

- Retail Industry News from IRI for Week Ending 6/1/07-

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Thanks to MNB
for this selection of
articles.

MNB's Tales Of Tesco

• *Business Week* analyzes Tesco's multi-format marketing efforts in Japan, noting that "last month, Tesco opened its first store in Japan in the Oizumi Gakuen district of Tokyo's Nerima ward. The store, which stocks about 2,500 items, is the first of 35 due to open in the country by February, 2008. The expansion into the world's second largest retail market (after the U.S.) comes after four years of research there following Tesco's \$340 million acquisition in 2003 of C Two-Network, a small supermarket operator."

In other words, Tesco bought a supermarket chain in Japan to gauge consumers' responses to its fresh food offerings, and now is expanding its reach by opening c-stores that can give it greater reach and presence.

"Nevertheless, Japan is a notoriously tough market to crack for retailers, particularly foreign ones," *Business Week* writes. "Even local giant Aeon, Japan's biggest retailer, has an operating margin of under 2% for its supermarket business. And ask executives at France's Carrefour and Wal-Mart: Carrefour quit Japan in 2005—selling its eight stores to Aeon—after failing to appeal to Japanese consumers. The failed mission cost Carrefour \$264 million in accumulated losses." As for Wal-Mart, it owns more than half of the Seiyu chain there, but "has yet to post a full-year profit since Wal-Mart took an initial stake in the Japanese company in 2002."

Bidders For Australia's Coles Group Dropping By Wayside

Two members of a consortium looking to make a bid for Australia's Cole Group reportedly have withdrawn from the process, according to published reports. Both Kohlberg Kravis Roberts (KKR) and CVC Asia Pacific made the decision to abandon their roles in the consortium, which had not yet made

an actual bid for Australia's second largest retailer.

According to analysts, these developments seem to leave Westfarmers, Australia's largest home improvement chain, in the driver's seat in terms of acquiring Coles, which has put itself up for sale. Ironically, it was KKR that started the process less than a year ago by making an unsolicited and ultimately unsuccessful offer for Coles. While there was no sale at the time, it opened the door for speculation and eventually the reality that Coles' ownership was unlikely to remain as it was.

The remaining four members of what was the KKR consortium are The Texas Pacific Group, Bain Capital, Blackstone Group and Carlyle Group; it appears, for the moment at least, that they remain interested in acquiring Coles. There has been speculation that Tesco and/or Wal-Mart might make a play for Coles, or that Woolworths – Australia's largest retailer – might be interested in some of its assets. But none of those possibilities have been realized.

Coles is expected to be sold for upwards of \$16 billion (US), though the pullouts by KKR and CVC have led some market analysts to suggest that due diligence by the companies may have revealed some financial realities about Coles' operations that made it look less appetizing.

Coles has set June 25 as a deadline by which final bids must be submitted for the company.

Exclusive E-Interview: Private Label – Strategy, Economics & Opportunity

We were at Staples the other day, and noticed that an enormous number of products there seemed to be private label. Then, we went to Costco, and saw that its private label tuna fish was actually more expensive than the national brand positioned next to it. Later that day, we shopped at both Trader Joe's and Stew Leonard's, two retailers that do an extraordinary business in packaged and fresh private label products, respectively.

Coincidence? We think not.

The simple fact is that private label is one of the chief weapons in a retailer's ability to differentiate itself. And so it was timely when we received "over the transom" (a phrase, we should note, that is so completely out of date that it clearly defines us as an old guy simply for using it) a report from management consultant W. Frank Dell on private label strategies. Dell's premise is that the most common approaches to private label lack any foundation in economic theory, which results in millions of sales and profit dollars being lost each year.

With this in mind, we decided to engage Dell in this exclusive e-interview:

MNB: Traditionally, Private Label has been priced attractively compared to National Brands...and yet Costco seems to always have its Private Label tuna priced higher than the comparable National Brand, What does this tell us about Costco both strategically and economically?

Frank Dell: To start with you have picked one of the few retailers that actually has a Private Label Strategy. Costco started their Private Label program by co-branding with National Brands, which established their quality quotient in the consumer's mind. They were then able to expand their Private Label line as a truly National Brand equivalent and therefore did not require the large price discounts

you have traditionally observed.

Recently, Costco was selling Kirkland Albacore tuna (8 pk, 6 oz) for \$8.99, Bumble Bee Albacore tuna (10 pk, 6 oz) for \$10.99 and Chicken of the Sea chunky light (16 pk, 6 oz) for \$8.99. On a per unit measure Kirkland is the highest, yet on a transaction measure they are \$2.00 less than Bumble Bee and equal in price to Chicken of the Sea. This illustrates two points we make in our most recent edition of Dellmart Perspective. First, retail pricing tactics are different by consumer shopping trip. Pantry loading (club) is a different shop than fill-in or immediate consumption (supermarket). Second, competitive type Private Label products should be priced based on true quality and strategic achievement. Excessive price discounts equate to lost sales and profits.

MNB: Is it your sense that when Tesco starts opening stores in the US, it will use Private Label – especially in the prepared food arena – the same way as it has in the UK? How do you think Tesco will differentiate itself both in terms of Private Label and Prepared meals? And how should competitors in California, Arizona and Nevada respond?

Frank Dell: Prepared food, fresh meat and produce are all store branded by the consumer, yet typically are not Private Label. This is a missed opportunity and an indication of not having a Private Label strategy. Private Label prepared food was started by UK retailer Marks & Spenser, followed by Tesco and Sainsbury.

American retailers are facing a very real competitor in Tesco, as they are one of the world's best merchants. They were early to learn and now excel at target consumer marketing. Further, Tesco has correctly identified that the American shopper is trending towards the European pattern. Meaning weekend shopping is for pantry loading and daily is for immediate consumption.

I anticipate Tesco will open these stores with 30% to 35% Private Label including prepared food. Over time Private Label will increase to over 50 percent. Just like with Wal-Mart, local retailers will require a plan to effectively compete. It starts with target consumers. When a retailer's target consumer shops Tesco, it loses sales. One hint: the Tesco shop will be a fast one, thus consumer time from entering the store to leaving will be a factor.

MNB: Something we noticed recently while in a Staples was how much product it has converted to Private Label...the numbers seem to grow with every visit. From a pricing perspective, what are the advantages of Staples making such a move? And what is the "below the surface" strategic point that most people may not be seeing?

Frank Dell: Non-food retailers are classified as good, better or best based on their merchandise quality. Staples would be classified as "good" since they sell lower quality merchandise. This achieves a low price image for Staples, which helps capture the sales of traditional stationery stores. Staples' founders were from the grocery industry and their Private Label program reflects this. Initial Private Label items were basic or core items of lower quality or second tier aggressive priced. This re-enforced their low price image.

As we point out in our Dellmart Perspective, consumers purchase based on value, which is the ratio of quality and price. Quality is defined as how a consumer expects the product to perform. Low quality and low price do not always equate to high value. Too low a price can be detrimental to sales.

I have observed the same increase in Staples' Private Label items and space allocation for them. It is now to the point where a consumer must hunt for a name brand item. Staples appears to be following the Ann Page plan so named for A & P's failed Private Label program. Their Buyer/Merchants appear to have a case of Gross Margin infatuation. They are so thrilled with the Private Label Gross Margin percent they just keep adding items and space. This lacks a true customer focus and a real Private Label strategy.

Activity Based Costing studies have shown excess space allocation turns even high gross margin items into negative profit contributors. Slow selling Private Label items are rarely profitable. All too often, Gross Margin infatuation leads to low volume Private Label items. Over loading Private Label works when you are the only store in town, but long-term consumers will seek alternative sources.

***MNB:* What do you think is the biggest missed opportunity today for mainstream retailers that may have Private Label products, but aren't using them effectively?**

Frank Dell: The single biggest missed opportunity is not having a comprehensive Private Label strategy making the store a customer destination and achieving a significant competitive point of difference. Most retailers' rationale for Private Label is as a profit improver. Meaning their objective is to increase their gross margin percent. New traditional retailers pull customers into their store with their Private Label. In the real world most retailers have outsourced their Private Label program to a broker and use rebates as a profit center. Dellmart's Private Label Buyer Survey tells us retailers stock on average 2,300 Private Label items. The vast majority of these items are National Brand equivalents. They are rarely, if ever, aggressively promoted or featured. If Trader Joe's can utilize Private Label to make their store a true destination, why can't mainstream retailers achieve more from their Private Label program?

***MNB:* What advice would you give to retailers that have a Private Label but are looking for a way to use it better both strategically and from a price point perspective?**

Frank Dell: There are a number of steps retailers should be taking. Retailers should start taking control and committing the resources for a Private Label strategy that is fully integrated with the company, its format and target customers. They need to rationalize the number of store brands. Too many store brands is as bad as too few. Next, utilize their strategy to rationalize the Private Label items. Discontinue the dogs and items that don't support the strategy. Now it is time to rebuild by creating labels that are current and convey the desired image. Retailers should not cheapen on quality as their name is on the product. High quality is always a good decision. Create and execute a promotional program that achieves their strategic objectives. Monitor progress and adjust the plan as results dictate. Retail space should be allocated based on the items' volume with minor adjustment for the sections visual presentation. Continue to re-price Private Label items as they progress in achieving their strategic objectives. Always keep an eye on what is happening outside the company for trends and ideas. The fastest way to obsolescence is an internal only perspective.

***MNB:* Finally, what companies do you think do the best job with Private Label, and why?**

Frank Dell: There are many great examples of what can be accomplished with Private Label. The top of the list must be Trader Joe's. They have created unique products that consumers want and have made their store a destination trip. Duplicating their strategy is not the answer for most retailers, but it does set the bar as to what can be accomplished with Private Label. Wild Oats developed such a good

Private Label program that some traditional retailers are stocking the line. This is not unlike what Loblaw's achieved with its President Choice line. Safeway's "O" Private Label line is an excellent tactic to reduce target customers shopping at the natural/organic formats. Ukrop's store branding of their prepared food was way ahead of its time. Publix's "buy a National Brand and get their Private Label for free" promotion shows commitment and faith in their Private Label. This creates trial with side-by-side comparison, what more can one ask for. Meijer's Food Club promotions are legendary. I have watched consumer not buy just a few cans, but case after case of their Private Label.

NYC Online Grocery Site Looks To Change The Conversation

The *New York Sun* reports on a new online grocery service in the Big Apple, Bread-n-Brie, "which combines food delivery services similar to those of FreshDirect and social networking opportunities of sites such as Facebook...On the site, customers can get store credit for sharing their favorite recipes, and chat with other customers on the site's 'BnBuzz!' message board."

According to the story, "Bread-n-Brie's two delivery trucks now make just three stops in Manhattan — two on the Upper East Side, and one downtown — and then dispatches its pushcart-wielding staffers, called 'BnButlers' to hand out the packages on foot...FreshDirect, whose delivery trucks are a city staple, began making deliveries nearly five years ago, boasts 100,000-plus regular New York-area customers, and has fulfilled more than 5 million orders to date."

Men Shopping In Supermarkets More, But Still Are Invisible To Many Retailers

Reuters reports on a study by TNS Retail Forward suggesting that "U.S. men are doing more and more grocery shopping, both for themselves and their families, but retailers are still not doing much to make the trip any more enticing."

Mandy Putnam, a vice president at Retail Forward, tells *Reuters*, "Men do represent a large part of grocery shopping dollars and they aren't being very well accommodated ... sales are being lost."

The numbers suggesting that men are an expanding segment of the shopping population are persuasive. In 2002, 41 percent of men said they did at least some of the family grocery shopping, and by 2006 that was up to 71 percent.

Men, Putnam says, are "great at picking out the stuff that they bought before. It's the new stuff, or something new and different that a manufacturer is trying to promote, that they have trouble with."

A&P Reportedly Selling Louisiana Stores

Published reports say that the Great Atlantic & Pacific Tea Co. (A&P) is negotiating with a number of companies to sell its 21 Sav-A-Center stores in Louisiana. A&P has said that it believes it can sell the companies to a single buyer "committed to the continuity of the business going forward."

A&P has been working to sell off operations – such as its Farmer Jack stores in Michigan – that it deems to be non-core, as it works to bolster its northeastern US business and acquire Pathmark Stores there.

Market Interest In Kroger Continues

The *Wall Street Journal* reports that as speculation persists that Kroger Co. could be the target of private equity companies looking to make an acquisition, or could be interested in pursuing a leveraged buyout (LBO), stock market traders have “snapped up call options on the company. The apparent belief is that Kroger’s stock price is likely to increase in coming weeks, and they want to be positioned to take advantage of the price increase.

Kroger has denied any interested in pursuing an LBO.

A Sneak Peek At London’s New Whole Foods

The *Atlanta Journal Constitution* reports that in London, the new Whole Foods scheduled to open next week “has been shrouded in more secrecy than Britain’s MI5 counterintelligence agency,” but that reporters were offered a sneak peek this week.

“Except for the workers racing back and forth, putting the finishing touches on what will be the chain’s first overseas outpost, the new store’s wide aisles, clean lines and natural wood evoked any Whole Foods store in the United States,” the paper writes. “Customers will be able to book facials, massages, and other treatments in the Whole Body department, just as they do in New York. Elsewhere there will be a spot for tasting olive oils and a stand for buying chocolates...But while the emphasis on health and copious choices remains, plenty of differences lurk beneath the sawdust-splashed surfaces.

“Among the new concepts Whole Foods will be trying here is a Q Bar, also known as a knowledge bar. It’s a place where people can get answers to every question imaginable, from ‘Why is my fish dry?’ to ‘Why is my skin dry?’

“Also new is a muesli bar, where customers can mix different grains, dried fruit and other items to come up with their perfect breakfast cereal.

“Another distinctive feature is the Mediterranean bar, apparently London’s largest, where customers can choose from a wide selection of antipasti.

“And while a Whole Foods hot bar in America might include barbecue, the one in London will include dishes such as Moroccan braised lamb shanks and roast pork with fennel.”

Essentially, the *Journal Constitution* writes, “the three-story Whole Foods has a hip, young, eco-friendly feel. It’s a place with as much grandeur as the venerable Harrods Food Hall — the entrance area is even called the parlor — but without the sometimes-stuffy older employees...”

FastNewsBeat

- The *Cincinnati Business Courier* reports that two Bigg's stores in the marketplace are offering different services to appeal to consumers – weekend valet parking “at its Oakley store in Hyde Park Plaza...complimentary to customers who register in advance,” and an expanded kosher foods section in its Pleasant Ridge store.
- The *Boston Herald* reports that Dunkin' Donuts has begun to sell customized gift cards that can be personalized with pictures and messages created and uploaded by consumers. The cards cost \$4.50, plus the dollar value of the card.
- The *New York Times* reports that “Chinese regulators acknowledged for the first time Thursday that two Chinese companies had ‘engaged in some misconduct’ in the way they labeled and sold a poisonous ingredient that ended up in cold medicine, killing at least 100 people in Panama last year.” While this same ingredient has ended up in toothpaste exported from China, leading the US to ban such items from entering the US, Chinese officials said that the companies had broken no laws and that the toothpaste was safe.

The MNB Wal-Mart Watch

- The *Wall Street Journal* this morning reports that “a softer U.S. economy, rising gasoline prices and business miscues” have meant that Wal-Mart has “a growing amount of unsold goods in its stores, including about \$2 billion worth of clothes and home-décor products.” Which means that the retailer is looking to cut back on some of its soft goods purchases – and that a number of its Chinese suppliers are “feeling the pinch” and are looking for markets to replace Wal-Mart.

That could have some impact on the Chinese economy: “About 20% of all Chinese exports go to the U.S., its biggest overseas market,” the *Journal* writes. “Wal-Mart imported \$18 billion in goods from China in 2004.”

- The *New York Times* reports this morning that “the New Jersey Supreme Court ruled yesterday that a lawsuit claiming off-the-clock violations could proceed as a class action on behalf of nearly 80,000 current and former Wal-Mart employees.” Wal-Mart had argued that it would be better to hear the cases individually.
- *Forbes* reports that WakeUpWalMart.com is launching a new marketing campaign aimed at undermining the world's biggest retailer, this time focusing on how much product it sources from China, despite the fact that the company had a longtime commitment to the notion of “made in America.”

According to the story, “In materials provided to reporters on the sidelines of a Wal Mart media conference, the group included a 1985 press release from Sam Walton in which he criticizes the loss of U.S. jobs to imports and pledges to buy American-made products whenever possible to protect domestic manufacturing jobs.”

Wal-Mart replied to the attack by saying that it remains committed to buying products from US companies, but that as a global company “it is necessary to source globally to ensure that we meet the needs and wants of our customers.”

- In assessing the ongoing battle between Wal-Mart and its former marketing executive Julie Roehm, *Fortune* concludes that it almost doesn't matter what happens in the courts. “This is a public-relations

battle," it writes, suggesting that Roehm has managed to draw blood by accusing CEO Lee Scott of getting preferential prices on yachts and a diamond ring from a supplier, in direct violation of company ethics standards. (Roehm was fired for the same sorts of infractions, as well as for engaging in an adulterous relationship with an underling She has denied both allegations, and is suing in court for breach of contract.)

"Right now," *Fortune* writes, "it looks like Roehm has the upper hand. Scott has plenty of things to worry about.

"Wal-Mart's stock is an underperformer. It's not clear if the retailer has a viable long term strategy. Meanwhile, Wal-Mart's hardball tactics are drawing fire. It recently had to apologize to the New York Times after it revealed that one of the former members of its Threat Research and Analysis Group had eavesdropped on a reporter's cell phone calls.

"The last thing Scott needs is more questions about his jewelry purchases. If nothing else, Wal-Mart's CEO should have paid more attention to the part in the company's ethics policy about avoiding appearances of impropriety.

"Wal-Mart's lawyers may still find a way to avoid paying Roehm her severance. But she's already had her revenge."

The Balance Sheet

- Costco reports that its third quarter profit dropped 4.9 percent to \$224 million, from \$235.6 million in the year-earlier period. Q3 net sales reached \$14.34 billion from \$13.01 billion, with same-store sales up seven percent.
- Dollar Tree Stores reported that its Q1 net income was up 16 percent to \$38.1 million, compared to \$32.9 million during the same period a year ago. Q1 sales were up 14 percent to \$975 million.
- Longs Drug Stores reported that its May sales were \$372.9 million, up 2.2 percent from \$364.9 million in the comparable period a year ago. Same-store sales were flat.

Executive Suite

- Steve Neibergall, a two-decade veteran of Safeway Inc., has been appointed president of the chain's Eastern Division, overseeing the company's stores in the Mid-Atlantic states. He replaces Hank Cominiello, who has become group vice president of Retail Initiatives for Safeway.