

October 5, 2016



Key Trends Impacting Grocery Retailing

Context of Discussion

Food retailing is at an inflection point due to many external trends beyond control of the retailer. Without change, many traditional retailers will “race to the bottom” through unwarranted discounting.

Successful retailers will embrace these trends, dig deep into customer purchase behavior, and will fundamentally alter the customer-value proposition in order to effectively compete for the next generation’s food dollar.

Core Topics

- Unprecedented Change
- State of the Industry
- eCommerce
- Private Label
- Organics, Specialty, and Ethnic Foods
- Strategies, Formats, and Concepts
- Action Items





Unprecedented Change

Uncertainty Reigns | Technological Advancements | Demographic Changes



Uncertainty Reigns

Economic Uncertainty

- Still hungover from the 2008 financial collapse
- Households in all economic tiers experienced near-universal decreases in median incomes across U.S. metropolitan areas since 1999¹
- Upcoming election and other factors indicate another economic downturn will occur in eighteen months or less²

Industry Uncertainty

- Changing shopper behaviors
- New competitive pressures
- Eat at home; eat away from home, grocerants, and meal kits
- Food deflation

¹Source: Pew Research Center

²Source: Stifel estimates, FactSet



The Longest Streak of Falling Food Prices in More than 50 Years

THE WALL STREET JOURNAL.

BUSINESS

Food Price Deflation Cheers Consumers, Hurts Farmers, Grocers and Restaurants

Farm Belt cutbacks hit more businesses even as consumers save big at the grocery store

By **HEATHER HADDON** and **JULIE JARGON**

132 COMMENTS

Aug. 29, 2016 1:13 p.m. ET

The U.S. is on track this year to post the longest stretch of falling food prices in more than 50 years, a streak that is cheering shoppers at the checkout line but putting a financial strain on farmers and grocery stores.

The trend is being fueled by an excess supply of dairy products, meat, grains and other staples and less demand for many of those same products from China and elsewhere due to the strong dollar. Lower energy costs for transportation and refrigeration also are contributing to sagging food prices, say economists.

“Deflation is a godsend for consumers,” said Bob Goldin, vice chairman of food consultancy Technomic Inc.

Nationwide, the price of a gallon of whole milk on a...
over a year ago; the price of a dozen large eggs fell...

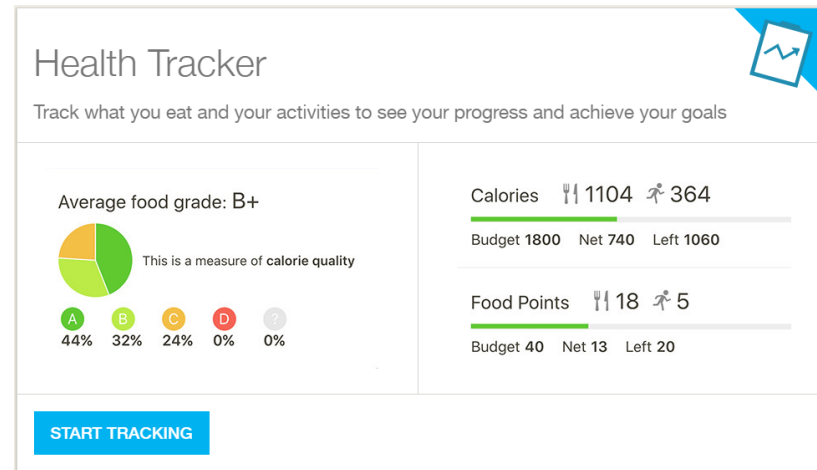
Food Inflation Rate (High/Low) of Downward Trends			
1948	1958	2006	2016
4.9%	.3%	3.6%	.02%

Source: U.S. Bureau of Labor and Statistics



Technological Advancements

- Ubiquitous technologies
- The Internet-of-Things
- Pervasive connectivity changes the rules of engagement
- New capabilities are disrupting every aspect of grocery retailing
 - Personalized pricing and promotions
 - Real-time targeting
 - Health scoring



Demographic Changes: Millennials

- Millennials, largest consumer segment, are now forming families
- First generation born into the digital world, therefore they thrive on information
- Very price/value conscious (limited disposable income)
- Want it all: convenience, value, in-store, online, delivery, pick-up, RTE, RTC
- Less loyal than Baby Boomers (products/banners)
- Shop more channels

I call them the Panera generation. We taught them to eat, but we didn't teach them how to cook.



Demographic Changes: Hispanics

- Hispanics are the fastest growing ethnicity¹
- Today, Hispanics account for 18% of the U.S. population
- By 2060 the Hispanic population will account for nearly 30% of the U.S. population
- Hispanics are significantly more engaged throughout the entire shopper journey, both online and offline
- Hispennials are digitally engaged and have significant spending power
Seventy percent of the Hispanic population in the U.S. is under the age of 40. Non-Hispanics under the age of 40 account for less than 50%..

¹ HispanicLink™ by IRI©

US Percentage Population Growth by 2060

Total Non-Hispanic +19.5%

Hispanic +57.5%

Source: Pew Research Center



An infographic presented by Latino digital network MiTu at Social Media Week Los Angeles





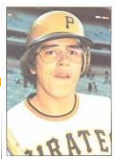
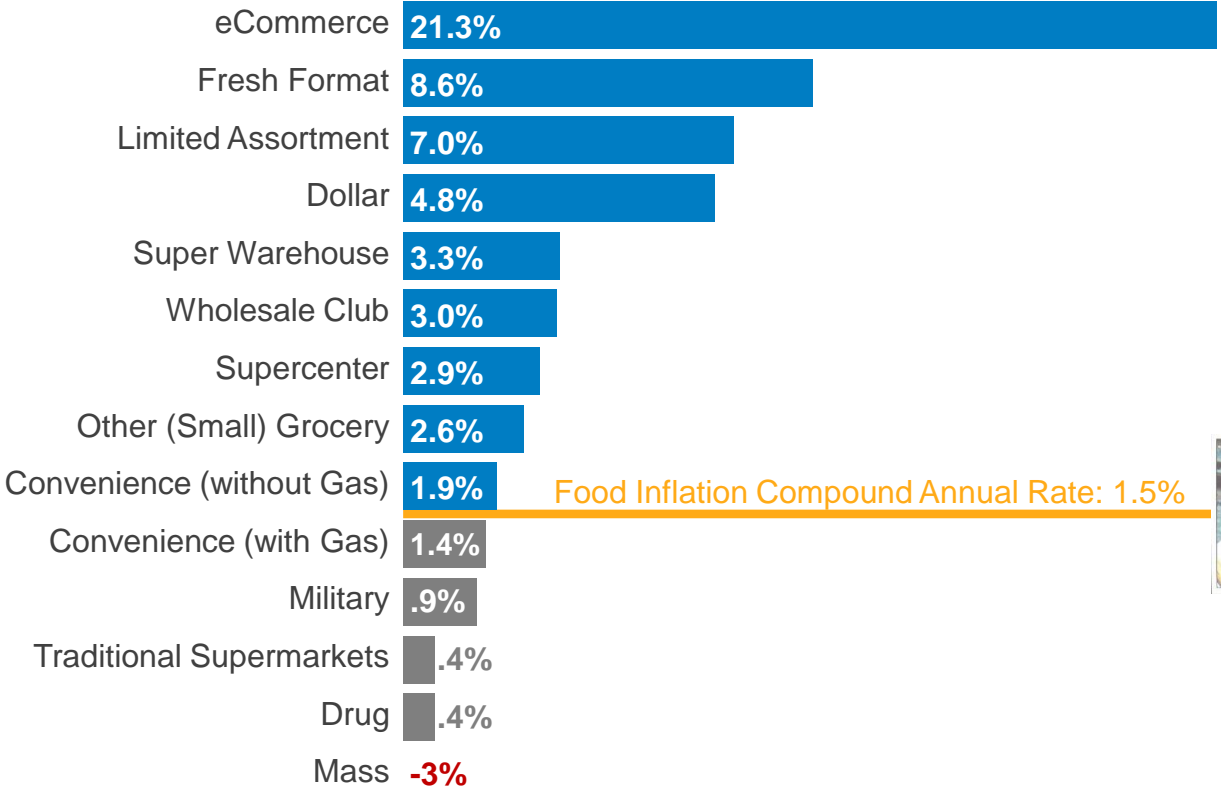
State of the Industry

Channels | eCommerce | Strategy, Formats, and Concepts



Anticipated Compound Annual Sales Growth vs. Inflation: 2016-2020

Food and Consumables



Source: Willard Bishop Future of Food Retailing



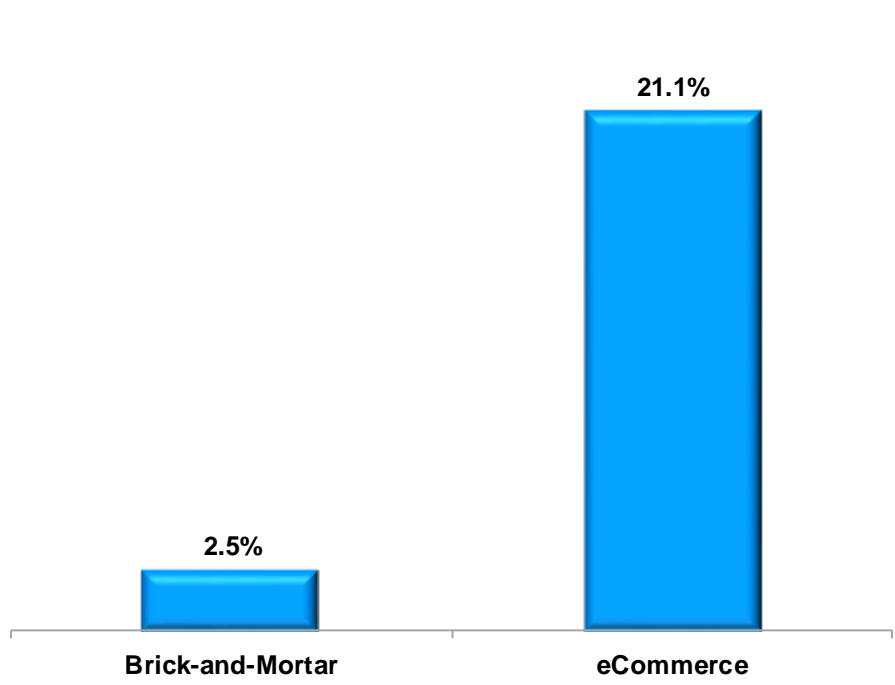
eCommerce



eCommerce: Rapid Growth and Higher Spend-Rate

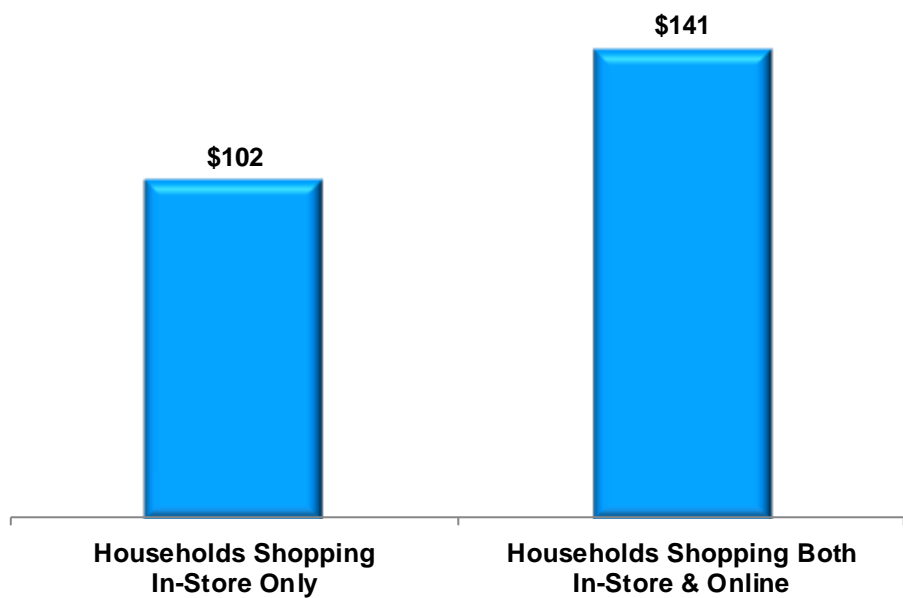
Food and Consumables

Annual Growth Rate



Click-and-Mortar Retailers Capture 38% More in Incremental Sales

Households shopping in-store and online spend 38% more than households shopping in-store only



eCommerce appeals to non-price sensitive shoppers, which is creating new opportunities for increasing margin

Source: Willard Bishop and eMarketer 2015

Are Groceries the Next Big Driver of Global eCommerce?

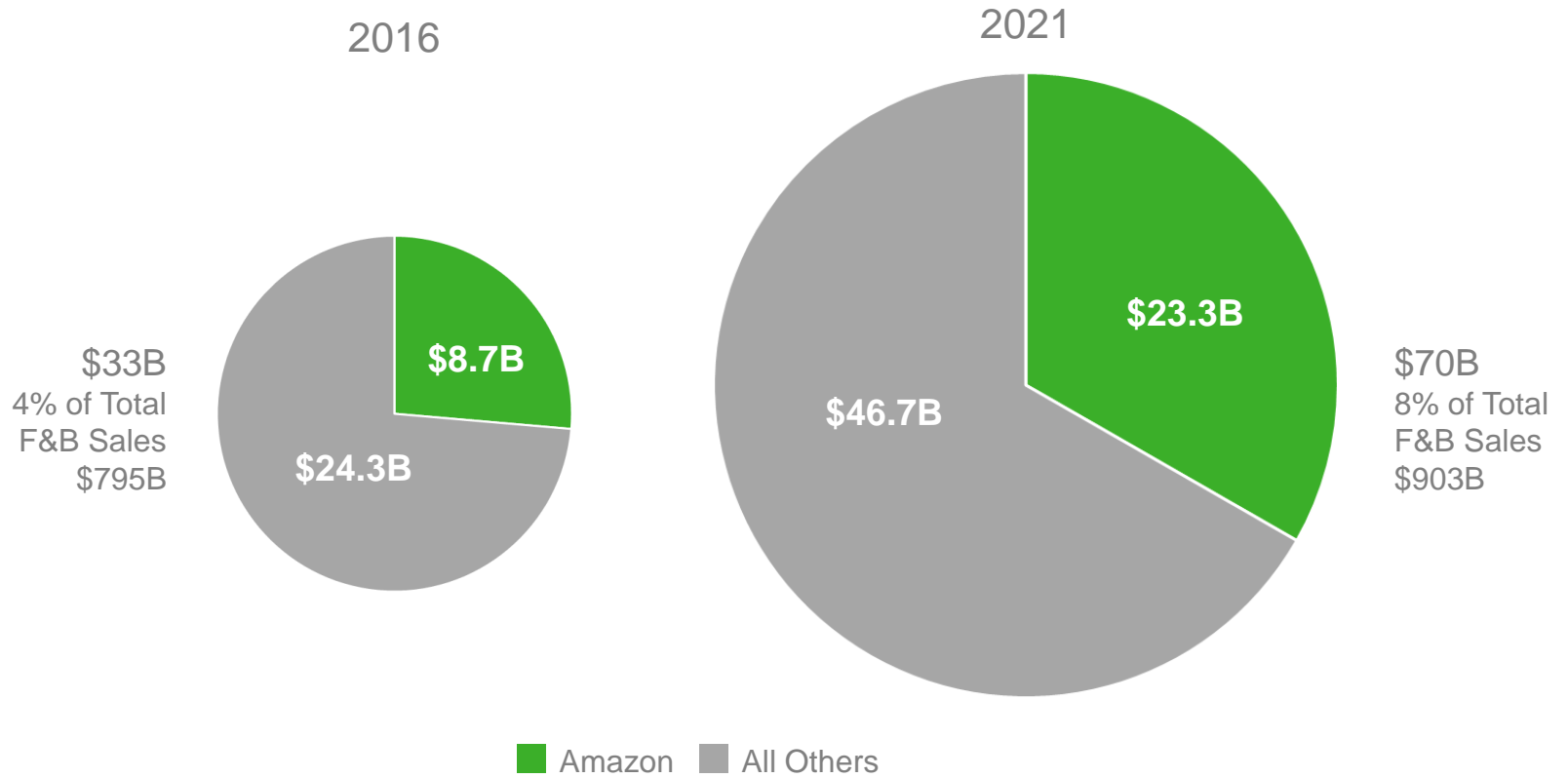
Jan 22, 2016

Global eCommerce is making deeper inroad across a broad swath of products, but online grocery is set to be one of the biggest winners this year. **Around the world, more than a third of online shoppers expect to buy groceries over the Internet in 2016 – 34% vs. 21% in 2015** – according to a new Alphawise survey from Morgan Stanley Research.”

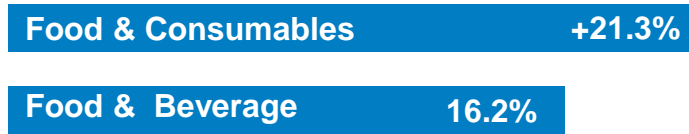
Morgan Stanley



Estimated Online Sales of Food and Beverage (US)



eCommerce CAGR 2016 - 2021



Sources: Cowan and Company and Willard Bishop

Amazon Widens the Gap Between #1 and #2

Walmart's e-commerce growth slows to 8% as Amazon soars to record sales

BY **MADLINE VUONG** on February 18, 2016 at 2:50 pm

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GeekWire



(Photo via C. Gil/Shutterstock.com)

Amazon is expanding its online lead over Walmart, according to the latest results from the retail giants. The competition between the two companies is watched closely, since Amazon is the number one online retailer and Walmart is the number two.

Walmart's net online sales were up only 8 percent for the peak holiday quarter, [the retail chain reported today](#). (Walmart didn't break out specific e-commerce dollars.) That compared to 22 percent growth in Walmart's online sales for the fourth quarter of last year.

Despite Walmart rolling out special holiday offerings including [an early start to Black](#)



Amazon is Aggressively Capturing Market Share

Amazon Prime

- Approximately 55 million members in the U.S.
- Nearly 70% of all Prime purchases are from repeat customers
- More than 90% of members renewed their subscription in 2015¹

Expansion and testing of new products and services continues

- Private label
- Amazon express
- Click and collect
- Meal kits



¹Internet Retailer

Amazon Owns Shopper Engagement

- Amazon Prime
- Prime Now (pilot: flat fee for 2 hour delivery)
- Subscribe and Save
- Amazon Family
- Prime Pantry
- B2B (different pricing)
- Fresh
- Dash Buttons
- Echo
- Home Services



amazon vehicles

A NEW DESTINATION FOR CAR RESEARCH



Explore services by category



Why Amazon Is Venturing Further Into Bricks-and-Mortar Retail

■ The e-commerce giant has announced it will open three physical bookstores. While the initiative might seem silly at first glance, it is a savvy move.

The Street, Aug 30, 2016

Amazon.Com Stats

2.2 billion visits annually | Avg. time on site: 11:39 | Bounce rate: 22%

Forty-four percent of new product searches start with Amazon; out-numbering Google, Bing & Yahoo combined.

Source: Bloomreach



Understanding Walmart's Acquisition of Jet.com

- **Volume-driving algorithm and sophisticated pricing technology**
- **Jet can leverage Walmart's vendor relationships and distribution network to increase margins**
- **Jet's founder, Marc Lore will remain with Jet and lead Walmart's U.S. eCommerce business**
- **Share goal of being the everyday low cost provider**
- **Adding 350,000+ subscribers monthly**



But the biggest asset Walmart gains by paying \$3 billion for a company whose business model is largely unproven is creative brain power.

- Sucharita Mulpuru
Forrester Retail Analyst

About the Algorithm

- Provides discounts to shoppers based on order size and proximity to partner warehouse
- Options for additional savings
 - Pay with debit card
 - Extended delivery times
 - Waive 'right to return'
 - Adding "Smart Items"
Adding detergent and dryer sheets pop-up as a "Smart Item"
 - Sales tax*

The logo for Jet.com, featuring the word "jet" in a bold, lowercase, purple sans-serif font. The letter "j" has a small dot above it, and the "e" has a horizontal bar that extends to the right.

* Location specific and likely to change when integrated with Walmart



Working eCommerce to Your Advantage

- Online buyer is less price sensitive
- Rethink the relationship with the online consumer
 - Driven by convenience
 - Insight-based merchandising
 - New merchandising opportunities
 - Personalized offers
 - Use trade dollars to subsidize home delivery





Private Label



Private Label SKUs Drive 60.9% of Total Store True Profit for Safeway

Manufacturer Scorecard
(Top Manufacturers at Safeway)

Rank	Manufacturer		Share of Total Store				
			Sales	Adjusted Gross Profit	True Profit	SKUs	Space
1	Private Label	✓	35.2%	44.8%	60.9%	16.3%	25.1%
2	Pepsico, Inc.		3.1%	2.0%	1.2%	1.6%	3.2%
3	Kraft Heinz	✓	2.5%	2.2%	3.6%	1.5%	2.1%
4	Nestle		2.4%	2.0%	2.6%	1.7%	2.7%
5	Procter and Gamble		2.0%	1.1%	-1.4%	2.4%	3.5%
6	Coca Cola Company		1.8%	0.9%	1.0%	0.7%	1.3%
7	General Mills, Inc.		1.6%	1.4%	0.7%	1.4%	2.1%
8	Unilever		1.1%	0.9%	0.7%	1.3%	1.2%
9	Hormel Foods Corporation	✓	1.1%	1.0%	1.6%	0.6%	0.7%
10	Driscoll Strawberry Corporation	✓	1.1%	1.1%	2.5%	0.1%	0.2%
11	Kelloggs		1.0%	0.8%	0.7%	0.7%	1.4%
12	Bimbo Bakeries USA	✓	1.0%	0.8%	2.6%	0.3%	0.6%
13	Anheuser Bush InBev		0.9%	0.4%	0.6%	0.3%	0.7%
14	ConAgra Foods, Inc.		0.9%	0.9%	1.1%	0.7%	1.2%
15	All Other Manufacturerers		42.9%	37.8%	26.2%	69.0%	53.5%
1	Private Label (Center Store Only)		17.8%	26.6%	49.9%	8.7%	16.2%

Private Label – Safeway’s share of private label volume is lagging the Composite (21.1% vs. 25.6%). (Center store SKUs only). However, Safeway’s penny profit (adjusted gross profit/unit) is significantly higher (\$1.09 vs. \$.76).

✓ Manufacturers yielding a greater share of true profit dollars than their share of store space.

Source: Willard Bishop SuperStudy™



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Space Allocations for PL Paper, Ice Cream & Cereal Exceed True Profit %

Private Label Scorecard (Center Store at Safeway)

Rank	Category	PL Share of Center Store				
		Sales	Adjusted Gross Profit	True Profit	SKUs	Space
1	Fluid Milk	2.1%	2.0%	3.44%	0.1%	0.23%
2	Cheese	1.7%	2.5%	5.13%	0.2%	0.34%
3	Eggs	1.1%	1.5%	2.98%	0.0%	0.12%
4	Paper	0.6%	0.7%	0.52%	0.1%	0.84%
5	Bottled Water	0.6%	0.7%	0.69%	0.1%	0.56%
6	Ice Cream	0.6%	0.6%	0.49%	0.3%	0.56%
7	Frozen Poultry and Meat	0.5%	0.5%	1.00%	0.1%	0.19%
8	Cereal	0.4%	0.5%	0.50%	0.2%	0.55%
9	Cream or Creamer	0.4%	0.7%	1.42%	0.1%	0.05%
10	Coffee	0.4%	0.4%	0.68%	0.2%	0.25%
Total		100.0%	100.0%	100.0%	100.0%	100.0%

Source: Willard Bishop SuperStudy™



Private Label is a Centralized Strategy at Kroger



- One-third of the conventional grocery items sold at Kroger are private label
- Their multi-tier PL approach applies to a broad range of shoppers



- **Honest**
- **Easy to understand**
- **Affordable**
- **Free from 101** artificial preservatives and ingredients

Simple Truth has become a \$1.5 billion brand, making it the nation's largest natural and organic brand.

Source: Cincinnati Business Courier

No antibiotics | No added hormones
No preservatives | Certified 100% organic

Private Label Positioning

- Private label is a key way Kroger fulfills against their “Low Prices” promise
- NBE Kroger brand serves as the foundation of Kroger’s holistic private label offering and delivers PL options across the store
- Economy line of private label successfully neutralizes impact of LAS and dollar stores by providing shoppers with value-oriented options
- Private Selections has grown to a billion-dollar brand providing shoppers with high-end, differentiated products

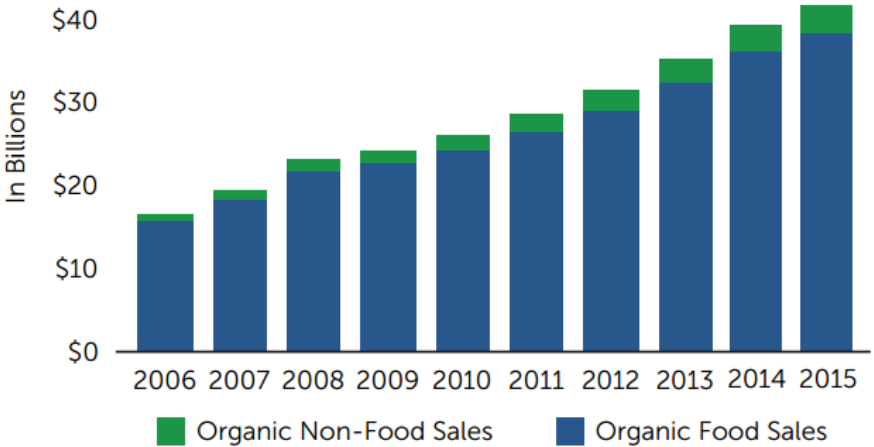




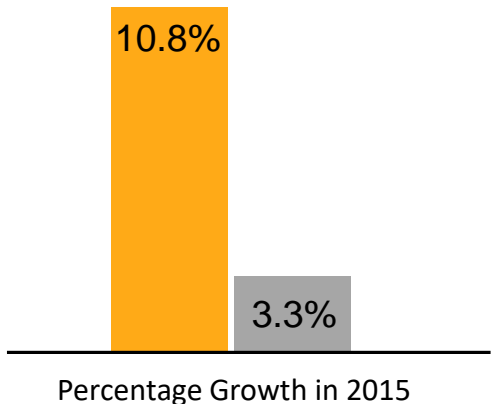
Organics, Specialty, and Ethnic Foods

In 2015, the Organics Industry Experienced its Largest Dollar Gain Ever

Total U.S. Organic Sales and Growth, 2006–2015



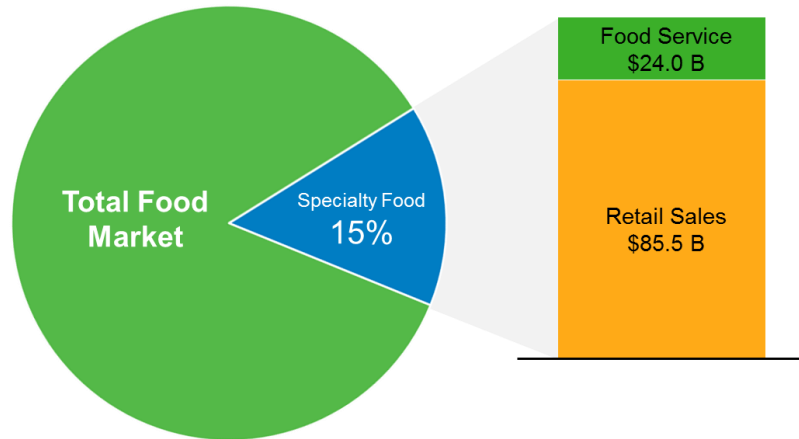
Organic Industry Growth: vs. Traditional Food Market



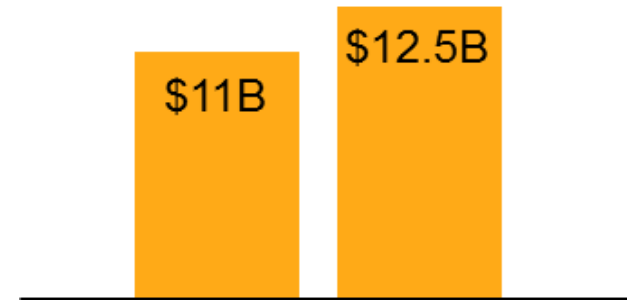
Source: Organics Trade Association

Specialty Foods Hits Record Sales of \$109.5B

Total Specialty Foods Sales: \$109.5 B
Up more than 20% since 2012



Ethnic Foods have had steady growth
Up 13.6% in 2 yrs



- Millennials in particular are open to experimentation; 35% said food should be fun to eat, compared with 21% of non-millennials.
- The leading product attribute consumers said they look for in food and beverage is taste or flavor, ahead of value, health, and convenience.
- Spices are surging in product development (globally) and products launched last year containing chili grew 34% in North America.

Sources: Specialty Food Association, Mintel International and SPINS/IRI

Source: IFT/Food Business News



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Where CPG-Owned VC Firms and Food Accelerators are Investing



- High protein, organic and non-gmo ingredients
- Grass-fed milk from respected cows that roam free on sustainable family farms
- No additives (stabilizers, thickeners, artificial preservatives, gross)
- Unique sweet and savory varieties that taste amazing.

Sources: CB Insights and Willard Bishop



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Strategies, Formats, and Concepts

Traditional Operators Seek Scale, Differentiation, and eCommerce



“We invested in Lucky’s because of their great people and unique go-to-market strategy, which includes a culinary department that showcases amazing, restaurant-quality prepared foods.”

- Rodney McMullen
CEO, Kroger



The Separation of Eating at Home vs. Eating Away from Home is Fading

Supermarket



Prepared Foods



Grab and Go

Prepared Pick-Up



Pre-Ordered
Online or In-Store
(Kiosk prior to
shopping)

Meal Kits



In-Store
Third-Party
Hybrid

Grocerant



Ordered Onsite,
Pre-Ordered
Online or In-Store
(Kiosk prior to
shopping)

Restaurant



Food Service Revenues in Supermarkets Expected to Reach \$30MM in 2017

**Young Consumers
Flock to Grocerants
for Quality, Value,
Variety, and Tech**

\$28B annual sector outpaces health care and education foodservice

"Retail foodservice operators will continue to steal share from restaurants over the next decade as they have done since 2006," said Wade Hanson, principal, Technomic, in his State of Foodservice at Retail presentation.

Supermarkets grew their foodservice revenues 10.4% annually from 2006 to 2015, from \$12.5 billion to nearly \$28 billion. That's five times the 2.1% annual rate of traditional restaurant growth in the same period. Further, Technomic projects that supermarket foodservice will grow 9.3% in 2016 and sustain a similar pace over the coming decade.

Meanwhile, convenience stores saw foodservice revenues 2.4% annually since

The Business

Insider cites research from NPD Group's recent report "A Generational Study: The Evolution of Eating," which finds fresh, restaurant-quality food, chef-driven menus and instore experiences are reasons for millennials to visit and spend at grocerants.

Source: National Restaurant Association//Technomic



Lidl Announces \$100 Million Regional HQ & DC in Maryland

August 9, 2016



- Operates about 11,000 stores in 26 countries throughout Europe
- Near-term plans aim for 2,000 new stores in the United States by 2020
- Plans to open ~~100~~¹⁵⁰ stores by 2018

Forbes

September 27, 2016

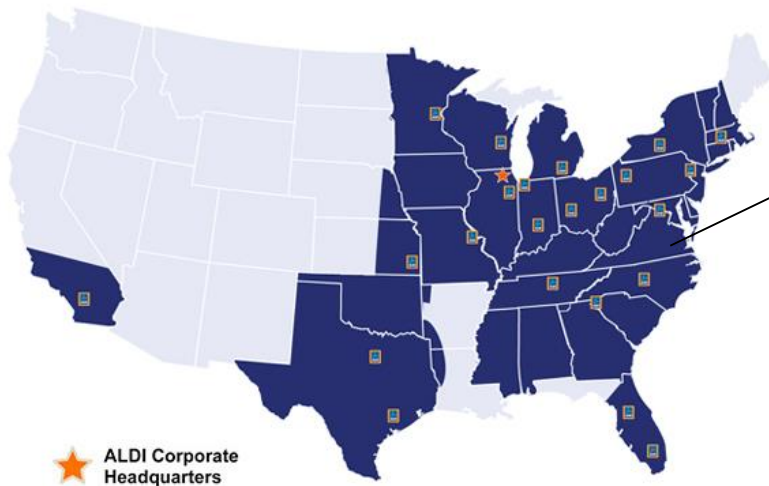
The discount German supermarket chain Lidl is expected to open its first 150 U.S. stores in 2018, a larger debut than the original estimate of 100 stores. It's going to make quite a splash.

Division's most likely to be impacted: Acme, Eastern, Houston (Florida), Shaw's



Aldi Accelerates US Expansion

- Operates more than 10,000 stores worldwide
- Operating 1,500 stores in 32 U.S. states



IGD RetailAnalysis

August 18, 2016

Aldi is investing \$57m to establish a division headquarters and 500,000 sq. ft. distribution center in Dinwiddie County, Virginia.

- U.S. expansion plans call for an additional 500 new locations by 2021.

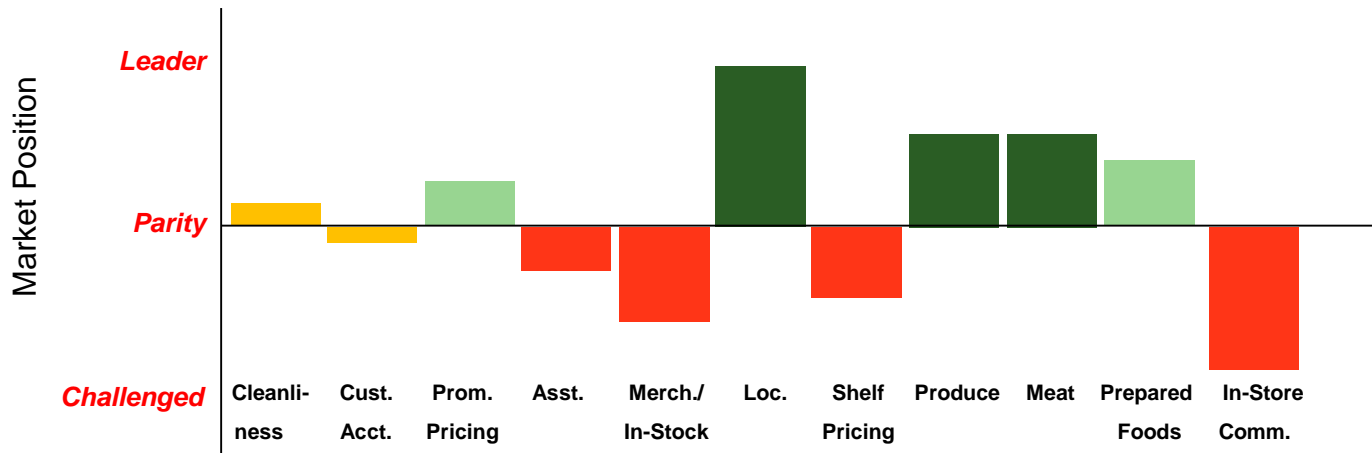
Willard Bishop estimates potential growth of Limited Assortment Stores to be more than 1,000.

Success Today Means Picking Your Battles

- Lead on one or two highly important elements
- Improve your “challenged” elements to at least “parity”

Retailer “A” Value Equation Assessment

(Summary of Retailer “A” Performance/Image and Magnitude of Required Enhancements)

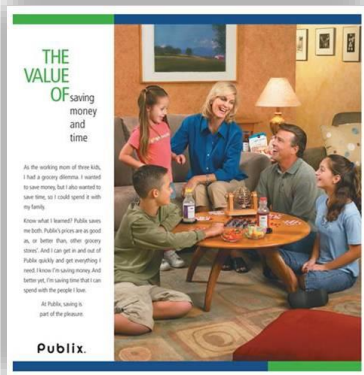


Non-Price-Based Ways for Enhancing Price Image

Elevating Entry-Level Store Brands

- Stagnant sales in supermarkets
- Competition from non-traditional formats
- Reductions in government benefits
- Improper positioning of private label (national brand equivalents)

Price Communications



Craft your message



Define "Ways to Save"



Maximize use of endcaps (value and signage)



Communicate savings



Bundle offers





Action Items



Action Items: Adopt a Change-Oriented Mindset

- **Private Label**
Loyalty driver and investment fund creation
- **Pricing Strategy** (to eliminate potential price image negatives)
Promotion optimization and integrated communications (print, in-store, digital)
- **eCommerce**
Defensive and offensive approaches
- **Tools**
Data and analytics
- **Food Service**
Take advantage of “blurring lines” between food at home and food away from home
- **Localization**
Assortment and merchandising
- **Personalization**
Pricing and communication (includes digital engagement)





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