

Outlook: Growth Pace Slows & New Opportunities Emerge

By Retail Forward, Industry Outlook, Mass Channel, July 2007

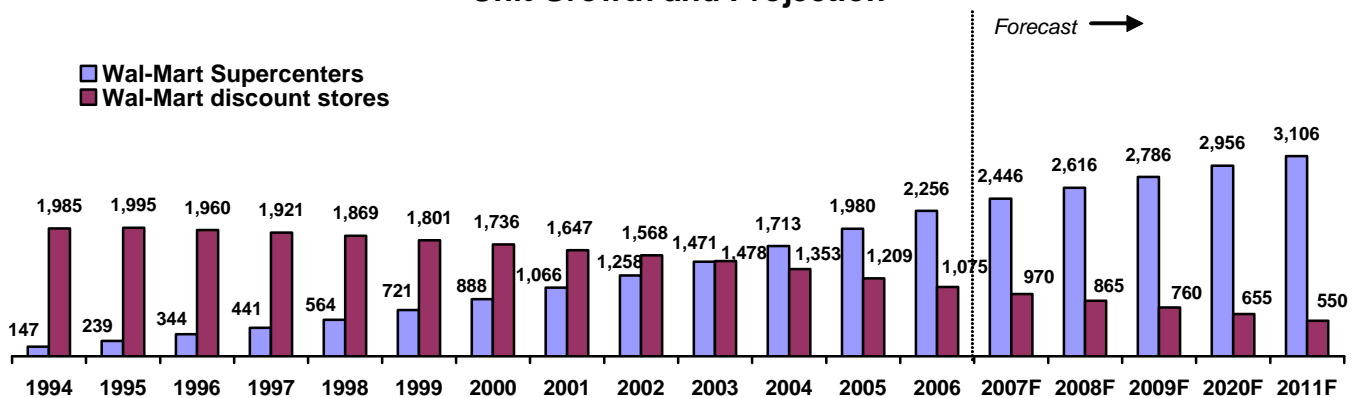
During the next five years, the mass channel landscape will be dotted with fewer Supercenters than previously forecast – the result of Wal-Mart’s recent announcement to scale back expansion plans. TNS Retail Forward forecasts mass channel sales to grow at a solid pace, albeit slower than previously expected due to the deceleration of Wal-Mart Supercenter rollout.

Supercenter Unit Projections Reduced

Last fall, Wal-Mart was expecting to add 265-270 supercenters in 2007. That number has now been reduced to 190-200 and plans call for approximately 170 supercenter additions in future years, according to Wal-Mart’s announcement at its Annual Shareholders Meeting in June.

Based on these figures, Wal-Mart will operate approximately 3,100 supercenters and 550 discount stores in 2011, according to TNS Retail Forward’s latest projections. At the end of June, Wal-Mart operated 2,337 supercenters.

Wal-Mart Supercenter vs. Wal-Mart Discount Store Unit Growth and Projection



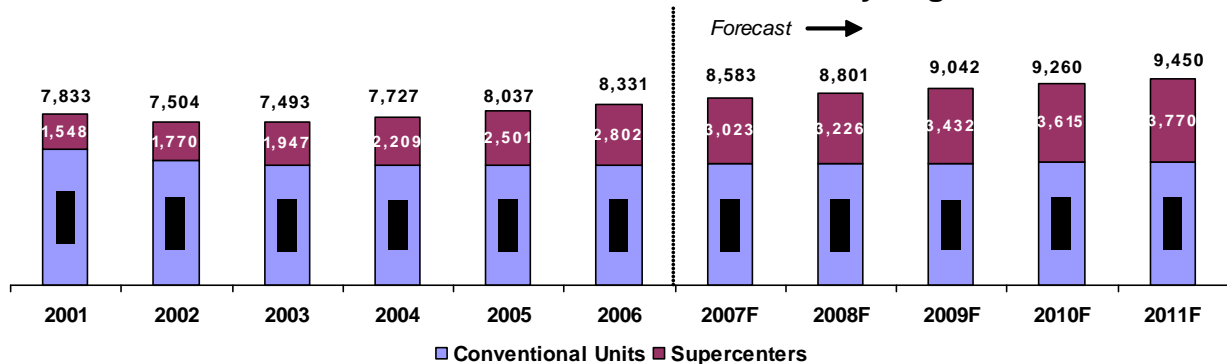
Sources: Company reports and TNS Retail Forward

This time last year, we projected there would be about 4,000 supercenters in operation by 2010. We’ve backed down on this number expecting closer to 3,600 in 2010 due to Wal-Mart’s slowdown.

- The number of Supercenter units is expected to grow at a 6.1% compound annual growth rate through 2011, which is about half the pace of the previous five-year period.
- Wal-Mart will still contribute the lion’s share of unit growth for supercenters: +850 in the next five year. Despite the much publicized slowdown, the company’s expansion plans are still quite aggressive.

- Target plans 30-35 new supercenters in 2007, including the first SuperTarget stores in California. TNS Retail Forward estimates that Target will operate a total of 295 supercenters in 2010. (For more details, please see TNS Retail Forward's Target 2010 Growth and Outlook, October 2006.)
- Meijer plans to open five stores in 2007 and seven in 2008.

Mass Channel Unit Growth and Forecast by Segment



Compound Annual Growth Rate			
	Conventional Units	Supercenters	Total Mass Channel
2001-2006	-2.5%	12.6%	1.2%
2006-2011F	0.5%	6.1%	2.6%

Sources: Company reports and TNS Retail Forward

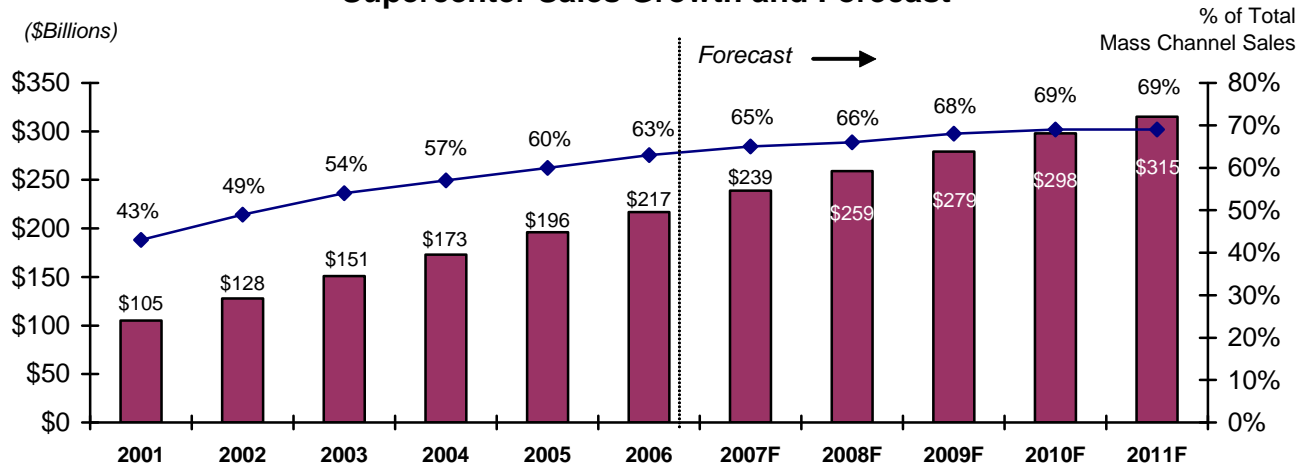
Supercenter Forecast Slows

Supercenter sales are forecast to grow at a slower pace than previously expected, but projections remain solid at a healthy 7.8% compound annual growth rate through 2011 – the highest five-year annual growth forecast across food, drug and mass channels.

However, sales growth will fall from its annual double-digit pace earlier than previously predicted.

- Just last year, TNS Retail Forward projected that supercenter annual sales growth would remain in the double-digits through 2010. Now after adjusting for Wal-Mart's slower expansion plans, supercenter sales growth will fall to the high single-digits in 2008.
- We project that the channel will start to produce mid-single digit sales growth in 2011.

Supercenter Sales Growth and Forecast



Supercenter Compound Annual Growth Rate

	Nominal Sales	Real (2000) Sales
2001-2006	15.6%	16.4%
2006-2011F	7.8%	7.9%

Sources: Company reports, U.S. Department of Commerce and TNS Retail Forward

Flat Conventional Unit Growth

The conventional discount department store count has declined by approximately 750 stores in the past five years driven by Wal-Mart's conversions to the supercenter format. Unit growth during the next five years is expected to remain flat as the falloff in store count subsides.

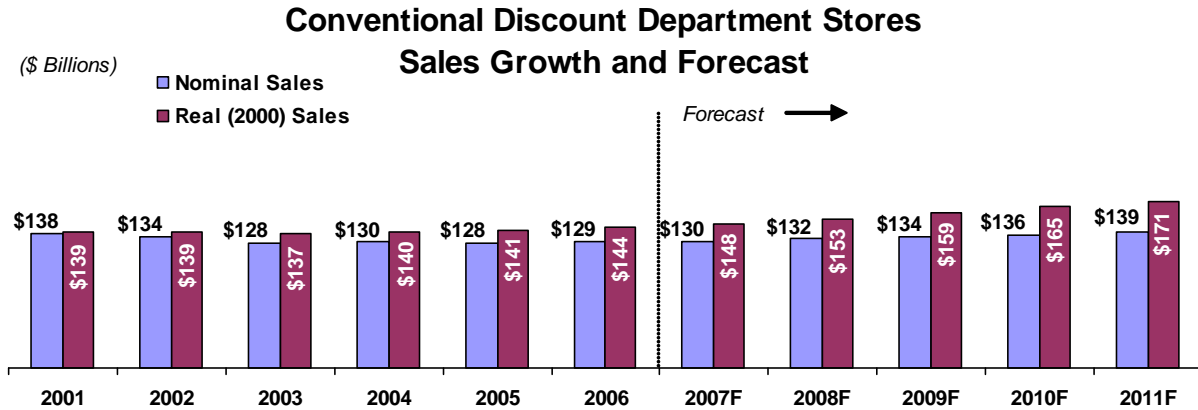
Wal-Mart's conversions to the supercenter format are expected to slow down in the coming years. Continued conversions will be offset by expansion at Target and Kohl's.

- Target is expecting to operate 2,000 stores in 2010. Target plans to open 120 new – which translates into 100 net new – stores in 2007 (including the 30-35 SuperTargets previously cited).
- Kohl's plans to have 1,200 stores by 2010, up from 817 stores at the end of 2006.

Regional players will be pressured to fortify their positions on a market-level basis as the industry's big hitters continue their rapid expansion across the country.

Modest Growth at Conventionals

Nominal sales were up 0.5% at conventional discount department stores in 2006. Sales are expected to grow between 1-2% annually during the next five years, resulting in a compound annual growth rate of 1.5% through 2011 or 3.6% after accounting for deflation.



Conventional Discount Department Store Compound Annual Growth Rate		
	<u>Nominal Sales</u>	<u>Real (2000) Sales</u>
2001-2006	-1.3%	0.6%
2006-2011F	1.5%	3.6%

Sources: U.S. Department of Commerce and TNS Retail Forward

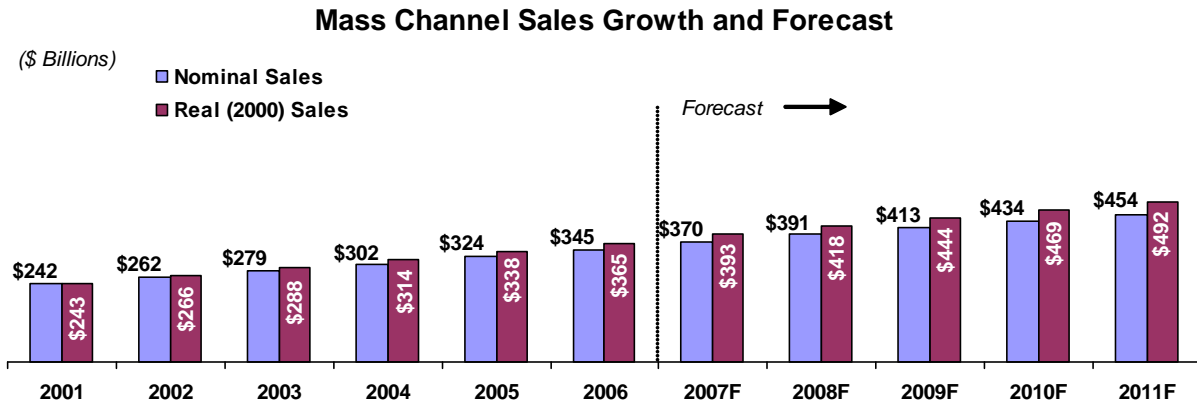
Helping to buoy conventional discount department store sales going forward:

- Conventional Wal-Mart stores that have not yet been converted or will not be converted likely are some of the better performing stores among the remaining conventional units.
- Expansion-minded players like Kohl's and Target.

Still the scheduled Wal-Mart conversions will likely offset a significant amount of sales potential for this segment.

In Total, Mass Channel Sales Moderate Yet Remain Solid

TNS Retail Forward forecasts the total mass channel (the combination of supercenters and discount department stores) to grow at a compound annual rate of 5.6% through 2011, compared with 7.3% average annual growth in the prior five-year period.



Mass Channel Compound Annual Growth Rate		
	Nominal Sales	Real (2000) Sales
2001-2006	7.3%	8.5%
2006-2011F	5.6%	6.2%

Sources: Company reports, U.S. Department of Commerce and TNS Retail Forward

Most major retailers will be out of expansion room in the United States for their core concepts by 2015. The mass channel in particular will be challenged due to the format's big-box size requirements. Future growth opportunities could take the form of new formats, geographies, marketing tools, services and the Web. Suppliers looking to effectively serve the mass channel should focus on consumers, costs and community.

Opportunities

Leading mass channel players will need to look for new opportunities to drive growth forward. The significance of this search will intensify as the expansion runway runs out. Avenues for future growth can take several forms, e.g., new formats, geographies, marketing tools, services and the Web.

- *New formats* – Those with a flexible strategy, e.g., the pursuit of alternative locations such as malls or urban areas, will be better positioned to meet real estate challenges in the future. Key players also will be challenged by consumers' increasing demand for convenience. For example, Tesco has identified a unique niche in the United States that targets convenience and has yet to be tapped on a large scale. The first U.S. Tesco Fresh & Easy Neighborhood Market stores open this fall. (For more details, please see TNS Retail Forward's Tesco's U.S. Invasion, September 2006.)

A smaller format could provide mass channel players with new pipeline for growth, while also delivering greater convenience. Speculation began bubbling about Wal-Mart's interest in smaller convenience-oriented formats after David Wild, a former Tesco executive, was named senior vice president of new business development at Wal-Mart earlier this year. Wild, who worked for Tesco for 18 years before joining Wal-Mart in 2004 as chief merchandising officer, was responsible for helping the British retailer expand the company's c-store operation.

- *New geographies* – Wal-Mart's International division represented 22% of the company's total net sales in 2006, up from 17% five years ago and 5% a decade ago. Continued growth in international operations is a critical component of Wal-Mart's growth strategy going forward. Target has yet to take the leap into global waters, but is keeping tabs on potential future global opportunities. A new format could postpone the need to go global.
- *New services* – Consumer spending on goods will continue to lose ground to spending on services. Consequently, services will take on an increasingly important role not only for the mass channel, but retailing as whole. Mass channel players increasingly will invest in health clinics, financial services, etc. – services that not only are in high demand, but require minimal real estate investment (i.e., raise sales but take up little space). An example: Wal-Mart continues to grow its financial services business and recently announced plans to open 1,000 Wal-Mart MoneyCenters by the end of 2008, up from 225 in operation today. Wal-Mart MoneyCenters offer check cashing, money orders, bill payment and money transfers – the kind of convenience-oriented services that can help drive traffic, boost margins and potentially raise comps.
- *New Web site features* – Leading mass channel retailers are increasingly using their Web sites not only as another disruption channel but as marketing vehicles to drive shoppers into the store. Wal-Mart recently completed the national rollout of its "Site to Store" service, which allows shoppers to order products online – even those that aren't available in stores – and have them shipped for free to a local Wal-Mart store. In December 2006, Target introduced "Find it at Target store," which allows guests to confirm the availability of an item at a Target store before they head out on a shopping trip.

Supplier Implications

The leading mass channel players increasingly will look to suppliers for solutions that target their respective consumers, costs and communities.

- *Consumers* – Despite the mass channel's moniker, offering a variety of goods targeted to the masses is no longer sufficient. Instead, suppliers must help mass retailer accounts localize merchandising efforts to satisfy local consumer wants and needs. Key players will look to suppliers to help them identify local-area demographics, tastes and trends to achieve better sales performance. Wal-Mart's "Store of the Community" will become the norm. But suppliers beware: players will expect unique programs in an effort to maintain differentiated positions in the marketplace.

- *Costs* – Rising expenses in the mass channel will only be accentuated in future years as sales growth slows. Retailers will expect suppliers to work to eliminate excess supply chain costs and initiate new cost controls.
- *Communities* – As used here, “community” takes on a broader meaning beyond Wal-Mart’s “Store of the Community.” Because of their size, scale and influence, mass players will be held to tough standards in terms of the role they play in the community. As environmental concerns grow, this “role” increasingly will involve the measure of a retailer’s ecological footprint. Suppliers will play an important role in assisting retailers to meet sustainability goals. This could mean reducing packaging, using better-for-you materials, searching for alternative/more efficient energy resources, etc. These initiatives not only serve to boost the corporate image, but also the bottom line because sustainability initiatives often come with the added bonus of lower costs, e.g., lower product handling and transportation costs associated with reduced packaging.

Suppliers also need to think thorough the fact that fewer new Wal-Mart Supercenters means fewer locations to sell through. But by no means should suppliers take their eye or resources of the Bentonville behemoth – the company is expected to add about another 850 supercenters in the next five years. Wal-Mart’s deceleration should also remind suppliers to not put all their eggs in one basket. Supermarkets and other food, drug and mass retailers stand to gain some ground from the Wal-Mart Supercenter slow down. Expect suppliers to take a closer look and invest more in other key customer accounts to determine where they can raise their coverage and improve performance with other retailers.