

On the *FAST* Track

PACE-SETTING RETAILERS CHURN OUT **STRONG RESULTS** DESPITE LACKLUSTER ECONOMY

> By Pat Terry

Faced with a mature market, lukewarm economy and a shrinking middle class, traditional supermarkets are battling for sales and market share with an ever wider number of competitors: mass merchandisers, discounters, limited-assortment formats, warehouse clubs, specialty stores, convenience

stores, drug chains, dollar stores and the list goes on. Retailers on both ends of the continuum, from Walmart to Whole Foods Market, are opening new, smaller-format stores in cities and near college campuses, while Walgreens and Dollar General are adding more fresh food in stores serving food deserts.

In this extended feature, *Retail Leader* takes a look at publicly traded market leaders in six retail channels, using various yardsticks to find out what puts them "on the fast track." In a slow-growing economy, single-digit sales increases are the norm, and even those aren't a given. But some retailers are outpacing the competition, turning in double-digit sales or earnings gains.

WAREHOUSE CLUBS: **COSTCO WHOLESALE CORP.**

Costco Warehouse Corp., the nation's largest warehouse club, continues to produce healthy sales gains, soaring profits and a steady store-opening schedule.

While the company's low prices have lured frugal shoppers, its profits have been helped by higher membership fees, which most customers continue to pay. Costco also has attracted a strong contingent of small business owners, who outspend most other segments.

Net income for the first 36 weeks of fiscal 2013, ended May 12, jumped 29 percent to \$1.42 billion from \$1.10 billion a year ago, while sales for the year-to-date period rose about 9 percent to \$72.67 billion. The company's results reflect a 14 percent increase in membership fees to \$1.57 billion.

Costco reported net income of \$1.71 billion for the 53 weeks ended Sept. 2, up 17 percent from fiscal 2011. Total fiscal 2012 revenues, including membership fees

Despite economic uncertainty and heavy competition, Costco achieved a 29 percent hike in profits and a 9 percent sales gain in the first 36 weeks of fiscal 2013.





“You can’t be a one-trick pony.”

— CRAIG ROSENBLUM
Willard Bishop.

of \$2.1 billion, were \$99.1 billion compared with \$88.9 billion the prior year, when membership fees were \$1.9 billion. U.S. sales of food and grocery accounted for \$41 billion in fiscal 2012, and U.S. comparable-store sales rose 7 percent over fiscal 2011.

As of March 12, 2013, Costco operated 622 warehouses, 448 of them in the United States and Puerto Rico, 85 in Canada, 32 in Mexico, 23 in the U.K., and 34 in Japan, Taiwan, Korea and Australia. According to

Zack’s Investment Research, Costco opened 16 new locations in fiscal 2012 and plans to open 28 new outlets during fiscal 2013.

“Costco loves affluent customers,” says David J. Livingston of DJL Research in Milwaukee. “You don’t see them going into low-income neighborhoods; they go where the money is.”

MASS MERCHANDISER/ SUPERCENTER: **WALMART**

After several disappointing quarters, Walmart appears to be back on track, stressing growth through international operations, a major commitment to global e-commerce and a return to the basics here at home. Walmart U.S. also is busy building new, smaller formats in urban food deserts, where fresh food options have been scarce.

Total revenues were \$469.16 billion in fiscal 2013, ended Jan. 31, 2013, up 5 percent from fiscal 2012. Consolidated net income rose 8 percent to \$17.76 billion in fiscal 2013.

Walmart U.S. reported \$274.49 billion revenue in fiscal 2013, a 4 percent increase.

Grocery accounted for 55 percent of sales. Sam’s Club reported \$56.42 billion in net sales for 2013, a 5 percent increase from the previous fiscal year.

In the United States where Walmart operates more than 4,653 stores, including 4,033

Walmart locations and 620 Sam’s Club locations, the retailer is stressing everyday low prices, beefing up product assortments and rolling back prices on competitive items, after an attempt to capture middle-income consumers sent its core customer base off to dollar stores, discounters and other formats.

Growth also is expected to come from new formats aimed at different types of shoppers. “Walmart is adding new, smaller formats—Neighborhood Market and Walmart Express—in urban and rural markets with limited access to fresh food,” says David J. Livingston of DJL Research in Milwaukee. “They’ve been testing the Walmart Express concept near college campuses,” says Livingston, and are currently building a 5,000-square-foot store in Tempe, Ariz., near Arizona State University. “It’s a little convenience store, basically designed to pull shoppers from about a two-block radius, an area with lots of dormitories and housing.” In 2011, Walmart opened an Express at the University of Arkansas in Fayetteville, and it is planning a 2,500-square-foot Express store on the Georgia Tech campus in Atlanta.

“Walmart’s always had the traditional Walmarts, then they had the supercenter concept where it was 50 percent grocery and 50 percent other, then they had Neighborhood market, then Walmart Express and now they have this new campus store at Arizona State,” says Rosenblum. “You can’t be a one-trick pony.”

As of March 31, Walmart had 10,818 retail units total. Walmart U.S. counted 554 discount stores, 3,176 supercenters and 280 supermarkets, which include Neighborhood Market and two Hispanic banners, and 23 small formats, including Walmart Express, Walmart on Campus and Super Ahorros banners.

Globally, the company has 6,165 units in 27 countries, ranging from Brazil (561 stores) to the U.K. (566) and Mexico (2,360). Walmart International rang up net sales of more than \$135 billion in fiscal 2013, up 7 percent from year-ago figures.

E-commerce is the next major growth engine for Walmart, Neil Ashe, executive vice president, president and CEO of Global E-Commerce, said during Barclay’s Retail and Consumer Conference on May 1. Walmart has a history of transforming retail—first in

In an effort to appeal to value-conscious shoppers and differentiate itself from online retailers, Walmart offers a money-back guarantee on fresh produce.



discount stores, then warehouse clubs, grocery and international, he says. "But you should also know we're one of the world's largest, fastest-growing and most dynamic e-commerce organizations."

Walmart is building e-commerce sales at Walmart.com, delivering goods to homes or to a nearby store for pickup with no shipping charge. Food and grocery are still in beta testing, and reportedly a loss leader. But the company is integrating e-commerce with bricks and mortar so that customers can shop online, from home or mobile, then walk into a store and pick it all up. Or they can walk through a store adding products to their mobile shopping carts, pay online and take purchases home.

The company's commitment to building a global technology platform will take several years, Ashe said.

SPECIALTY STORES/FRESH FORMAT: WHOLE FOODS MARKET

Whole Foods Market, a national leader in the fresh, organic and natural format, called fiscal 2012 "the best year in our company's 32-year history" in its annual report. The specialty chain added 25 stores, expanding into eight new markets, and wrapped up fiscal 2012, ended Sept. 30, with 335 stores. The company said it has opened 17 stores in fiscal 2013 and also has announced a goal of 1,000 U.S. stores. The company expects Canadian sales to surpass \$1 billion over the next decade.

Sales for the 53-week period reached \$11.7 billion, a 16 percent increase over the \$10.1 billion reported for fiscal 2011, which had 52 weeks. Identical store sales increased 8 percent. Net income for fiscal 2012 was \$465.6 million, compared with \$342.6 million in 2011, an increase of nearly 36 percent.

In the second quarter of 2013, the company reported net income of \$142 million, a 21 percent increase from a year ago, while total revenue rose 13 percent to \$3.03 billion. Identical store sales increased about 7 percent.

Whole Foods, like other food and grocery retailers, faces strong competition in the mature grocery industry. But the specialty chain has enlarged market share due, in part, to decreasing the pricing gap with competitors on value oriented, nonperishable items to counter its sobriquet, "Whole Paycheck."

The company also continues to differentiate via its philosophy and product assortment. For instance, in April 2012, Whole Foods stopped selling wild-caught seafood from red-rated fisheries, those companies supplying fish rated as unsustainable by



Whole Foods Market plans to open more than 30 new stores this year.

the Blue Ocean Institute and Monterey Bay Aquarium. Several years ago, Whole Foods stopped selling extremely depleted fish such as orange roughy and bluefin tuna. Now it will no longer offer such species as Atlantic halibut, gray sole, skate wing, sturgeon and turbot.

Whole Foods had plans to open about 32 to 34 new stores in fiscal 2013. That number may include 20,000-square-foot stores—compared to its average 37,000 square feet—planned for smaller markets near college campuses, such as South Bend, Ind. "They're looking at the educated and affluent community around a big university," says Livingston. "I think you'll see Trader Joe's do the same thing."

TRADITIONAL SUPERMARKETS: THE KROGER CO.

The traditional supermarket channel, including such names as Kroger, Publix and Safeway, accounted for nearly \$430 billion or a 40 percent share of the total \$1 trillion food and grocery sector in 2011, according to consulting firm Willard Bishop LLC in Barrington, Ill. Overall store numbers, however, decreased 1 percent, as traditional supermarket customers weathered the recession by spending less at their favorite markets, trading down to value formats or shifting their stock-up trips to nontraditional, price-oriented formats. Along the way,



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D.J.L. Research

smaller stores and supermarkets have closed.

Traditional supermarket revenues are projected to grow to \$440.8 billion by 2016 but represent just 37 percent of the overall market.

Kroger Co., which has achieved more than 37 consecutive quarters of same-store sales gains, leads the supermarket and grocery industry with a 19 percent share of market, according to the 2012 IBISWorld Industry Report.

Kroger's "Customer First" operating philosophy, as seen through its robust in-store experience and innovative private-label products, is proving to be a winning strategy. For fiscal 2013, Kroger expects identical store sales growth of 2.5 percent to 3.5 percent, excluding fuel, according to its fiscal 2012 report.

Kroger's net earnings for fiscal 2012 rose 149 percent to \$1.5 billion from \$602.1 million the previous year, due largely to a \$590.7 million after-tax pension consolidation charge the company incurred in the fourth-quarter of fiscal 2011, the company said.

Total sales for fiscal 2012, ended Feb. 2, 2013, increased 7 percent to \$96.8 billion from the prior year. About 90 percent of transactions in Kroger stores involve one of its loyalty programs, which the company says gives it a competitive edge in the form of extensive purchase data and customer insights. Kroger is now testing personalized customer pricing via mobile phone apps, digital coupons and loyalty card swipes at checkout.

E-commerce will be a critical factor in growing market share, according to Craig Rosenblum, a partner at Willard Bishop. "Retailers like Kroger are saying that by the end of this year, by 2014, they're going to see 8 to 10 percent of their sales coming via the Internet."

The Cincinnati-based supermarket retailer also is orchestrating growth through new formats. Kroger began construction in April this year for an 88,000-square-foot Marketplace Superstore on Hilton Head Island, which will compete with Publix, Walmart, Bi-Lo, Piggly Wiggly and Food Lion. Kroger Chief Financial Officer Michael Schlotman said Kroger's Marketplace stores are part of a multiformat strategy to crack new markets and grow density within existing markets.

IBISWorld expects Kroger's share of market and revenue to continue expanding, as the company competes with lower product prices and broadens its customer base through acquisitions.

Kroger operates 2,424 supermarkets and multidepartment stores, including 1,090 with fuel centers, in 31 states. The company's two dozen supermarket banners include Kroger, City Market, Dillons, Jay C, Food 4 Less, Fred Meyer, Fry's, King

Soopers, QFC, Ralphs and Smith's. The company also operates 786 convenience stores, 328 fine jewelry stores and 37 food-processing plants.

DOLLAR STORES: DOLLAR GENERAL CORP.

Dollar stores continue their aggressive expansion, reaching out to their lower-income consumer base while also attracting economically squeezed, middle-income and affluent Americans with expanded assortments of food and nonfood consumables.

Dollar General Corp., with stores in 40 states, is on the fast track with impressive growth in both profits and revenue. Net income jumped 24 percent to \$953 million in fiscal 2012 from \$767 million in fiscal 2011. Net sales for the company were \$16.02 billion for fiscal 2012, ended Feb. 1, 2013, increasing 8 percent over the previous year.

Same-store sales for fiscal 2012 increased about 5 percent against the comparable 52-week period a year ago—marking the 23rd consecutive year of same-store sales gains for Dollar General. Increased customer traffic and average transaction size contributed to the gains, paced by consumables including snacks, candy, beverages and perishables. Consumables accounted for nearly 74 percent of sales, reaching \$11.8 billion in fiscal 2012, for a 9 percent increase over fiscal 2011.

Looking ahead, Dollar General, with 10,506 stores, plans to add 635 new stores during fiscal 2013. Last year, the fast-growing dollar store chain made its entrance into California, opening 50 stores and a warehouse. Of the 635 new stores, most will be traditional, but 20 will be 10,000-square-foot Dollar General Plus formats, larger than the traditional Dollar General format of 7,200 square feet to accommodate a wider selection of merchandise and more cooler space.

The company is planning some 40 new stores boasting the new, larger Dollar General Market format of 17,000 square feet and offering an increased assortment of fresh products.

Value retailers like Dollar General are adding fresh foods to the mix, particularly in stores serving food deserts.



While Dollar General plans to open in numerous food deserts, a spokeswoman says, 70 percent of the chain's stores currently are located in underserved markets, generally serving populations of fewer than 20,000 people. The model includes rural, suburban and metro markets, and sites are chosen based on customer need, value and traffic patterns. "Most of our customers come from a three- to five-mile radius or within a 10-minute drive," she says.



Walgreens flagship store in downtown Chicago offers hand-rolled sushi, frozen yogurt machines and spa services.

DRUGSTORES: WALGREENS CO.

After a challenging 2012, Walgreens is growing again. While it lost some pharmacy customers and revenue last year due to a contract disagreement with Express Scripts, Walgreens reached a new multiyear agreement with the pharmacy benefit manager in July that welcomed back Express Scripts customers in September.

The retailer felt the benefits of the renewed alliance in the second quarter, ended Feb. 28, 2013, when Walgreens reported an 11 percent increase in net earnings to \$756 million from \$683 million a year ago, while sales for the quarter were \$18.647 billion, nearly matching 2012 levels of \$18.65 billion.

The second-quarter results were a substantial improvement from the company's slight dip in sales for fiscal 2012, ended Aug. 31, when total revenue was \$71.63 billion, 0.8 percent below the \$72.18 billion reported in fiscal 2011. Net earnings were \$2.13 billion in fiscal 2012, a decline of 22 percent from the \$2.71 billion reported in 2011, when the company's earnings included a \$273 million after-tax gain on the sale of Walgreens Health Initiatives Inc.

Walgreens has been aggressively growing in several directions, and its efforts brought a 3 percent increase in sales

for March and April combined. Its new customer loyalty program, Balance Rewards, recorded 68 million registrations through April 2013.

Walgreens says its strategic alliance with Alliance Boots GmbH, a U.K.-based pharmacy-led health and beauty group, will give it a growing presence in Europe and emerging markets. The partnership will create the "largest pharmaceutical wholesale and distribution network in the world, including associates and joint ventures, with more than 370 distribution centers, delivering to more than 170,000 pharmacies, doctors, health centers and hospitals in 21 countries," according to Walgreens' 2012 annual report. Walgreens and Alliance Boots have since entered into an agreement with AmerisourceBergen Corp., a pharmaceutical wholesaler that currently is supplying some of Walgreens specialty items. The agreement translates to a new, 10-year primary distribution role for AmerisourceBergen in providing branded and generic drugs to Walgreens.

Domestically, Walgreens is on an innovative mission: to create a complete "Well Experience," transforming the role community pharmacy plays in health care. The chain is rolling out Well Experience pilot stores in select markets, featuring enhanced product assortments, new e-commerce technologies, and bringing pharmacists out to interact with patients and offer consultation. Walgreens also has initiated new online and mobile options for prescription information, ordering and delivery.

Expanded fresh, healthier food is being highlighted in the nearly 350 Walgreens locations with the Well Experience format, including a marketwide transformation of all 68 stores in the Indianapolis area. The company also is opening flagship stores offering more freshly prepared food, such as hand-rolled sushi and frozen yogurt machines, and unique twists such as a spa offering manicures and an in-house liquor department featuring high-end tequila and vodka, microbrew beers and a "Virtual Bartender" kiosk.

Walgreens stores also offer prepared meals for immediate consumption, expanded grocery items for quick but healthy pick-up and a growing selection of healthy food choices critical to underserved food desert communities, which lack grocery stores or other outlets for nutritional food. In a unique partnership with nonprofit Growing Power, Walgreens will sell the group's fresh produce at 19 Chicago stores Walgreens is retrofitting in "food desert" communities. **RL**

Freelance writer Pat Terry, a former staff writer at the Chicago Tribune and Fairchild Publications, has reported on everything from supermarkets to home goods, apparel to metalworking.