2015 Retail Industry Report

Mazzone & Associates, Inc.

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Firm Overview

Mazzone & Associates, Inc. is a mergers and acquisitions advisory firm serving the middle market. We provide comprehensive transactional services for middle market companies, private equity groups and individuals buying and selling companies, raising capital and structuring debt. Mazzone & Associates has experience working on more than 300 transactions valued in excess of $50 billion across a broad range of industries. We are relationship focused and appreciate that assignments are "life events" for many of our clients. Mazzone & Associates' goal is to achieve the maximum results and value for its clients and their shareholders by executing transactions with the integrity, premium service and confidence they want, require and deserve.

The sources for this industry report were National Retail Federation, IBIS World. Capital IQ, and interviews with leading industry executives.

Retail Industry: Defined by M&A

Mazzone & Associates (M&A) specializes in transactions in the Retail Industry. The U.S. has well-established distribution channels for all types of retail companies. According to the National Retail Federation, total sales from the more than 3.6 million retail establishments in the U.S. reached about $3.2 trillion in 2014, and retailers supported more than 12 million jobs in the U.S. Sales in the Retail Industry are expected to increase at a rate of 4.1% in 2015. The 4.1% increase would mark the biggest annual growth since 2011 when retail sales for the year increased 5.1%.

Numerous opportunities for growth exist in the U.S. market for retail providers of all sizes, including individual direct marketers or direct sellers, small to medium-sized franchise unit owners, and large "big-box" store operators. New distribution companies are opening stores and units daily to serve a large, affluent consumer base. To better understand the dynamics of the Retail Industry, we have broken the Retail Industry down into five segments in this report:

- **Big-Box & Department Store Retailers.** Big-box and department stores retail a broad range of general merchandise, such as apparel, jewelry, cosmetics, home furnishings, general household products, toys, appliances and sporting goods. Discount department stores, which are also included in this segment of the Retail Industry, retail similar lines of goods at low prices. A Big-Box Retailer has retail stores that occupy an enormous amount of physical space and offer a variety of products to its customers. These stores achieve economies of scale by focusing on large sales volumes. Because volume is high, the profit margin for each product can be lowered, which results in very competitively priced goods. The term "big-box" is derived from the store's physical appearance. Located in large-scale buildings of more than 50,000 square feet, the store is usually plainly designed and often resembles a large box. Walmart, Best Buy, The Home Depot and Ikea are examples of Big-Box Retailers. The supercenters of Big-Box Retailers such as Walmart and Target, which offer fresh groceries in their stores, and warehouse clubs such as Costco and BJ's Wholesale Club that operate under membership programs are not included in this Big-Box & Department Store Retailer segment because those stores are included in the Warehouse Club & Supercenter Retailer segment described below.
- **Warehouse Club & Supercenter Retailers.** Warehouse Club & Supercenter Retailers have large stores that primarily retail a general line of grocery products, along with merchandise items (e.g., apparel and appliances). Warehouse clubs offer customers a wide selection of goods (often in bulk) at discounted prices, in exchange for a membership fee paid by each customer. Supercenters are large discount department stores that also sell perishable groceries. However, unlike warehouse clubs, supercenters do not have eligibility requirements for customers.
- **Supermarkets & Grocery Stores.** The Supermarkets & Grocery Stores segment sells general lines of food products, including fresh and prepared meats, poultry and seafood, canned and frozen foods, fresh fruits and vegetables and various dairy products. Delicatessens primarily retailing food are also included in this segment.

- **E-tailers.** E-tailers sell retail goods on the Internet. The E-tailer segment includes e-commerce and online auction websites whose primary activity is selling goods online. Brick-and-mortar store operators that have also set up websites in conjunction with physical outlets are excluded from this report. E-tailing is synonymous with business-to-consumer (B2C) transactions. Two distinct categories of e-tailers are (i) pure plays and (ii) bricks and clicks. A pure play e-tailer uses the Internet as its primary means of retailing. Examples of pure play e-tailers are Dell and Amazon.com. A brick and click e-tailer uses the Internet to push its good or service but also has the traditional physical storefront available to customers. Combining this new type of retail and the old of a general store is a new type of store which is part of the green economics movement, promoting ethical consumerism.
- **Other.** There are several other retailers within the Retail Industry. Many of those retailers can be classified into large, important segments where Mazzone & Associates has experience and expertise including: apparel, home furnishing retailers, convenience stores, and dollar stores. For the sake of brevity, which by the time you finish this report you may find to be an ironic statement, we have chosen to restrict the analysis within this report to the initial four segments notes above.

	Revenue ($billions)	Profit ($billions)	Annual Growth (2009-14)	Annual Growth (2014-19)	Businesses	Wages ($billions)
Big-Box & Department Store Retailers	$166.1	$4.8	- 4.1%	-1.4%	72	$19.5
Warehouse Club & Supercenter Retailers	462	25.4	3.5%	2.1%	27	40
Supermarkets & Grocery Stores	584.3	8.8	1.3%	0.8%	42,036	56.7
E-tailers	297.9	21.2	10.3%	5.9%	131,447	18.5

Key Factors for Success

The key factors for success in the Retail Industry that M&A looks for are set forth below.

Ability to control stock on hand. Many of the Retail Industry's goods and products are seasonal, with 32.1% of annual sales occurring between October and December. Therefore, retail stores must have tight stock control measures to ensure that popular items are re-ordered and sufficient product lines are available to maximize sales.

Customer centric work force. Retail stores require sales staff that are friendly, helpful and provide excellent customer service.

Ability to expand and curtail operations rapidly in line with market demand. Retail stores need to be able to expand operations during peak periods to meet increased demand (i.e., Christmas trading) but also curtail operations during weaker trading conditions (i.e., economic slowdown).

Attractive product presentation. Retail stores require an effective layout and design, good shelf management, friendly and helpful service and a clean environment.

Strong logistics and distribution backbone. A core strength for most successful retailers is the ability to control margins and costs through efficient and effective logistics and distribution systems between its manufacturers and among its stores to properly manage inventory, among other things.

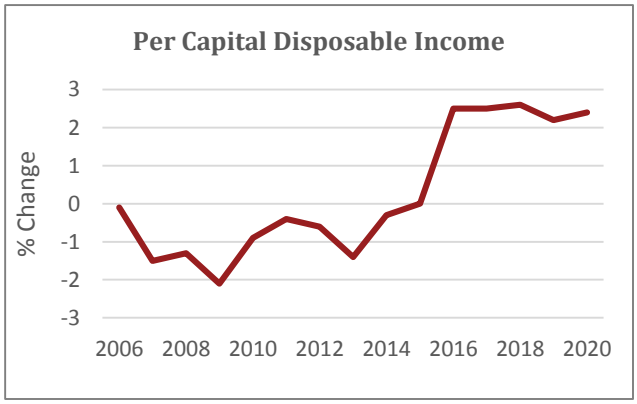
"Successful retailers focus on three key things: the customer, the customer and the customer. Logistics, great products and merchandising help drive profitability for retailers, but the customer experience and service, whether in a store or on-line, are critical for any retailer's success."

-Dom Mazzone, Managing Director of M&A

Key External Drivers of Growth

M&A believes that the key external drivers of the Retail Industry continue to slowly rebound from the Great Recession. Our analysis of those factors is set forth below.

- **Internal Industry Competition.** Retailers compete within the various industry segments due to the range of goods and services that they provide. Some of the Retail Industry's largest competitors are amongst players in each segment within the industry. For example, Walmart and Target are moving strongly from the Big-Box & Department Store Retailer segment into the Supermarkets & Grocery Stores segment as their supercenters have started offering grocery items and similar products and services as traditional grocery stores. E-tailers also pose significant competition to various brick-and-mortar retailers in the industry because e-commerce websites allow consumers to conveniently buy products from the comfort of their own homes. Many Big-Box & Department Store Retailers are behind on their e-commerce strategies, which will likely cause significant consolidation opportunities for e-tailers and e-commerce software companies.
- **Per Capita Disposable Income.** Retail sales depend heavily on the financial health of the consumer sector, including per capita disposable income. In periods of low disposable income growth, consumers cut back on spending by delaying purchases or substituting costlier goods with inferior products. Spending trends are heavily influenced by the unemployment rate and general economic growth, with periods of strong economic activity associated with rises in disposable income, and vice versa. Per capita disposable income is expected to increase over 2015, creating a potential opportunity for the Retail Industry.



- **Consumer Confidence Index.** Consumer confidence levels determine the number and frequency of purchases. Low consumer confidence causes consumers to delay purchases or buy cheaper alternatives. In contrast, purchases increase as consumer sentiment rises since consumers feel more confident about their economic future (i.e., they anticipate lower unemployment, increased wealth and higher disposable incomes). Consumer sentiment is expected to continue to increase.
- **Population**. Population growth is an important component of Retail Industry growth. As the population increases, so does the Retail Industry's customer base. Additionally, population growth in specific regions is an important indicator of future establishment growth because the number of stores is generally related to the area's population. Population is expected to increase slowly over the next five years.

Mergers & Acquisitions Marketplace

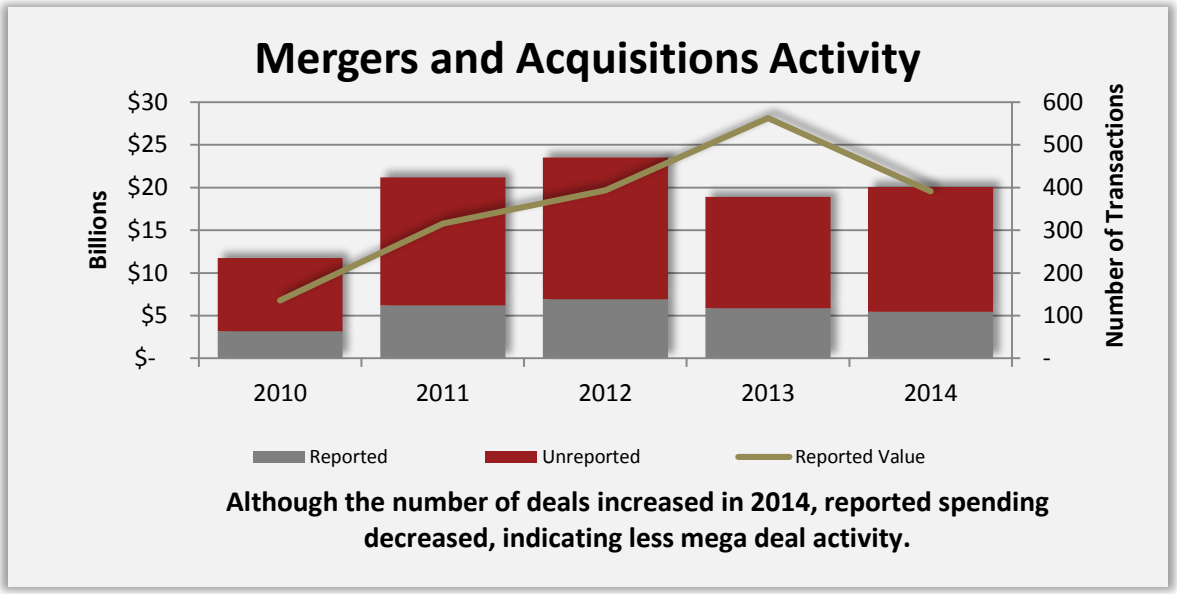
The Retail Industry's 2014 mergers and acquisitions deal volume increased from 2013, however overall reported spending declined more than $8.0 billion, or nearly 30% from the 2013 peak. 2014 reported spending of $19.5 billion is still more than double the amounts seen in the low of 2010, evidencing the market is still more robust than it was in the recessionary environment. Interestingly, deal volume in 2014 actually increased 6% over 2013, indicating smaller deals have accounted for more of the overall spend.

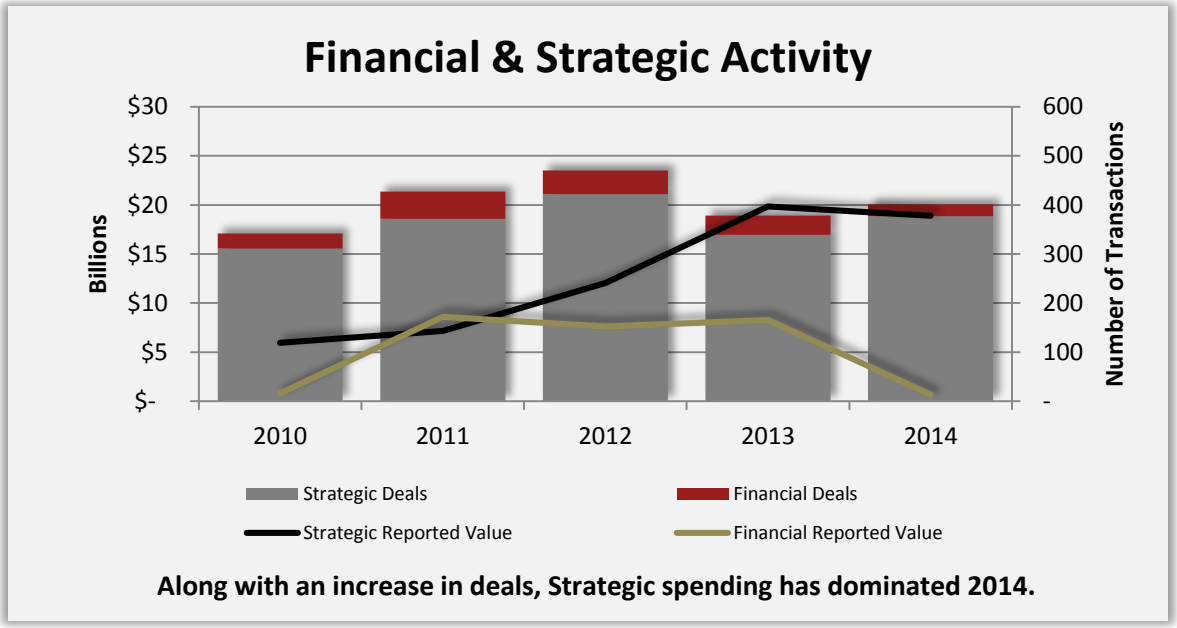
Changes in buyer activity shed some light on the shifting landscape in 2014. Strategic buyers have again dominated the mergers and acquisitions activity, both in volume and spending. Strategic buyers closed 11% more deals in 2014 than in 2013. Reported strategic spending decreased by 5%, primarily due to changing dynamics in deals greater than $1 billion. Although the volume of strategic deals above $1 billion was roughly the same in both 2014 and 2013, spending declined 23% in this tier as average deal size decreased to approximately $2.0 billion. Financial buyers however, had a decline in both the number of closed transactions and reported spending in 2014, which marked the second year of declining volume. Financial buyers chose to focus on smaller opportunities within the retail space as no transactions greater than $1 billion were reported by this group.

Examining the activity within the retail categories, Specialty/Other retail deals have accounted for the majority of volume over the past few years. While Specialty retail has accounted for most of the volume and spending, the Grocery category has seen an increase in spending, especially in 2013 and 2014. The consolidation of the Grocery category appears to continue into 2015 with Albertsons' acquisition of Safeway for $11.8 billion already closing in the first quarter. Nearly a third of all spending in 2013 was on department store deals, with Neiman Marcus and Saks being the most notable transactions of brand and size. However no department store deals over $1 billion closed at all in 2014 as both strategic and financial buyers sought out smaller, more growth oriented opportunities.

Valuations are high within the Retail Industry supported by the rise in some transaction comps over the prior year. The median EV/EBITDA for 2014 was 13.0x and EV/Revenue was 0.6x. These premiums are likely to decrease the number of transactions moving forward as value buys in the space will become scarce. Turning to the public equity markets, the Retail Industry has stayed strong with the rest of the market and experienced above average performance in 2014. As of December 31, 2014, median EV/EBITDA was 11.4x and median EV/Revenue was 0.9x, with the EBITDA multiple up again from the prior year.

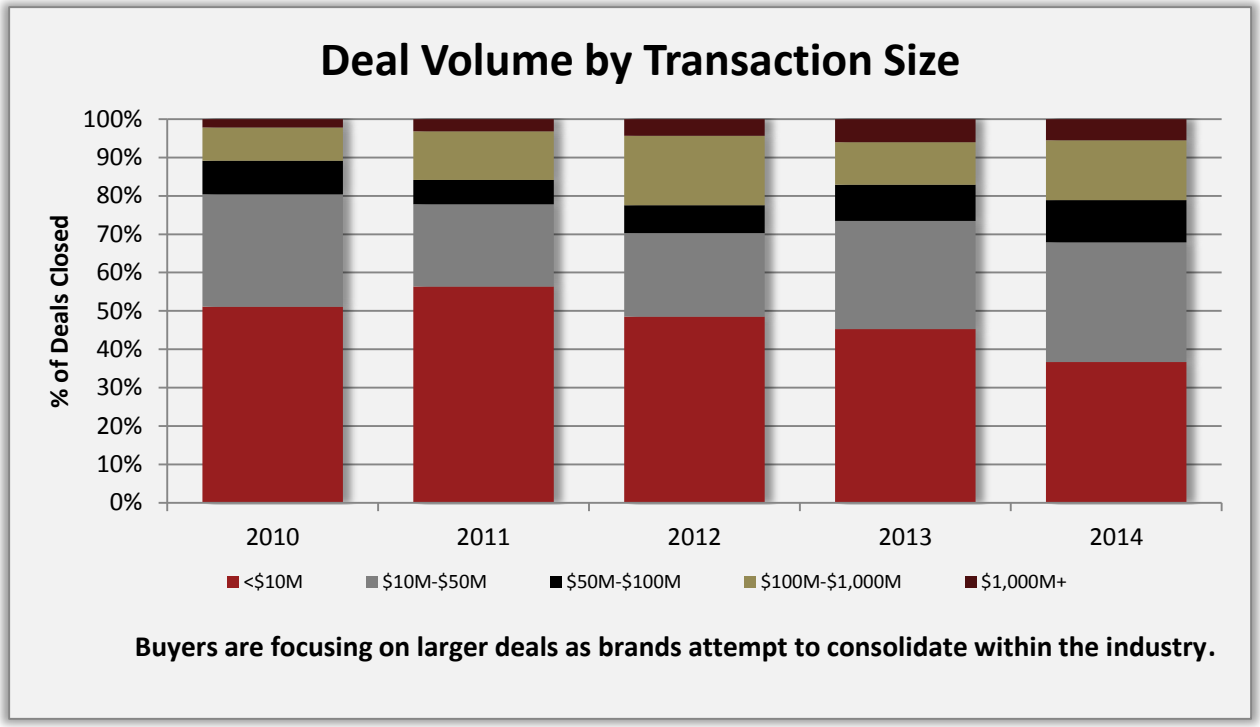
Behind the increase in transaction and trading multiples in the Retail Industry is a continued resurgence in the overall spending of consumers. The consumer confidence index has increased over the last few years and can reasonably be expected to remain high despite predictions of moderate increases in annual U.S. gross domestic product (GDP) output. With stable and improving economic conditions, this industry is likely to attract additional buyers. An increase in demand paired with strong multiples should entice owners to consider selling, thus providing a positive outlook for activity in 2015.





Comparable Median Transaction Multiples	2010	2011	2012	2013	2014
EV/EBITDA	17.9x	8.4x	10.5x	10.7x	13.0x
EV/Revenue	0.5x	0.6x	0.5x	0.8x	0.6x

Public Company Median Trading Multiples	2010	2011	2012	2013	2014
EV/EBITDA	7.4x	8.5x	9.2x	10.6x	11.4x
EV/Revenue	0.6x	0.7x	0.8x	0.9x	0.9x



2014 Noteworthy Closed Transactions

Date	Target	Buyers/Investors	Size ($ in millions)
Jan	Harris Teeter Supermarkets, Inc.	The Kroger Co. (NYSE:KR)	2,658
Jun	Susser Holdings Corporation	Energy Transfer Partners, L.P. (NYSE:ETP)	2,474
Aug	Hess Retail Corporation	Speedway LLC	2,370
Sep	Jos. A Bank Clothiers Inc.	The Men's Wearhouse, Inc. (NYSE:MW)	1,826
Dec	Market Basket, Inc.	Arthur T. Demoulas (existing shareholder)	1,600

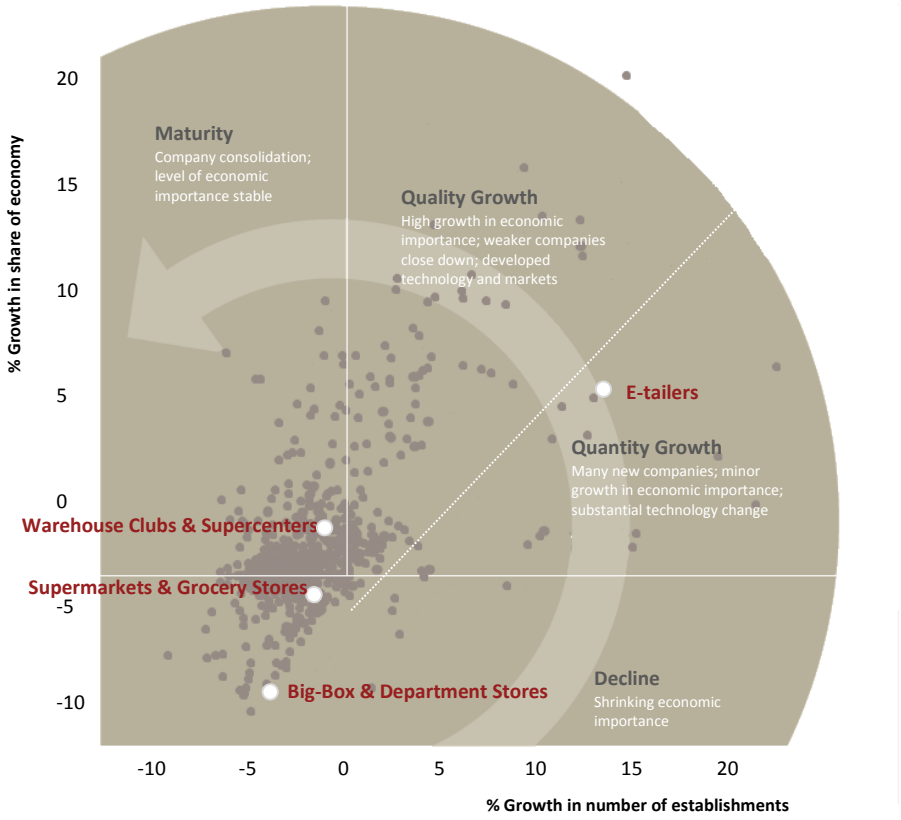
Retail Industry Mature Life Cycle

The different segments within Retail Industry are in various phases of their life cycles. Typically, an industry or industry segment is considered to be in a decline phase of its life cycle when industry value added (IVA), a measure of an industry or industry segment's contribution to the U.S. economy, falls below GDP. In contrast, a growth phase occurs when IVA outpaces GDP, while a mature phase occurs when IVA mirrors U.S. GDP. U.S. GDP is anticipated to rise an at annualized rate of 2.5% in the 10 years to 2020.

- **The Big-Box & Department Store Retailer segment is declining.** In the 10 years to 2020, IVA is expected to decline at an annualized rate of about 4.6%. The recession took a toll on the industry and many companies have failed to adapt accordingly to a post-recessionary environment, in which consumers are easily able to compare prices and access online retailers.

In addition, the number of big-box and department stores is declining as Walmart and Target continuing making strong moves into the warehouse clubs and supercenters (and out of the traditional big-box store model).

- **The Warehouse Club & Supercenter Retailer segment is mature.** In the 10 years to 2020, IVA is forecast to increase at a rate of 2.5% per year on average, mirroring U.S. GDP. In addition, the number of industry enterprises is projected to remain steady, further reflecting the industry's mature state.
- **The Supermarkets and Grocery Stores segment is mature.** The Supermarkets and Grocery Stores industry is in the mature stage of its life cycle. However, in the 10 years to 2020, IVA is expected to increase at a relatively slow rate of 0.6% per year on average. Typically, an industry is considered to be declining when industry growth falls below GDP. However, supermarket and grocery stores have historically suffered from low profit margins, which lowers this industry's contribution to the economy. Additionally, intense competition in the food retailing sector has also contributed to the industry's slow growth.
- **The E-tailer segment is growing.** In the 10 years to 2020, IVA is expected to increase at an average annual rate of 12.8%. High IVA growth relative to the economy as a whole is highly indicative of a growing life cycle stage. Moreover, the industry is still experiencing the entrance of many new operators and rapid innovation.



Big-Box & Department Store Retailers

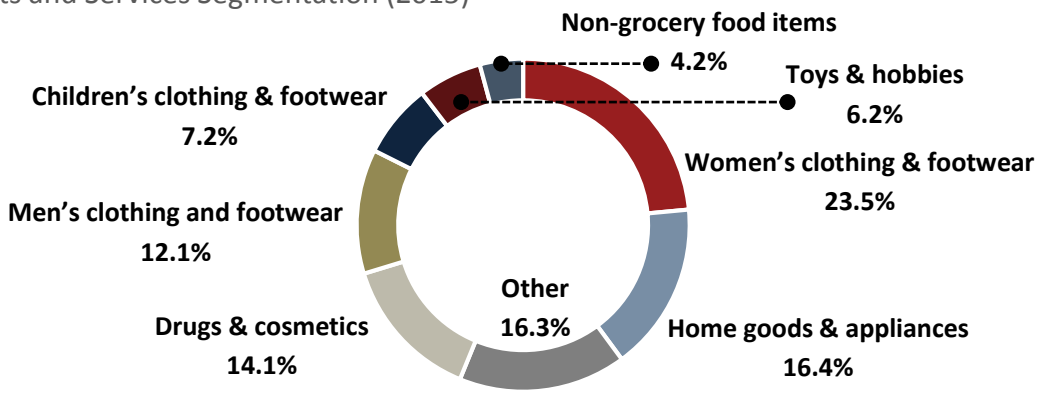
The Big-Box & Department Store Retailer segment will continue its long-term decline, with revenue expected to fall 4.5% per year on average to $163.6 billion in 2015. While rising competition from e-tailers has accelerated declines, revenue contraction is primarily attributable to the increasing number of major players that have expanded their product range to include groceries, which transitions their revenue to the Warehouse Club and Supercenter Retailer segment. This trend is expected to continue through 2015, with revenue falling 4.4% during the year.

Brick-and-mortar stores incur higher operational costs than e-commerce stores because they pay for high-traffic retail space and require sales associates. As a result of these cost savings, online companies are increasingly undercutting traditional department store prices. Many high-end department stores have consequently opened more discount outlet store locations to remain competitive. Low disposable income during the recession spurred many consumers to opt for outlet stores and, despite recovering economic conditions, many consumers still prefer to shop at outlet stores. For example, Nordstrom has simultaneously closed its underperforming traditional stores and opened multiple discount Nordstrom Rack stores over the past five years.

Several factors have suppressed segment returns over the past five years. Major players that benefit from strong purchasing power can negotiate favorable supply contracts with lower purchase costs than smaller department stores. As more major players shift to supercenters, the concentration of operators with high buyer power has decreased, which has reduced the average segment profit. Price-based competition from e-tailers has also limited product markups. As a result, profit is anticipated to decrease from 5.5% of total segment revenue in 2010 to 4.1% in 2015, despite rising disposable income levels.

In the five years to 2020, continued retail outlet growth is forecast to aid segment declines. Improved consumer spending and disposable income will also encourage consumers to shop at traditional retail outlets. However, companies such as Walmart and Target will continue to shift their stores toward the supercenter format and reduce their share of the Big Box & Department Store Retailer segment. Overall, revenue is expected to fall by 2.6% per year on average in the five years to 2020, totaling $143.5 billion.

Products and Services Segmentation (2015)



Current Performance

The Big-Box & Department Store Retailer segment comprises retailers that sell a wide range of merchandise. While big-box retailers, such as Walmart and Target, have historically dominated the segment, many have expanded their product offerings to include groceries. This one-stop-shop format has boosted revenue for segment players; however, general merchandise stores that offer groceries are included in the Warehouse Club and Supercenter Retailer segment, which effectively removes them from the Big Box & Department Store Retailer segment. As a result, revenue is expected to decline 4.5% per year on average to $163.6 billion. Heightened price-based competition from e-tailers has also limited segment demand despite increased consumer spending.

Savings and Supercenters

To aggressively increase their product lines and capture additional consumer dollars, discount giants, such as Walmart and Target, have transformed their department stores into supercenters by adding fresh grocery sections. By supplying all of a household's necessities, including apparel, small appliances and groceries, in one location, discount retailers offer convenience to consumers by eliminating the need to visit multiple stores. For instance, Walmart recently converted about one-third of its stores from general merchandise stores to supercenters, which are not included in this segment. Target also adopted its new PFresh layout, which includes an expanded line of perishable groceries. As a result, although demand has been consistently high for discount department stores, much of their growth has been redirected toward the Warehouse Club and Supercenter Retailer segment, reducing their market share within the Retail Industry. This trend is expected to continue through 2015, reducing revenue 4.4% during the year.

Performance has varied among segment players over the past five years; while some big-box & department stores have flourished, others have struggled. Stores in this segment operate in two distinct areas: up-market department stores and discount variety counterparts. Similar to other retail stores, traditional department stores within the segment have suffered from intense price-based competition from e-tailers, reducing sales. Demand for discount department stores, however, has boomed since the recession as price-conscious consumers looked for ways to save amid declining disposable income. Attracted by growing demand, the number of discount retailers in the segment has expanded considerably over the five-year period. This has shifted the high-end and discount department stores' respective shares of total operators considerably, with discount stores now accounting for the largest share of segment revenue. New entrants in the discount department store segment are expected to increase the number of operators 0.6% per year on average to 68 companies.

Some traditional big-box & department stores have also reentered the segment following its devastating decline during the recession. In the wake of the housing market's collapse, consumer confidence crashed significantly over the year. Moreover, per capita disposable income fell, marking the first decline in nearly two decades. U.S. households were consequently forced to reevaluate expenditures

and cut back on products they deemed nonessential, such as high-end apparel and jewelry. Companies merged, were sold or filed for bankruptcy and company figures subsequently plummeted. As the economy started to improve, many small employers have entered the segment, while companies such as Walmart have continued to shift their focus toward supercenters. As a result, market share concentration has decreased considerably over the past five years. Smaller department stores require less staff and the average number of employees per establishment has subsequently fallen. The proliferation of smaller department stores, coupled with the gradual exits of major players, is anticipated to reduce employment 4.7% per year on average to 918,916 workers.

Fluctuating Demand

Demand for traditional big-box & department stores depends on changes in consumer confidence in the economy and per capita disposable income. U.S. households constitute the entire market and, therefore, as households save or spend, the segment contracts or expands. In 2010, as the U.S. economy began its recovery, disposable income and consumer confidence returned. Falling unemployment encouraged consumers to increase discretionary spending, which had been stifled during the recession. Despite improved spending conditions, revenue growth has yet to return to pre-recessionary levels because many consumers are continuing to purchase from discount department stores or buy segment products online.

Conversely, discount department stores have benefited from consumers' cautious spending. Although most consumers initially sought out discount stores to save money during the recession, customers have become comfortable with the associated price savings and continue to demand inexpensive goods, despite increasing disposable income. As a result, discount department stores have continued to capitalize on their increased share of the consumer dollar. Nevertheless, rising e-commerce sales have limited demand for discount stores during the period.

Competition, Convenience and Profit

Over the five years to 2015, competitors, such as supercenters, warehouse clubs and e-tailers, have siphoned sales away from department stores. Each competitor features a vast array of substitute products, brands and options with varied advantages. For example, supercenters showcase a comprehensive array of specialty goods, enabling consumers to choose from a wider selection, while warehouse clubs offer items in bulk packaging at extremely discounted prices. Moreover, e-tailers provide the most convenient shopping experience by allowing consumers to compare prices and product information in the convenience of their homes. As a result, these competitors have progressively limited the growth of the Big-Box and Department Store Retailer segment, driving value- and convenience-seeking consumers away from segment operators.

Profit for the Big-Box and Department Store Retailer segment is expected to account for 4.1% of revenue in 2015. While profitability improved following the recession, price-based competition from e-tailers within the Retail industry has continued to pressure returns. Moreover, the gradual exit of

major players, such as Walmart that boast higher profit margins than smaller players, has further suppressed returns during the period.

Segment Outlook

The Big-Box & Department Store Retailer segment will continue to contract over the five years to 2020, albeit a slower rate. On the strength of economic recovery, revenue declines are forecast to slow to an average annual rate of 2.6% during the period, totaling $143.5 billion. Growing competition from e-tailers is expected to place further price pressures on segment operators, while even more companies shift to the Warehouse Club and Supercenter Retailer segment. To effectively compete, operators will target niche luxury consumers or expand their outlet store presence.

Conditions and Competition

As a retail segment, big-box & department stores depend heavily on consumer spending and disposable income conditions to spur demand. Improved demand conditions are expected as the economy continues to recover and gain traction. In the five years to 2020, consumer spending and per capita disposable income are forecast to increase at annualized rates of 2.6% and 2.4%, respectively. These improvements will aid traditional big-box & department stores sales as consumers, armed with higher disposable incomes, increase their purchases. Nevertheless, outlet and discount department stores are anticipated to continue capturing a greater share of the market as consumers look for deals.

Historically, consumers have had only two options for purchasing new products: traditional brick-and-mortar shops and mail order catalog retailers. However, the internet now provides consumers with a new and convenient method of shopping. Because these e-tailers do not require physical stores or stock maintenance, they can achieve great cost savings through their operations and offer services, such as free shipping, to deter consumers from traditional stores. Consequently, the number of consumers

placing online orders is forecast to increase over the five years to 2020, bolstered by improvements in websites that make it easier for individuals to search for items, compare prices and make purchases.

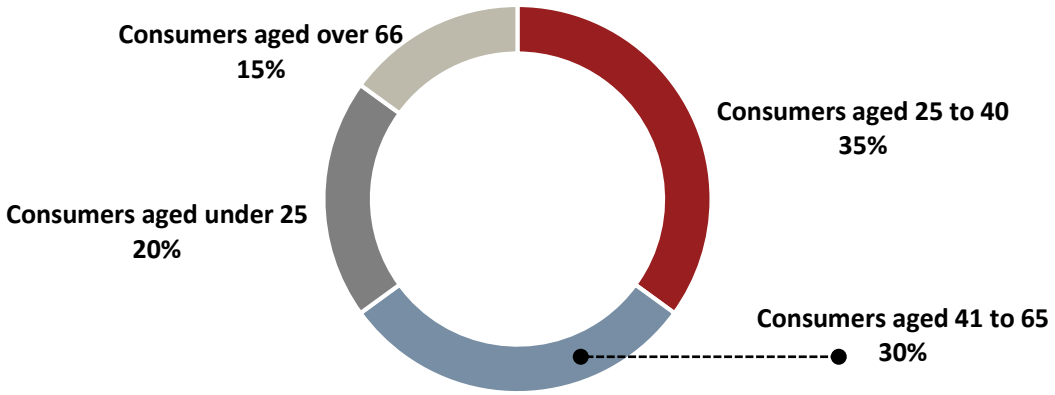
Faster internet connection speeds will also support the rise of e-commerce, along with growing confidence in the security of online retailing sites. As a result, the Big-Box & Department Store Retailer segment will continue to lose customers to the convenience of online shopping, with revenue decreasing 4.1% during 2016, as the percentage of services conducted online increases. While many stores are increasing their online presence and sales, revenue derived from online sales is not included within the segment. Some companies have also acquired e-tailers. For example, Nordstrom purchased Trunk Club in July 2014 and owns the popular private flash sale site, HauteLook.

Industry Structure

The Big-Box & Department Store Retailer segment will continue to lose establishments as major players move into the Warehouse Club and Supercenter Retailer segment. Big-box retailers, including Walmart and Target, will further expand their discount store offerings to include groceries and exit the segment. Market share concentration is consequently expected to continue falling, but high saturation and competition in the segment will limit new entrants and force some players to exit the segment, decreasing the number of operators 1.8% per year on average to 62 companies. Employment will follow suit, decreasing 3.6% per year on average to 763,101 employees.

Profit margins are expected to decrease slightly over the next five years as low-cost department stores comprise a greater share of the segment and major players continue to leave the segment. Discount outlets, such as Neiman Marcus' Last Call and Saks Fifth Avenue's Off Fifth, sell brands similar to their traditional stores at discounted prices. As consumers flock to these stores to save, high-end retailers will continue to close their traditional stores and expand their discounted offerings. Because these items are heavily discounted, profit margins will decline. Moreover, high-margin retailers with strong buyer power such as Target will continue to decrease their share of the market, accelerating this trend. Some stores, such as Nordstrom, have shifted their traditional stores to smaller formats with a greater share of luxury goods to appeal to high-end consumers that do not shop at outlet stores. This trend is anticipated to aid profit margins by lowering overhead costs and encouraging high-markup purchases.

Major Market Segmentation (2015)



Competitive Landscape

The majority of stores in this segment operate as part of a national chain with numerous locations across the United States. In addition, stores tend to be on the larger side, with almost 90.0% of all stores employing more than 50 employees. Segment concentration measures the extent to which the top four players dominate a segment. The top four largest operators are expected to account for about 53.3% of segment revenue in 2015.

Market share concentration in the Big-Box & Department Store Retailer segment has decreased considerably over the past five years because many major players like Walmart and Target are transitioning to the Warehouse Club and Supercenter Retailer segment. This trend is expected to continue decreasing segment concentration over the next five years. Some high-end retailers, however, are expanding their discount outlet store offerings, consequently slowing concentration declines.

Basis of Competition

Internal Competition

Enterprises operating in this segment compete with other players that operate department stores. This segment is sectored into two distinct operators: up-market department stores and their discount variety counterparts. Despite this segmentation, both types of stores experience the same internal competition. Competition in this segment tends to be based on price, product range and quality, promotional offers, customer service levels and store location.

Price is possibly the most influential basis of competition within this segment. Consumers are generally price-conscious and will comparison shop to find what they consider to be a bargain. The range and quality of products offered by operators will also influence where consumers shop. If segment players operate in the up-market segment of the segment, then they should ensure that their product range and quality are comparative with other players in this segment.

Operators also compete on the basis of promotional deals. A number of segment players have highlighted the seasonal nature of their business and noted that the latter months of the year leading up to Christmas are usually busier than other months. Hence, promotional deals are usually conducted during the slower business months to maintain consumer awareness and boost company sales. During the economic downturn, players have had to lower their price markups on merchandise in order to remain competitive. As a result, many consumers have now become conditioned to wait for sales, which have hurt retailer margins. Operators in this segment also compete on the basis of store location. Operators planning to expand their store numbers will look for locations which are in prominent shopping centers and which provide easy access for consumers.

External Competition

Enterprises operating in this segment compete with players in other segments. These operators supply products that are also sold by department stores and hence consumers may opt to purchase from them as opposed to going to department store operators. These segments include supercenters and warehouse clubs, hardware stores, specialized clothing and shoes stores, furniture stores, home furnishing stores, electronics and appliance stores, pharmacies and drug stores, and cosmetics and beauty outlets. Segment research suggests that segment operators have experienced increased pressure from specialty retailers and home good chains in recent years. Further competition comes from e-tailers that can offer lower prices on merchandise, as they do not have to pay for physical store space. Department store operators have responded by introducing new product ranges along with revamping promotional and advertising initiatives.

Barriers to Entry

A number of key factors may encourage or indirectly act as a prohibitive measure for new entrants in the Big-Box & Department Store Retailer segment. The economies of scale illustrate the level of market dominance held by key players in the segment. This segment includes company giants like Walmart and Target that can negotiate favorable supply contracts with buyers. Like most in the Retail industry, department stores are subject to a low level of capital intensity as the majority of operational costs are devoted to the payment of wages as opposed to equipment such as fixtures and fittings. Despite this, department stores are typically located high traffic areas where rent costs are high.

Product Differentiation

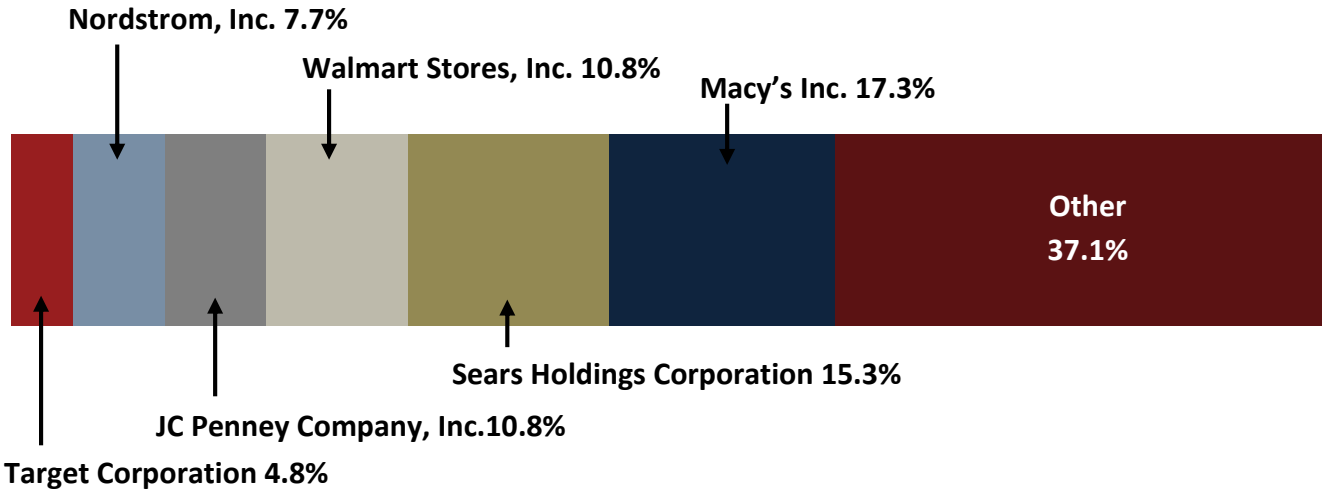
The level of product differentiation examines the extent to which department stores supply unique products. The type of department store in operation (i.e. traditional, general merchandise or discount stores) influences the level of product differentiation. In general, merchandise from players in the traditional department store segment is vastly different in range and quality from merchandise offered by discount store operators.

Distribution Networks and Licenses

The existence of distribution networks between department stores and suppliers may be viewed as a barrier to entry. Existing operators benefit from the relationships they have established with suppliers over time. On the other hand, department stores should ensure that they obtain the relevant business trading licenses before operating. In most cases, this is not a formidable barrier to entry.

Barriers to Entry checklist	Level
Competition	High
Concentration	Medium
Life Cycle Stage	Decline
Capital Intensity	Low
Technology Change	Medium
Regulation & Policy	Light
Industry Assistance	None

Major Companies



Target Corporation

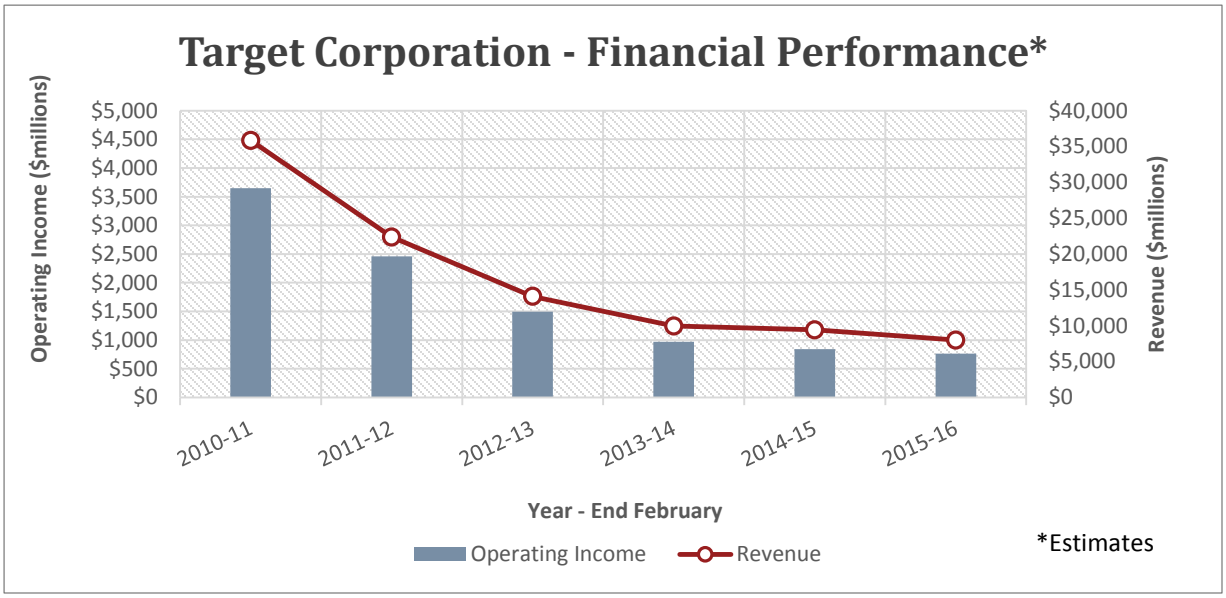
Market Share: 4.8%

Headquartered in Minneapolis, the Target Corporation is a large-format general merchandise retailer, operating 1,763 stores across 49 states and the District of Columbia. Since its incorporation in 1902, the company has evolved into one of the largest retailers in the country with about 347,000 employees. Similar to Walmart, Target offers daily essentials and consumables at discounted prices. However, the company has carved out a niche market by focusing on selling fashionable and trendy products.

Target comprises 240 general merchandise stores, 1,292 expanded food assortment stores, 249 SuperTarget stores, eight CityTarget stores and one TargetExpress store. Target's retail business has been traditionally composed of two distinct store formats: general merchandise stores that carry apparel, jewelry, shoes, home appliances, housewares and electronics while excluding groceries, and SuperTargets that carry a wider selection of such goods, in addition to a full line of perishable groceries. Since the recession, Target has been aggressively adding groceries as part of its general merchandise stores' product offerings. Products include fruit, vegetables, fresh meat, bakery items, dairy and frozen foods. This transition has allowed the retailer to capture more consumer dollars by providing a complete one-stop shopping experience, it has also siphoned revenue away from the Big-Box & Department Store Retailer segment over the period because merchandise stores with grocery lines are excluded from this segment.

Financial Performance

Target's total revenue is expected to increase during fiscal 2015. However, while the company's total revenue has grown over the five years to fiscal 2015, segment-specific revenue is expected to decline at an average rate of 26.3% per year to $7.8 billion. The rise in total revenue can mainly be attributed to the company's rapid expansion, even in tough economic times. However, the company's segment-specific revenue has suffered as a result of store format conversions. During the period, Target has remodeled hundreds of general merchandise stores to include an assortment of perishable and nonperishable foods, which shifted their revenue from the Big-Box & Department Store Retailer segment to the Warehouse Club and Supercenter Retailer segment, but Target remains a major company in this segment.



Nordstrom, Inc.

Market Share: 7.0%

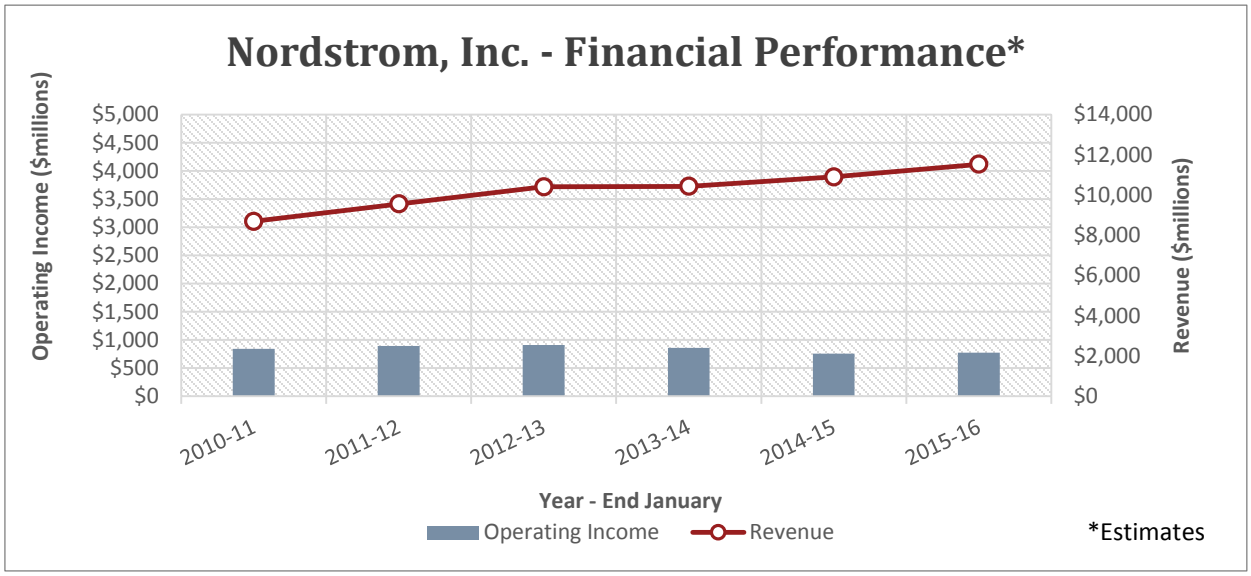
Founded in 1901, Nordstrom Inc. has effectively carved out a significant share of the wealthy consumer and aspirational shopper markets (i.e. mid-income consumers that occasionally purchase luxury products) by providing near-luxury goods (i.e. branded goods that are more affordable than true-luxury goods). Headquartered in Seattle, the company operates 115 full-line department stores, multiple e-commerce sites and 176 off-price Nordstrom Rack stores with about 67,000 employees.

In response to heightened competition from e-tailers, the company has increasingly invested in web-based fashion startups. The company owns HauteLook, an online private sale site, and purchased Trunk Club, a personalized clothing service for men, in July 2014 to expand its online reach outside the scope

of its traditional online site. While e-commerce is not included as part of the segment, such steps reflect proactive major player initiatives to stem losses from its traditional full-line stores.

Financial Performance

The majority of revenue growth is attributable to the company's Nordstrom Rack expansion efforts that target price-conscious consumers. America's wealthier consumers, who significantly increased their luxury spending as the economy and stock market improved, helped stem declines in its traditional full-line stores. Nonetheless, online competition has reduced full-line store revenue in recent years. In response, Nordstrom's segment-specific efforts include smaller department stores exclusively selling luxury items and, subsequently, targeting aspirational shoppers through its Nordstrom Rack stores. The strategy has boded well for the company and Nordstrom's segment-specific revenue will increase at an average annual rate of 5.8% per year to total $11.5 billion in the five years to fiscal 2016.



JC Penney Company, Inc.

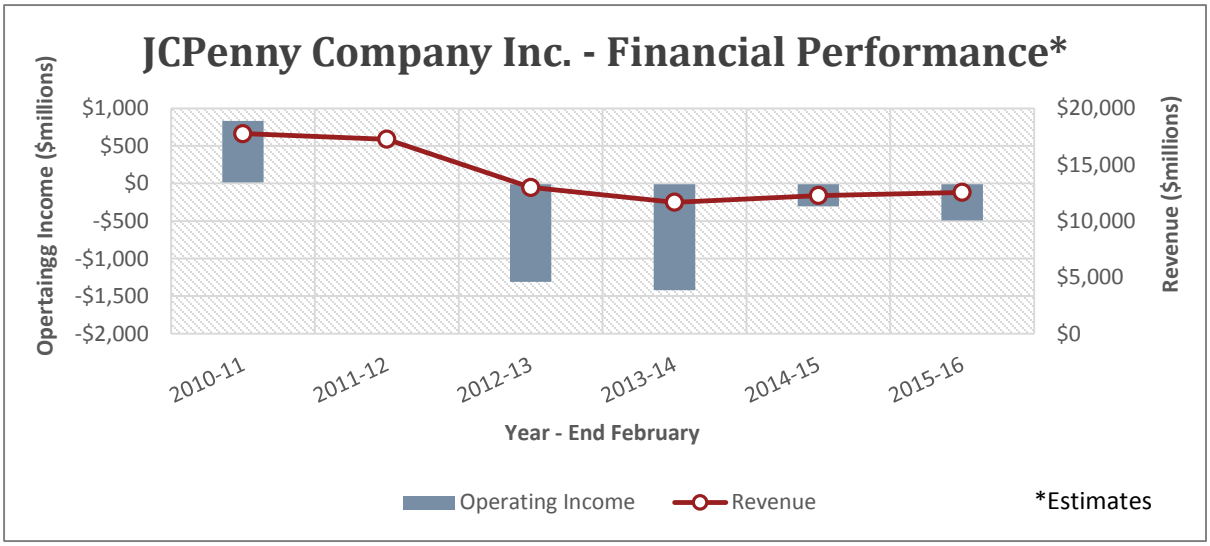
Market Share: 7.7%

Commencing operations in 1902 as a soft goods retailer, JCPenney Company Inc. is squeezed between upscale competitors and major discounters, as JCPenney primarily serves mid-income U.S. households. Headquartered in Piano, TX, and operating 1,062 locations, the company stocks a range of family apparel, jewelry, shoes, accessories and home furnishings, many of which are private label. JCPenney's private-label brands generate gross profit margins that are three to five percent higher than national brands. Given the earnings potential of private brands, the retailer aims to increase the breadth of private labels offered in each store. The company employs about 114,000 part- and full-time employees.

JCPenney is still recovering from a tumultuous year in 2012, and the new company CEO has implemented a number of strategies to improve the company's overall position. Strategies included closing underperforming stores, reducing corporate personnel, centralizing the merchandising process for department stores and catalogs and, most notably, eliminating the department store's time-honored coupon and clearance sales program in favor of a "Fair and Square" everyday low prices strategy. However, this strategy failed, turning off loyal customers that did not return even after JCPenney's hallmark clearance strategies were reintroduced and the company's CEO was replaced in April 2013. The company yet again replaced its CEO in October 2014.

Financial Performance

In the five years to fiscal 2016, JCPenney's revenue is expected to fall at an annualized rate of 6.7% to $12.6 billion. Over this period, the company's growth has been limited by the aftermath of the recession, which decimated consumer wealth and spending habits. Furthermore, unlike Macy's, JCPenney focuses on marketing its products to middle- and low-income households, making the company more susceptible to external competition from Walmart and Target. In addition to lower revenue, a drop in operating income hurt the company early in the period. Fixed costs drove this drop in profit, although the operator has successfully trimmed variable costs, including wages and marketing expenses, to stem losses.



Walmart Stores, Inc.

Market Share: 10.8%

Founded in 1962 and headquartered in Bentonville, AR, Walmart Stores Inc. is the world's largest retailer and grocery chain by sales, as well as the third-largest employer worldwide (following the U.S. and Chinese militaries) with 2.2 million workers in its 10,942 stores worldwide. The company leverages

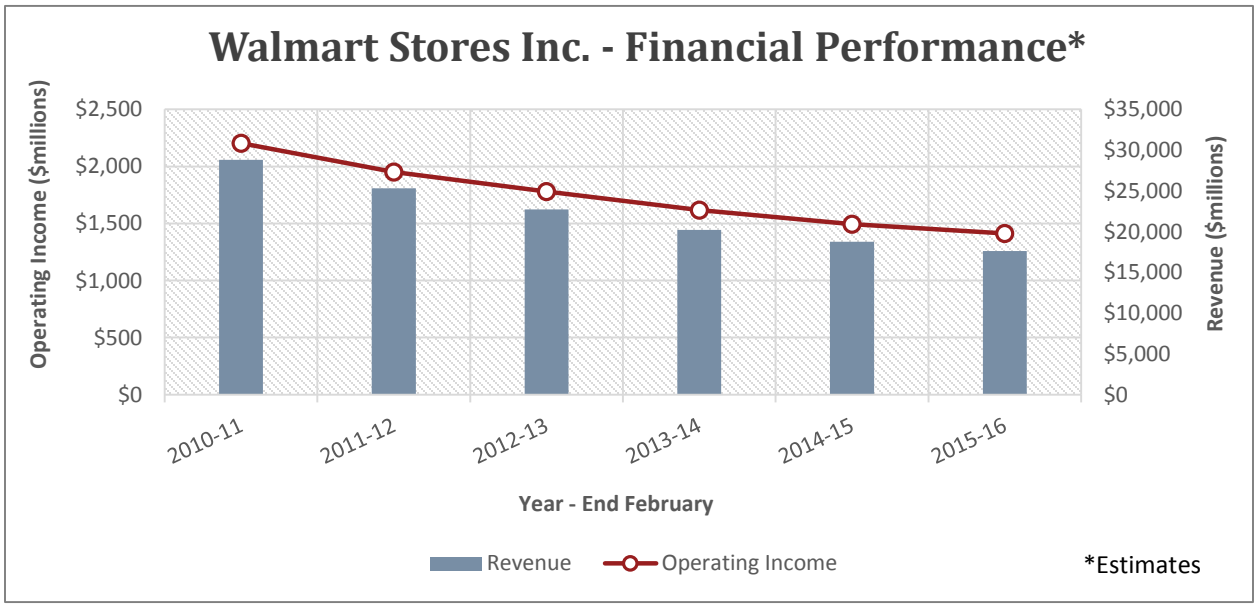
its massive size to exert high purchasing power over its suppliers and, therefore, it can obtain significant cost savings and pass them down to consumers with heavily discounted prices.

Walmart operates three separate divisions: Walmart U.S., Sam's Club and Walmart International. Under the Walmart U.S. division, the company runs supercenters that offer general merchandise and a full-line supermarket, as well as general discount stores that offer the same products but no perishable groceries. Only Walmart U.S.'s general discount stores operate in this segment while the retailer's remaining stores (including supercenters) are accounted for in the Warehouse Club and Supercenter Retailer segment.

Walmart's first discount store opened in 1946 under the name of Walmart Discount City. The company owns 508 discount stores in the United States, many of which are open 24 hours a day. General discount stores retail an assortment of merchandise, such as apparel, electronics, toys, health and wellness products, home furnishings and housewares. The number of discount stores has declined from 803 in fiscal 2010 due to an increasing focus toward supercenters, which have grown from 2,747 stores in fiscal 2010 to 3,288 in fiscal 2015. As a result, Walmart's share of segment revenue has fallen steadily over the five-year period.

Financial Performance

In the five years to fiscal 2016, Walmart's U.S. segment-specific revenue is expected to fall at an average annual rate of 9.3% to $17.6 billion. This decline is primarily due to Walmart's strategy of slowly exiting the Big-Box and Department Store Retailer segment and entering the Warehouse Club and Supercenter Retailer segment. Moreover, same-store sales have decreased since the recession, as many consumers have returned to higher-quality retail outlets or are opting for supercenters with a greater selection.



Sears Holdings Corporation

Market Share: 15.3%

Headquartered in Hoffman Estates, IL, Sears Holdings Corporation is the third-largest merchandise retail company in the United States, after Walmart and Target. The company was created in March 2005 as a result of a merger between Sears Roebuck and Co. and Kmart Holding Corporation. As a result, the company is segmented into three operations: Sears domestic division, Sears Canadian division and Kmart. Only sales from full-line Sears and Kmart discount stores are relevant to this segment. In April 2014, the company completed the spin-off transaction of its Lands' End business.

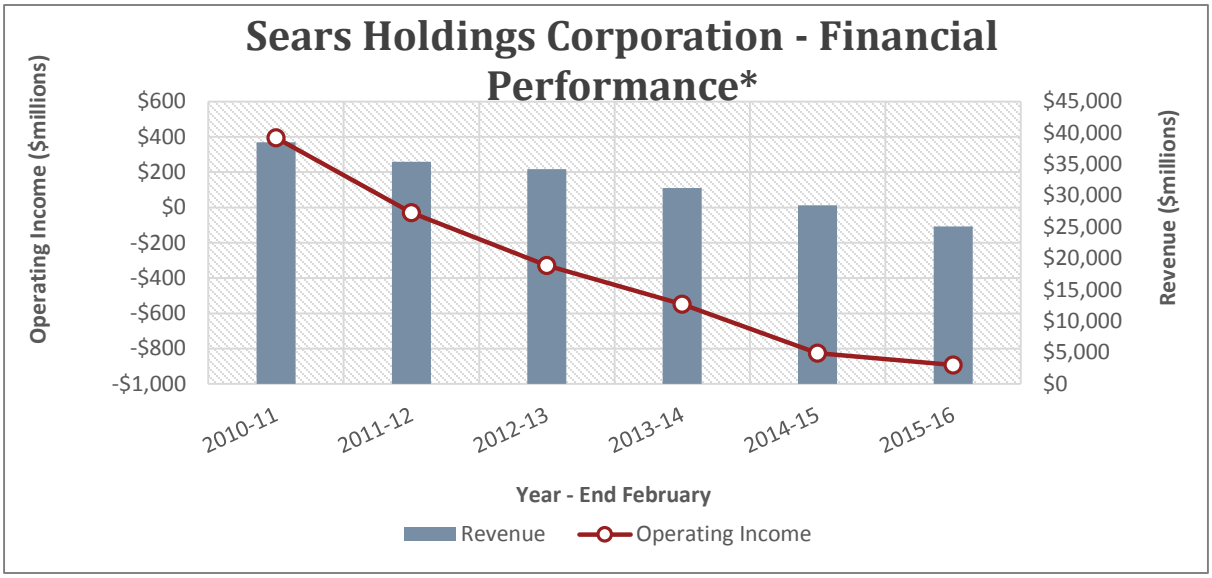
Under the Sears domestic division, the company operates 709 full-line and 37 specialty stores that are primarily located in malls. These stores offer an array of products and services, including home appliances, consumer electronics, tools, sporting goods, outdoor living, lawn and garden equipment, automotive services and products (e.g. tires and batteries), home fashion products, apparel, footwear, jewelry and accessories. Sears retains the traditional department-store format, with decentralized cash registers and specialized sales associates.

Kmart operates as a general merchandiser in direct competition with Walmart and Target. Most Kmart stores are one-floor, free-standing units that carry an array of products across many merchandise categories, including consumer electronics, seasonal merchandise, outdoor living, toys, lawn and garden equipment, food and consumables and apparel. Sears operates 979 Kmart stores nationwide.

Financial Performance

In fiscal 2016, Sears' segment-specific revenue is expected to fall, totaling $25.1 billion. The company's segment-relevant sales are expected to follow a similar trend relative to the five years prior falling at an estimated annualized rate of 8.2% over the five years to fiscal 2016. Despite the company's strong brand recognition and size, Sears' domestic sales have been consistently declining because its low-end competitors (e.g. Walmart and Target) and mid-tier competitors (e.g. JCPenney and Macy's) have been increasingly capturing the department store's market share through wider selection and steeper discounts, thereby squeezing the company's sales and margins.

Weak consumer demand has exacerbated the company's revenue drops. Consumers delayed big-ticket purchases, such as appliances and electronics. More than half of the Sears domestic division's decline in sales in fiscal 2011 can be attributed to low consumer electronic sales. Since the merger of Kmart and Sears, the company has closed hundreds of full-size stores, reducing transactions and leading to lower sales for the company.



Macy's Inc.

Estimated market share: 17.3%

Founded in 1858 and headquartered in Cincinnati, Macy's Inc. is a national retailer of midrange items that operates 840 locations in 45 states, the District of Columbia, Guam and Puerto Rico and employs about 172,500 workers. Macy's retails a range of men's, women's and children's apparel and accessories, as well as a wide assortment of cosmetics, fragrances and home furnishings. In addition to its Macy's-brand department stores, the company operates Bloomingdale's, which is an upper-tier retailer. The company also runs Bloomingdale's Outlet stores, a concept that was launched in 2010 and now accounts for 13 stores.

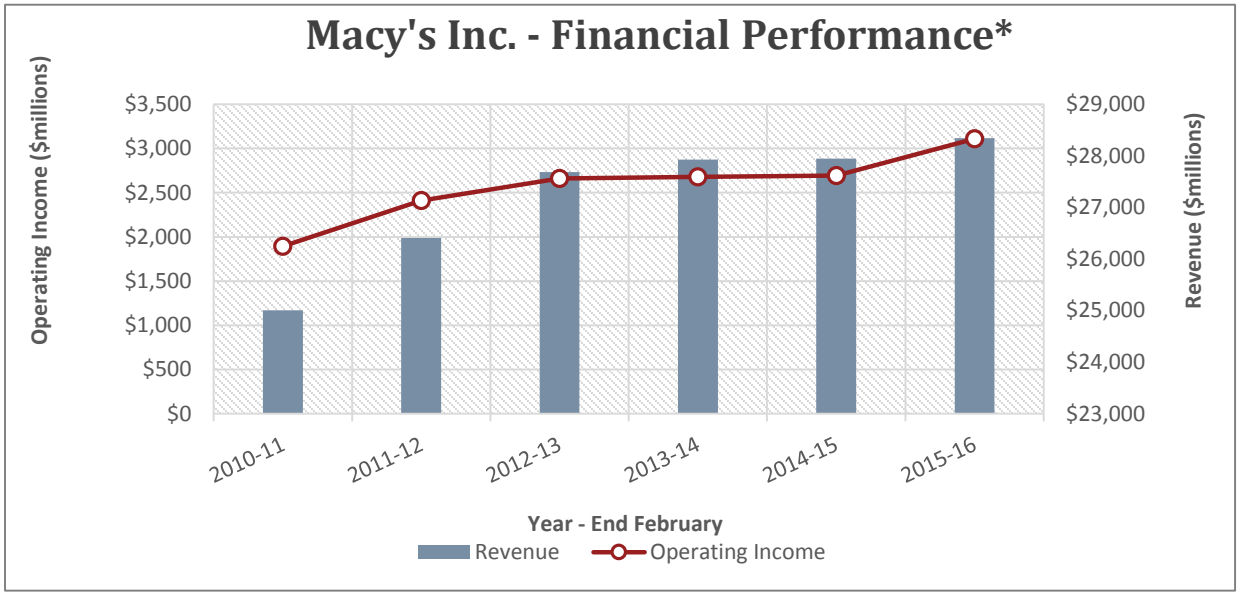
At the peak of the recession, Macy's announced a major restructuring plan designed to strengthen its local focus and improve customer service. As a result, the company has consolidated its Macy's North, Macy's Midwest and Macy's West units and more than 2,500 jobs were cut by these changes. The company has increasingly grown its online presence and outlet stores to leverage e-commerce growth and appeal to price-conscious customers.

Financial Performance

Macy's revenue is expected to increase at an annualized rate of 2.5% to $28.3 billion during the five years to fiscal 2016. Macy's poor sales during the recession caused declines, however, as the economy recovered, sales began to rebound and the company experienced higher revenue due to an increase in demand for women's apparel, men's apparel, luggage and furniture. Revenue increased further in subsequent years as disposable income climbed and consumers began to spend more on discretionary goods. Comparable store sales increased that year and strong cosmetic, fragrance, handbag, watch,

men's apparel, home textile and furniture sales boosted performance. Nonetheless, growth has slowed in recent years, due to heightened competition.

In terms of profitability, Macy's has been consistently subjected to high impairment charges, store closing costs and division restructuring costs. However, the company has posted robust operating income growth since the recession, supported by strong performance at its stores. Since then, operating income has been increasing steadily thanks to improved operational efficiencies at Macy's and a resilient performance from Bloomingdale's.



Other Companies

The Big-Box and Department Store Retailer segment can be broadly divided into three areas: upscale or traditional department stores, mid-tier department stores and general merchandise stores (or discount department stores). Traditional department stores are aimed at medium- to high-end consumers and provide an extensive range of products, such as apparel, home furnishings (e.g. furniture, floor coverings, curtains, draperies and linens), household appliances and goods. Mid-tier department stores are similar to their high-end counterparts but do not offer high-fashion merchandise or lucrative brands. General merchandise stores or discount retailers are similar to traditional department stores but are focused on the mid- to lower-end consumer market. While discount or variety stores stock products similar to those of a traditional department store, the selection of merchandise is usually at the lower end of the price scale.

Additionally, department stores differ from supercenters and warehouse clubs, such as Walmart's Supercenters and Sam's Club, Target's SuperTarget and PFresh stores and Costco. These operators sell similar merchandise as department stores, but they also offer grocery items. Additionally, warehouse clubs, such as Costco, sell products in bulk and often require a membership to buy merchandise.

Neiman Marcus Group Inc.

Estimated market share: 2.9%

Beginning operations in 1907 as a fashionable women's store, Neiman Marcus Group Inc. is located in Dallas and operates about 41 upscale department stores across 20 states and the District of Columbia. Product labels include high fashion, high-quality merchandise, such as Donna Karan and Versace. The company also has 36 off-price, clearance centers that sell marked-down merchandise. In October 2005, Texas Pacific Group (TPG) and Warburg Pincus LLC purchased the company for $5.1 billion; in September 2013, the company agreed to sell its operations to Ares Management LLC and the Canada Pension Plan Investment Board for about $6.0 billion.

While the company primarily markets its goods to the wealthiest American consumers, which are less subject to changes in the economy, the recession nonetheless adversely affected company revenue. To this end, Neiman Marcus's revenue plummeted at the peak of the recession. However, shortly after, the company was able to increase its revenue by launching more sales and marketing campaigns. The company is expected to generate $4.8 billion in fiscal 2014, year-end August.

Saks Incorporated. / Lord & Taylor / Hudson's Bay

Estimated market share: 2.5%

Hudson's bay company comprises top North American retailers Hudson's Bay, Lord and Taylor, Saks Fifth Avenue and Home Outfitters. In 2013, Saks' executives agreed to sell the company to Hudson's Bay for $2.4 billion. Combined the company generated $7.6 billion in 2013 and operates 320 stores. Saks Fifth Avenue and Off 5th, the former's outlet counterpart account for 112 of the company's stores.

As a luxury retailer of purely discretionary items (per the company's annual report), the company was greatly affected by the economic recession, especially as a result of declines in disposable income and consumer sentiment. While Lord and Taylor has continued to decline amid heightened online competition, Off 5th stores have continued to grow in popularity, bringing U.S. segment-specific revenue to an estimated $4.1 billion during fiscal 2015, year-end February.

Cost Structure Benchmarks

Segment costs are generally similar for most operators, but can vary between firms of different operating sizes and specialties. Larger operators benefit from cost savings achieved through bulk purchasing, allowing them to generate higher returns. These firms also benefit from lower operating expenses, as they can use their vast distribution and supply networks to ship products and manage inventories. In contrast, smaller operators have lower profit margins and higher operating costs, as they are unable to take advantage of economies of scale.

The size, location and product mix of individual department stores is also a major determinant of cost structure. For example, high-end clothing and accessories are likely to generate higher profit margins, but this may reverse during economic downturns as individuals substitute luxury items for cheaper products, benefiting discount department stores.

Profit

Profit, measured as earnings before interest and taxes, is expected to account for 4.1% of segment revenue in 2015. In addition to a fall in demand and fixed costs, segment operators have aggressively competed on prices to retain customers or steal business away from their competitors. Moreover, major players that typically generate the highest returns are pivoting to the Warehouse Club and Supercenter Retailer segment. Profit is consequently projected to contract from 2010 despite the improving economy.

Purchases

Similar to other retail industries, purchases comprise the largest expense for this segment and are estimated to account for about 67.4% of segment revenue in 2015. Purchase costs have remained relatively stable in terms of revenue, as operators have increased their outlet store offerings and substituted expensive products with low-cost alternatives. Overall, segment purchases generally include apparel, furniture, appliances, hardware, jewelry, toys and all other items.

Wages

Wages are estimated to account for about 11.5% of segment revenue in 2015, a decrease from 12.6% in 2010. The segment is labor-intensive, with employees undertaking a variety of duties for daily operations. This includes the arrangement and stocking of product display shelves, cash handling and transaction processing and assisting customers with queries (i.e. the right product to use for a particular job).

Rent and Utilities

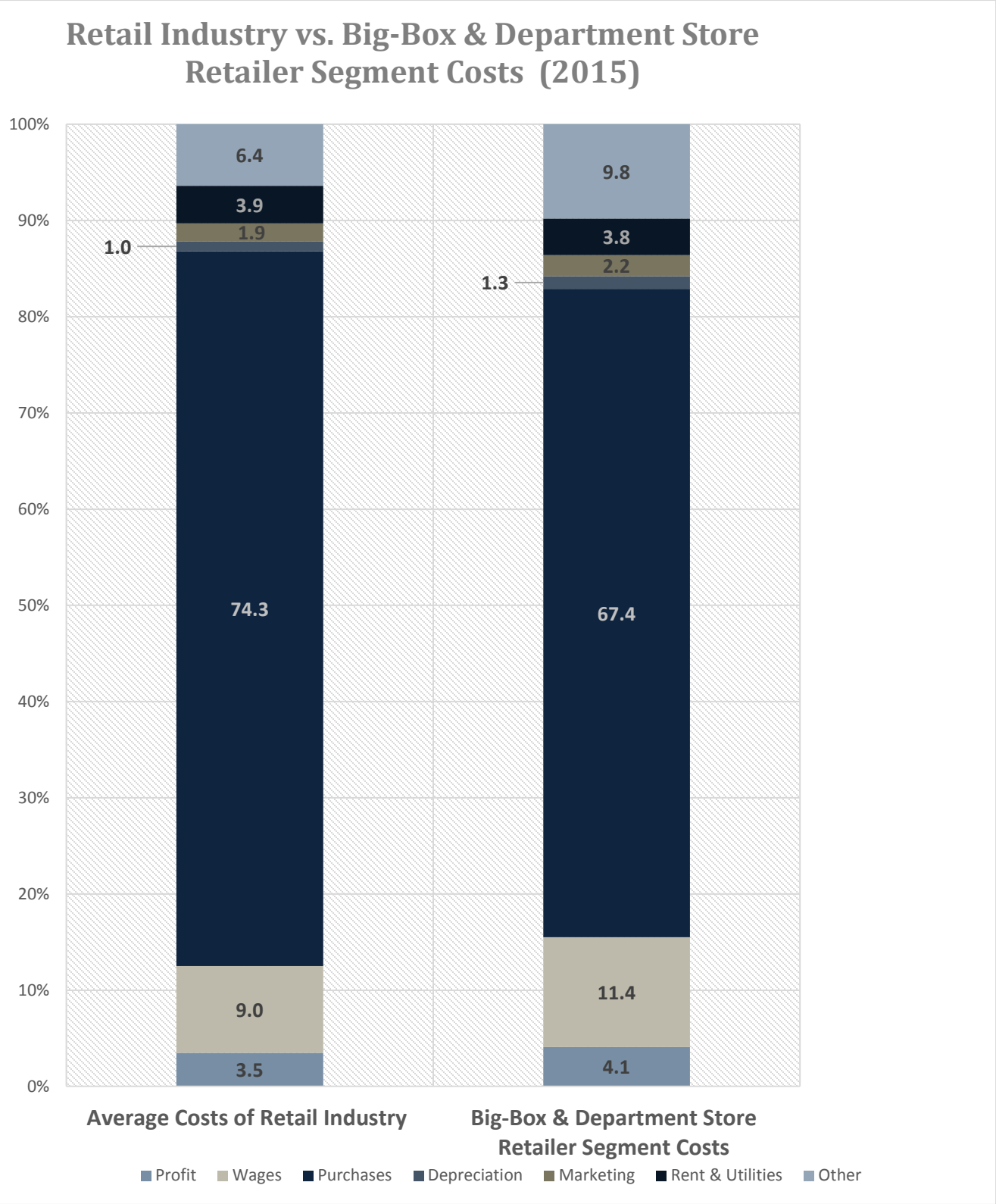
Rent and utilities are estimated to account for about 3.8% of segment revenue. Department stores are generally located in high-traffic, price-premium areas and therefore account for a considerable share of segment revenue. Over the past five years, rent costs have increased due to the fixed cost nature of commercial rental agreements, as most contracts are more than five years in length. However, it is important to note that operators that were not locked into long-term lease agreements benefited from the recent economic downturn. During this period, building owners and landlords suffered from elevated vacancy rates and weak demand, allowing many tenants to sign or renew lease agreements at favorable terms and rental rates.

Depreciation

Operators in this segment are required to depreciate assets and other non-annual expenses over a period of time. The cost of depreciation and amortization will invariably fluctuate between operators depending on their size and the number of assets involved. Depreciable assets include fixtures, fittings and cash registers/point-of-sale (POS) systems. Retail industries benefit from lower levels of depreciation totaling about 1.3% of revenue in 2015.

Marketing and Other Costs

Operators in this segment advertise via a number of mediums. The breadth of options available to players is, however, largely controlled by their size and hence their cost constraints. Larger department stores often advertise through mail and online publications coupled with television advertising. Such marketing costs are expected to account for 2.2% of revenue in 2015. Other costs include transportation expenses, administrative costs and professional services that pertain to accounting and legal related expenses. These are expected to comprise the remainder of segment revenue.


Retail Industry vs. Big-Box & Department Store Retailer Segment Costs (2015)
100%
90%
80%
70%
60%
50%
40%
30%
20%
10%
0%
6.4
3.9
1.9
1.0
74.3
9.0
3.5
9.8
3.8
2.2
1.3
67.4
11.4
4.1
Average Costs of Retail Industry
Big-Box & Department Store Retailer Segment Costs
Profit
Wages
Purchases
Depreciation
Marketing
Rent & Utilities
Other

Big-Box & Department Store Retailers: Key Statistics

Year	Revenue ($millions)	IVA ($millions)	Establishments (Units)	Enterprises (Units)	Employment (Units)	Wages ($millions)	Consumer Spending ($billions)
2006	$252,278.4	$44,904.1	9,969	370	1,532,456	$33,876.9	$9,821.7
2007	$241,457.2	$46,323.2	10,116	442	1,619,833	$35,044.7	$10,041.6
2008	$224,784.6	$38,114.3	8,813	138	1,292,007	$27,156.2	$10,007.2
2009	$210,460.3	$35,431.2	8,663	57	1,196,705	$26,231.9	$9,847.0
2010	$206,459.1	$38,956.0	8,626	66	1,166,282	$26,055.5	$10,036.3
2011	$201,232.3	$37,667.1	8,625	77	1,203,147	$26,003.6	$10,263.5
2012	$191,617.8	$32,425.0	8,196	75	1,085,098	$21,393.0	$10,449.7
2013	$180,179.3	$30,159.3	7,557	72	1,018,602	$20,505.3	$10,699.7
2014	$171,132.1	$28,750.2	7,266	69	956,847	$19,509.1	$10,967.5
2015	$163,578.0	$27,412.9	7,155	68	918,916	$18,579.7	$11,303.0
2016	$156,875.7	$26,368.2	7,037	68	874,618	$18,053.8	$11,601.0
2017	$152,479.6	$25,762.9	6,957	68	833,321	$17,681.5	$12,016.5
2018	$149,066.2	$25,171.4	6,867	66	813,029	$17,420.0	$12,306.2
2019	$145,579.3	$24,711.3	6,827	64	787,919	$17,141.2	$12,578.2
2020	$143,492.9	$24,422.1	6,783	62	763,101	$16,960.4	$12,861.1

Annual Change

Year	Revenue	IVA	Establishments	Enterprises	Employment	Wages	Consumer
2006	-3.9	2	4	4.2	6.1	5.1	3
2007	-4.3	3.2	1.5	19.5	5.7	3.4	2.2
2008	-6.9	-17.7	-12.9	-68.8	-20.2	-22.5	-0.4
2009	-6.4	-7	-1.7	-58.7	-7.4	-3.4	-1.6
2010	-1.9	9.9	-0.4	15.8	-2.6	-0.7	1.9
2011	-2.5	-3.3	0	16.7	3.2	-0.2	2.3
2012	-4.8	-13.9	-5	-2.6	-9.8	-17.7	1.8
2013	-6	-7	-7.8	-4	-6.1	-4.2	2.4
2014	-5	-4.7	-3.9	-4.2	-6.1	-4.9	2.5
2015	-4.4	-4.7	-1.5	-1.5	-4	-4.8	3.1
2016	-4.1	-3.8	-1.7	0	-4.8	-2.8	2.6
2017	-2.8	-2.3	-1.1	0	-4.7	-2.1	3.6
2018	-2.2	-2.3	-1.3	-3	-2.4	-1.5	2.4
2019	-2.3	-1.8	-0.6	-3	-3.1	-1.6	2.2
2020	-1.4	-1.2	-0.7	-3.1	-3.2	-1.1	2.2

Key Ratios

Year	IVA/ Revenue (%)	Revenue/ Employee ($)	Wages/ Revenue (%)	Employees/ Establishments	Wages/ Employee ($)
2006	17.8	164.6	13.4	153.7	22,106.3
2007	19.2	149.1	14.5	160.1	21,634.8
2008	17	174	12.1	146.6	21,018.6
2009	16.8	175.9	12.5	138.1	21,920.1
2010	18.9	177	12.6	135.2	22,340.7
2011	18.7	167.3	12.9	139.5	21,613.0
2012	16.9	176.6	11.2	132.4	19,715.3
2013	16.7	176.9	11.4	134.8	20,130.8
2014	16.8	178.9	11.4	131.7	20,388.9
2015	16.8	178	11.4	128.4	20,219.1
2016	16.8	179.4	11.5	124.3	20,641.9
2017	16.9	183	11.6	119.8	21,218.1
2018	16.9	183.4	11.7	118.4	21,426.0
2019	17	184.8	11.8	115.4	21,755.0
2020	17	188	11.8	112.5	22,225.6

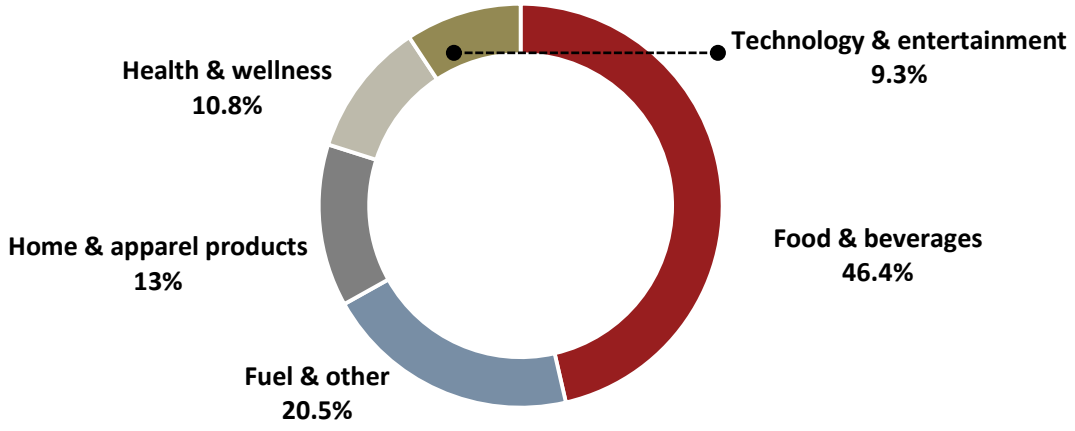
Warehouse Club & Supercenter Retailers

The Warehouse Club and Supercenter Store Retailer segment is one of the fastest growing segments in the retail sector. Consequently, that revenue will rise at an annualized 3.4% to total $462.0 billion in the five years to 2015. The segment's ability to pass down lower prices on a range of merchandise to consumers has been the primary driver of this success. Even when household budgets were strained during the recession, the segment attracted new value-focused customers, leading to strong financial performance. Accordingly, in 2015 revenue is expected to increase 1.2%, due to rising consumer disposable income.

With sales on the rise, the segment has consistently expanded over the five years to 2020. The segment's two largest players, in particular, which account for an estimated 82.2% of market share, have established new stores in order to capture a larger portion of consumer income. As a result, the number of segment locations has increased at an average annual rate of 4.0% to an estimated 5,444 locations over the five years to 2015. At the same time, however, the segment's dependence on economies of scale to keep prices low has resulted in a number of mergers and acquisitions, decreasing the number of companies in the segment at an annualized 1.4% to 27 operators.

During the next five years, the segment will continue to grow, albeit at a slower rate, as retail giants such as Walmart and Target shift focus back to smaller, more conveniently sized stores, amid concerns that supercenters and warehouse clubs have reached a point of saturation. Still, improving disposable incomes, consumer confidence and corporate profit, which are key drivers for the Retail industry, will aid segment growth. In the five years to 2020, revenue is projected to increase at an average annual rate of 2.1% to $512.0 billion. Profit is also expected to grow slightly, reaching a projected 5.6% of revenue in 2020, up from an estimated 5.5% in 2015. Store expansion will be limited, however, as smaller operators continue consolidating, in order to compete with the players dominating market share. This trend, coupled with the shift toward smaller store formats, will likely limit the segment's long-term growth.

Products and Services Segmentation (2015)



Current Performance

Demand for the Warehouse Club and Supercenter Store Retailer segment has remained consistent during the past five years. As disposable income dwindled during the recession, consumer confidence plummeted and business sentiment weakened. Many households and businesses turned to segment stores to take advantage of discounted prices. Over the five years to 2015, segment revenue grew at an annualized rate of 3.4% to $462.0 billion. However, after a decade of rapid expansion, the segment has begun to mature. Additionally, the availability of space for new locations has become limited, and the introduction of different product lines has been slow, since clubs and supercenters already market a variety of goods. These factors have created a saturated market, which has slightly slowed the segment's expansion. Nonetheless, the segment continues to outperform the retail sector as a whole.

Resilient Demand

Consumers and businesses spend liberally on discretionary goods when the economic outlook is strong, unemployment is low and households and businesses have robust income. This leads to high demand for retail goods, including those sold at warehouse clubs and supercenters. While most retail industries typically struggle when the opposite conditions are occurring, the Warehouse Club and Supercenter Store Retailer segment remains resilient because its discounted prices continue to attract households and businesses. Such was the case during the economic downturn, when disposable income rose by a slight 0.3% in 2010, following its first decline in nearly two decades, and segment revenue still grew 2.9% that year.

Furthermore, although the economy began to show signs of a slow recovery in the latter half of 2009 and into 2010, unemployment continued to increase. According to the Bureau of Labor Statistics, unemployment peaked at 10.6% in January 2010. Despite these adverse conditions, cautious consumers continued to patronize supercenters and warehouse clubs. Since then, the unemployment rate has slowly fallen at an annualized 3.1% over the five years to 2015. As the economy recovers, consumers will continue frequenting warehouse clubs and supercenters, but will likely spend more per trip, as disposable income increases. As a result, revenue is expected to increase 1.2% in 2015.

Segment Opposition

The segment's dominance in the Retail industry over the past five years has put many major players in the media spotlight. Activist groups claim that these stores damage local retail districts and independent retailers and grocers. Opponents also claim that the growing number of segment locations leads to traffic congestion and suburban sprawl. These groups also suggest that segment players force U.S. companies to ship high-paying manufacturing jobs overseas to meet demand for lower prices. Some communities have even passed special ordinances to keep big retailers out. In contrast, segment leaders argue that supercenters respond to consumer demand. Some policymakers point out that the stores

also create jobs, while enabling customers to save money for other expenditures, pouring much-needed tax dollars into the surrounding communities.

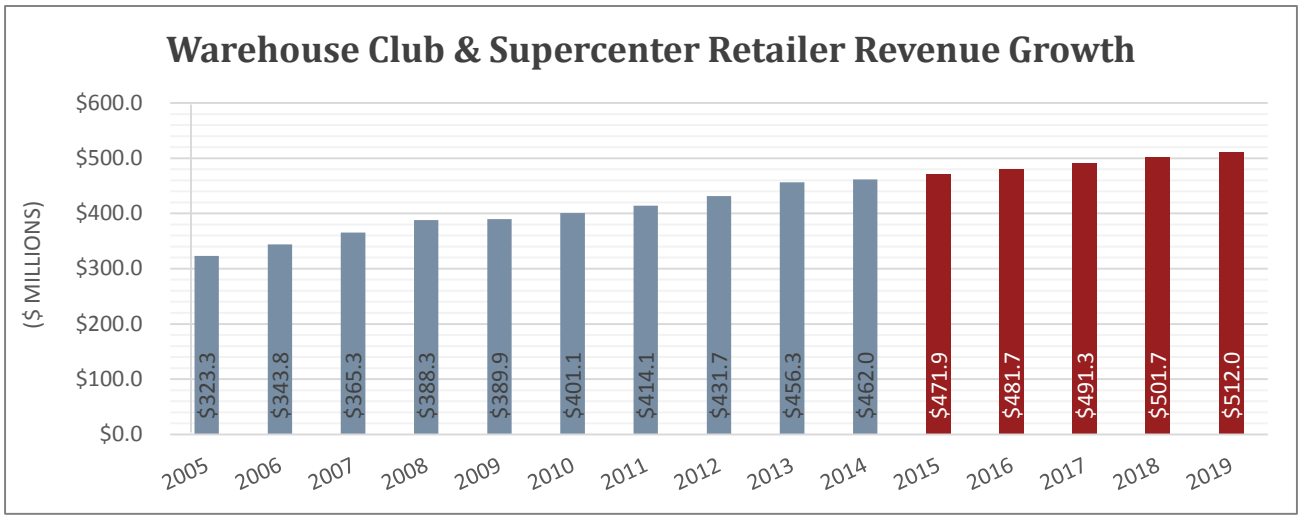
Warehouse clubs and supercenters have also responded to opposition by improving wages and benefits. This move has contributed to growing labor costs as a percentage of revenue, which is countercyclical to the Retail industry's larger, recession-induced trend of contracting these costs. Total wages are anticipated to increase at an average annual rate of 3.5% to $40.0 billion in 2015. These rising labor costs have mitigated profit growth, spurred by higher-margin products, including private-label offerings. As a result, the segment's profit margin has remained fairly consistent, rising only slightly from 5.2% of revenue in 2009 to 5.5% in 2015.

Product Offerings

Warehouse clubs have begun to offer more private-label products (e.g. Costco's Kirkland Signature line) during the past five years. Most club shoppers are price-conscious, and although national brands may draw interest, lower-priced, private-label versions typically offer better customer value and higher profit for stores. In recent years, improved product quality and packaging have helped private-label products overcome a historically low-quality image. As consumers repeatedly have positive experiences with private labels, their usage will continue to increase. For instance, private-label products from BJ's Wholesale Club, a major segment player, will account for more than 10.0% of its revenue, a share that is still growing.

In addition, supercenters and warehouse clubs have been expanding their food retailing business, in order to appeal to more time- and price-sensitive consumers. By supplying inexpensive core food products and limiting unpopular offerings, supercenters and clubs have been able to compete with supermarkets and traditional grocery stores on convenience and low prices. In particular, food has become a key strategy for Walmart and recently, distribution improvements have allowed Walmart Supercenter to become the nation's largest grocer, surpassing top supermarket chain Kroger.

In an effort to retail new product mixes in a more consumer-friendly manner, some stores are shifting to smaller, more convenience sized formats, which are not included in this segment. The large supercenter layout is not as popular today as it was five years ago, according to grocery research company Retail & Shopper Insights. While most stores continue to offer an extensive product assortment of general merchandise and groceries, smaller stores cater to consumers' desire for quick shopping, prepared foods, fresh produce and a more enjoyable shopping experience. Walmart, Target and BJ's have led the trend toward smaller store formats and BJ's asserts that smaller formats allow it to have a higher density of clubs in each of its markets, permitting the company to maximize distribution, advertising and management support. For this reason, the rapid rise in the number of establishments, that previously characterized this segment, has slowed. Consequently, the number of establishments is grew at an annualized rate of only 4.0% to reach 5,444 stores in the five years to 2015.



Segment Outlook

The Warehouse Club and Supercenter Store Retailer segment is forecast to increase its share of the retail sector over the five years to 2020, with revenue growing at an average annual rate of 2.1% to $512.0 billion. Large segment stores will be one of the Retail industry's primary beneficiaries of a forecast multiyear rise in spending, which will be supported by growing consumer confidence, business sentiment and disposable income. Consequently, revenue is projected to increase 2.2% in 2015 alone.

Macroeconomic Drivers

Rising consumer confidence and increased corporate profit over the next five years will likely contribute to continued growth from the segment's key markets. It's forecasted that the consumer confidence index will increase at an average annual rate of 4.9% over the five-year period, while corporate profit is expected to increase 2.9% per year on average as well. Since businesses account for about 35.0% of memberships at warehouse clubs, a rise in corporate profit will be a primary contributor to the segment's financial success.

During the economic downturn, supercenters and clubs gained new customers as the economy weakened. While consumers and businesses are expected to adopt a positive outlook concerning the economy, segment operators will retain a large portion of customers gained during the recession by continuing to offer a diverse, comprehensive product range. Furthermore, as the economy continues to recover, average working hours are expected to increase, which will contribute to less leisure time for consumers. As a result, the one-stop-shop format of supercenters and warehouse clubs will help the segment take advantage of rising consumer demand for convenience. Therefore, stores will likely require more employees for daily operations, as store traffic continues to increase. To meet this demand, companies will hire more workers and so employment is expected to increase at an annualized 3.7%, from 1.6 million workers in 2015 to 1.9 million in 2020.

In addition, per capita disposable income is expected to increase by an average annual rate of 2.5% over the next five years, helping boost sales of nonessential items, such as apparel and electronics. During

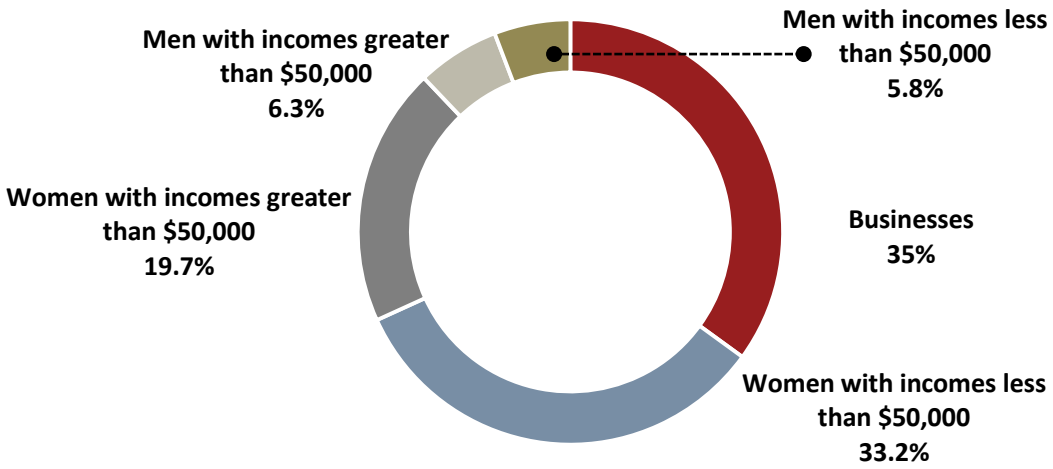
this period, average transaction amounts will also rise, as customers increase purchases of other goods while shopping for groceries. Stores will continue to grow their need-based categories, which includes healthcare items and food goods, although the gap in revenue generated by these and discretionary products will likely narrow. Discretionary goods often produce higher profit margins as compared with food products, and a shift toward purchasing more discretionary goods is expected to slightly increase profit. Consequently, profit is expected to grow from 5.5% of revenue in 2015 to 5.6% in 2020.

Rising Competition

Despite its consumer appeal, the Warehouse Club and Supercenter Store Retailer segment will likely lose some customers to external competition, such as discount department stores (i.e. Walmart's general merchandise stores and traditional Target stores, excluding SuperTarget), over the next five years. This reduction in revenue will mainly be due to the parent companies' ongoing shift toward smaller storefronts, which are not included in this segment. In an effort to cater to rising demand for quick shopping, prepared foods, fresh produce and a more enjoyable shopping experience, general merchandise retailers have gradually introduced locations that are more convenient and smaller in size, which offer an assortment of limited general merchandise, fresh produce and stock grocery selections.

Since smaller stores require less real estate space, major players can expand into previously untapped urban markets, of which warehouse clubs and supercenters could not enter, due to their large space requirements and local government zoning regulations. Therefore, major players' focus on expansion through smaller express stores is expected to slightly hamper segment revenue growth in the long term. As a result, the number of establishments will grow at a rate of only 3.1% per year on average in the five years to 2020 to reach 6,355 stores, which is slightly slower than the rate of 4.0% in the previous five-year period. ;

Major Market Segmentation (2015)



Competitive Landscape

This segment is highly concentrated. The top two companies in the segment, Walmart and Costco, together account for 82.2% of segment revenue in 2015. Given the high level of segment concentration and substantial capital required to generate enough revenue to compete with the major players, concentration is expected to remain high.

During the past two decades, the growth of supercenters and club stores has had a notable effect on grocery retailing in the United States, including a contraction of small "mom and pop" retailers and mergers and acquisitions among large retailers. A mere 2.0% of all establishments in this segment employ nine or fewer employees, which is the typical employment size of a small business. In comparison, more than 90.0% of all establishments employ 100 people or more. Grocery stores specifically shifted from a segment dominated by small grocers serving local markets to one characterized by large retailers active across international markets.

Basis of Competition

Competition within the Warehouse Club and Supercenter Store Retailer segment has undergone considerable change over the past few decades. When Price Club, a former major player, pioneered the membership warehouse concept in 1976, the main companies selling comparable merchandise were department stores, grocery stores and traditional wholesalers. Since that time, new merchandising concepts and marketing techniques have led to a more intense and focused competitive environment, where the top four players account for nearly 90.0% of segment revenue.

Internal Competition

Price is the most important basis of competition in the segment. The recession put a premium on value over convenience and selection. Consumers expect low prices but may be willing to pay more for larger economy sizes and a lower cost per serving. In a study 2012 by Nielsen, when asked how consumers would prefer manufacturers to address a price increase in raw materials, 38.0% stated that they would prefer to purchase larger sizes with lower per-serving or per-use costs. Consumers look for monetary value in their purchases, so some operators set their prices in conjunction with product strategies and marketing programs to remain competitive.

Customer loyalty is another important competitive factor. In order to encourage customers to return, stores provide convenient front parking, logical layouts, clear signage, generous operating hours and convenient locations. A clean, friendly and professional atmosphere is also maintained in these stores. Furthermore, segment operators compete through stocking a wide range of goods that is comparable with competing stores. For instance, it is becoming increasingly important for retailers to have strong-execution of high-demand grocery and perishable categories.

Due to the land size required to develop warehouse clubs and supercenters, competition for prime location is fierce. For instance, about 86.0% of BJ's 201 full-size warehouse clubs have at least one competitive membership warehouse club in its trading area within 10 miles or less. Stores offer their customers an easy shopping experience through carefully plotted and maintained store layouts.

In addition, retailers must respond to growing customer traffic and membership renewal rates by expanding in square footage and filling a high percentage of the target customers' needs. Stores also encourage customer support through loyalty cards, resulting in repeat consumers purchasing new products.

External Competition

The segment is also subject to external competition from a range of operators outside of the segment that supply a similar line of products. Each of the following industries supplies products that are also sold by club stores and supercenters, providing consumers with an alternative store from which to make their purchases. Some of the specialty retailers include: furniture stores, suppliers of new household, outdoor and office furniture; home furnishing stores, suppliers of new home furnishings; supermarkets that stock general lines of food products; hardware stores, suppliers of a general line of new hardware items, such as tools and builders' hardware; convenience stores; men's, women's and children's clothing stores; department stores; and dollar and variety stores. External businesses generally compete on product range, brands offered, store design, location and especially price. The homogeneous goods offered and the saturated market means that many of these external competitors try to undercut each other in price.

It is important to note that segment major players, like Walmart and Target, are shifting their focus from expansion through supercenters to expansion through small-scale stores (i.e. stores closer to the size of convenience stores). This new strategy will likely cause the segment's major players to face higher competition from specialty stores, since smaller size will likely limit the cost efficiency achieved through large-scale formats. Consequently, this trend may result in some leakage of revenue out from this segment to the Big-Box and Department Store Retailer segment which includes smaller general discount-department stores.

Barriers to Entry

The segment has a high level of concentration with the top two players expected to account for an estimated 82.2% of market share in 2015; therefore, prospective operators planning to enter this segment will encounter strong competition from existing operators. The dominance of players fluctuates by region; as such, the economies of scale vary depending on where an operator plans to launch new stores.

Barriers to Entry checklist	Level
Competition	Medium
Concentration	High
Life Cycle Stage	Mature
Capital Intensity	Medium
Technology Change	Medium
Regulation & Policy	Light
Industry Assistance	None

Start-up Costs

Construction and development costs for a full-size (i.e. about 112,000 square feet) store range from $5.0 million to $7.0 million. Land acquisition costs for a club generally range from $3.0 million to $5.0 million, but can be significantly higher in some locations.

Large club stores and supercenters benefit from significant discounts in purchasing, distribution and advertising due to their size. In order to set up a large and competitive store, considerable capital is required to purchase merchandise, purchase or lease premises in which to sell the merchandise and hire and train employees. To boost awareness of an unfamiliar retail brand, advertising may also add to costs. In some regions, players may face difficulty obtaining planning permission for large-scale retail outlets and the legal and administrative costs of appealing against unfavorable planning board decisions can add an additional entry barrier not encountered in other retail sectors.

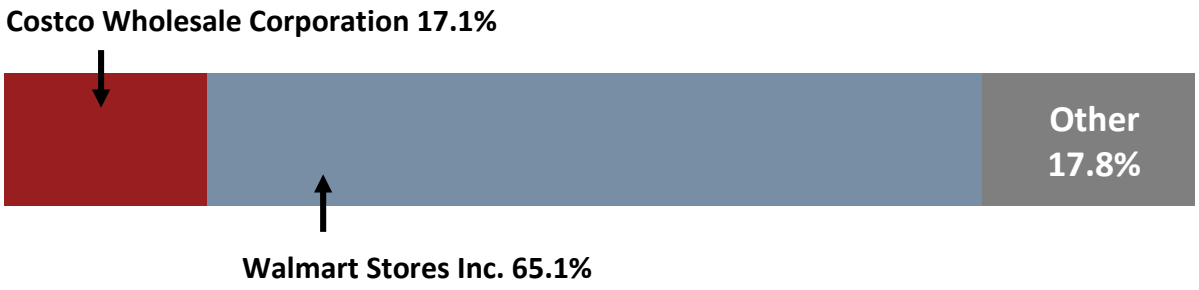
Distribution Networks

Because of the expansive reach of the segment, competition for getting products onto the shelves of warehouse clubs and supercenters among manufacturers is fierce, which results in favorable purchasing terms for operators in the segment. Establishing size in order to garner the same purchasing clout as incumbents can pose a major barrier to new entrants.

Suppliers of products to the club stores and supercenters include manufacturers and distributors. Prominent retailers buy from a large number of suppliers, ensuring that they are not reliant on any one in particular. Companies may have long-term relationships with suppliers; however, there are generally few long-term contracts that would prevent a new company from entering the segment.

The preexistence of relationships between operators and suppliers may in some cases be viewed as a barrier to entry. Existing operators have built trust and loyalty with their suppliers over a period of time. For instance, retailers, such as Walmart, have locked in the supply base across most fresh food categories and are simply not accessible to other suppliers. This loyalty means food retailers, especially those wanting to establish a relationship with produce suppliers and growers, face a limited pool of choices. In addition, there has been a notable consolidation in the past decade among U.S. produce suppliers and growers, thus making it even more difficult to select an appropriate vendor.

Major Companies



Costco Wholesale Corporation

Market Share: 17.1%

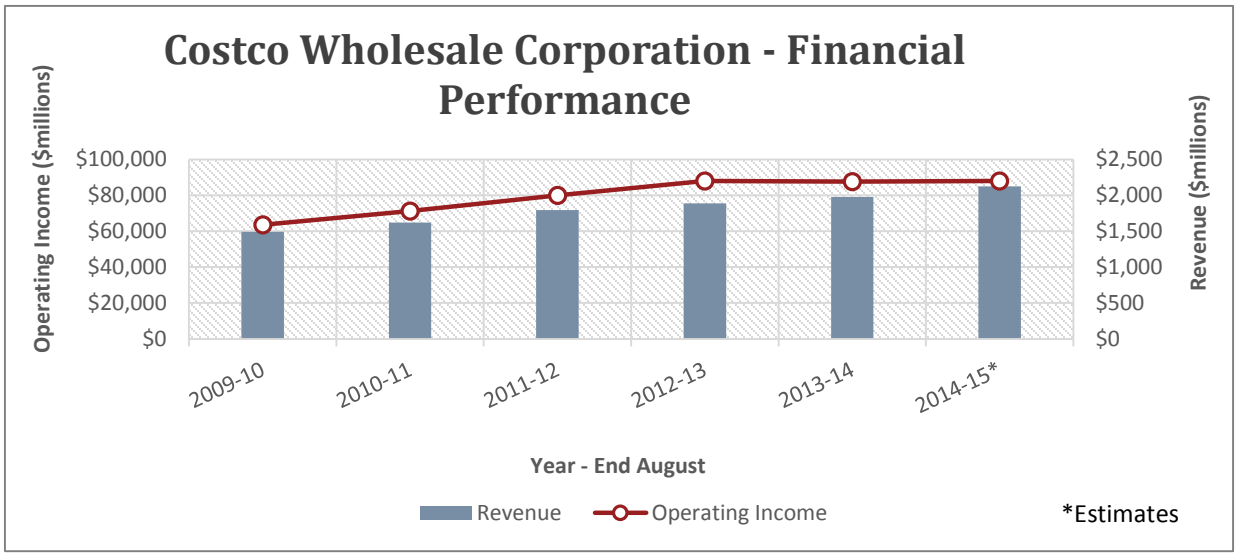
Brand Names: Costco, Kirkland

Founded in 1983 in Seattle, Costco Wholesale Corp. originated the membership concept for wholesale club retailers. By providing low prices on consumables, such as fresh foods, health and beauty care items; high-quality apparel; electronics; hardware; jewelry; and other general merchandise, the company pioneered the retail concept, which encourages members to visit regularly to achieve savings. Customers become a member by paying an annual fee to shop at Costco stores. This membership format is designed to promote customer loyalty and solidify a recurring revenue stream, which helps the company lower retail prices. Costco member renewal rates are strong and have varied from 85.0% to 88.0% over the past five years. In fiscal 2013, Costco generated $105.2 billion in total revenue.

Costco currently operates 451 membership warehouses in the United States, with about 184,000 employees. In the United States, Costco has 67.0 million members. The company's stores stock 3,900 products on average, ranging from alcoholic beverages and appliances to fresh food and furniture. In the five years to 2015, Costco increased its selection of fresh food and adding specialty stores within its warehouses, such as optical departments and gas stations. The decision to expand its product range follows strong competition from Sam's Club and Target, which also offer consumables at discounted prices. As a result, Costco has expanded its premium private-label Kirkland Signature to about 300 items to differentiate the company's offerings from its competition. Nonetheless, the most significant threat to Costco's growth is over expansion, which contributed to negative store sales in fiscal 2009. By building new stores relatively close to existing stores, those new locations siphon customers away from older stores. As a result, the company has slowed its domestic expansion plans, opening ten domestic stores in fiscal 2013, down from a peak of 25 new domestic stores in fiscal 2007.

Financial Performance

The provision of higher-end brands, efficient store execution and a focused set of 3,600 stock-keeping units and private-label offerings have translated into a strong financial performance over the past five years. Consequently, Costco's U.S. revenue is expected to increase at an average annual rate of 6.9% to $79.0 billion in the five years to fiscal 2015. However, despite the company's competitive advantages, the retailer was not left unscathed by the recession. In fiscal 2009, Costco's U.S. sales declined for the first time in the company's history, experiencing a 0.6% drop to $56.5 billion. This decline can be attributed to a decrease in big-ticket discretionary purchases and lower year-over-year gas prices. Lowered sales also translated into falling profit for Costco, which decreased 9.0% to $1.4 billion over the same year. Nevertheless, Costco's membership model has seen steady profit margins since fiscal 2010.



Walmart Stores Inc.

Market Share: 65.1%

Brand Names: Walmart Supercenters, Sam's Club

Walmart Stores Inc. (Walmart) is the world's largest retailer and grocery chain by sales. The company was founded in Bentonville, AK, in 1962 by Sam Walton, currently operating 3,288 supercenters and 632 warehouse clubs in the United States alone. Walmart has nearly 11,000 stores worldwide and employs 1.3 million workers. The first Walmart Supercenter opened in 1988 and the number of supercenters quickly expanded, growing in line with increasing demand for convenient discount shopping, especially since most of the company's stores are open 24 hours a day. In fiscal 2015 Walmart generated $476.3 billion in total revenue.

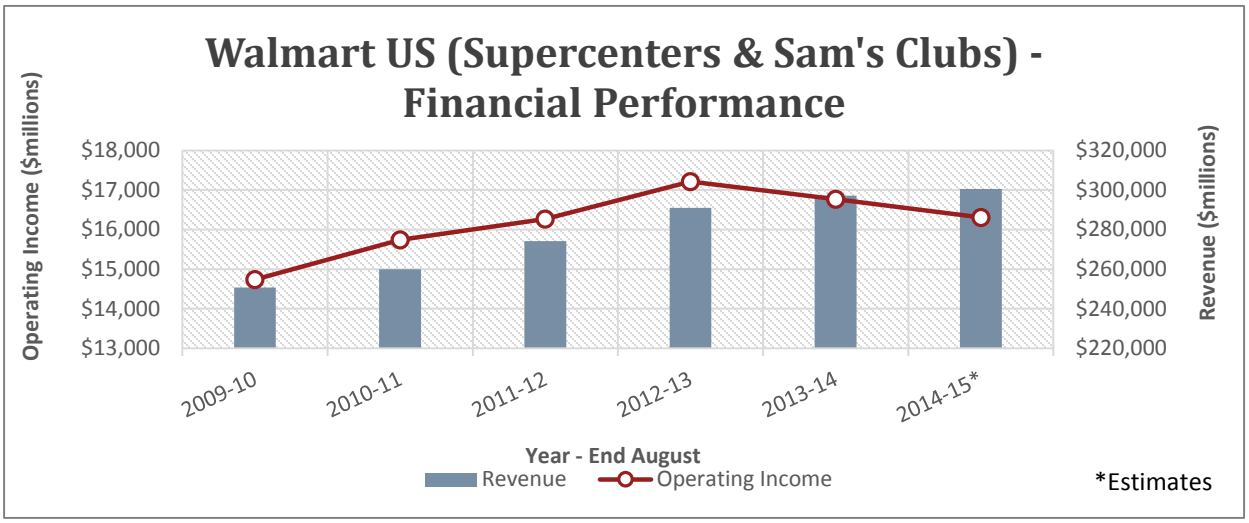
The company operates three separate divisions: Walmart U.S., Sam's Club and Walmart International. In addition to its supercenters, which offer general merchandise and a full line of groceries, the Walmart U.S. division features general discount stores that offer the same products but no groceries and neighborhood markets that offer groceries but no merchandise. Additionally, the Sam's Club division, which started in 1983, comprises of membership warehouse clubs that are distinct from the supercenters, as they are membership-based, sell larger packaging units and have a limited stock-keeping unit count. Small businesses comprise of Sam's Club's core customer base, including convenience stores, restaurants, offices, day care centers, schools and motels. Similar to its parent company, Sam's Club's main strategy is price competitiveness.

Financial Performance

The supercenters division's comparable store sales increased 3.2% in fiscal 2010, an indication that people with lower incomes were attracted to Walmart's lower prices, relative to other retailers. Much of this growth came from the conversion of Walmart's existing discount stores, which are not part of this

segment. These smaller, merchandise-focused stores are being phased out and company executives are closing the stores altogether or converting them into supercenters.

Walmart's Sam's Club division performed well in the five years to 2015. However, despite Sam's Club's growth during the recession, the warehouse slowly lost market share to competitors Costco and BJ's Wholesale Club over the period. Over the past five years, many of the new stores that opened have been replacements or expansions of older clubs. Walmart's segment-specific operations are expected to generate $300.6 billion in revenue over fiscal 2015, representing an average annual growth rate of 3.7% over the five-year period.



Other Companies

Meijer Inc.

Estimated market share: 3.2%

Meijer Inc. is a family-owned supercenter retailer that operates more than 190 supercenters and employs 60,000 workers since 1934. More than half of these locations are in Michigan, while the rest are spread throughout Ohio, Indiana, Illinois and Kentucky. As the inventor of the one-stop-shop concept, Meijer stores have evolved through the years to include fresh produce and meat departments, pharmacies, comprehensive electronics departments, garden centers and apparel offerings. The retailer offers about 120,000 lines of goods in large-scale stores that average 200,000 to 250,000 square feet in size.

Since Meijer is a private company, it does not release its financial information to the public. However, the company has reported that it has faced increased pressure from warehouse club stores and mass merchandisers that provide similar goods at discounted prices. In response, the supercenter has been

expanding its selection of private-label products that provide more value to consumers. Consequently, Meijer is expected to generate $15.0 billion in 2015, or an estimated 3.2% of segment revenue.

BJ's Wholesale Club

Estimated market share: 2.6%

BJ's Wholesale Club Inc. is one of the nation's largest membership warehouse clubs. Founded in 1984, BJ's currently operates 201 traditional big-box warehouse clubs in 15 states. Its stores, which average about 112,000 square feet in size, are concentrated in the Northeast region of the United States and offer about 7,500 general merchandise, as well as gas services. Its wide assortment of goods provides members with a larger merchandise variety, compared with its main competitors, Costco and Sam's Club. Two private equity firms, Leonard Green & Partners LP and CVC Capital Partners, acquired the company in 2011.

BJ's offers two types of membership levels: business and inner circle. Inner circle members are generally homeowners with above-average income relative to their geographic area. Membership fees are $50.00 per year for both business and inner circle members and, similar to other wholesale clubs, such membership offers foster customer loyalty. In addition to regular membership, BJ's offers high frequency, high-volume members a rewards membership program, which provides a 2.0% rebate for a higher membership fee of $100.00 on nearly all in-club purchases. The company made a greater push to convert existing inner circle members to rewards members in the five years to 2015. In 2015, BJ's Wholesale Club Inc. will generate an estimated $11.9 billion in sales and 2.6% of segment revenue.

SuperTarget

Estimated market share: 2.2%

Target Corp. is a large-format store specializing in discount retail, under which 249 SuperTarget stores operate in the United States. The first SuperTarget was built in 1995 in Omaha, NE and the company offers all the general merchandise products of a regular Target store, plus a selection of full groceries, fresh produce, bakery and deli.

Recently, SuperTarget has been increasing its food selection, echoing the strategy of the segment at large. As other superstores have found, the food business is attractive because it features high shopping frequency. Therefore, Target Corp. has publicized that the SuperTarget concept, which includes a large selection of groceries, has been one of the key vehicles for growing its national footprint. However, after years of accelerating its SuperTarget rollout, the parent company did not open any new SuperTargets in 2010. Instead, the Target Corp. invested an estimated $1.0 billion into remodeling 350 regular stores, adding mini-grocery selections in their smaller discount store formats. The slow growth can be attributed to the cost effectiveness of remodeling an existing store, rather than building a new supercenter. In addition, size constraints in limited urban markets have led to slowdowns in SuperTarget's growth. Moreover, the company did not open any SuperTarget stores in 2012. In 2015,

the company is expected to generate $10.1 billion from SuperTargets alone, representing 2.2% of segment revenue.

Cost Structure Benchmarks

Warehouse clubs and supercenter stores are characterized by their large-scale operations, which give players in the segment an advantage in contracting with foreign suppliers to import at a lower average cost than applied to other retailers. The larger scale also allows operators to purchase goods in bulk, reducing the cost of distribution, stocking and labor per item sold. Opening stores close to each other has also allowed players to lower costs for distribution, training and advertising.

A successful business model for a warehouse club or supercenter depends on high volume of sales; therefore, low sales due to slow store traffic reduce efficiency and increase operating costs. Because companies stock only a few products in each category, merchandising misjudgments can disastrously affect sales. With thin margins, warehouse clubs depend on efficient operations to keep costs low, such as direct manufacturer shipments and cross-docking facilities to reduce distribution and storage costs. Companies must strike the proper balance between low inventory costs and potential lost sales.

Profit

In 2015, profit margins, measured by earnings before interest and taxes, for the average company in the segment are estimated at 5.5% of revenue. Rising production costs over the past decade have been passed on throughout the supply chain to retailers. This trend has had an adverse impact on retailers, reducing profitability. Instead of absorbing rising costs or raising retail prices, big-box stores have internalized cost-cutting strategies to keep profit relatively steady over the past five years.

Purchases

As is typical of the Retail industry, purchases or cost of goods sold is the largest operating expense. This cost category consists of goods purchased from vendors for resale to consumers. Products in this category include a general line of groceries, apparel, furniture and appliances. Due to the large-scale nature of this segment, most merchandise is sourced directly from manufacturers and then shipped to selling warehouses or to a depot. Purchasing from manufacturers instead of distributors allows players in this segment to eliminate many of the costs associated with multiple-step distribution channels. Merchandise selected for sale in warehouse stores is designed to appeal to both business and consumer clients. It's estimated that purchase costs as a share of segment revenue will be 74.8% in 2015.

Wages

It's estimated that wages, the second-largest segment cost, will account for 8.7% of segment revenue in 2015, and have held relatively steady since 2009. Although wages account for about the same share of revenue in 2015 than they did in 2009, average salary per employee has risen in response to outcry over

low wages. Due to the nature of products retailed by this segment, merchandise is generally stored on racks above the sales floor and displayed on pallets containing large quantities of each item, which requires extensive labor to manage. As there has been limited advent of new software available to replace human jobs that traditionally managed inventory, it's expected that the segment will remain labor intensive and overall wages as a share of segment revenue will increase during the five years to 2020.

Depreciation

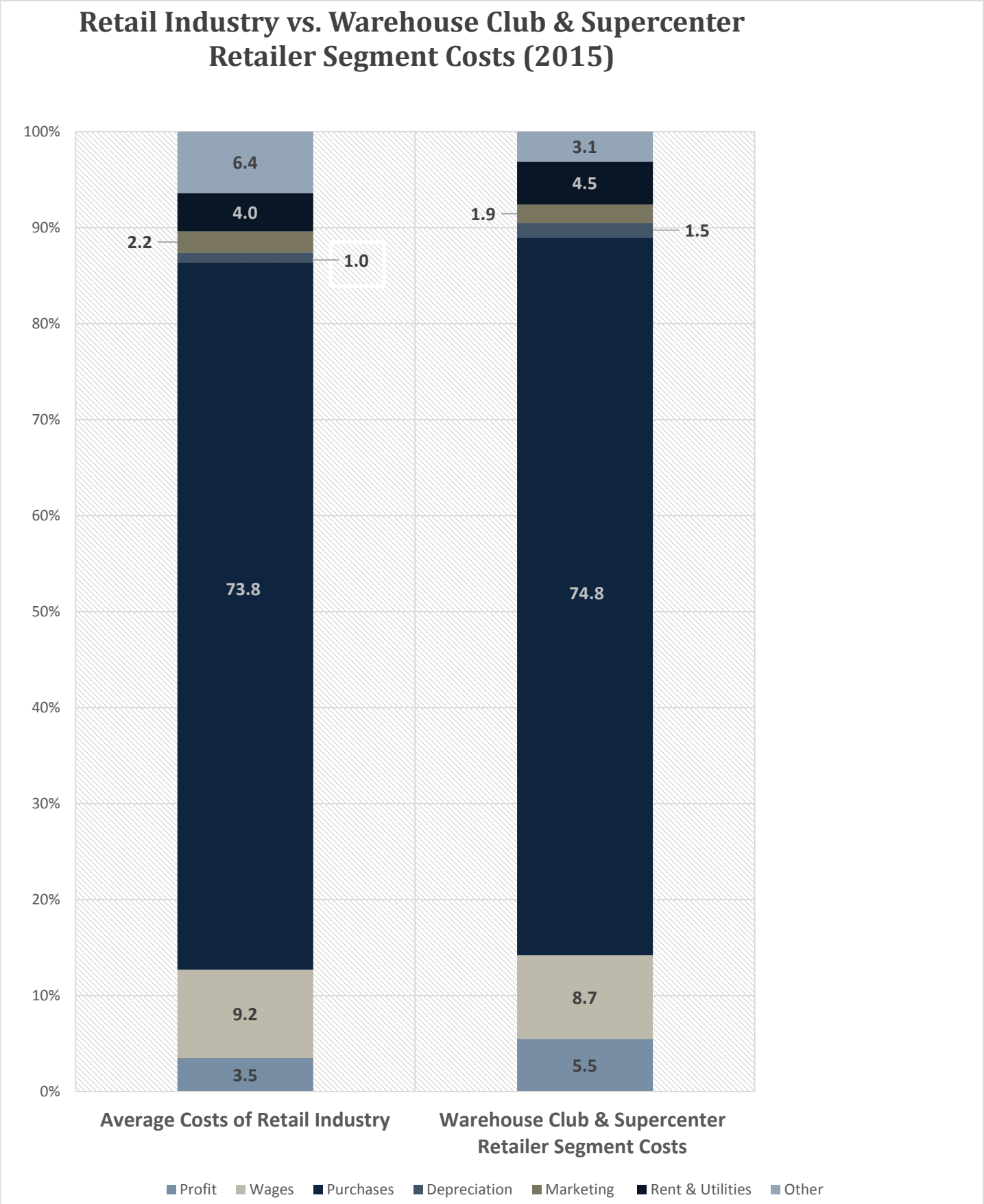
Operators in this industry depreciate a variety of assets over time. The cost of depreciation invariably fluctuates between operators depending on their size and the number and types of assets involved. Items that depreciate include shelving displays and computer scanners. Retail depreciation is often low compared with other industries such as manufacturing, which usually have depreciation rates between 2.0% and 3.0%. Depreciation costs have remained fairly consistent in recent years, and estimates that depreciation will account for 1.5% of revenue in 2015.

Marketing Costs

Operators in this segment advertise through various media. The breadth of options available to players, however, is largely limited by their size and cost constraints. Smaller operators tend to use newspapers, catalogs and sometimes radio advertising, while larger players can afford network and cable TV advertising. The majority of the segment's advertising is undertaken during the holiday season, which is the segment's busiest period. It's estimated that advertising will account for 1.9% of segment revenue in 2015.

Other

Other costs include rent, utilities and administrative expenses. Rent and utilities costs have increased over the past five years and are expected to account for 4.5% of segment revenue in 2015. Other expenses account for an estimated 3.1% of segment revenue.


Retail Industry vs. Warehouse Club & Supercenter Retailer Segment Costs (2015)
100%
90%
80%
70%
60%
50%
40%
30%
20%
10%
0%
6.4
4.0
2.2
1.0
73.8
9.2
3.5
3.1
4.5
1.9
1.5
74.8
8.7
5.5
Average Costs of Retail Industry
Warehouse Club & Supercenter Retailer Segment Costs
Profit
Wages
Purchases
Depreciation
Marketing
Rent & Utilities
Other

Warehouse Club & Supercenter Store Retailers: Key Statistics

Year	Revenue ($millions)	IVA ($millions)	Establishments (Units)	Enterprises (Units)	Employment (Units)	Wages ($millions)	Consumer Spending ($billions)
2005	323,348.3	44,400.3	3,137	35	925,055	23,059.4	40,939.4
2006	343,843.7	46,668.8	3,210	41	964,891	23,287.4	40,922.3
2007	365,374.9	49,384.5	3,277	38	1,261,113	24,173.6	40,330.7
2008	388,327.0	58,845.3	4,411	33	1,374,613	33,215.8	39,792.0
2009	389,978.2	57,502.2	4,482	29	1,410,487	33,713.5	38,946.4
2010	401,093.7	59,175.3	4,544	24	1,335,162	33,104.2	38,598.1
2011	414,052.5	61,226.0	4,776	25	1,400,753	34,726.6	38,474.5
2012	431,778.7	62,343.5	5,038	26	1,486,199	36,868.5	38,299.4
2013	456,344.7	69,649.4	5,215	27	1,542,675	38,617.9	37,736.8
2014	462,006.9	72,338.1	5,444	27	1,604,382	39,997.6	37,352.0
2015	**471,959.0**	**74,967.7**	**5,667**	**28**	**1,664,676**	**41,458.6**	**38,305.0**
2016	481,719.3	75,840.8	5,815	29	1,733,339	43,083.9	39,186.0
2017	491,364.1	78,887.7	5,989	30	1,791,149	44,492.2	40,294.0
2018	501,708.0	81,640.2	6,127	30	1,853,839	46,019.0	41,366.0
2019	512,035.4	84,019.8	6,355	31	1,922,431	47,665.3	42,312.0

Annual Change (%)

Year	Revenue	IVA	Establishments	Enterprises	Employment	Wages	Consumer
2005	8.7	1.4	5	-20.5	0.3	3.1	-2.6
2006	6.3	5.1	2.3	17.1	4.3	1	-0.1
2007	6.3	5.8	2.1	-7.3	30.7	3.8	-1.5
2008	6.3	19.2	34.6	-13.2	9	37.4	-1.3
2009	0.4	-2.3	1.6	-12.1	2.6	1.5	-2.1
2010	2.9	2.9	1.4	-17.3	-5.4	-1.8	-0.9
2011	3.2	3.5	5.1	4.2	4.9	4.9	-0.3
2012	4.3	1.8	5.5	4	6.1	6.2	-0.5
2013	5.7	11.7	3.5	3.8	3.8	4.7	-1.5
2014	1.2	3.9	4.4	0	4	3.6	-1
2015	**2.2**	**3.6**	**4.1**	**3.7**	**3.8**	**3.7**	**2.6**
2016	2.1	1.2	2.6	3.6	4.1	3.9	2.3
2017	2	4	3	3.4	3.3	3.3	2.8
2018	2.1	3.5	2.3	0	3.5	3.4	2.7
2019	2.1	2.9	3.7	3.3	3.7	3.6	2.3

Key Ratios

Year	IVA/ Revenue (%)	Revenue/ Employee ($)	Wages/ Revenue (%)	Employees/ Establishment	Wages/ Employee ($)
2005	13.7	349.5	7.1	294.9	24,927.6
2006	13.6	356.4	6.8	300.6	24,134.7
2007	13.5	289.7	6.6	384.8	19,168.5
2008	15.2	282.5	8.6	311.6	24,163.7
2009	14.7	276.5	8.6	314.7	23,902.0
2010	14.8	300.4	8.3	293.8	24,794.1
2011	14.8	295.6	8.4	293.3	24,791.4
2012	14.4	290.5	8.5	295	24,807.2
2013	15.3	295.8	8.5	295.8	25,033.1
2014	15.7	288.0	8.7	294.7	24,930.2
2015	**15.9**	**283.5**	**8.8**	**293.7**	**24,904.9**
2016	15.7	277.9	8.9	298.1	24,856.0
2017	16.1	274.3	9.1	299.1	24,840.0
2018	16.3	270.6	9.2	302.6	24,823.6
2019	16.4	266.4	9.3	302.5	24,794.3

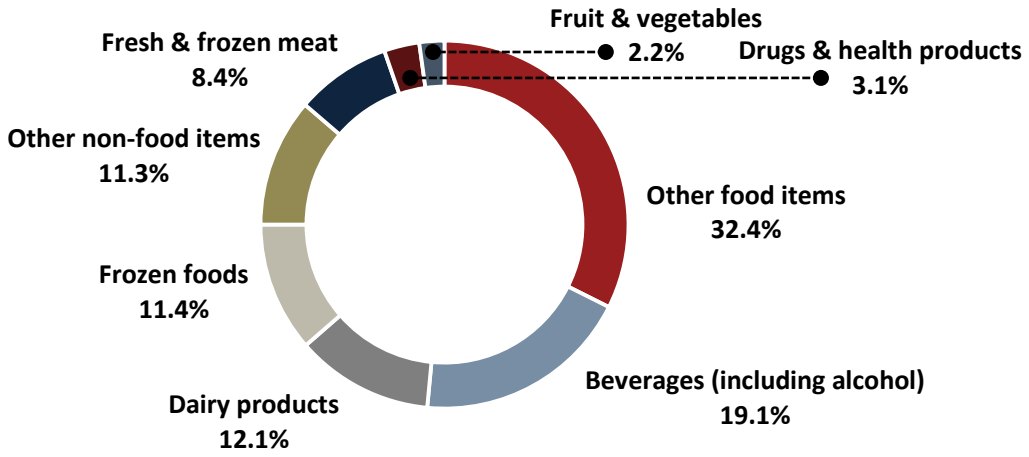
Supermarkets & Grocery Stores

The Supermarket and Grocery Store Retailer segment has grown over the past five years, benefiting from a strengthening domestic economy. As per capita disposable income has grown over this period, some consumers have traded up to premium, organic and all-natural brands, helping lift segment revenue. On the other hand, inflationary food costs, as exhibited by the double-digit annualized growth of the agricultural price index, have caused many consumers to continue purchasing private label brands even after the recession. While a shift toward more generic goods curbs revenue growth, it helps operators maintain profit margins, as store brands are less costly to produce than national brands. Overall, segment revenue grew an annualized 1.3% to $584.3 billion over the five years to 2015.

Despite having achieved growth during this period, supermarkets and grocery stores faced intensifying competition from alternative retailers. Namely, consumers have increasingly turned toward warehouse clubs and supercenters, such as Costco and Walmart, because of the cost savings and convenience of these retailers. Mass merchandisers are able to offer lower prices due to their scale of operations. Additionally, they offer consumers convenience, as they retail a variety of nonedible goods, including clothing and gardening tools. Due to increased competition from a variety of retailers, many supermarket chains offered substantial discounts and promotions to drive foot traffic to their stores and strengthen consumer loyalty. As a result, segment profitability is expected to stagnate over this period.

Over the next five years, the segment is anticipated to grow as a result of rising discretionary income, albeit at a more conservative rate than in the previous five-year period. As health concerns intensify, more consumers will seek all-natural and organic products, which are priced at a premium. Operators are also anticipated to benefit from steady commodity markets that will cause input costs to rise much more conservatively than in the past. However, segment profitability is anticipated to decline as competition from alternative retailers' heats up, causing operators to offer discounts and promotions. Consequently, segment revenue is forecast to rise slowly, increasing at an average annual rate of 0.8% to $606.8 billion in the five years to 2020.

Products and Services Segmentation (2015)



Current Performance

The Supermarket and Grocery Store Retailer segment retails a variety of household goods and edible grocery products, including fresh and prepared meals, poultry and seafood, canned and frozen foods and fruits and vegetables. Over the past five years, segment participants benefited from a strengthening domestic economy and rising disposable income levels, which enabled consumers to trade up to branded and premium products. The segment has also benefited from growing demand for all-natural and organic products during this period. Despite various consumer trends that have supported the growth of the segment, inflationary food costs have caused many consumers, particularly those in lower income households, to limit their purchase of goods at retail stores and stock up on discounted items. Overall, segment revenue increased at an average annual rate of 1.3% to $584.3 billion over the five years to 2015.

Due to the nondiscretionary nature of segment products, operators enjoy a steady level of demand for food and nonfood items. However, alternative retail stores, such as convenience stores, dollar stores and mass merchandisers, also offer goods similar to those of grocery stores. In recent years, supercenters and warehouse clubs have obtained a greater share of the food retailing market. Mass merchants, such as Costco and Walmart, offer lower prices than segment participants because they sell their products in bulk. These stores also offer convenience, as they sell a variety of nonfood items, including clothing and furniture. Due to evolving consumer needs, dollar stores and convenience stores have also expanded more rapidly than supermarkets, according to research conducted by Booz and Company.

Cashing in on Lifestyle Trends

Per capita disposable income rose an annualized 1.4% over the five years to 2015. As more Americans returned to work in the years following the recession, improving discretionary income allowed consumers to purchase a variety of grocery items. Moreover, growing health and environmental concerns, the former of which is more significant, have driven consumers to purchase more all-natural and organic food. According to research conducted by the Organic Trade Association in 2011, about 75.0% of consumers purchase organic food because they believe it is healthier for them than nonorganic food. Thus, organic and all-natural product sales have grown tremendously in a stagnant segment, increasing 12.0% in 2013 alone, according to research firm IRI. Consequently, segment participants have benefited from the sale of organic goods, which are sourced at similar prices as nonorganic foods and then priced at a premium. According to the U.S. Department of Agricultural, premiums on organic fruits and vegetables can range from 30.0% to over 100.0%.

In response to growing demand for organic and all-natural products, traditional grocers have expanded their organic offerings, allocating more floor and shelf space to these goods. In addition, specialty grocers that focus strictly on all-natural and organic goods have entered the market in recent years and achieved substantial growth. For example, Whole Foods Market, a public company, achieved double-

digit annual growth from 2010. Growing sales have caused these specialty retailers to expand their store count. Sprouts Farmers Market, Fresh Market and Whole Foods Market each opened more than 20 locations in 2014. Segment establishments grew at an average annual rate of 0.8% to 67,084 over the five years to 2015.

While many consumers have gravitated toward branded organic goods, others have increasingly turned to generic brands over the past five years. After reaching an all-time high during the recession, sales of private label food have stabilized at a new high, according to Booz and Company. Generic brands used to be perceived as subpar compared to national brands, but about half of consumers now believe store brands possess the same quality as branded goods. Furthermore, the introduction of premium generic brands, such as Whole Foods' 365 Every Value Organic, has boosted consumers' perception of generic products.

Competition and Shrinking Profit

Supermarket and grocery store operators have benefited from rising discretionary income and various consumer trends over the past five years. Yet, several factors, including intensifying competition and increasing commodity prices, have dampened the segment's performance. With the emergence of nontraditional food operators in the retail food market, competition has intensified. For example, Walmart and Costco belong to the Warehouse Club and Superstore Retailer segment and have competed aggressively with segment operators for consumer dollars. In the past few years, major retailer Target has also expanded its grocery offerings, luring even more customers away from mainstream supermarkets. Therefore, segment operators have been forced to lower prices and offer promotions to compete with competitors, thus dampening profit margins. Earnings have risen slightly over the period from 1.4% in 2010 to 1.5% in 2015.

To better compete with mass merchandisers, the leading supermarket chains have engaged in mergers and acquisitions in recent years. For instance, The Kroger Company merged with Harris Teeter in 2014 to expand its customer base in the Southeast and Mid-Atlantic. Also, in 2014, Safeway and Albertson's announced a definitive merger agreement. Such consolidation allows retailers to lower per-unit costs through economies of scale and maintain profitability. Retailers have also been hesitant to raise wages in an attempt to keep operating costs low. As a result, the segment total wages have stagnated over the five years to 2015.

Segment Outlook

Over the next five years, the Supermarket and Grocery Store Retailer segment is expected to benefit from the continued recovery of the U.S. economy. As per capita disposable income rises, more shoppers will trade up to premium, value-added products at retail stores. In addition to growing demand for premium goods, operators will benefit from slowly growing input costs, as commodity markets steady compared with the cost spikes present in the previous five-year period. However, due to intensifying competition from alternative retailers, such as dollar stores and wholesale clubs, segment profitability is anticipated to slightly decline as operators offer discounts and promotions to drive sales volumes. Overall, it's projected that segment revenue to grow at an average annual rate of 0.8% to $606.8 billion in the five years to 2020, including a 1.1% increase in 2016.

Premium Growth

Supermarket operators are anticipated to benefit from growing demand for all-natural and organic food in the upcoming years, driven by growing health concerns. The organic food market has experienced double-digit growth in the past and the market is still growing, as it only accounts for just over 4.0% of total food sales, according to the U.S. Department of Agriculture. Furthermore, per capita disposable income is projected to rise 2.5% per year on average over the five-year period, allowing consumers to trade up to premium products and purchase a greater variety of grocery products. For instance, consumers are anticipated to purchase expensive varieties of dark chocolate, nutrient-enhanced granola and snacks, helping lift segment performance.

In addition to growing demand for high-margin, premium goods, the cost of inputs is expected to steady over the next five years. The agricultural price index, which represents the prices received by farmers for all agricultural products, is forecast to grow an annualized 0.9% in the five years to 2020, which is extremely modest when compared with the annualized growth of 6.0% in the previous five-year period. As commodity markets settle down, the cost for purchases, from fresh produce to packaged goods, is anticipated to grow slowly. Slowly rising costs will allow retailers to better manage prices and demand.

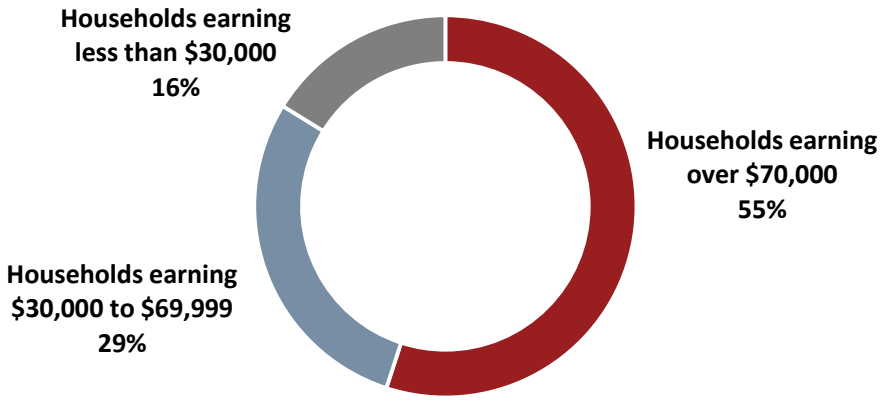
Falling Profit and Participation

Compounded by slowly rising input costs, segment profitability is also expected to decline as operators engage in extensive promotional activity. Due to the intensifying competition in the food retailing sector, operators will have to offer steeper discounts and promotions to drive foot traffic to their stores. While a majority of consumers will continue to purchase household staples at supermarkets, an increasing share of the population will purchase items in bulk at warehouse clubs and supercenters for cost savings. Additionally, dollar stores and convenience stores will also compete fiercely with segment participants to capture a greater share of the food retailing market.

To remain competitive and boost customer loyalty, operators will offer a greater range of amenities on site, including ATMs and movie rental services. Companies are also anticipated to introduce advanced mobile applications that allow consumers to make purchases, access loyalty card data and check prices of items while shopping. Such technology has the potential to strengthen customer loyalty and make the shopping experience more convenient for consumers.

Due to increased competition and lower profitability, companies are expected to expand slowly over the next five years. As such, the number of segment enterprises is forecast to rise at an average annual rate of only 0.1% during the five years to 2020. Similarly, segment employment is expected to rise 0.3% per year on average to 2.5 million over the period. Another contributing factor to the segment's slow growth in terms of store locations will be merger and acquisition activity. To benefit from economies of scale, the leading operators are anticipated to acquire smaller, regional competitors and merge with larger supermarket chains in the upcoming years. Consequently, establishment growth is expected to be suppressed during the period.

Major Market Segmentation (2015)



Competitive Landscape

The Supermarket and Grocery Store Retailer segment is highly fragmented, with over one-third of enterprises employing less than five employees. Moreover, the top four operators account for an estimated 30.8% of segment revenue in 2015. The remaining share of the market is mainly composed of small- to medium-sized operators that cater to local and regional markets. It’s estimated that more than 42,032 operators will actively compete for the remaining 69.2% of market share in 2015. The overwhelming majority of these retailers are small businesses; over 50.0% of all segment retailers employ fewer than 5 employees. Still, market share concentration has increased over this period, mainly driven by merger and acquisition activity among the leading operators.

Basis of Competition

Internal Competition

Supermarket and grocery store operators fiercely compete for the consumer's dollar in an increasingly competitive food retailing sector. Due to the homogeneous nature of the goods sold at supermarkets, segment participants compete on price, offering discounts and promotions in addition to customer loyalty awards. Supermarkets rely on a large volume of sales with low markups and offer generic- or store-branded food items that are less expensive than branded products to drive sales. Most stores offer weekly savings on popular products, aimed to entice new consumers.

Other than low prices, grocery stores must attract customers with the range and quality of products they offer. Segment players who offer an extended range of goods cater to a larger consumer base from both low- and high-income households. However, if grocery stores price their high-quality products too high, they risk losing sales, even from high-income households. In the years following the Great Recession, private label products have maintained their popularity among consumers. In particular, higher-end generic goods, such as Whole Foods' 365 organic line of products, have enjoyed increasing sales as consumers seek affordability and value. Consequently, retailers that offer a range of private label products have benefited from improved sales and margins.

Supermarkets offer a variety of products and services, aside from traditional grocery and nonedible products. For instance, through its partnership with Starbucks, Safeway operates in-store Starbucks-branded coffee shops at many of its locations. Other additions that can make the shopping experience more convenient for consumers include ATM machines, movie rental kiosks and other amenities.

External Competition

The Supermarket and Grocery Store Retailer segment faces intense external competition, particularly from mass merchandisers, such as Walmart and Costco. While Walmart and Costco do not necessarily specialize in grocery retailing, they generate a substantial portion of revenue from the sale of grocery products. External competition from warehouse clubs and supercenters has intensified in recent years, as many consumers prefer one-stop-shops where they can purchase a variety of goods, such as apparel and furniture, in addition to traditional groceries. Mass merchandisers also provide lower prices than most supermarkets, as they benefit from economies of scale. Supermarkets also face competition from convenience stores, discount retailers and food service providers.

Barriers to Entry

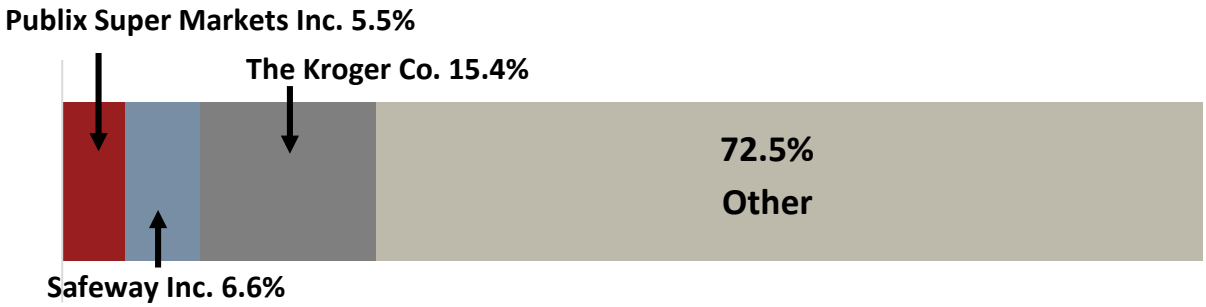
Barriers to entry in the Supermarket and Grocery Store Retailer segment are moderate. However, the level of initial capital investment is high. In the past, the major operational cost for segment participants was wages. In addition, the introduction and installation of point of sale (POS) systems over the past decade has raised the level of capital expenditure for supermarkets. POS systems are not the only consideration for a prospect; new entrants must consider a whole range of expenses, including leasing a building. Start-up costs can be financed through a combination of owner investment, short-term loans and long-term borrowing. If new entrants are unable to secure financing for these initial investments, they will not be able to enter the segment.

Barriers to Entry checklist	Level
Competition	High
Concentration	Low
Life Cycle Stage	Mature
Capital Intensity	Low
Technology Change	Medium
Regulation & Policy	Medium
Industry Assistance	Low

The pre-existence of distribution networks between operators and suppliers can be a barrier to entry, as existing operators have established relationships of trust and loyalty with their suppliers over a period of time, allowing them preferential treatment and pricing. Also, the leading retailers have locked in supply bases for certain fresh food categories, which are inaccessible to new entrants. Consequently, new food retailers, especially those wanting to establish relationships with produce suppliers and farmers, may face a limited pool of choices. There has also been a noticeable trend of consolidations in the past decade among U.S. produce suppliers and growers, making it even more difficult to select an appropriate vendor.

On the other hand, no direct licenses are required to operate supermarkets or grocery stores, which significantly lowers barriers to entry. Additionally, the segment is highly fragmented, with the top four chains only accounting for about 30.8% of segment revenue in 2015. Thus, prospects can successfully enter the segment by specializing in a specific product category like all-natural, organic and gluten-free.

Major Companies



Publix Super Markets Inc.

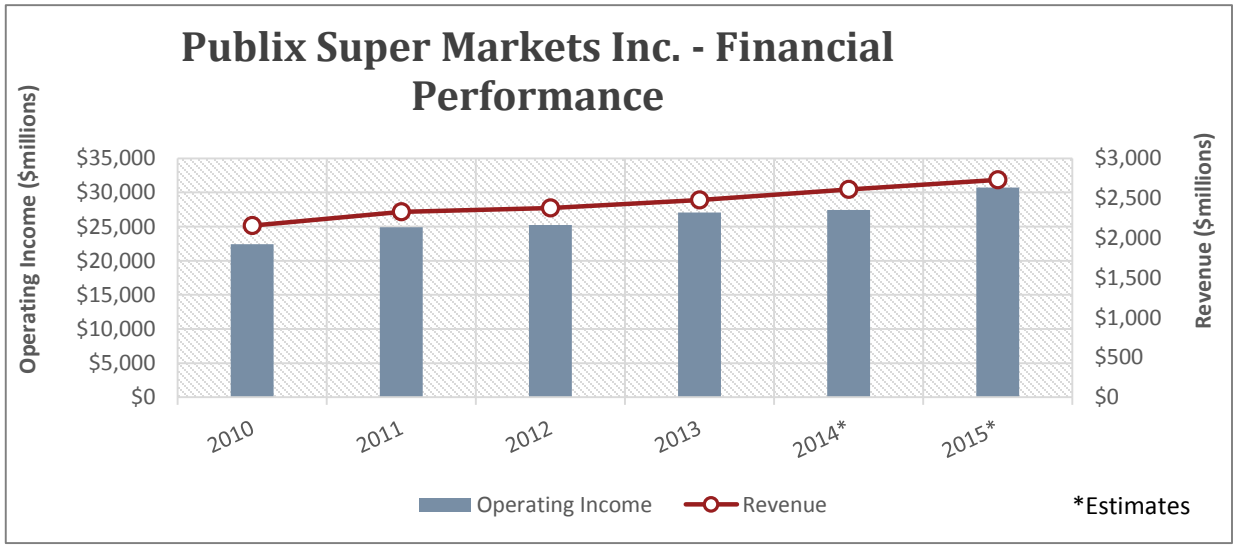
Estimated market share: 5.5%

Publix Super Markets began operations in 1930 in Florida and is regarded as the largest employee-owned supermarket chain in the United States. Furthermore, a majority of its 1,079 supermarket locations are in Florida, while a significant portion of sites are located in Georgia, Alabama, South Carolina and Tennessee. In 2013, the company employed 166,000 full-time and part-time employees. Publix operates in only one segment, but the company also manufactures a variety of products under its private labels that it sells in its retail business. Moreover, about 85% of its sales are generated from grocery items, while the remainder comes from the sale of health and beauty care items, general merchandise, pharmacy, floral and other products and services.

The company has achieved growth over the past five years by expanding the number of storefronts to its roster, benefiting from higher product prices and increased customer counts due to an improving economy. For instance, in 2013, Publix opened 22 new stores and remodeled 109 locations. Additionally, the company expanded its operations into North Carolina in 2014.

Financial Performance

Over the five years to 2015, the company's revenue increased an annualized 4.9% to $31.9 billion. The company has historically enjoyed higher margins than its competitors by implementing a variety of programs. For instance, the company launched its GreenWise organic brand, which possesses higher margins than its other private label brands. In addition to its generic products, the company offers notable customer service, which helps the chain retain customers. Also, its newest innovation is the Aprons Cooking School, which is offered in eight locations. These efforts have allowed the company to boost sales, increase customer loyalty and maintain its earnings over the period.



Safeway Inc.

Market Share: 6.6%

Brand Names: Safeway, The Von Companies, Dominick's Finer Foods, Carr-Gottstein Foods, Genuardi's Family Markets, Randall's Food Markets

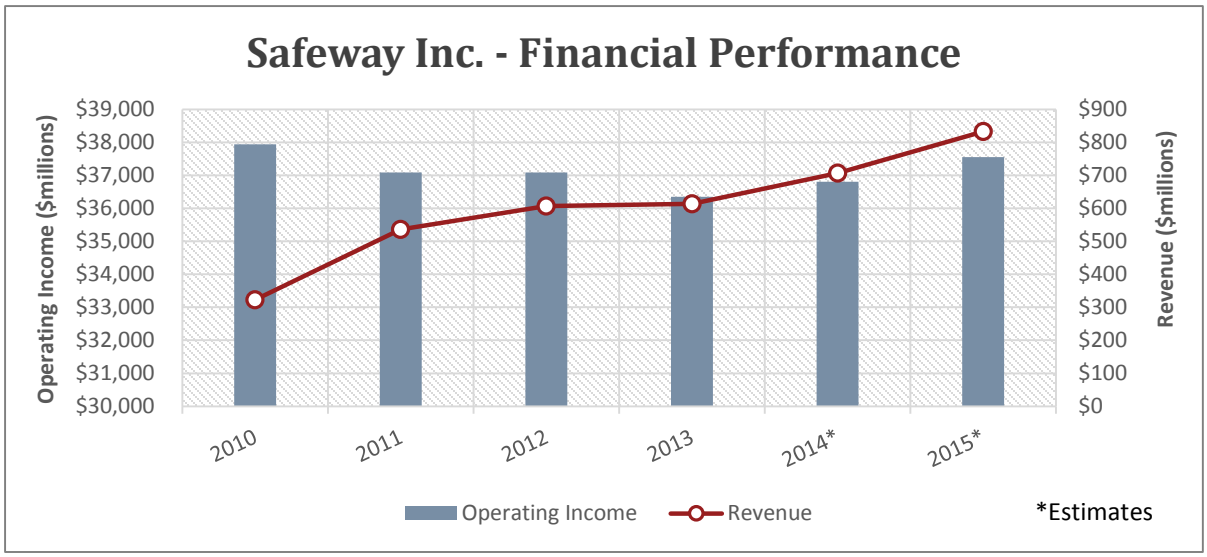
Safeway Inc. was founded in 1926 and is headquartered in Pleasanton, CA. The company employs more than 138,000 workers and operates over 1,300 stores throughout the West, Midwest and Mid-Atlantic regions of the United States, as well as in Canada. In addition to its retail operations, the company runs an extensive network of distribution, manufacturing and food processing facilities to support its retail business. Safeway organizes its business into seven geographic retail segments: Denver, Eastern, Northern California, Phoenix, Northwest, Texas and Southern California. Across the United States, the company operates one store format. Excluding the company's previous Dominick's, Genuardi's and Canada Safeway Limited subsidiaries, which were sold in 2013, the company generated total revenue of $36.1 billion in 2013.

The company operates a number of other grocery stores and about 20 manufacturing plants across the United States and Canada, as well as 13 distribution centers. Over the past five years, Safeway sold its underperforming subsidiaries and focused on improving the performance of its Safeway-branded stores. Furthermore, the company outfitted its supermarkets with a new store format. The newer outlets feature a wider variety of perishable food, organic products and high-end groceries designed to compete with groceries at upscale specialist stores. In 2009 and 2010 alone, the company built or remodeled 164 stores to fit the new format. In addition to its physical retail stores, the company operates GroceryWorks.com Operating Company, an online grocery channel.

Safeway and Albertson's announced a definitive merger agreement in March 2014. The Food and Water Watch group then filed a complaint with the Federal Trade Commission, detailing the reasons why the merger should not be approved. The group believes the merger will decrease competition in the segment and raise food prices, harming both farmers and consumers. However, the merger was approved by the Federal Trade Commission in January of 2015 and was completed January 30, 2015. The $9.0 billion merger will significantly boost Safeway’s share of the market, creating a network of about 2,400 retail stores, 250,000 employees and 27 manufacturing facilities.

Financial Performance

Over the past five years, Safeway has achieved overall growth as improvements in discretionary income allowed consumers to trade up to branded and premium products at its retail stores. However, in 2010, as per capita disposable income remained repressed, the company's revenue slightly declined. In the following years, the company focused on promotional programs and expanded its private label offerings to boost sales. Despite an increase in revenue, Safeway's operating margin suffered during this period due to higher purchase costs and administrative expenses. Overall, Safeway's revenue is anticipated to increase an annualized 2.9% to $38.3 billion over the five years to 2015.



The Kroger Co.

Market Share: 15.4%

Brand Names: Dillons Food Stores, Food 4 Less, Hilander, Kroger, Owen's, Pay Less Super Markets, Quality Food Centers, Ralph's, Smith's Food & Drug Centers

The Kroger Company was founded in 1883 and is the largest grocery store chain in the United States. Headquartered in Cincinnati, the retailer employs more than 375,000 people throughout the United States. The company operates one retail segment, which includes its retail food and drug stores, multi-department stores, jewelry stores and convenience stores. Along with its retail business, Kroger operates 38 manufacturing facilities where it produces a variety of private label goods, primarily baked goods and dairy products, which are sold at its retail outlets. In fiscal 2014, the company earned $98.4 billion in total revenue.

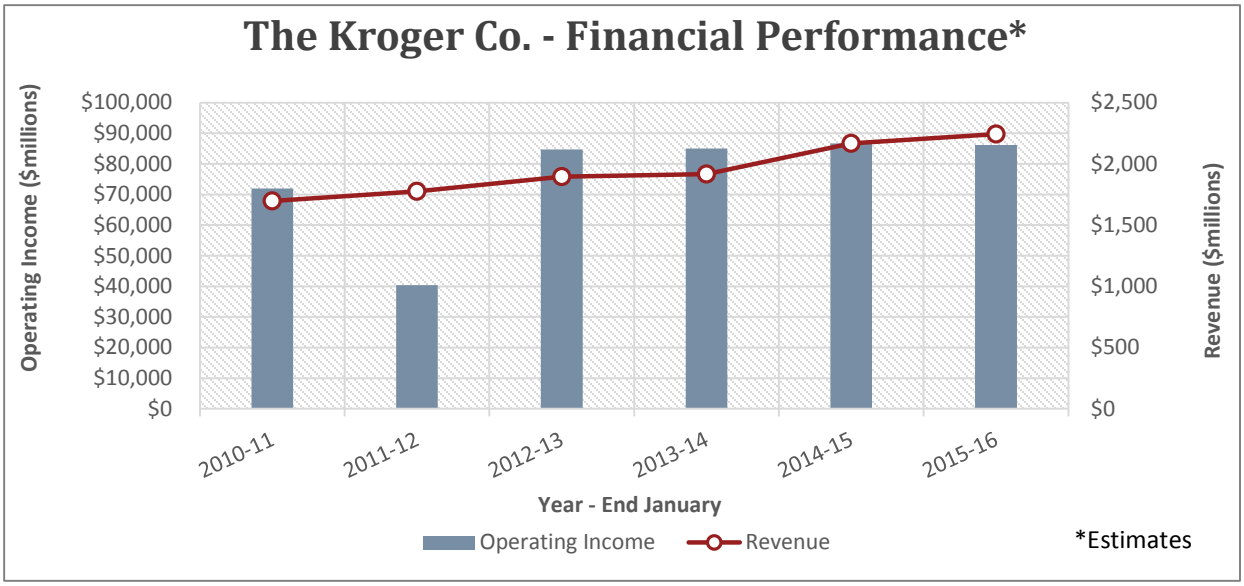
Kroger participates in the Supermarket and Grocery Store Retailer segment through its food and drug stores segment and multi-department stores. The company operates more than 2,600 supermarkets and grocery stores (including fuel centers) across the United States, which accounts for 91.6% of total company revenue. Kroger trades under 16 brand names across 32 states. Also, the company uses private labels as a way to differentiate its products and compete against other segment players. The company sells about 14,000 private-label items in three tiers: Private Selection is the premium-quality private label, offering food and beverages that cater to consumers' specific gourmet tastes; the mid-range Banner brand makes up the majority of private-label sales; and Kroger Value maintains an emphasis on price.

Over the past five years, Kroger has focused on driving sales productivity in markets that it already operates in, as opposed to acquiring multiple companies. Since Kroger is the largest grocery retailer, it aims to acquire companies in locations where it can expand its market share. For instance, in 2011, the company acquired eight stores from Schnucks, a St. Louis-based grocery chain. In January 2014, the

company merged with Harris Teeter Supermarkets, allowing Kroger to expand into the southeastern and mid-Atlantic markets, marginally boosting its market share. Kroger is rumored to be looking to expand again in 2015. Jacksonville-based Bi-Lo Holdings LLC, parent of Winn-Dixie, was named as a possible target.

Financial Performance

Kroger has achieved consistent growth over the past five years, benefiting from higher sales and merger and acquisition activity. As discretionary income continued to strengthen, consumers began trading up to branded products at retail stores, helping lift the company's performance. Kroger also benefited from expanding its private label offerings, which includes its upscale generic products and value goods. While the company benefited from improved sales and acquisitions during this period, intensifying competition from warehouse clubs and supercenters has dampened its performance. Namely, Walmart supercenters are one of Kroger's top two competitors and have taken market share away from Kroger in the overall food retailing sector. Nevertheless, over the five years to 2015, Kroger's segment-specific revenue increased at an average annual rate of 5.7% to $89.7 billion.



Other Companies

The Supermarket and Grocery Store Retailer segment is highly fragmented in the United States. While operators control a substantial share of the market in specific regions and cities, it is difficult for regional players to obtain significant share of the national market. Nevertheless, some of the leading supermarket chain operators are listed below.

Delhaize America LLC

Estimated market share: 3.3%

Delhaize America, a subsidiary of Belgian Delhaize Group, is a grocery retailer operating in 11 states in the Southeast and Mid-Atlantic. Delhaize America operates under five banners including Food Lion, Bottom Dollar Food, Hannaford Bros, Harvey's and Sweetbay. Formed in 1957 by former employees of Winn-Dixie Stores, the company now generates about $20.0 billion in annual sales. Much of that growth over the years stemmed from key acquisitions, including that of the remaining share of Food Lion. However, more recently, the company has consolidated a number of its operations in order to increase efficiencies. The closures were carried out in the beginning of 2012 when the company announced it would reposition some of its Food Lion stores. The company currently operates over 1,553 stores in the United States, down from 1,640 in 2010. Delhaize is expected to generate $19.3 billion in segment-relevant revenue in 2015.

Whole Foods Market

Estimated market share: 2.5%

Whole Foods Market is one of the world's leading natural food retail chains and is the first national "certified organic" grocer in the United States. Founded in 1980 in Austin, TX, the company specializes in natural and organic foods. After acquiring its top competitor, Wild Oats Markets, the company now operates 362 locations in the United States, Canada and the United Kingdom. Furthermore, 96.7% of the company's revenue is generated within the United States and one-third of revenue is generated from the sale of nonperishable goods. Along with its unique positioning, the grocer has benefited from the popularity of its private label brands, such as 365 Organic Everyday Day Value and Wellshire Farms. In 2015, segment-specific revenue is expected to reach $14.7 billion, representing a strong growth from the previous year. This is despite investors' concerns that company growth is slowing due to heightened competition from newer segment entrants such as Sprouts and The Fresh Market.

Walmart Stores Inc.

Estimated market share: 1.3%

Founded in 1962 and headquartered in Bentonville, AR, Walmart Stores Inc. is the world's largest retailer and grocery chain by sales, as well as the third largest employer worldwide (following the U.S. and Chinese military) with 2.2 million workers in its 10,942 stores worldwide. The company leverages its massive size to exert high buying power over its suppliers, meaning it can obtain significant cost savings and pass them down to consumers with heavily discounted prices. Walmart is currently the number one seller of groceries, although the majority of its revenue generated from this channel comes from its supercenter stores. However, segment-relevant revenue is generated through the company's

Neighborhood Markets, a chain of smaller grocery stores launched by the company in 1998. Neighborhood Markets are smaller than the company's traditional (i.e. standard format) supercenters and include pharmacies, liquor stores, delis, bakeries and photo shops.

Over the past five years, Walmart has sought to improve its same store sales by growing its Neighborhood Markets presence to more urban locations. The company currently operates this class of store in 407 locations and expects to have 500 open by 2015 year end. However, at the moment, this segment of the company's operations is too small to make a significant splash within the Supermarkets and Grocery stores segment. In 2015, it's estimated that Walmart will achieve segment-relevant revenue of $7.4 billion from its Neighborhood Markets stores, which accounts for just over 1.0% of segment market share.

Cost Structure Benchmarks

The cost structure for this segment is based on an estimate of the average segment participant. Consequently, profit margins and other costs vary from retailer to retailer and depend on a number of factors such as ease of access to suppliers and scale of operations.

Profit

In 2015, segment profitability is anticipated to account for 1.5% of revenue, representing a slight increase from 1.4% in 2010. The Supermarket and Grocery Store Retailer segment has historically been characterized by low margins, due to the fragmented nature of the segment. Supermarket operators compete largely on price, as the products sold by retailers are homogeneous. Consequently, companies offer discounts and promotions frequently to drive foot traffic to their stores and boost customer loyalty and retention rates. Over the past five years, the segment faced intensifying competition from warehouse clubs and supercenters that offer even lower prices than supermarkets. Therefore, while disposable income levels have recovered from the recession, operators have increased promotional activity to drive foot traffic to their stores, dampening profit margins. While this trend holds true for the segment as a whole, specialty retailers, such as all-natural and organic grocers, have enjoyed high and even increasing margins during this period. Over the next five years, it's anticipated that segment profitability to slightly decline as supermarkets face growing price-based competition from alternative retailers.

Purchases

Purchases account for an overwhelming majority of revenue, estimated to constitute about 75.4% of segment revenue in 2015. This figure represents a slight increase from 2010. This segment's share of revenue has increased during this period, as the cost of goods increased at a faster rate than segment revenue. As commodity markets fluctuated during this period, the cost of many key agricultural products, from fruits to meat products, increased. Consequently, higher input costs have been passed

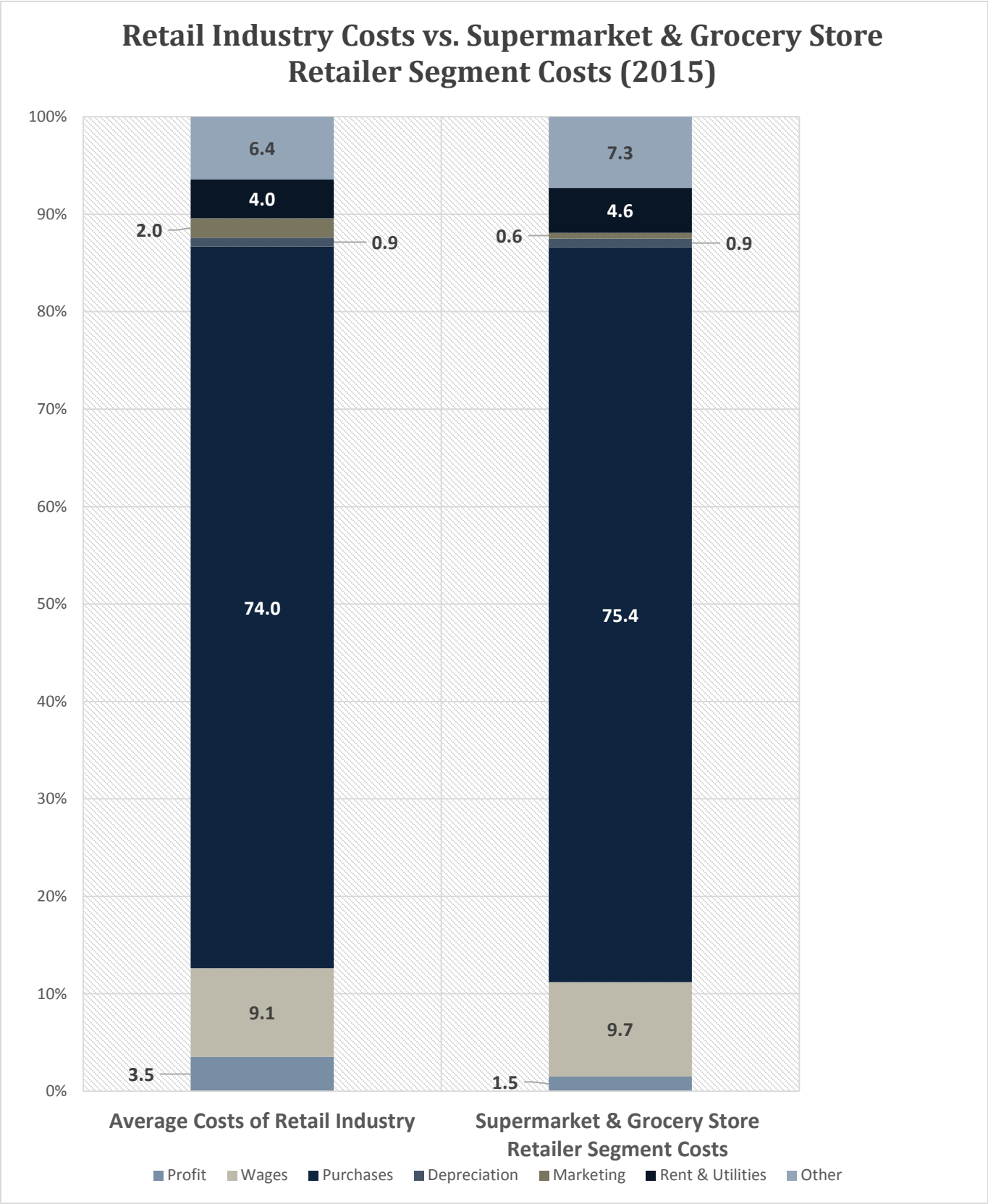
down the supply chain to food manufacturers and retailers, lifting purchases' share of revenue during this period. Over the next five years, as commodity markets steady, purchases' share of revenue is forecast to remain the same.

Wages

Wages constitute the second largest cost segment for this segment, accounting for about 9.7% of segment revenue in 2015. This figure represents a slight decline from 10.3% in 2010. In search for ways to maintain profitability, many operators froze wages over the past five years. In addition, the implementation of self-checkout aisles has reduced the number of workers needed per store. Consequently, even as the number of employees increased during the period, wages' share of revenue declined during this period. It’s anticipated that this trend to persist over the next five years, as operators implement a variety of mobile applications and advanced point of sale systems that take the place of workers.

Other

Other costs associated with operating a supermarket include advertising and promotions, rent and utilities, depreciation and various administrative expenses. While supermarkets offer promotions regularly to drive foot traffic to their stores, marketing is expected to only account for about 0.6% of revenue. Furthermore, rent and utilities constitute about 4.6% of revenue, representing a growth from five years ago due to higher utility costs.


Retail Industry Costs vs. Supermarket & Grocery Store Retailer Segment Costs (2015)
100%
90%
80%
70%
60%
50%
40%
30%
20%
10%
0%
6.4
4.0
2.0
0.9
74.0
9.1
3.5
7.3
4.6
0.6
0.9
75.4
9.7
1.5
Average Costs of Retail Industry
Supermarket & Grocery Store Retailer Segment Costs
Profit
Wages
Purchases
Depreciation
Marketing
Rent & Utilities
Other

Supermarket & Grocery Store Retailers: Key Statistics

Year	Revenue ($millions)	IVA ($millions)	Establishments (Units)	Enterprises (Units)	Employment (Units)	Wages ($millions)	Consumer Spending ($billions)
2006	531,046.9	67,568.5	66,054	42,506	2,473,518	55,354.5	35,461.0
2007	540,086.8	68,253.5	64,142	40,923	2,424,912	55,831.6	35,870.0
2008	551,558.0	68,176.5	63,384	40,343	2,450,033	56,042.2	36,082.0
2009	546,609.2	71,964.1	63,634	40,456	2,440,412	57,205.7	35,600.0
2010	548,990.6	69,806.9	64,380	41,027	2,402,743	56,631.1	35,705.0
2011	564,147.7	67,782.9	64,366	40,888	2,413,784	55,935.8	36,294.0
2012	570,350.4	70,641.7	66,047	41,568	2,434,913	56,953.3	36,759.0
2013	576,401.2	70,917.5	65,723	41,161	2,440,431	57,083.9	36,771.0
2014	581,642.2	71,102.0	66,428	41,656	2,460,376	57,142.6	37,709.0
2015	**584,293.8**	**70,727.1**	**67,084**	**42,036**	**2,489,995**	**56,704.1**	**38,708.0**
2016	590,721.0	71,536.2	67,055	42,011	2,492,478	57,595.2	39,496.0
2017	596,628.2	73,198.7	67,355	42,137	2,500,724	58,450.1	40,351.0
2018	601,401.3	73,456.9	67,321	42,051	2,504,131	59,297.5	41,232.0
2019	605,009.7	73,103.0	67,723	42,261	2,513,687	60,089.9	42,016.0
2020	606,824.7	74,400.8	67,937	42,341	2,522,334	60,794.7	42,814.0

Annual Change (%)

Year	Revenue	IVA	Establishments	Enterprises	Employment	Wages	Consumer
2006	0	-2.2	-1.8	-2.7	-0.9	-0.8	3
2007	1.7	1	-2.9	-3.7	-2	0.9	1.2
2008	2.1	-0.1	-1.2	-1.4	1	0.4	0.6
2009	-0.9	5.6	0.4	0.3	-0.4	2.1	-1.3
2010	0.4	-3	1.2	1.4	-1.6	-1	0.3
2011	2.8	-2.9	0	-0.3	0.5	-1.2	1.6
2012	1.1	4.2	2.6	1.7	0.9	1.8	1.3
2013	1.1	0.4	-0.5	-1	0.2	0.2	0
2014	0.9	0.3	1.1	1.2	0.8	0.1	2.6
2015	**0.5**	**-0.5**	**1**	**0.9**	**1.2**	**-0.8**	**2.6**
2016	1.1	1.1	-0.1	-0.1	0.1	1.6	2
2017	1	2.3	0.4	0.3	0.3	1.5	2.2
2018	0.8	0.4	-0.1	-0.2	0.1	1.4	2.2
2019	0.6	-0.5	0.6	0.5	0.4	1.3	1.9
2020	0.3	1.8	0.3	0.2	0.3	1.2	1.9

Key Ratios

Year	IVA/ Revenue (%)	Revenue/ Employee ($)	Wages/ Revenue (%)	Employees/ Establishment	Wages/ Employee ($)
2006	12.7	214.7	10.4	37.4	22,378.9
2007	12.6	222.7	10.3	37.8	23,024.2
2008	12.4	225.1	10.2	38.7	22,874.1
2009	13.2	224.0	10.5	38.4	23,441.0
2010	12.7	228.5	10.3	37.3	23,569.4
2011	12	233.7	9.9	37.5	23,173.5
2012	12.4	234.2	10	36.9	23,390.3
2013	12.3	236.2	9.9	37.1	23,390.9
2014	12.2	236.4	9.8	37	23,225.1
2015	**12.1**	**234.7**	**9.7**	**37.1**	**22,772.8**
2016	12.1	237.0	9.7	37.2	23,107.6
2017	12.3	238.6	9.8	37.1	23,373.3
2018	12.2	240.2	9.9	37.2	23,679.9
2019	12.1	240.7	9.9	37.1	23,905.1
2020	12.3	240.6	10	37.1	24,102.6

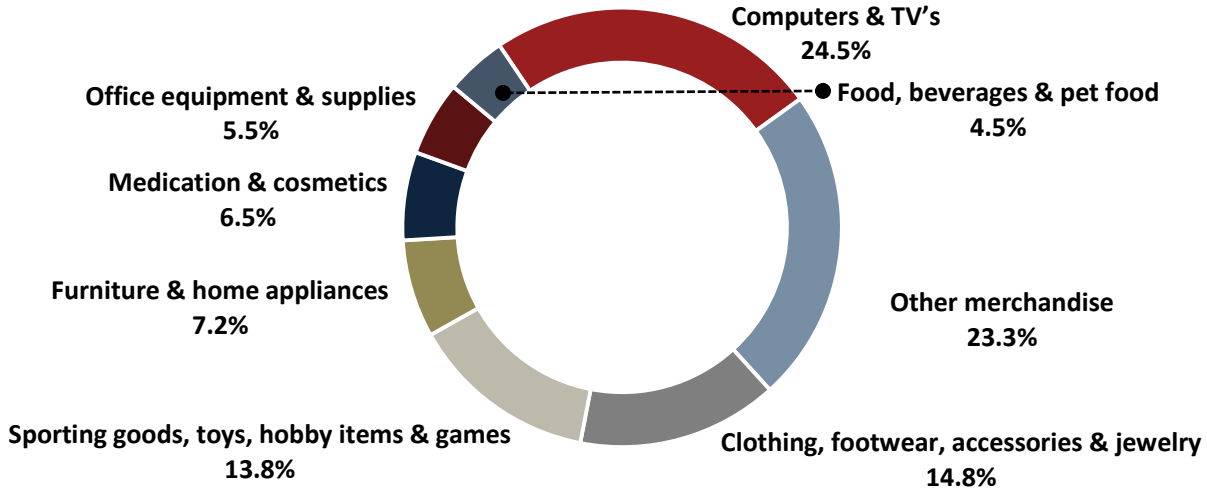
E-tailers

Every year, more time-strapped consumers are being lured by offers of free shipping to purchase goods from online retail marketplaces, one of the fastest-growing industries in the United States. In 2013, the National Retail Federation estimated 140 million shoppers have fled from brick-and-mortar malls to shop from the comfort of their own living rooms (latest available data). Over the past five years, the E-tailer segment revenue has grown at an exceptional rate, outperforming most retail industries, due in part to higher levels of disposable income and increasing internet traffic volume. Despite the brief recession-induced slowdown in 2009, segment revenue rose at an average annual rate of 10.3% in the five years to 2015 to reach $297.9 billion. As a result of this steady growth, average segment profit margins have also improved, increasing from 5.3% of revenue in 2009 to an estimated 7.1% in 2015.

As internet traffic increases and online shopping becomes more popular, retailers are expanding the products they carry to include common household goods such as DVDs, Blu-rays, books, clothing, footwear and even grocery and cleaning products. Hard-to-find niche products or products that are no longer being produced have also found a place in online markets. Shopping from home has never been easier and consumers are relishing the opportunity to multitask by combining necessary shopping and family time. As product ranges have grown, so has the number of segment operators. The number of enterprises grew at an average annual rate of 11.7% in the five years to 2015, to 131,447 operators.

In the next five years, continued economic recovery is expected to drive the segment's strong growth, but as the segment becomes more established over the next five years, revenue growth is anticipated to temper. Rising disposable income and declining unemployment will improve consumer confidence, increasing consumers' likelihood and ability to buy. Additionally, internet traffic volume will continue to flourish over the next five years, boosting consumers' accessibility to e-tailers. Together, it's forecasted that these factors will cause segment revenue to grow at an average annual rate of 5.9% over the five years to 2020, to total $397.2 billion.

Products and Services Segmentation (2015)



Current Performance

The E-tailer segment has experienced a decade of growth as more and more Americans have become accustomed to making purchases online. The segment was briefly slowed by the recession; however, the economic recovery has been a boon to segment revenue. Consumer confidence surged in 2010, while per capita disposable income also began to recover from the economic downturn. As cash-strapped consumers searched online for deals and engaged in comparison shopping, the percentage of services conducted online grew steadily. Over the past five years, segment revenue has grown an annualized 10.3% to $297.9 billion in 2015, with an increase of 4.3% expected in 2015 alone. E-tailers are benefiting from the economic recovery as higher disposable income and improved consumer confidence are encouraging individuals to spend more money.

Technology Leads the Way

Growth in this relatively new segment has coincided with the increasing ubiquity of internet access. The costs of obtaining an internet connection and a computer or mobile device have declined considerably in recent years, making it more affordable for consumers to connect to the internet. Meanwhile, faster internet speeds, greater bandwidth and better connection stability have made online shopping more attractive to consumers. Similarly, more consumers with internet access results in more consumers having access to e-tailers, increasing the likelihood that consumers will purchase goods from segment operators.

E-tailers owe much of their success to the development of eBay's PayPal and other secure payment methods, which add a practical component to the "shop anytime, anywhere" spirit of the online marketplace. Security concerns about making credit or debit card transactions online, which consumers expressed in the early days of online shopping, have largely faded. Aside from security, the segment's payment processes are also designed for convenience. For instance, PayPal allows users to create personal online accounts, making it easier for them to transfer funds to a retailer from their credit cards or bank accounts without disclosing any financial details. Meanwhile, Amazon.com allows for "one-click ordering," which enables consumers to buy goods with default payment methods stored in their accounts.

Growth Accelerates Rapidly

The number of enterprises in the E-tailer segment has increased over the five years to 2015, rising at an annualized 11.7% to 131,447 operators. As a result of the segment's low barriers to entry and few skill requirements, companies can easily enter this growing segment. The two largest segment companies are estimated to hold nearly 22.0% of segment market share in 2015, while local sole proprietors make up roughly half of segment enterprises. Despite the many single-operator businesses entering the segment, employment will rise at a slower rate than enterprises during the five-year period, due to the

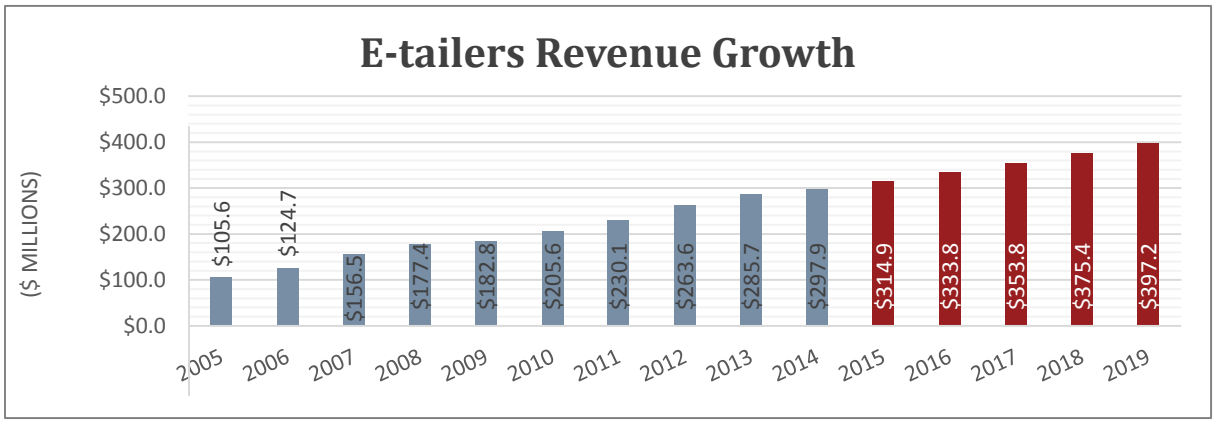
segment's low emphasis on customer service. Employment is expected to increase at an average annual rate of 6.6% to 266,052 workers.

Even with this segment's rapid rise, operators must grapple with an increasingly competitive environment. To generate sales, operators have been forced to aggressively compete on price via seasonal promotions and other discount initiatives, particularly during the recession and recovery period. Also, many players have had to invest heavily in advertising (e.g. Google Adwords) to distinguish themselves from the competition, which increasingly includes traditional retailers with robust retail websites of their own. As a result, the segment is expected to generate average profit margins amounting to just 7.1% of revenue in 2015, even though operators benefit from low overhead costs.

In response to high competition, some operators have begun offering additional services, such as free shipping, as a way to retain customers and attract new ones. Additionally, new forms of online retailing known as "social commerce" have emerged as operators attempt to generate higher sales and reduce costs. For instance, websites such as Groupon and LivingSocial sell products at discounted prices, but require group participation and, thus, consumer word-of-mouth promotion. This new model essentially guarantees high sales volumes, while cutting out the need for advertising. It’s expected that these social commerce websites to gain popularity in the coming years, further aiding segment growth.

Sales Tax Struggles

In the five years to 2015, e-tailers have been successful at competing with traditional brick-and-mortar stores by providing the convenience of at-home shopping, coupled with discounted prices for the same or comparable products. Operators can achieve these lower price points because of two key advantages of the online marketplace. First, because they have no physical storefronts, online operators have avoided fees associated with property ownership. Additionally, e-tailers are not required to charge sales tax on out-of-state purchases, which lowers prices for most online shoppers. As the law currently stands, operators are required to collect sales tax only if the business has a physical presence in the state that the purchase was made. If a business does not have a presence in the state, the burden of tax falls on the purchaser, who is required to report it on their income tax form as a use tax. However, since use tax generated through online purchases is small, many consumers do not report such tax, resulting in large sums of uncollected funds for U.S. states. With the rising popularity of online shopping and many states facing budget deficits, the segment's battle regarding sales tax has gained increasing attention in recent years. To collect additional revenue, many states, including California, Colorado, Minnesota, Connecticut and Missouri, have passed legislation that will require segment players to collect sales tax (see the Regulation and Policy section). This move toward tax collection will likely have a detrimental effect on the segment, as it eliminates one of the major cost-saving advantages of operating online. Additionally, small and mid-size operators would likely incur the additional cost of hiring tax specialists to handle various rate calculations and any audits initiated by tax jurisdictions. This legislation faces major opposition, but if passed, it would significantly affect the bottom line of all e-tailers.



Segment Outlook

The E-tailer segment will attract a larger customer market as more households purchase items online. In the five years to 2020, revenue is expected to increase at an annualized 5.9% to $397.2 billion. However, the looming threat of regulation may hamper sales and slow profit growth in the coming years. The segment's projected growth is the result of several economic factors. Firstly, per capita disposable income is projected to grow over the next five years, while the unemployment rate is expected to drop to 4.8% in 2015, though this percentage still reflects relatively high unemployment levels. Improved disposable income and employment levels will revive consumer confidence, which is anticipated to grow in the five years to 2020.

When income increases and consumers are more willing to spend money, segment operators will experience a revenue boost. The segment will also benefit from the release of pent-up demand from the recession and recovery period, when many consumers delayed discretionary purchases in response to economic uncertainty.

Ease of E-Commerce Supports Growth

The segment will benefit from additional changes in consumer preferences during the next five years. Rather than spending more on goods in department stores or other retail outlets, consumers will increasingly turn to less-costly options offered online. As a result of this shift in customers' shopping tendencies, the segment is expected to continue to experience solid growth. E-tailers will also continue to benefit from low operational costs because they do not have to rent, staff or operate brick-and-mortar stores. To this end, average segment profit margins are projected to account for an estimated 8.3% of revenue by 2020, up from 7.1% in 2015. Improvements in productivity and efficiency have driven rapid profit growth, with segment revenue growth outpacing employment and wages.

Internet traffic volume will continue to steadily grow during the next five years, further contributing to segment growth. Internet traffic volume is anticipated to reach 156.5 exabytes per month in 2020, as consumers gain easier and more convenient access to the internet with improved technology and the rise of smartphones and public Wi-Fi access. More consumers will have access to e-tailers and therefore shop at online segment establishments.

Operators Look for Clicks

Competition within the segment will be based on the reputation and reliability of operators and prices. Operators will attempt to expand the number of regions they service to capture a wider range of customers. Therefore, shipping and handling costs will also be a point of differentiation among players, as will the ability to provide timely product delivery and refunds. The functionality of shopping websites and the ease by which consumers can place orders will contribute to the number of repeat and loyal customers as well.

To increase their customer base, e-tailers will continue to improve the online sales process. These efforts will include more accurate product descriptions, more competitive prices and lower freight and delivery costs. Furthermore, operators will gradually place a greater emphasis on customer service, increasing their efforts to meet the various needs of online shoppers. Operators will strive to deliver superior after-sales service and devise ways of assuaging consumer concerns regarding privacy and credit card payment issues. e-tailers that meet these requirements will ultimately benefit from strengthened brand recognition and higher consumer spending.

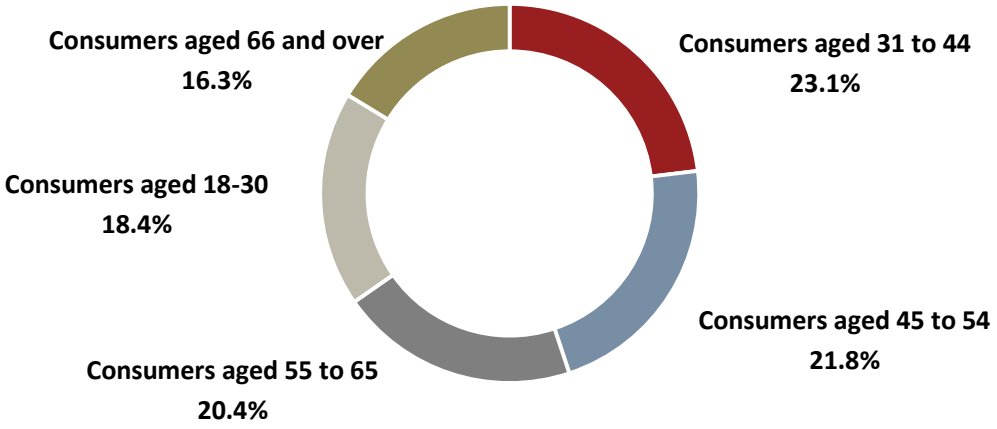
While existing segment operators focus on improving the customer experience, new businesses will continue to enter the segment. It's forecasted that in the five years to 2020, the number of enterprises will grow at an annualized 8.1% to 194,134 operators. Similarly, segment employment is projected to rise at an annualized 6.9% to 371,356 workers, while wages are forecast to jump an annualized 7.3% in the next five years, to $26.3 billion.

Legislation Threats

E-tailers will continue to wage a legislative battle over tax laws to protect their bottom lines. As the law now stands, businesses are required to collect sales tax only on transactions that take place within a state where that company has a physical office. If the business has no presence in the state of the transaction, then the tax burden falls on the purchaser, who must report the use tax in their income tax filing. This has been an area of significant cost savings in past years for e-tailers, allowing them to reduce prices and attract customers by dodging sales tax.

As a result of these factors, many states facing budget crises will likely pursue legislation that requires online operators to collect sales tax. In fact, such legislation has already passed in 24 states, including California, Colorado, Minnesota, Connecticut and Missouri. A shift in policy along these lines could be devastating to segment operators in the coming years. By burdening e-tailers with sales tax on all purchases, this legislation could remove a significant portion of the cost saved by operating online, resulting in considerable losses in sales transactions. Furthermore, many small and mid-size operators would need to hire tax specialists for compliance reasons, thereby hampering average segment profit margins.

Major Market Segmentation (2015)



Competitive Landscape

The E-tailer segment is highly fragmented with a low level of market share concentration. Segment concentration has increased over the past five years due to merger and acquisition activity. Large companies are buying up smaller ones that offer innovative technologies and services. Further, acquisitions allow major players to expand their product mix to reach a wider customer base. The four largest players are expected to account for an estimated 23.5% of segment revenue in 2015; dominant player Amazon.com is responsible for 18.8% of segment revenue alone. According to U.S. Census data, nearly three-quarters of all segment operators employ fewer than five people. The nature of the segment results in this sort of market share structure because it is not very costly to start an online store, and virtually no skills are required.

Basis of Competition

Internal Competition

Competition in the E-tailer segment is high, and the trend is steady. Operators should ensure that detailed descriptions (e.g., color, size, functionality and quantity) accompany products for sale. Due to the online-based nature of the E-tailer segment, consumers are not able to physically examine products before buying them. Hence, the more product details operators provide, the more closely they mimic the traditional shopping experience.

While product and service prices are relatively stable from one e-tailer to another, shipping charges can vary significantly. Although online store and auction operators cannot control freight charges, an effective marketing technique has been to absorb a percentage or even all of the cost in delivery to the consumer. E-tailers that are able to offer free or discounted shipping and handling appear more competitive and attractive to prospective customers.

Mode of delivery also becomes an important aspect of competition because purchases such as wine, groceries, and large or fragile goods can have very specific shipping needs. Furthermore, consumers must divulge personal details (such as an address) for delivery of goods. Consumers entrust e-tailers with this information with the belief that it will not be forwarded to a third-party without their consent.

Each e-tailer's refund policy should be clearly outlined to consumers at the time of purchase. As with traditional retailers, consumers should know whom to contact in the event that a refund is needed. The reputation of an e-tailer has a significant impact on repeat buyers. Due to the absence of a physical shop front, consumer awareness of e-tailers comes from media advertising and, more importantly, from word-of-mouth recommendations.

External Competition

E-tailers compete with players in other retail segments, such as brick-and-mortar department stores and big-box retailers. These stores often have websites where consumers can make purchases, which has intensified online competition over the past five years. Such external competition is based on efficiency, price and product availability.

Barriers to Entry

Barriers to Entry checklist	Level
Competition	High
Concentration	Medium
Life Cycle Stage	Growth
Capital Intensity	Medium
Technology Change	High
Regulation & Policy	Medium
Industry Assistance	Low

Prospective operators can establish e-commerce sites without much difficulty. This industry has a low level of concentration, with the two largest players accounting for about 21.8% of the available market. The industry is highly fragmented, with a large number of small and independent players dominating the industry. These two characteristics are reflective of low barriers to entry; nonetheless, incumbent operators can still benefit from the reputations they have established as reliable operators who supply merchandise of an acceptable quality. Existing operators have also had to gain the trust of consumers with regard to providing secure websites for personal information, such as credit card details.

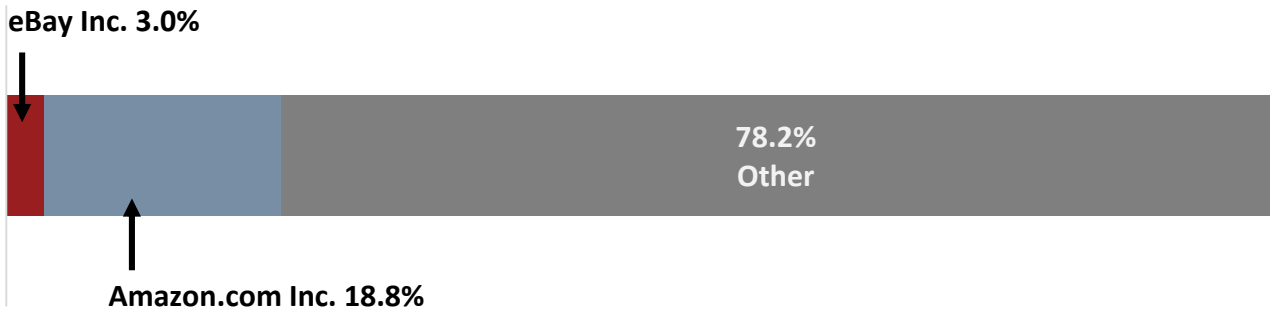
The industry has a moderate level of capital intensity, which can prevent new entrants. The initial and continuing costs required to establish an electronic shopping site can be quite extensive, depending on its functionality and features. Establishing databases requires an initial capital investment along with subsequent costs for maintenance.

Product differentiation between a traditional retailer and an online retailer is nonexistent. As such, retailers operate in a highly competitive environment. A low level of product differentiation is likely to make it difficult for operators to establish a niche market. The pre-established distribution networks between operators and suppliers may, in some cases, be viewed as a barrier to entry. Existing operators

benefit from the relationships they have built with their suppliers. As such, they may be offered better lines of credit and low-priced, high-quality stock compared with players new to the industry.

Players not fazed by the financial costs will need to implement a strategy to attract traffic to their website. As new players, they will need to prove that they offer a broad product range and that their goods are competitively priced. Retailers also have to ensure customer loyalty and repeat buyers. Those that choose to match the low prices offered by established e-tailers will suffer a decline in profitability. Some players may choose to respond to the price pressure by expanding the range and quality of merchandise they offer in order to appeal to a broader market.

Major Companies



eBay Inc.

Market Share: 3.0%

Brand Names: Stubhub.com, Shopping.com, Rent.com

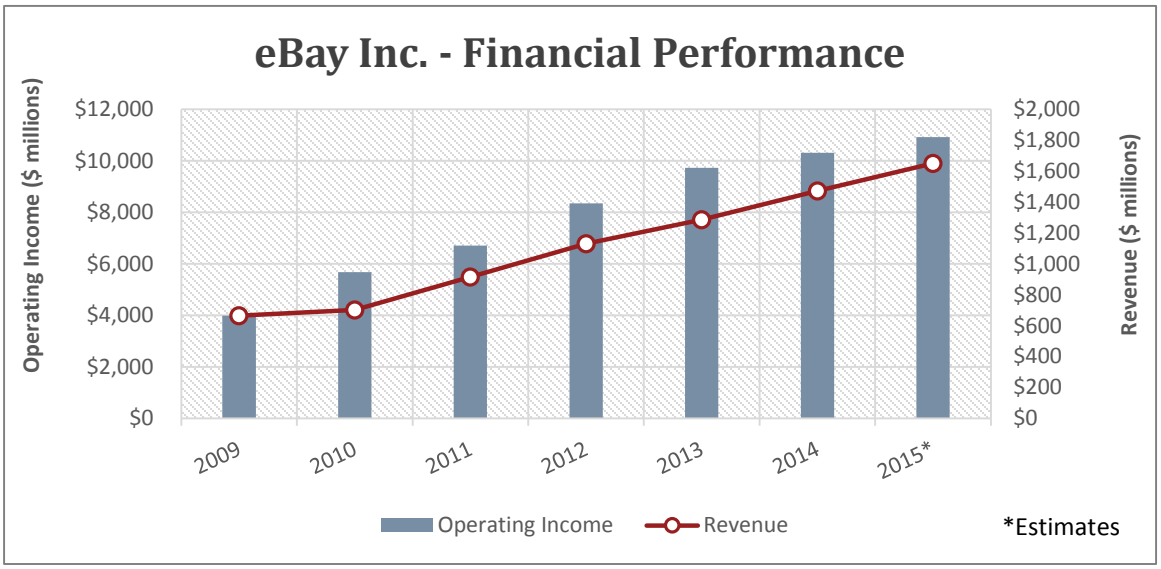
Through its eponymous site and related websites, eBay sells about 45,000 categories of products via fixed price or auction listings. The company, headquartered in San Jose, CA, began as an auction website in 1995 and has since introduced a fixed-price selling format that now generates 66.0% of eBay's gross merchandise volume, which is the total value of all closed items. The company's business model generates revenue through advertising, as well as listing and selling fees. In 2013, eBay's total company revenue was about $16.0 billion.

In the five years to 2015, the company expanded its international presence via acquisitions of other auction sites based abroad. In 2013, the company acquired the payment platform Braintree to spur growth in mobile payments. In November 2009, eBay completed the sale of internet phone service Skype to an entity owned and organized by an investor group. Today, eBay has operations throughout the world that facilitate auction activities.

EBay's has operations span three primary business segments: marketplace, payment and communications. The segment most relevant to the E-tailer segment is the marketplace segment. Commerce websites in this segment include a secondary ticket marketplace (Stubhub.com) and an online shopping comparison website (Shopping.com).

Financial Performance

In the five years to 2015, eBay's marketplace segment revenue is expected to rise at an average annual rate of 17.2% to $8.8 billion, faster than overall segment growth. The company's U.S. segment also outperformed the segment in terms of profit, which rose from $665.3 million in 2009 to an expected $1.7 billion in 2015, amounting to growth of 21.7%. The reasons for strong performance include profitable acquisitions, divestment of less-profitable businesses and slower growth in wages than in revenue, allowing for more profit.



Amazon.com Inc.

Market Share: 18.8%

Brand Names: Zappos.com

Listed as one of the top 100 companies in Fortune magazine, Amazon.com has harnessed the online-selling platform to grow into a company that is expected to generate over $56.0 billion in U.S. revenue in 2014. Launched in July 1995 as an online bookseller with weekly revenue of about $20,000, this publicly listed Seattle-based company has expanded its product range to include music, DVDs, videos, wireless products, consumer electronics, hardware, lawn and patio items, clothing and kitchen products. The company earned total revenue of $74.5 billion in 2013.

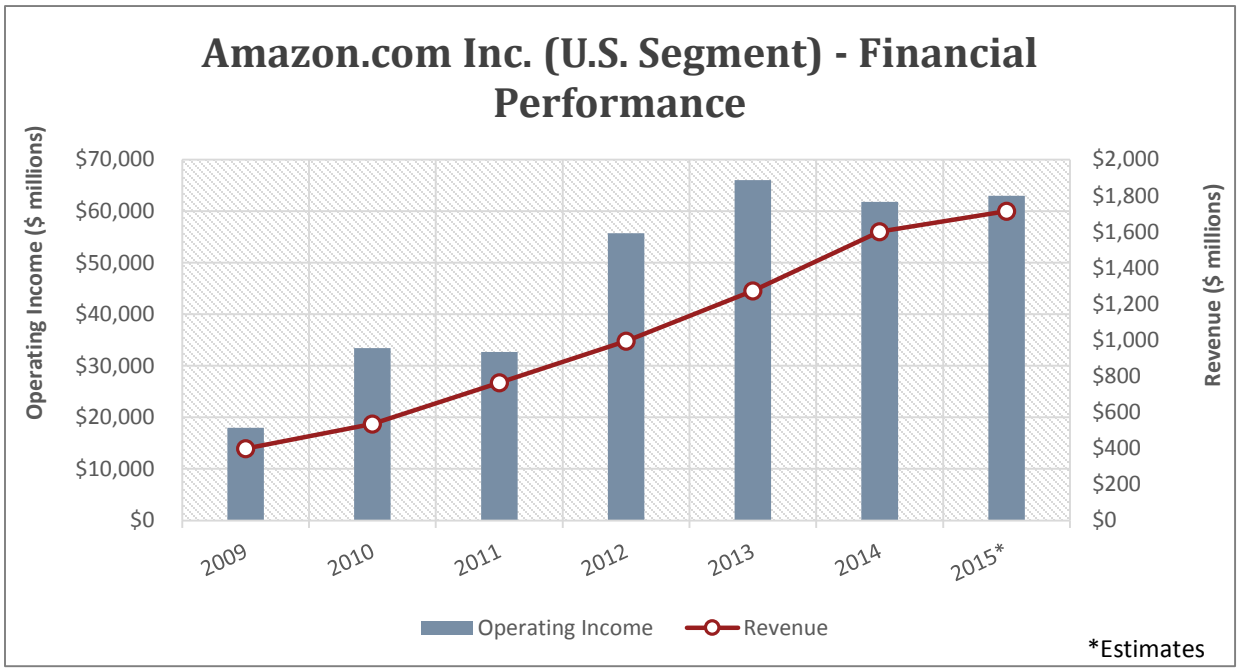
In the five years to 2015, the company has mainly expanded through acquisitions. In 2012, Amazon acquired Kiva Systems, a supply chain robot maker, to improve efficiency at its fulfillment center. In

2010, Amazon purchased deal-a-day site Woot.com for $110.0 million; in 2009, Amazon purchased Zappos, an e-commerce company, for $880.0 million. In addition, Amazon.com sells the Kindle e-book reader and delivers web content to television via its Unbox digital download service.

One of the company's most significant developments over the past five years was the 2011 launch and continuing evolution of Amazon's Cloud programs: Amazon Cloud Drive (a competitor to Apple's iTunes), Amazon Cloud Player for Web (for PCs) and Amazon Cloud Player for Android. According to retail market research firm NPD Group, Amazon accounts for 22.0% of the digital music market. The introduction of these players represented the company's entry into the cloud-computing market by enabling customers to securely store music virtually and play it on any compatible phones, tablets or computers. While the long-term implications of this development are still unknown, it is nevertheless reflective of the company's strategy to further expand its offerings of downloadable music, video and text. Amazon.com also offers its own payment method application through Amazon Payments to safely facilitate electronic sales transactions.

Financial Performance

In the five years to 2015, Amazon's U.S. revenue rose at an average annual rate of 32.0% to $56.0 billion. Amazon has consistently outperformed the segment, increasing its U.S. market share from 8.4% in 2009 to an estimated 18.8% in 2015. Amazon's various acquisitions and ability to expand its product mix to attract more buyers have driven this rapid expansion. Amazon has also successfully maintained its bottom line: the company's U.S. operating income rose from $513.8 million in 2009 to an expected $1.8 billion in 2015. Similar to the company's revenue, Amazon's profit margins have risen at an annualized 28.0% over the past five years, through aggressive acquisitions and product expansion.



Other Companies

The E-tailer segment has a low level of concentration, with the two largest companies accounting for 21.8% of total segment revenue. The remaining market is made up of small and independent businesses that only operate online. Well-known segment operators include apparel websites Bluefly and Gilt, discount retailer Overstock and handmade-crafts seller Etsy.

Newegg Inc.

Estimated market share: 1.0%

Founded in 2001, California-based Newegg Inc. has grown to become the third-largest online-only retailer in the United States. Newegg primarily sells desktop and laptop computers and related components through its website. Newegg also stocks a wide range of consumer electronics, such as home theater systems, digital cameras, cell phones and game consoles. The e-tailer offers about 10.5 million products (including brand name products from Apple, Sony, Canon and Toshiba) and has more than 25.0 million registered users. The company filed for an initial public offering with the U.S. Securities and Exchange Commission in 2009, but withdrew its application in 2011. It's estimated that the company will generate revenue of $3.0 billion in 2015.

Groupon Inc.

Estimated market share: 1.0%

Groupon is an e-commerce website that connects local merchants to consumers by selling their goods and services at a discount. The company began by selling discounted gift certificates to restaurants and events, with the gift certificates valid only after several consumers purchased the coupon, hence the name "Groupon." Business insiders point to Groupon, which is expected to bring in about $1.8 billion in U.S. revenue in 2015, as an example of internet companies' precariousness. After blazing the trail in online daily deals in 2008, the startup had trouble getting its initial public offering off the ground in 2011. Investors fretted that the novelty of its coupons were wearing off and competitors crowded the market. In its annual report to the SEC, Groupon executives said that the company's scale, strong brand and experience are "sustainable competitive advantages." Company revenue and profit margins have grown over the past five years, despite ongoing turbulence in performance.

Cost Structure Benchmarks

Profit

The E-tailer segment's profit, measured by earnings before interest and taxes, is expected to account for 7.1% of segment revenue in 2015, up from 5.3% in 2009. In the mid-2000s, e-commerce sites opened at a rapid rate, so intense competition led to many new operators losing money. Since then, demand has outstripped supply, leading to better conditions for the remaining participants. In addition, wages have fallen as a share of revenue over the past five years, and these wage savings have translated into increased profit.

Purchases

Purchases are estimated to account for 71.8% of segment revenue in 2015, up from 63.8% in 2009, and make up the largest component of the segment's cost structure. Purchases consist of products bought from vendors (domestic or international) for resale to consumers; the volume of merchandise purchased follows overall sales trends for the year. Purchase costs have risen over the past five years because of the volatile trade-weighted index, a measure of the strength of the U.S. dollar relative to other currencies, which has caused foreign-made goods to become more expensive for Americans to buy. Because a large share of products sold by segment participants are manufactured abroad, this segment has risen as a share of segment revenue over the period.

Wages

The E-tailer segment has uncharacteristically low wage costs for a retail segment. Wages are a small component of the total cost structure because online stores do not have a wide network of stores to staff with employees. As a result, segment wages will account for an estimated 6.2% of revenue in 2015, a decrease from 8.5% of revenue in 2009 due to segment revenue increasing faster than employment.

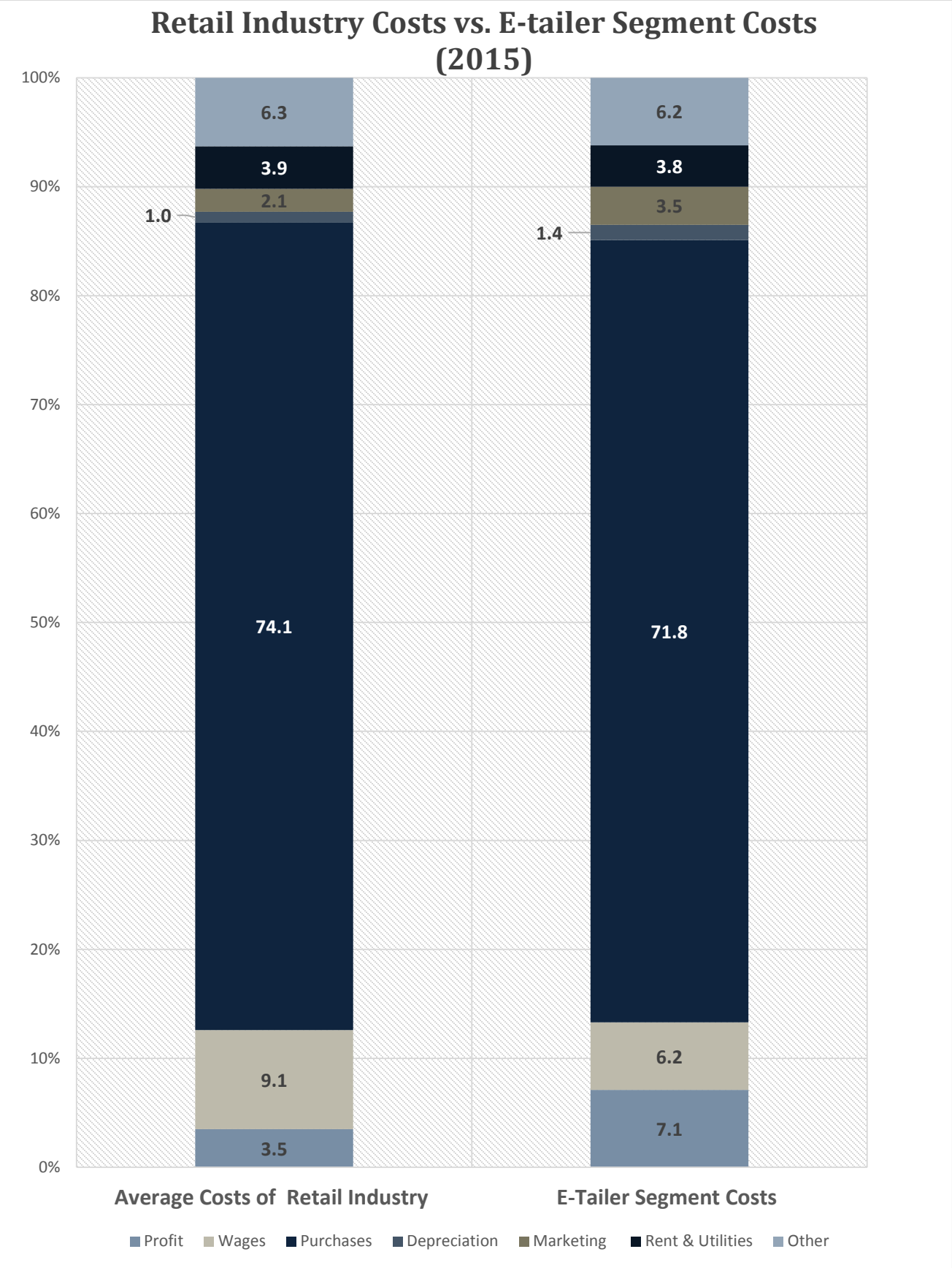
Depreciation

Operators in this segment are faced with depreciation on fixed assets, such as furniture and fixtures for offices, heavy equipment for warehouses, technology infrastructure, internal-use software and website development; the nature of the segment means there is a need to continuously maintain and update websites and databases. Depreciation costs for this segment have increased in recent years due to greater acceptance of online retailing, evolving technology and software programs and more advanced payment systems. Depreciation costs vary among segment operators depending on their size and the number of assets involved. Overall, the depreciation expense for this segment is expected to average 1.4% of revenue in 2015.

Other

Other costs are estimated to account for a combined 13.5% of segment revenue in 2015. This segment comprises a diverse set of expenses, including insurance premiums, interest charges, advertising expenses, rent and utilities, administrative costs, selling expenditures and taxes. Most costs pertain to transportation and shipping activities, however.

The nature of online shopping eliminates geographic boundaries. Consequently, goods can be purchased in any part of the country and delivered straight from the warehouse. As such, the segment incurs transport and outbound shipping costs, which are expected to comprise 5.2% of segment revenue, up from 5.0% in 2009. Often, retailers incur shipping costs through marketing strategies (e.g. providing free shipping and handling for purchases). Operators that employ such marketing strategies are more likely to draw customers in an already highly competitive environment.


Retail Industry Costs vs. E-tailer Segment Costs (2015)
100%
90%
80%
70%
60%
50%
40%
30%
20%
10%
0%
6.3
3.9
2.1
1.0
74.1
9.1
3.5
6.2
3.8
3.5
1.4
71.8
6.2
7.1
Average Costs of Retail Industry
E-Tailer Segment Costs
Profit
Wages
Purchases
Depreciation
Marketing
Rent & Utilities
Other

E-Tailers: Key Statistics

Year	Revenue ($millions)	IVA ($millions)	Establishments (Units)	Enterprises (Units)	Employment (Units)	Wages ($millions)	Consumer Spending ($billions)
2005	105,615.5	18,557.3	48,523	48,357	123,383	11,797.8	34,428.0
2006	124,763.2	20,224.0	56,846	56,660	132,853	12,239.1	35,461.0
2007	156,518.5	22,884.5	67,097	66,797	142,453	12,867.4	35,870.0
2008	177,431.4	26,268.0	73,188	72,935	189,555	15,622.1	36,082.0
2009	182,878.9	27,751.9	75,809	75,510	193,248	15,499.0	35,600.0
2010	205,646.4	30,808.5	89,612	89,297	206,553	15,796.3	35,705.0
2011	230,153.6	32,989.8	98,573	98,088	206,140	15,498.1	36,294.0
2012	263,654.9	36,626.2	112,728	109,925	228,077	15,797.5	36,759.0
2013	285,765.1	40,377.3	122,261	119,280	245,497	16,944.6	36,771.0
2014	297,942.8	43,828.9	137,544	131,447	266,052	18,503.8	37,352.0
2015	**314,925.5**	**47,068.6**	**148,052**	**141,792**	**282,721**	**19,670.1**	**38,305.0**
2016	333,821.1	51,734.8	163,450	155,262	306,606	21,357.1	39,186.0
2017	353,850.3	56,296.2	176,018	167,367	324,758	22,680.5	40,294.0
2018	375,435.2	61,190.6	198,372	180,254	350,471	24,773.3	41,366.0
2019	397,210.4	64,839.3	213,230	194,134	371,356	26,309.9	42,312.0

Annual Change (%)

Year	Revenue	IVA	Establishments	Enterprises	Employment	Wages	Consumer
2005	20.3	7	12	12.1	5.3	0.6	0.6
2006	18.1	9	17.2	17.2	7.7	3.7	3
2007	25.5	13.2	18	17.9	7.2	5.1	1.2
2008	13.4	14.8	9.1	9.2	33.1	21.4	0.6
2009	3.1	5.6	3.6	3.5	1.9	-0.8	-1.3
2010	12.4	11	18.2	18.3	6.9	1.9	0.3
2011	11.9	7.1	10	9.8	-0.2	-1.9	1.6
2012	14.6	11	14.4	12.1	10.6	1.9	1.3
2013	8.4	10.2	8.5	8.5	7.6	7.3	0
2014	4.3	8.5	12.5	10.2	8.4	9.2	1.6
2015	**5.7**	**7.4**	**7.6**	**7.9**	**6.3**	**6.3**	**2.6**
2016	6	9.9	10.4	9.5	8.4	8.6	2.3
2017	6	8.8	7.7	7.8	5.9	6.2	2.8
2018	6.1	8.7	12.7	7.7	7.9	9.2	2.7
2019	5.8	6	7.5	7.7	6	6.2	2.3

Key Ratios

Year	IVA/ Revenue (%)	Revenue/ Employee ($)	Wages/ Revenue (%)	Employees/ Establishment	Wages/ Employee ($)
2005	17.6	856.0	11.2	2.5	95,619.3
2006	16.2	939.1	9.8	2.3	92,125.1
2007	14.6	1,098.7	8.2	2.1	90,327.3
2008	14.8	936.0	8.8	2.6	82,414.6
2009	15.2	946.3	8.5	2.5	80,202.6
2010	15	995.6	7.7	2.3	76,475.8
2011	14.3	1,116.5	6.7	2.1	75,182.4
2012	13.9	1,156.0	6	2	69,263.9
2013	14.1	1,164.0	5.9	2	69,021.6
2014	14.7	1,119.9	6.2	1.9	69,549.6
2015	**14.9**	**1,113.9**	**6.2**	**1.9**	**69,574.2**
2016	15.5	1,088.8	6.4	1.9	69,656.5
2017	15.9	1,089.6	6.4	1.8	69,838.2
2018	16.3	1,071.2	6.6	1.8	70,685.7
2019	16.3	1,069.6	6.6	1.7	70,848.2

Appendix: 2014 Notable Retail Transactions

Date	Target	Buyers/Investors	Size ($s in millions)	Category
30-Jul	Provide Commerce, Inc.	FTD Companies, Inc. (NasdaqGS:FTD)	$422.4	E-tailers
27-Feb	Coastal Contacts Inc.	Essilor International SA (ENXTPA:EI)	390.8	E-tailers
30-Jul	Trunk Club, Inc.	Nordstrom Inc. (NYSE:JWN)	$322.5	E-tailers
2-Jul	Vitacost.com, Inc.	The Kroger Co. (NYSE:KR)	281.2	E-tailers
11-Jun	Healthy Directions, LLC	Helen of Troy Limited (NasdaqGS:HELE)	$195.9	E-tailers
19-Aug	Pet360 Inc.	PetSmart, Inc.	160.4	E-tailers
15-Jul	Shoes.com, Inc.	Hardy Capital Partners	$140.0	E-tailers
21-Aug	A.G. Industries, Inc.	WestRock Company (NYSE:WRK)	73.7	E-tailers
13-Jan	ideeli Inc.	Groupon, Inc. (NasdaqGS:GRPN)	$62.1	E-tailers
29-May	CPO Commerce, Inc.	Essendant Co.	40.0	E-tailers
11-Aug	Saatchi Online Inc.	Demand Media, Inc. (NYSE:DMD)	$15.7	E-tailers
15-Dec	Shoes.com, Inc.	Shoes.com Technologies Inc.	11.5	E-tailers
13-Jan	AutoNationDirect.com, Inc.	Autobytel Inc. (NasdaqCM:ABTL)	$11.0	E-tailers
26-Mar	Simplexity, LLC	Wal-Mart Stores Inc. (NYSE:WMT)	10.2	E-tailers
1-Aug	Treehouse Brand Stores, LLC	Geeknet, Inc.	$3.5	E-tailers
14-Feb	Altrec Inc.	TruSnow.com	3.3	E-tailers
27-Aug	Modern Everyday, Inc.	LiveDeal, Inc. (NasdaqCM:LIVE)	$2.6	E-tailers
16-Dec	Global Telesat Corp., Contracts With Globalstar, Inc. and Globalstar LLC	Orbital Satcom Corp.	0.3	E-tailers
17-Sep	Police Blotter	Bright Mountain Acquisition Corporation (OTCBB:BMAQ)	$0.1	E-tailers
11-Feb	PVPower, Inc.	Juhl Energy, Inc. (OTCPK:JUHL)	0.1	E-tailers
9-Jul	Harris Teeter Supermarkets, Inc.	The Kroger Co. (NYSE:KR)	$2,658.0	Supermarkets & Grocery Stores
24-Jul	Market Basket, Inc.	Arthur T. Demoulas	1,600.0	Supermarkets & Grocery Stores
20-Dec	Arden Group Inc.	TPG Capital, L.P.	$389.7	Supermarkets & Grocery Stores
28-May	Delhaize America, LLC, Sweetbay, Harveys and Reid's Supermarket Chains	BI-LO, LLC	246.0	Supermarkets & Grocery Stores
7-May	RBF, LLC, Rainbow Foods Grocery Stores, Pharmacies and Liquor Stores	SUPERVALU Pharmacies, Inc.; Diamond Lake 1994 L.L.C.; Uppsala, LLC; SUPERVALU Gold, LLC	$65.0	Supermarkets & Grocery Stores
31-Jan	Pro's Ranch Markets, Inc.	Cardenas Markets, Inc.; Northgate González Markets, Inc.	55.0	Supermarkets & Grocery Stores

20-Feb	Mi Pueblo, LLC	Victory Park Capital Advisors, LLC; Cha Cha Enterprises, LLC	$45.5	Supermarkets & Grocery Stores
7-May	Arz Fine Foods Ltd	Loblaw Companies Limited (TSX:L)	6.0	Supermarkets & Grocery Stores
28-Apr	Susser Holdings Corporation	Energy Transfer Partners, L.P. (NYSE:ETP)	$2,473.9	Other
22-May	Hess Retail Corporation	Speedway LLC	2,370.0	Other
26-Nov	Jos. A Bank Clothiers Inc.	The Men's Wearhouse, Inc. (NYSE:MW)	$1,826.0	Other
19-Feb	Zale Corporation	Signet Jewelers Limited (NYSE:SIG)	1,200.0	Other
25-Sep	Mid-Atlantic Convenience Stores, LLC	Sunoco LP (NYSE:SUN)	$949.8	Other
15-Jun	DCH Auto Group, Inc.	Lithia Motors Inc. (NYSE:LAD)	681.6	Other
4-Sep	The Sleep Train, Inc.	Mattress Firm, Inc.	$451.8	Other
11-Jun	WilcoHess, LLC	Hess Corporation (NYSE:HES)	364.0	Other
3-Jun	Brookstone Inc.	Shanghai International Group Co., Ltd.	$283.1	Other
17-Jul	Design Within Reach, Inc.	Herman Miller Inc. (NasdaqGS:MLHR)	161.0	Other
10-Sep	Barrier Motors, Inc., Audi, Mercedes-Benz, Porsche and Volvo Stores in Seattle-Bellevue Market	AutoNation, Inc. (NYSE:AN)	$106.7	Other
8-Nov	SPF Energy, Inc.	Parkland Fuel Corporation (TSX:PKI)	98.9	Other
14-Nov	SAC N PAC Stores, Inc. And 3W Warren Fuels, Ltd.	Sunoco LP (NYSE:SUN); Susser Holdings Corporation	$88.0	Other
17-Mar	Hastings Entertainment Inc.	Draw Another Circle, LLC	73.2	Other
20-Aug	Nice N Easy Grocery Shoppes, Inc.	CrossAmerica Partners LP (NYSE:CAPL); CST Brands, Inc. (NYSE:CST)	$65.0	Other
10-Mar	Sleep Experts Partners, L.P.	Mattress Firm, Inc.	65.0	Other
15-Apr	Town Shoes Limited	DSW Inc. (NYSE:DSW)	$61.9	Other
29-Aug	Back to Bed Inc. and M World Mattress LLC and MCStores LLC and TBE Orlando LLC	Mattress Firm, Inc.	60.3	Other
30-Jun	Sport Chalet Inc.	Vestis Retail Group, LLC	$58.8	Other
23-Jun	Centric Health Corporation, MEDIchair and Motion Specialties Retail Home Medical Operations	Birch Hill Equity Partners Management Inc.	45.2	Other
10-Apr	Marketplace Design Center	Lubert-Adler Partners, LP; PMC Property Group, Inc.	$42.0	Other
28-Apr	Mattress Liquidators, Inc.	Mattress Firm, Inc.	35.0	Other
14-Apr	Stittco Energy Limited	Gibson Energy Inc. (TSX:GEI)	$29.3	Other
12-Aug	Hannoush Jewelers, Inc., 27 Stores	Pandora A/S (CPSE:PNDORA)	29.0	Other
2-Apr	Access Ford, Ltd.	Lithia Motors Inc. (NYSE:LAD)	$26.1	Other
22-May	Automobile Canbec Inc.	AutoCanada Inc. (TSX:ACQ)	24.8	Other

5-Nov	Auto Boulevard Saint-Martin Inc.	AutoCanada Inc. (TSX:ACQ)	$24.2	Other
13-Aug	Tower Chrysler Plymouth Ltd.	AutoCanada Inc. (TSX:ACQ)	20.4	Other
28-Oct	ENN Canada Corporation	ENN Energy Holdings Limited (SEHK:2688)	$20.0	Other
19-Aug	Lakewood Chevrolet Ltd	AutoCanada Inc. (TSX:ACQ)	18.1	Other
28-Mar	Ashley Stewart Holdings, Inc	Clearlake Capital Group, LLC	$18.0	Other
4-Mar	Coast Wholesale Appliances Inc.	CWAL Investments Ltd.	17.8	Other
5-Aug	Optic Direct Inc.	New Look Vision Group Inc. (TSX:BCI)	$16.2	Other
9-Jul	Speed Commerce, Inc., Legacy Distribution Business	WYNIT Distribution, LLC	15.0	Other
10-Mar	Southern Max, LLC And Yotes Inc.	Mattress Firm Holding Corp. (NasdaqGS:MFRM)	$14.8	Other
12-Jun	High Up Dairy Mart, Incorporated	PMG HUDMI LLC	14.7	Other
7-Aug	Love Culture, Inc.	United LC Capital LLC	$10.5	Other
25-Apr	The Running Specialty Group Acquisitions 1, LLC	Finish Line Inc. (NasdaqGS:FINL)	10.5	Other
20-Jan	Aaron's, Inc., RIMCO Operations	Rent A Wheel	$10.0	Other
14-Jul	Coast Wholesale Appliances Inc.	CWAL Investments Ltd.	8.4	Other
30-Apr	Yocum Oil Company, Inc., Nine Holiday Gas and Convenience Stores	Holiday Companies	$8.0	Other
30-Jun	Sport Chalet Inc.	Vestis Retail Group, LLC	7.8	Other
8-Apr	Floors-N-More, LLC	ALJ Regional Holdings, Inc. (OTCPK:ALJJ)	$5.5	Other
8-Sep	American Optical Services, LLC, 10 Locations of The Eye Gallery and The Artful Eye	Emerging Vision Inc.	4.9	Other
3-Jul	CabinetWare, Inc.	Richelieu Hardware Ltd. (TSX:RCH)	$4.5	Other
3-Sep	The Vape Store, Inc.	Vaporin, Inc.	4.1	Other
17-Nov	Bridges Chevrolet Buick GMC Ltd.	AutoCanada Inc. (TSX:ACQ)	$4.1	Other
30-Apr	Calumet Photographic, Inc.	C&A Marketing Inc.	3.7	Other
21-Aug	Travel Center	TravelCenters of America LLC (NYSE:TA)	$3.2	Other
30-Sep	Frederick's of Hollywood Group Inc.	HRG Group, Inc. (NYSE:HRG); Fursa Alternative Strategies LLC; TTG Apparel, LLC; Tokarz Investments, LLC; Arsenal Group, LLC, Asset Management Arm	3.1	Other
4-Nov	West 49 Inc.	YM Inc.	$2.7	Other
7-Apr	Body Central Corp. (OTCPK:BODY)	Blackwood Capital Management, LLC	2.0	Other
20-Oct	Toronto Dodge Chrysler Ltd.	AutoCanada Inc. (TSX:ACQ)	$1.9	Other

12-Feb	GGW Brands LLC	GGW Acquisition LLC	1.8	Other
22-Oct	Go Green Hydroponics Inc.	OSL Holdings Inc. (OTCPK:OSLH)	$1.8	Other
20-Jul	New Dots, LLC	Simply Fashion Stores, Ltd.	0.7	Other
17-Feb	Astor & Black Custom Clothiers Ltd.	Bello Verde LLC	$0.4	Other
9-Apr	Jump Oil Company, Inc., 3600 South Big Bend Boulevard	Parson's Oil Company LLC	0.3	Other
16-Jun	Hydro-Grow Supply, Inc.	Green Energy Investments, Inc.	$0.3	Other
31-Mar	Toy Joy, Inc.	Wild About Music Inc.	0.1	Other