Kubas Consultants

Impact of Combo Stores

presented to

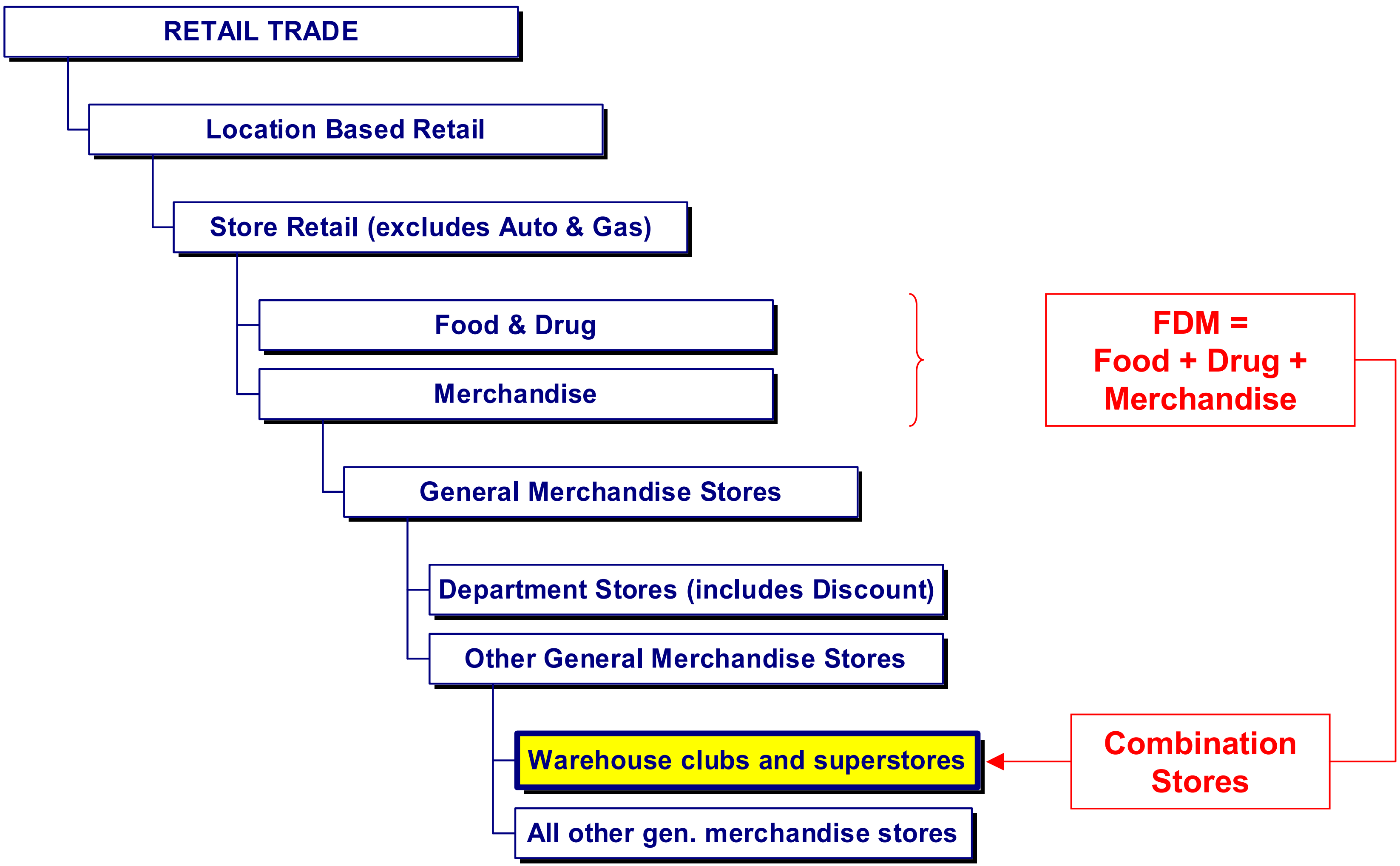
Retail Council of Canada:
The War of the Retail Titans

26 January 2006

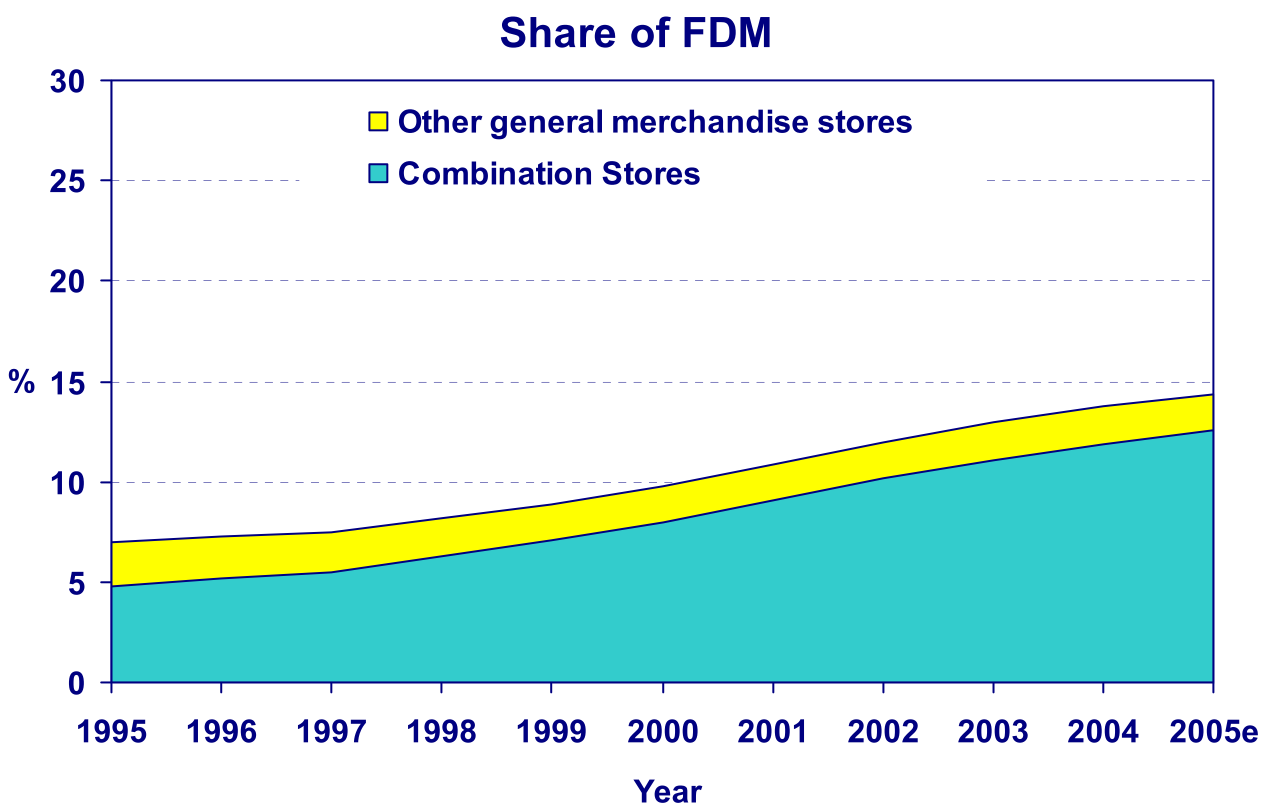
Agenda

- The US Experience
- The Canadian Experience
- Affected Merchandise Categories
- Market Trends and Developments
- Role of (the Lack of) Retail Loyalty
- Big Gets Bigger
- Implications for Vendors

Where Combinations Stores Fit



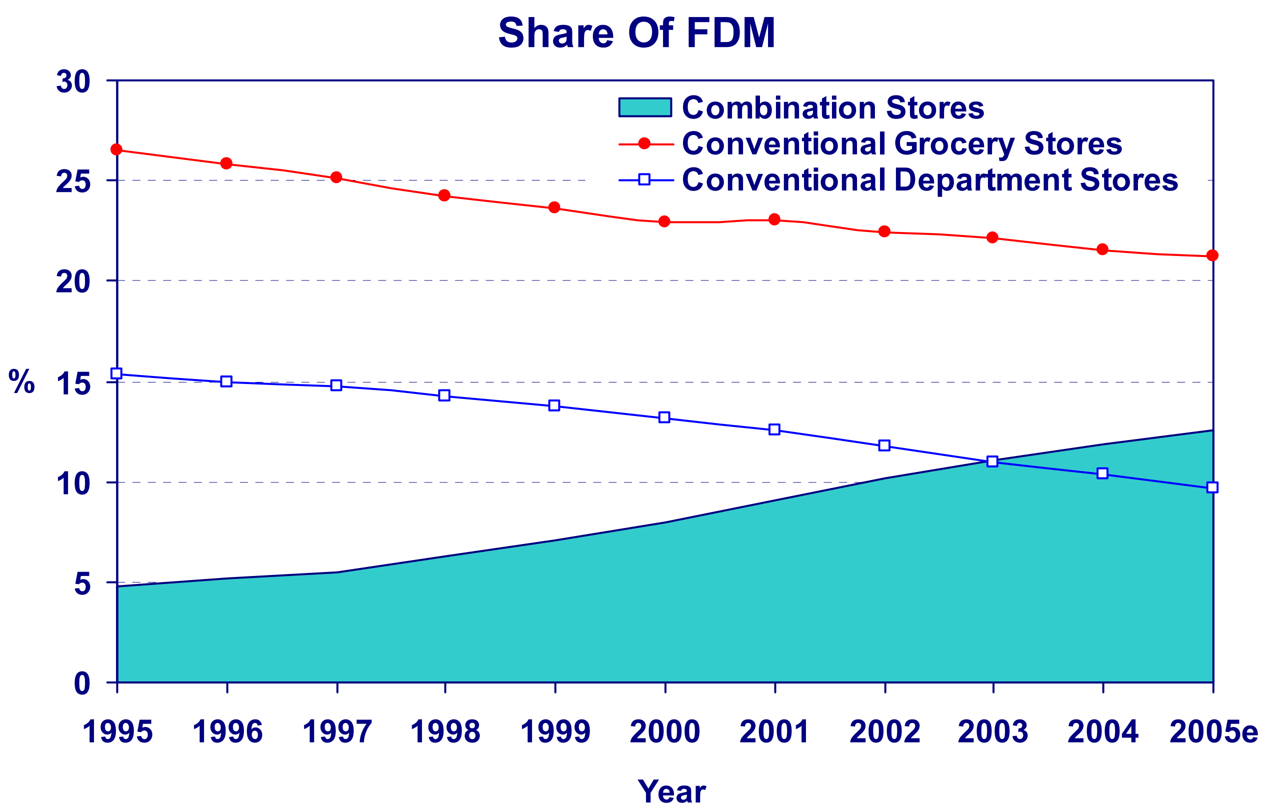
The US Experience



Source: US Census Bureau and Kubas Consultants' estimates

- **$278 billion in sales for US Combination Stores in 2005**
  - This more than *total* FDM in Canada!
  - Share of US FDM: 4.8% in 1995; 12.6% in 2005
- **Average annual compound growth rate over last 10 years: 15.6%**

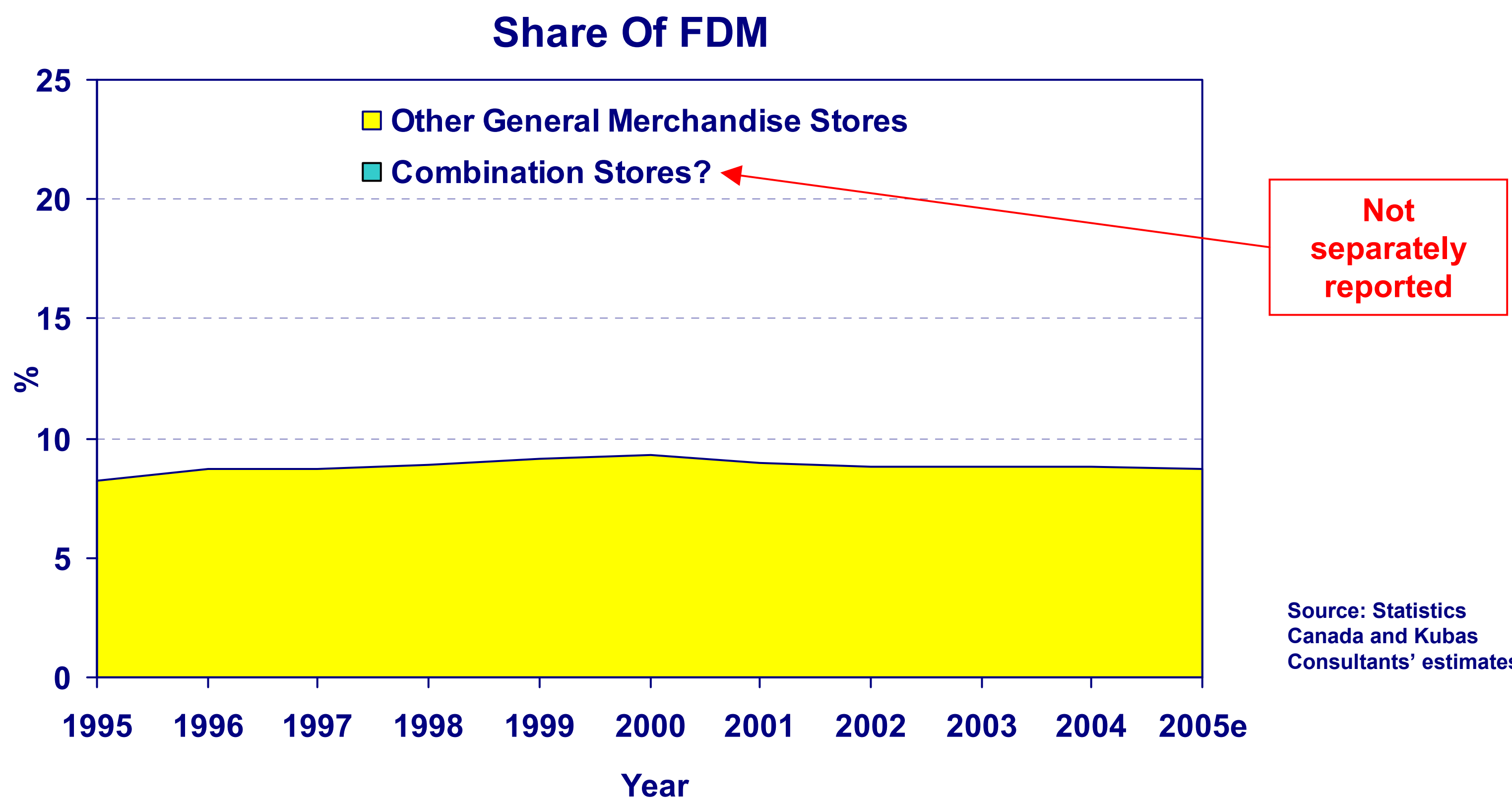
Impact in the US



Source: US Census Bureau and Kubas Consultants' estimates

- **Conventional grocery stores lost 5.3 share points**
- **Conventional department stores lost 5.6 (but on a smaller base)**
  - Combo Store sales overtook conventional department stores in 2003
- **But the incumbents didn't lose share *just* because of combo stores**

The Canadian Experience



Source: Statistics Canada and Kubas Consultants' estimates

- **All quiet on the northern front!**
  - Combo Stores not separately reported → for confidentiality reasons → too few retailers
- **Canada is 10 to 15 years behind the US in Combo Stores**
  - Other General Merchandise was about the same as US in 1995

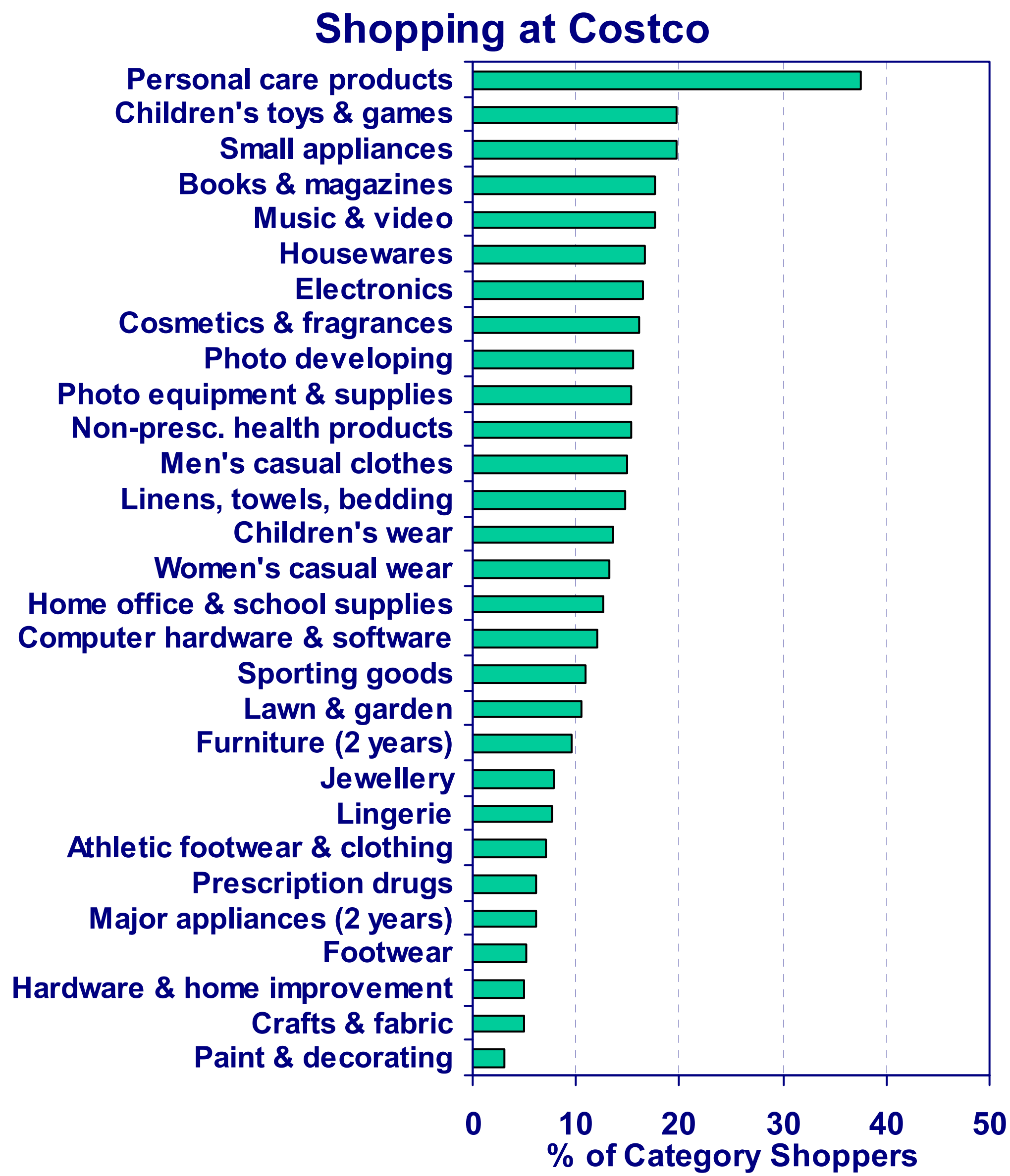
If …

- **If Combo Stores in Canada had developed at the same time as in the US …**
- **Their total retail sales would now be $9.2 billion in 2005**
  - Based on same share of FDM
- **If 1/2 of this came out of conventional supermarkets …**
- **… 2005 supermarket sales would be $4.6 billion and 7% lower**
- **If 1/4 came out of conventional department stores …**
- **… 2005 department store sales would be $2.3 billion and 10% lower**
- **The other 1/4?**
  - Would come out of speciality retailers’ sales, depending on the category

Affected Merchandise Categories

- Depends on what's offered
- Q: What merchandise do consumers shop Costco for?
- A: Many different categories
  - Personal care products is #1
  - But generally more hard goods
  - Soft goods mostly in the middle
  - Higher fashion items (jewellery and lingerie) below average
  - Home improvement & big ticket are toward the bottom

Source: Kubas Consultants,
Major Market Retail Report 2005



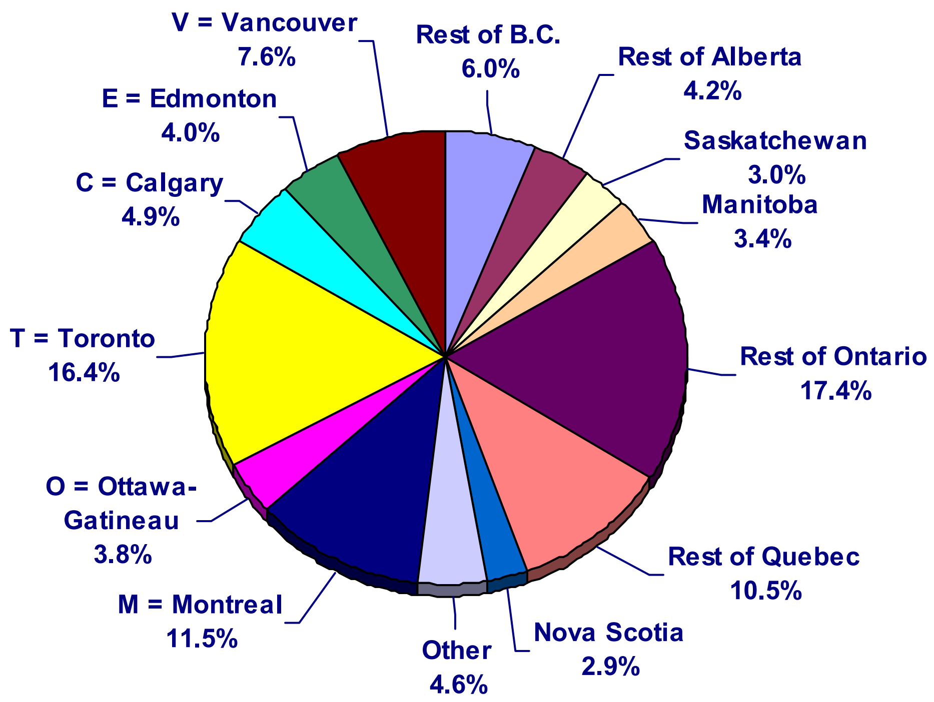
The Market Size Argument

- **Can the smaller Canadian market support big combo stores?**
- **Yes: Canadian retail is concentrated in 6 major markets**
  - VECTOM: Vancouver, Edmonton, Calgary, Toronto, Ottawa, Montreal

Canada: 48% of retail in VECTOM

US: 20% of retail in top 6 markets

Retail Sales Distribution 2005

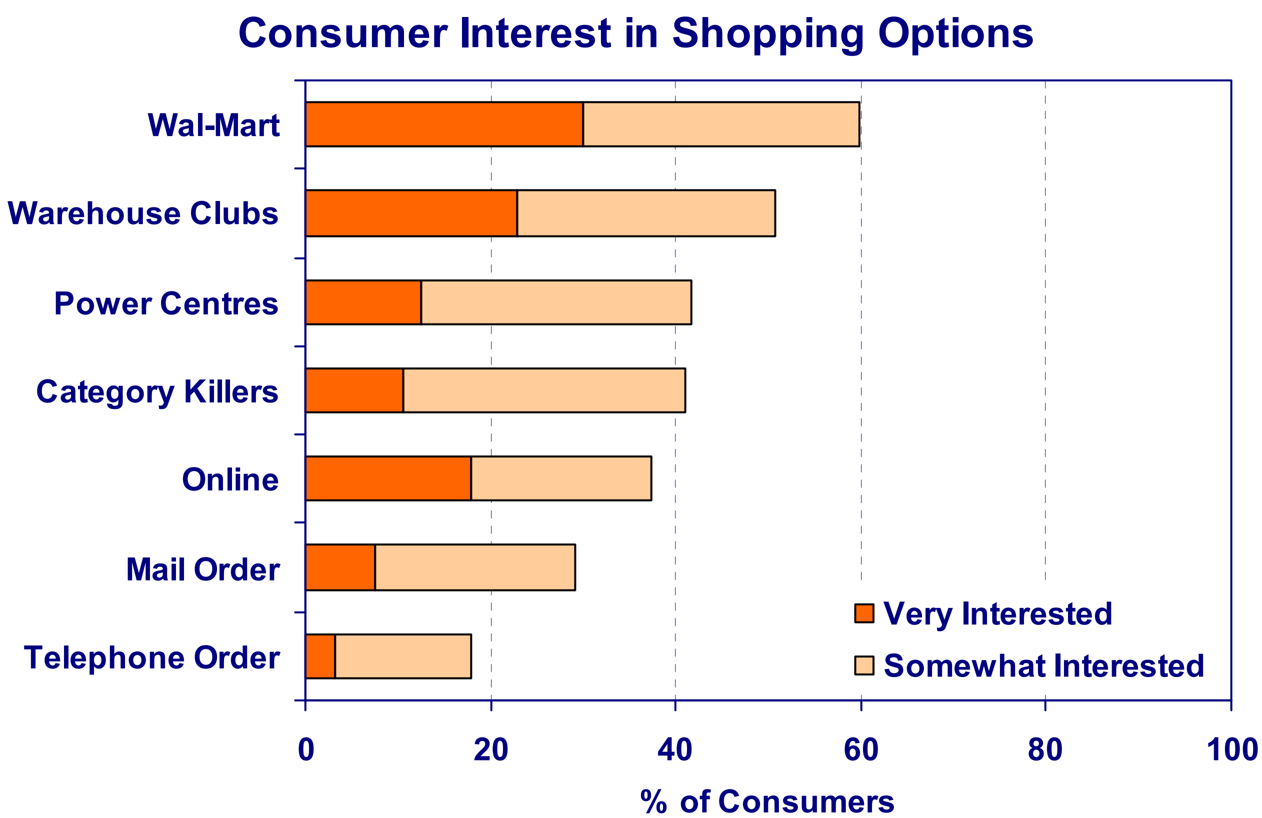


Source: Statistics Canada and Kubas Consultants' estimates

Supporting Market Trends

- **Category incursion**
  - Retailers offering “non-traditional” product lines
  - Retailers trying to cash in on shopper traffic, convenience items, and impulse purchases
- **Expanding expectations**
  - Realignment of shopper expectations of what different types of stores stand for
  - Eventually, “non-traditional” becomes “business as usual”
- **The breakdown of retail status**
  - Not “where I bought it” but “how little I paid for it”
  - The advent of “masstige”
  - Quality incursion riding along with category incursion
- **Population growth in Canada relies on immigration …**
  - And immigrants have different perceptions about mass, specialty, discount, prestige, …
- **So if you can buy anything, anywhere … why not a combo store?**

Consumer Receptivity

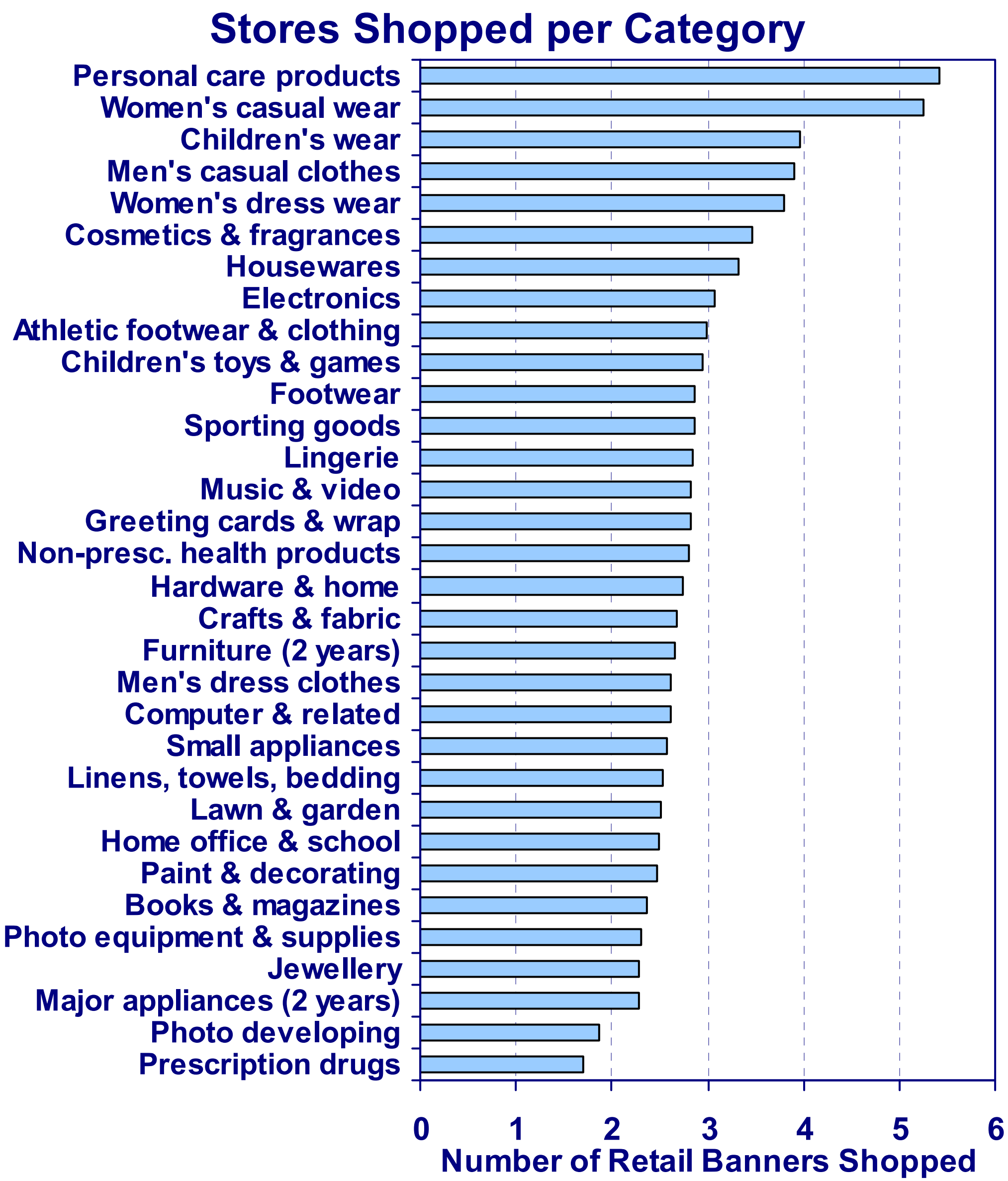


Source: Kubas Consultants, Major Market Retail Report 2005

- Enough consumers like big stores to make them work

Shopping Around

- Q: Will consumers cross over to combination stores?
- A: Yes – they already shop around for almost everything else
  - Average 2.9 retailers per category
  - But this varies by product



Source: Kubas Consultants,
Major Market Retail Report 2005

Small Appliances, For Example

- Consumers shop an average of 2.6 retailers for small appliances
- But this is concentrated in a few banners

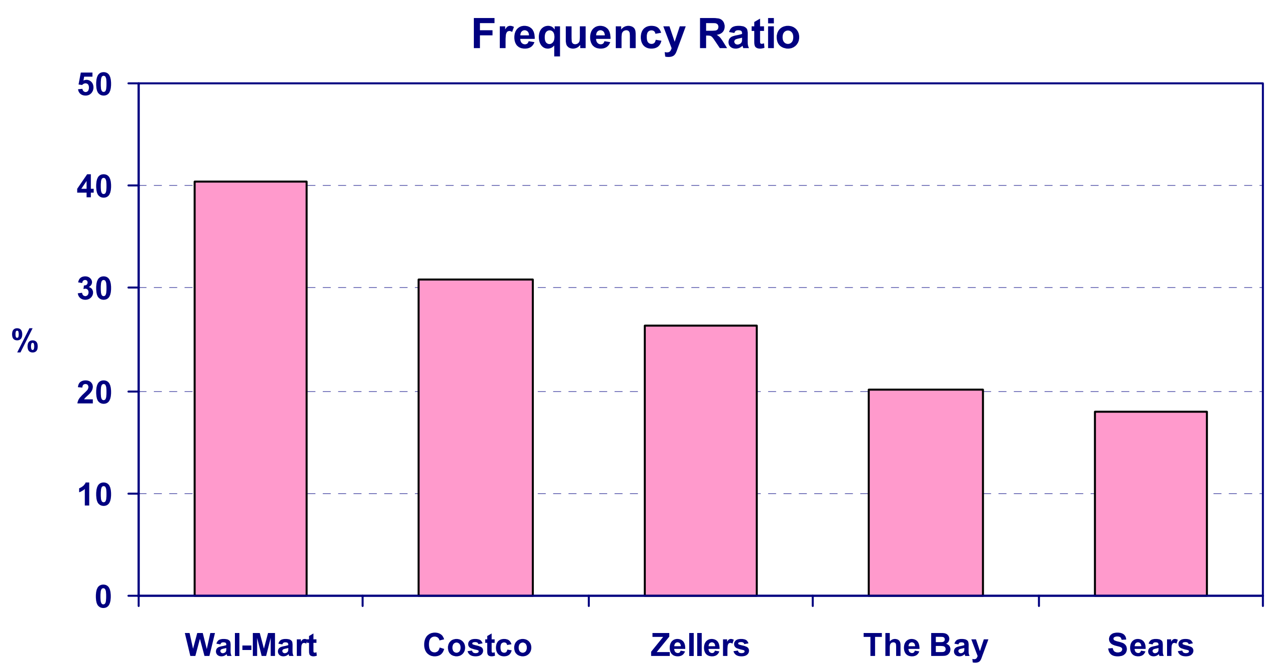
Cdn. Tire customers who also shop at	Wal-Mart customers who also shop at	Zellers customers who also shop at	Sears customers who also shop at	Bay customers who also shop at
Wal-Mart 55%	Canadian Tire 56%	Canadian Tire 59%	Canadian Tire 55%	Canadian Tire 51%
Zellers 33%	Zellers 35%	Wal-Mart 60%	Wal-Mart 53%	Wal-Mart 44%
Sears 24%	Sears 24%	Sears 33%	Zellers 42%	Zellers 32%
The Bay 22%	The Bay 19%	The Bay 25%	The Bay 42%	Sears 43%

Source: Kubas Consultants,
Major Market Retail Report 2005

- Cross-shopping ranges from 20% to 60% among any two retailers
- Loyalty? What loyalty?
- Another competitor can muscle in

Big Makes Combo Work

- It’s all about pricing, margin, operating efficiency, low costs, …
- To get traffic, volume, turnover, repeat customers, …
- Frequency Ratio = % of customers who shop often



Source: Kubas Consultants,
Major Market Retail Report 2005

How Big Can It Get?

- **We don’t know yet!**
- **Each succeeding bigger store seems to work**
- **Still looking for the limit**

Implications for Vendors

- **Generally more powerful retailers, with a stronger bargaining position**
  - Price pressure
  - More demand for co-op and allowances
  - More demand for special packaging
- **Need to make sophisticated technology work**
  - For precise logistics and inventory management
  - RFID seems inevitable
- **Or go the other way – create brand demand outside the retail channel**
  - But there a few “must have” products like Tide and iPod
- **In some cases however, a combo store could present another option**
- **Effects depend on product category**
  - More impact in hard goods than soft goods
    - But with exceptions, like personal care products
  - Home improvement and big ticket items seem more isolated
  - Plus some other categories, like computers and jewellery

What Can Slow It Down?

- Ageing Baby Boomers getting fed up
- Some day maybe we'll find out what "too big" is!