



AISLES OF OPPORTUNITY

Grocers are bullish on 2015, but new specters are bringing on sleepless nights for retailers.

Analysis by Jim Dudlicek, Bridget Goldschmidt
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Grocery retailers' confidence in another year of success continues to inch upward from the valleys of the past decade, and their optimism for the retailing climate has reached new heights, exclusive research from *Progressive Grocer* reveals.

Meanwhile, as the manner in which business is transacted continues to evolve, new issues are keeping grocers up at night.

On a scale of 0 (awful) to 100 (sensational), retailers surveyed by *PG* just topped 72, up nearly six points from their score for 2014. A year ago, however, retailers' forecast for the coming year was 71.8, indicating that 2014 didn't pan out quite as expected.

Still, sentiments are most definitely trending up, and have come a long way from the score of 58.4 reported in 2009.

Overall, grocers are significantly more optimistic about the retail climate compared with a year ago, with nearly half of respondents saying they're sweet on 2015; that's up from about 39 percent a year ago. Just more than a fifth express less

optimism (versus 28 percent a year ago) and just shy of 30 percent declare they envision no change.

As is typical, chain operators are the most confident, with nearly two-thirds expressing optimism for retailing this year, up from about 52 percent a year ago. About 44 percent of independent operators see

a rosy retail climate, up from 30 percent this year.

It's obvious that current economic conditions are buoying retailers' spirits. The Kroger Co. recently celebrated its 45th consecutive quarter of same-store sales growth. Describing 2014 as "an outstanding year by all measures," Rodney McMullen, chairman and CEO of the Cincinnati-based grocery giant, said at Kroger's March earnings call that the company "captured more share of the massive food market [and] delivered on

our commitments and invested to grow our business. ... [O]ur core operating performance without fuel shows that our associates are improving our relationship with customers in ways that grow loyalty and generate strong shareholder returns."

However, Ken Odeluga, senior market analyst for London-based City Index, warns that future trends in the market may prevent Kroger from delivering the staggering numbers that it did in Q4.

"With the shares having gained more than 64 percent over the last 12 months, and a 52 percent rise in 2013, the bar is getting higher for continued strong sentiment," Odeluga said in *Progressive Grocer*'s report on Kroger's last earnings call.

"The point is, a number of forces are coalescing that are expected to press on Kroger's 'batting' average over the next few quarters, largely from fuel-related to headwinds."

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GROCERS ARE SIGNIFICANTLY MORE OPTIMISTIC ABOUT THE RETAIL CLIMATE COMPARED WITH A YEAR AGO, WITH NEARLY HALF OF RESPONDENTS SAYING THEY'RE SWEET ON 2015.



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Kroger is likely “mindful of the impact lower crude oil prices, and consequently cheaper wholesale fuel, will have on customer perception,” Odeluga added. “I think essentially, Kroger is saying it will soon need to reduce prices to closer to the average forecourt rate for its biggest rivals.”

The recent drop in gasoline prices has left more money in consumers’ pockets to spend at retail, including grocery. That being said, consumer optimism about the economy in early March had fallen to its lowest level since August 2014, according to new survey results released by NACS, the Association for Convenience & Fuel Retailing. At the time of the report, gas prices had increased 29 cents per gallon versus the previous month as refineries began the transition to producing the more expensive summer-blend fuel required in many U.S. markets.

Meanwhile, leaders of the newly combined Albertsons Safeway have expressed high hopes for an improved and invigorated shopping experience as the merger partners become a

single entity in 2015. “We plan to be the favorite local supermarket in every community we serve,” said Robert Edwards, president/CEO of the 2,230-store enterprise. “We will do this by knowing, listening to and delighting our customers; providing the right products at a compelling value; and delivering a superior shopping experience.”

Market optimism also bodes well for the beneficiaries of the 168 stores cast off as a condition of the merger, most significantly Bellingham, Wash.-based Haggen, which, by exponential expansion of its banner throughout several states, has the potential of becoming the next great regional West Coast grocery chain.

Independents, too, have reason to be excited as they vie for the loyalty of consumers

looking for new, better and more personalized shopping experiences. Companies like Minneapolis-based wholesale distributor Supervalu Inc. are feeling bullish about the future of the independent grocer. Says Brian Audette, SVP of Supervalu’s corporate independent business, “We’re really focused on keeping our customers relevant.”



THE BOTTOM LINE

How was 2014? How are prospects for 2015?

Rated on a scale of 0-100, where 0=awful, 100=sensational

	Total
2015 (forecast)	72.2
2014	66.3
2013	67.7
2012	63.6
2011	65.6
2010	59.4
2009	58.4
2008	67.1
2007	70.9
2006	66.9
2005	65.2

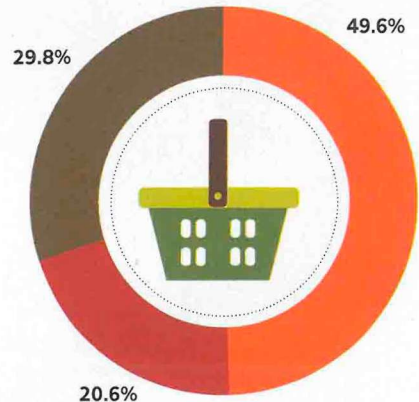
Source: Progressive Grocer Market Research, 2015

RETAIL CLIMATE

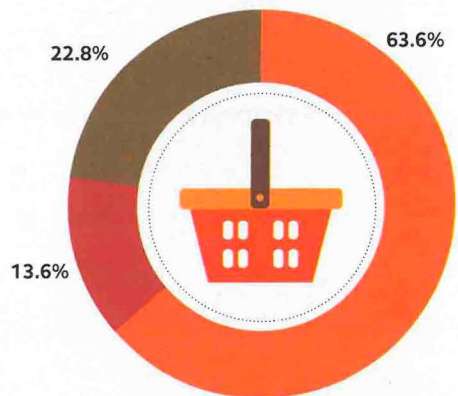
Compared with a year ago, are you more optimistic or less optimistic about the retailing climate for supermarkets?

More optimistic Less optimistic No change

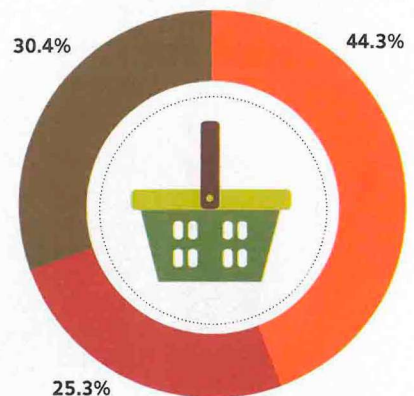
TOTAL



CHAIN



INDEPENDENT



Source: Progressive Grocer Market Research, 2015

WHAT ARE THE BIG ISSUES KEEPING YOU UP AT NIGHT?

Tossing and Turning

There was a notable change in priorities among grocers who responded to our question, "What are the big issues keeping you up at night?"

Topping the list: data protection and security, noted by more than 64 percent of respondents. A year ago, data security ranked fifth. Since then, retailers of all kinds have been rocked by data breaches of varying severity, from the double hit at Supervalu last summer to the lingering effects of the Target breach that resulted in an executive housecleaning.

"In 2014, we saw more attention paid to cyber-risks, namely because of Target's late-2013 attack," observes Tracy Kitten, executive editor of the Princeton, N.J.-based Information Security Media Group. "Media attention, coupled with the congressional hearings that occurred throughout the year to review merchant security, undoubtedly are to thank for bumping cybersecurity concerns to the top of the list among grocers. While we actually saw a flurry of breaches throughout 2013 targeting merchants across the board, including grocers like Schnucks, none of these breaches got a ton of public attention until Target."

Kitten asserts that retailers' cybersecurity is subpar. "I think more attention has been paid to PCI compliance in the last year and a half," she tells *PG*, "but we are still a long way out from having EMV [chips] fully implemented at the POS, and most grocers are not particularly innovative, relative to other merchants, when it comes to payments security. I doubt grocers will adopt EMV at a rate that exceeds other retailers."

Further, most merchants across the board have not historically made big investments in behavioral analytics to monitor transaction activity, Kitten notes.

"Grocers and all retailers have an obligation to protect their customers' cardholder data and personal information," Kitten says. "If consumers do not feel that their information is safe, they will stop shopping with that merchant, so data security has

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	Current	Rank	Last Year	Rank
Data Protection/Security	64.3%	1	28.8%	5
Price Increases	59.5	2	25.8	7
Benefits (Minimum Wage, Affordable Care Act, etc.)	56.3	3	59.5	1
Food Safety	37.3	4	16.0	8
Labor (Recruitment, Retention, Diversity, Training)	35.7	5	47.9	3
Keeping up With Advancements in Technology	33.3	6	28.2	6
Increasing Overhead Costs (Energy, Infrastructure, Maintenance, etc.)	28.6	7	45.4	4
Sustainability	20.6	8	12.9	9
Genetically Modified Organisms (GMO)	12.7	9	3.7	10
Feeding the Hungry	11.1	10	1.8	11
Competitive Threats	6.3	11	53.4	2
Animal Welfare	2.4	12	1.8	11

Source: Progressive Grocer Market Research, 2015

EXPECTED 2015 CHANGE IN COMPANY OPERATIONAL FACTORS

Score: 100=increase; 50=no change; 0=decrease

	Current	Rank	Last Year	Rank
Wage Costs	90.9	1	83.3	2
Benefit Costs	85.5	2	84.3	1
Competition	84.8	3	79.6	3
Technology Spending	82.8	4	75.8	5
Retail Prices	78.2	5	74.8	6
Capital Expenditures	66.4	6	57.5	7
Percent Net Profit	65.1	7	51.9	9
Percent Gross Margin	60.0	8	46.9	10
Energy/Fuel Costs	56.3	9	77.4	4
Employee Turnover	54.4	10	51.6	9

Source: Progressive Grocer Market Research, 2015





SUPERMARKET SALES BY FORMAT

	Number of Stores	Percent of Total	Sales (\$ Millions)	Percent of Total
Total Supermarkets (\$2 million or more)	37,716	100.0%	\$638,338	100.0%
Supermarket-Conventional	26,487	70.2	414,794	65.0
Supercenter (Grocery and Mass Merch.)*	4,150	11.0	159,824	25.0
Supermarket-Limited Assortment	3,242	8.6	16,106	2.5
Supermarket-Natural/Gourmet Foods	3,144	8.3	38,372	6.0
Warehouse Grocery	523	1.4	4,367	0.7
Military Commissary	170	0.5	4,876	0.8
Other Food Retail Formats				
Conventional Convenience**	152,120	n/a	\$412,703	n/a
Gas Station/Kiosk	22,303	n/a	n/a	n/a
Superette	13,070	n/a	19,974	n/a
Conventional Club	1,320	n/a	136,339	n/a
Military Convenience Store	674	n/a	4,067	n/a

*Supermarket-type items only
**Excluding gas

Source: Nielsen TDLinx; Progressive Grocer Market Research, 2015

SUPERMARKET SALES BY SALES RANGE

	Number of Stores	Percent of Total	Sales (\$ millions)	Percent of Total
Supermarkets (\$2 million or more)	37,716	100.0%	\$638,338	100.0%
Chains (11 or more stores)	30,925	82.0%	\$602,708	94.4%
\$2,000,000 to \$4,000,000	2,980	7.9	9,265	1.5
\$4,000,000 to \$8,000,000	6,858	18.2	39,604	6.2
\$8,000,000 to \$12,000,000	3,442	9.1	35,998	5.6
\$12,000,000 to \$20,000,000	4,833	12.8	79,087	12.4
\$20,000,000 to \$30,000,000	6,118	16.2	151,379	23.7
\$30,000,000 to \$40,000,000	3,217	8.5	111,580	17.5
\$40,000,000 to \$50,000,000	2,077	5.5	92,048	14.4
\$50,000,000+	1,400	3.7	83,747	13.1
Independents (10 or fewer stores)	6,791	18.0%	35,630	5.6%
\$2,000,000 to \$4,000,000	2,222	5.9	6,756	1.1
\$4,000,000 to \$8,000,000	4,015	10.6	21,751	3.4
\$8,000,000 to \$12,000,000	366	1.0	3,695	0.6
\$12,000,000 to \$20,000,000	148	0.4	2,252	0.4
\$20,000,000 to \$30,000,000	33	0.09	802	0.1
\$30,000,000 to \$40,000,000	3	0.01	105	0.0
\$40,000,000 to \$50,000,000	1	0.00	46	0.0
\$50,000,000+	3	0.01	225	0.0

Source: Nielsen TDLinx; Progressive Grocer Market Research, 2015

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a huge and direct impact on customer satisfaction and sales.”

Also higher on the list: price increases, at second place, noted by nearly 60 percent of survey respondents and up from seventh a year ago. Benefits, such as minimum wage and the Affordable Care Act, ranked third this year after leading the list in 2014. Competitive threats, No. 2 last year, plunged to 11th place — an interesting development, especially amid growing challenges from alternative channels like drug, dollar and digital.



Supermarket Sales by Store Format

Total supermarket sales topped \$638 billion in 2014, up from \$620 billion a year ago. That's an increase of about 2.9 percent, the same as PG reported last year, indicating a flattening trend that follows the 3.1 percent growth in 2012.

That flatness bears out when looking at store numbers by format. No surprise that conventional supermarkets dominate the marketplace, with 70 percent of all stores (down 1 percentage point from a year ago). Supercenters increased their share by just three-tenths of a percentage point, while natural/gourmet format stores account for more than 8 percent of stores, up about four-tenths of a point, with that growth driven in part by the rapid expansion of up-and-coming chains such as Sprouts and Fresh Thyme.

In share of sales, conventional supermarkets maintain a firm 65 percent



PROGRESSIVEGROCER'S
82nd ANNUAL REPORT
of the **GROCERY INDUSTRY**

AVERAGE PER-STORE SUPERMARKET PERFORMANCE MEASURES

	2014	2013	2012
Sales Volume (\$ Millions)	\$16.92	\$16.56	\$16.26
Selling Area (Square Feet)	33,300	33,250	33,100
Number of Checkouts	10.5	10.2	9.9
Average Weekly Sales			
Dollars per Store	\$325,478	\$318,462	\$312,758
Dollars per Square Feet	9.77	9.58	9.45
Dollars per Checkout	30,998	31,222	31,592

Source: Nielsen TDlinx; *Progressive Grocer* Market Research, 2015

hold on total sales, supercenters take a quarter, and natural/gourmet enjoy 6 percent, up almost a full point since last year.

Supermarket Sales by Store Count

Dollar sales growth outpaced unit growth among chains with 11 or more stores, as well as among

independents, with percentages holding steady year over year.

Larger chains added just 147 new stores in the past year, an increase of less than 0.5 percent on a total approaching 31,000 units, or 82 percent of all stores. Those stores accounted for nearly \$603 billion in sales, or more than 94 percent of all supermarket sales, consistent with their share a year ago.

Independent operators added 110 stores in the past year, an increase of 1.6 percent from a year ago. Indies' sales contribution rose nearly 2.7 percent since last year, for a total of \$35.6 billion, or a 5.6 percent overall share, unchanged from a year ago.

Store Performance Measures

Investments in people, space and service continue to reap positive results. Sales volume is up more than 2 percent and selling area is up slightly over a year ago, as is the number of checkouts. Likewise, dollars per store are up about 2 percent overall in the past year.