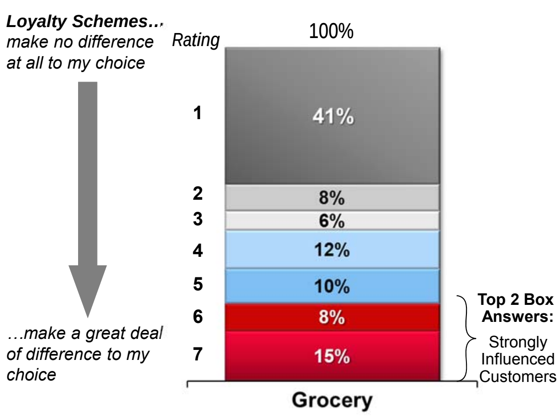
– Chief Merchant, Regional Retailer

1) Question: *Are there any private label brand products on display?*

Source: 2013 CROSSMARK In-Store Marketing and Merchandising Assessment; Booz & Company Analysis

In today's retail world, less than a quarter of shoppers are strongly influenced by loyalty schemes…

Grocery Customers:
Sensitivity to Loyalty Schemes



- Although nearly all grocery customers will participate in a loyalty scheme if offered (85%+
- …less than a quarter are strongly influenced by the schemes in terms of their store choice
- …and fully ~40% say that loyalty schemes make no difference at all
- This "freeloading" is very costly for retailers and undermines the loyalty program's economics
- It is imperative for retailers to use data analytics to drive incremental sales even to relatively unengaged segments

Source: Booz Consumer Survey, Booz & Company Analysis

In order to improve loyalty retailers are trying various forms of shopper loyalty programs

Loyalty Program Evolution

Historical				Today	Emerging
Discount Cards	**Proprietary Loyalty Program**	**Payment Cards Rewards**	**Personalized Programs**	**Gas / Grocery Cross Promotion**	**"Total Wallet" Loyalty**
•Provides additional discounts to consumers, but does not drive loyalty •Offers insights into current shopper behavior but does not provide under-standing of new customers	•Limited ubiquity, fungibility and hence low materiality and perceived value of reward •Like discount cards, does not provide any understanding of new customers	•Drives loyalty to the card but not necessarily to the retailer •Rarely provides exclusivity to the retailers, or incentive to use specific retailers	•Provides personalized offers, prices or rewards based on customer's purchase history, physical domicile and/or demographics	•Incents customers to spend at participating grocery store •Helps concentrate spend but does not lead to increase in overall basket size for category	•Has all aspects of an ideal loyalty program – ubiquity, exclusivity, fungibility, high perceived value, personalization, convenience, high ROI •Helps acquire new customers besides increasing the share of wallet of existing customers

Source: Booz & Company Analysis

Fully integrated retail marketing/merchandising capabilities are evolving as the new operating norm

Foundational

- Price Value Positioning
- On-Shelf Availability
- Paper Coupon
- Customer Service

- Targeting/Segmentation
- Shopper Card Marketing
- Shopper Engagement

- Health & Wellness Merchandising
- Ethnic Product Merchandising

New Capabilities

- Currency-Based Loyalty
- Localization (Store, Sourcing, And Assortment)
- Departmental Upgrades and Coherence

- WEB and Mobile Applications
- Mobile Couponing
- Coupons for You

- Ethnic Section/Merchandising

Next Generation

- Personalized Pricing and Promotions
- Hyper-Localization
- Total Store Coherence
- Geo-Shopping

- Mobile Shopping
- Mobile Payment
- "Whole Wallet" Coalition Loyalty

- Ethnic Store-in-Store
- Seamless Retailing

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Executives characterized technology as a highly disruptive force in the go forward grocery retailing market

- Identified as the **single greatest catalyst of change** at retail
- High **consumer adoption of mobile** smart devices
- The **Question of Big Data** – the challenges of scalability, affordability, end effective application
- In-store technologies – **automate the in-store experience as well as improve operating models**
- **"Seamless retailing"** – emerging table stakes demanded by the consumer

Technology was identified as the most important factor that will disrupt the industry going forward

92%	…of retailer and CPG manufacturer C-level executives believe that the fundamental **shopping experience is in deep transformation enabled by mobile devices**
88%	…believe that effective **in-store technology will be enabled by mobility**. Key applications: Price transparency and showcasing, in-store navigation, electronic rewards, payments, check-out, geo-positioning, and loyalty
78%	…believe that **advanced analytics will be used to reshape shopper contact to engagement strategies** – and that most retail and manufacturer organizations are in the initial stages of shopper-centric analytical innovation
72%	…believe that **"big data"** although critical for long term success, **is not well understood from a value creation perspective** – and, that affordability will drive prioritization

Note: Includes all Asian ethnicities

Source: Booz & Company Analysis 2013 Consumer Trends Survey; Booz & Company Analysis

4 Technology as a Differentiator

The evolution of consumer smartphone technology will outpace retailer's ability to harness the impending level of innovation

- **The New Smartphone**
  - 10x more powerful than today
  - 6 -10X more on-board memory
  - New "personalized" form factor
  - On always "communicating for you"
  - 6x − 8X more power life
  - 100 plus applications "just for you"

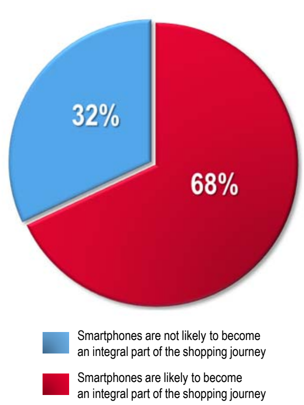
Note: Includes all Asian ethnicities

Source: Booz & Company Analysis 2013 Consumer Trends Survey; Booz & Company Analysis

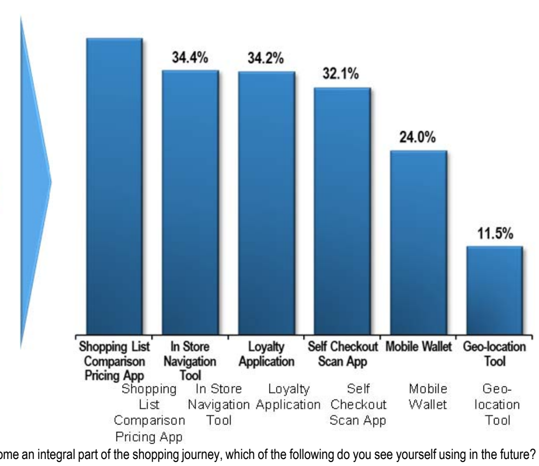
4 Technology as a Differentiator

Shoppers are most likely to use mobile technology to obtain lower prices, read online reviews and search for online coupons

Significance of Smartphones in the Shopping Journey [1]
% of Shoppers, N = 1503



Anticipated Activities



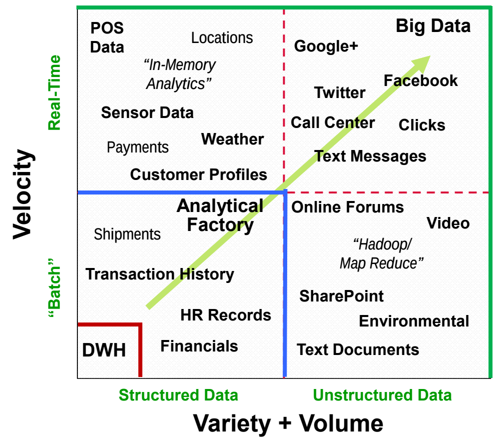
1) Q17.1A – Please select all that apply. Smartphones are likely to become an integral part of the shopping journey, which of the following do you see yourself using in the future? 32% of respondents (494 of 1503) selected "None of these".

Source: Booz & Company 2013 Consumer Trends Survey; Booz & Company analysis; Nielsen Analysis

Big Data at retail – details of every shopper/visitor, every interaction, every day, 7/24 – possible/cost effective/feasible?

Five Fundamental Issues from the C-Suite

1. *"What are we going to do with all this data?"*
2. *"We have no clue as to how to analyze all the data we have collected."*
3. *"Having a great deal of information that you can't instill into actionable insights relating to the customer experience is a lost opportunity. What is the roadmap?"*
4. *"If you can't translate the reams of information into a strategy that can be executed in the company by someone at the front lines, you don't really have much."*
5. *"Simply stated, its all about affordability and how it will change my bottom line. I am not there yet on this topic."*

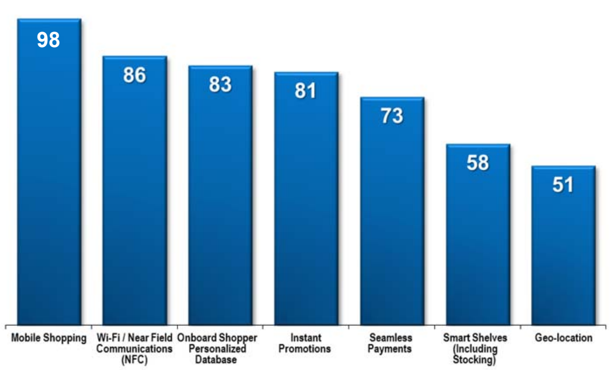


Although it was mentioned in all interviews – need, affordability, and differentiation was questioned

Source: Booz & Company/BARC

In-store technologies are destined to deliver a "responsive store" environment for shoppers

Technologies that Will Drive the Shopping Experience Transformation
N = 18 CTO Interviews

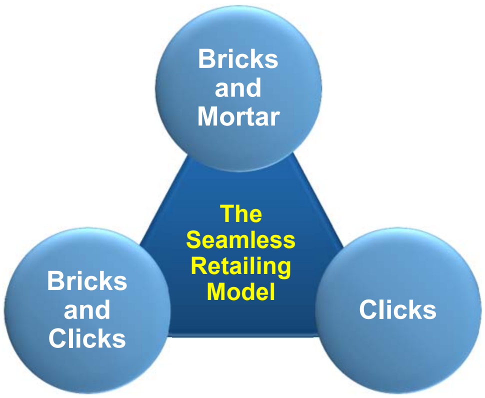


Implications

- **What will next generation in-store technology achieve**
  - Designed to "inspire" shopping
  - Discover new products
  - Instant "just in time" incentives
  - Connect shoppers to their preferences of all of the things they love
  - Shoppers will expect "relevant" suggestions automatically
  - Three technology differentiators
    - Personalized
    - Immersive
    - Helpful
- **Supports the shopper as well as it supports the retailer**

Source: CEO & CTO Interviews with NCR Technology, IBM Retail Group, and HP Retail Group; Booz & Company Analysis

Retailers are struggling with how to deliver the overall "seamless experience" which is core to shopping simplicity



Perspective from the C-Suite

"We know we need to solve the multi-channel retailing problem. However, with the pace of technology change, we are not sure where to start investing and the prioritization process is very challenging".

– CEO, Regional Grocer

"We have no clue as to where to invest and how to invest. We are not sure what is important and what is not. However, we will invest and invest heavily".

– CTO, National Grocer

"We are having solid success with our "Bricks and Clicks" model – however, it is costly and we are unsure as to how to integrate with the stores – big challenge".

– CMO, National Grocer

Source: FMI Executive Retailer and Manufacturer Interviews

Topics for Today's Discussion

- Introduction and Objectives
- The Challenges of Capacity and Demand
- Consumer Trends That Will Reshape the Industry
- Merchandising/Marketing Capabilities Driving Growth
- Technology as a Differentiator
- **Capabilities Needed to Win in Tomorrow's Market**

Summarizing today's conversation

- Rapidly **changing and volatile** environment
- Deep **structural issues** (over capacity, new entrants etc) combined with…
- …**unprecedented** technological change
- Very **challenging environment** for the traditional supermarket industry

- Winners will:
  - Successfully **differentiate from the other formats** and from like-formats
  - Redefine the **end-to-end shopping experience**
  - **Embrace and lead** with technology
  - Participate in the **transition to online purchasing** (one way or another)

Three questions to reflect on AFTER today's conversation

A conversation with your peers…

- *"Is our current strategy aligned with the major trends identified in this research?"*
- *"Is our organization FIT FOR GROWTH – that is, are we placing the right investment bets and cost structure?"*
- *"Has our growth plan adequately accommodated technology to differentiate ?"*

Retail and CPG executives consistently describe the future retail experience with three key words...

	Description
Personal	• Granular tracking of consumer purchases/ behaviors (deep analytics based on big data) • Personalization of every aspect of shopping experience • Consumer driven selection from curated offerings
Digital	• Real-time digital communication with consumers during their shopping experience • Personalized interactions based on consumer context (time of day, location in store, trip mission, etc.)
Virtual	• No physical boundaries of how I shop and where I shop (at home, on the go, PC/tablets/smartphones, etc.) • Range of options from purchase to pick-up/delivery • Consumer's purchase history, etc. held in the cloud and accessible from anywhere

Source: FMI Executive Retailer and Manufacturer Interviews