

TIMES & TRENDS

A Snapshot of Trends Shaping the CPG Industry

DOLLAR STORES

AN INDUSTRY GROWTH PHENOMENON



April 2006

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EXECUTIVE SUMMARY

- ▶ Aggressive store expansion among leading players drove 9.3% dollar channel sales growth; while the channel still captures only a fraction of CPG industry sales, it represents a viable growth path for many categories and brands and a competitive threat to traditional retailers
- ▶ Non-foods represent over half of dollar store CPG sales; however, product mix is shifting towards food and beverages, which dollar store retailers are increasingly leveraging to drive store traffic
- ▶ Dollar stores have achieved the “triple crown” in retail: increased shopper penetration, trip frequency, and average basket size; consumer shopping trends bode well for continued strong growth
- ▶ One-third of dollar store shoppers -- predominantly low income consumers -- comprise 85% of channel sales; with over 5% share of their CPG spending, dollar stores deliver reach within this growing consumer segment
- ▶ Private label is significantly less developed within the dollar channel versus other CPG outlets across most departments (with the exception of healthcare); dollar store retailers are increasing the presence of major national brands in their stores to enhance store image and value perceptions



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INTRODUCTION

CPG manufacturers and retailers should give serious consideration to the dollar store channel.

Timing is everything.

Dollar stores have been around for over 50 years, but the channel has only recently reached the status of major retail outlet.

The recent success of dollar stores is the culmination of a number of factors that have been at work for several years:

- ▶ The general population has become highly value-conscious due in large part to the availability and positioning of value retailers
- ▶ The number of low income consumers who *need* rock-bottom pricing is on the rise: those with income below \$25,000 have increased in number by over 10% in the past five years
- ▶ Dollar stores have increased appeal through upgraded stores and merchandise and have increased access through rapid store expansion

The time has come for CPG manufacturers to give serious consideration to the dollar store channel as a potential growth venue for their brands, and for retailers to view dollar stores as a potential competitive threat.

This report is intended to provide CPG manufacturers and retailers with dollar store insights required to

See potential new category, brand and store growth opportunities and risks

Act on these opportunities with speed and confidence and

Win at the shelf.

Dollar Store Definition

Within this report, dollar stores are defined as retailers selling merchandise at one of the following price points:

Extreme Value: Sell a vast majority of products at \$10 or less

Single Price: All products sold at one price point (such as \$1.00 or 99 cents.)

Source: Adapted from *Chain Store Guide* dollar store definition.



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DOLLAR CHANNEL OVERVIEW SIZE AND GROWTH

The dollar store channel has grown into a major retail outlet.

With an estimated \$27.5 billion in North American sales and over 23,000 store locations, the dollar store channel has grown into a major retail outlet. Sales increased 9.3% last year.¹

The channel has evolved from one in which small independents were loosely setting industry direction to one in which large, sophisticated companies are implementing strategic plans and programs that are literally reshaping the industry.

Today, despite the fact that there are over 1,000 dollar store companies, the industry is highly concentrated: the top four publicly traded retailers control roughly two-thirds of sales.

The dollar store channel warrants consideration in CPG manufacturer distribution strategies and retailer competitive strategies. Leading dollar store retailers should be the primary focal point for both.

A handful of leading retailers dominate channel sales.



Source: Annual Reports; Earning Releases

1. Chain Store Guide Custom Analysis



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DOLLAR CHANNEL OVERVIEW GROWTH DRIVERS

Store expansion has been the primary driver of growth.

Over the last several years, dollar channel store expansion has occurred at a remarkable pace. The top four publicly traded dollar store retailers alone added over 1,400 stores during the past year.

The dollar channel is still far from saturated. As a majority of consumers shop at dollar stores within five miles from their homes, an individual market can support numerous store locations.¹

And, store expansion shows no signs of slowing. Dollar General has announced plans for an additional 800+ stores in 2006, while Family Dollar plans to add 400 stores, according to company documents.

Growing comparable store sales, however, proved to be challenging for dollar stores in 2005. Core lower income consumers faced economic hardship as a result of rising fuel costs and were forced to decrease spending on discretionary purchases – particularly during the fourth quarter.

As dollar stores increasingly expand food and beverage offerings, they will play a larger role in providing consumers' basic necessities – which will in turn protect sales during tough economic times.

Dollar Store Leading Retailers Store Count Change Fiscal Year 2005 vs 2004

Dollar General	+734
Family Dollar	+500
Dollar Tree	+179
99 Cents Only	+9

Source: Annual Reports; Earning Releases

Dollar Store Leading Retailers Comparable Store Sales Change Fiscal Year 2005 vs 2004

Dollar General	+2.0%
Family Dollar	+2.3%
Dollar Tree	(0.8%)
99 Cents Only	+0.3%

Source: Annual Reports; Earning Releases

“Financial analysts believe that the extreme value industry is the most under-saturated major sector in retailing with a lot of untapped and under-penetrated markets remaining.”

– Chain Store Guide

1. Confection, August 2005



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DOLLAR CHANNEL OVERVIEW PRODUCT MIX

Dollar store product mix is shifting from non-foods to food & beverage.

"Our goal is that a customer can come in and buy a full week's complement of groceries at our store."

David Perdue
Chairman & CEO,
Dollar General

Led by general merchandise categories, non-food products represent over half of dollar store CPG sales.

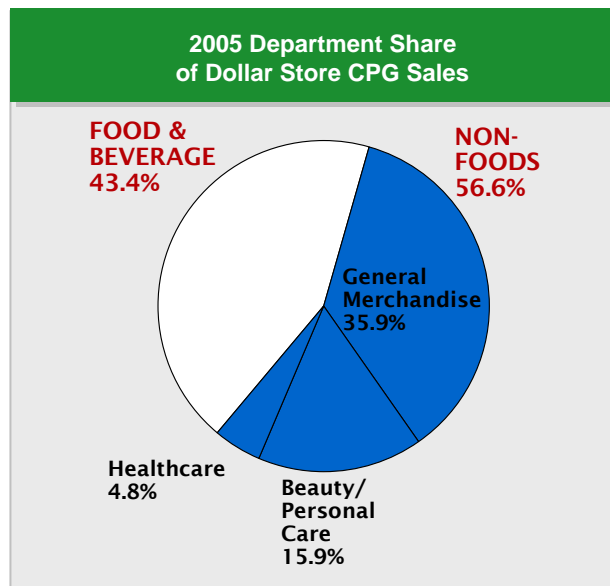
As leading dollar store retailers increase focus on food and beverages to increase store traffic, however, product mix is shifting away from non-foods.

In fact, each of the major players is in the process of adding refrigerated and frozen food sections to their stores.

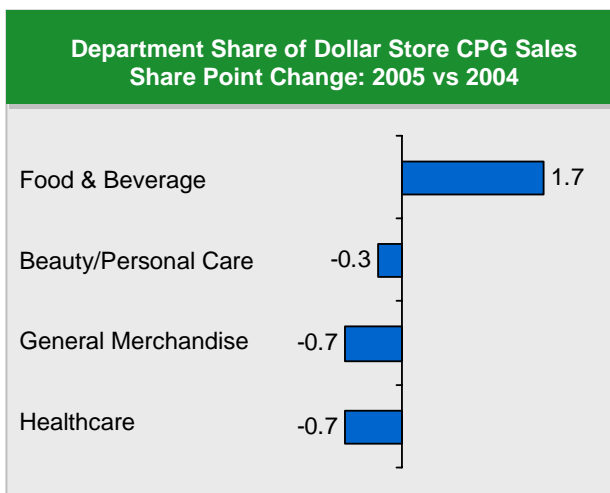
Family Dollar added coolers to 1,000 stores during fiscal year 2005, with plans to install another 2,500 this year.¹

While Dollar Tree's single price format, \$1.00 for all items, will limit the chain's ability to add higher-ticket food items, the chain will increase focus on food with the addition of 200 coolers this year.²

In addition to adding coolers to its existing stores, Dollar General has taken the focus on food one step further in creating a new format, Dollar General Market, which has twice the square footage of a traditional Dollar General store and plenty of room for a wide assortment of food and beverages – including fresh produce and meat.



Source: IRI Consumer Network®



Source: IRI Consumer Network®

1. Supermarket News, 10/24/05

2. Ibid



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DOLLAR CHANNEL OVERVIEW SHARE TRENDS

The dollar channel holds a small share of total CPG spending.

Despite rapid growth, the dollar channel did not significantly grow CPG share in 2005 (+.02 share points), as the channel's dollar sales base is small relative to traditional CPG outlets.

Dollar stores hold a 1.4% share of total CPG spending – a fraction of industry sales.

Channel share varies across departments, with beauty/personal care and general merchandise share significantly above average.

While dollar stores are a small player in a huge market, the channel's market impact and potential should not be underestimated.

In a market with low sales growth (total CPG industry sales increased just 1.4% in 2005 across food, drug, mass channels, including Wal-Mart), all growth opportunities and risks need to be carefully evaluated.

Further, as will be described in more detail throughout this report, a number of favorable trends will drive continued dollar channel growth: increased availability of food and beverages, increased presence of major national brands, increased reach across consumer segments, and continued store expansion.

2005 Channel Share of Total CPG* Spending and Point Change vs 2004		
	Share	Change
Food	57.7%	0.0
Supercenter	13.0%	+0.8
Mass	9.3%	-0.5
Club	6.3%	-0.2
Drug	5.2%	+0.1
Dollar	1.4%	0.0

*Across IRI Reviews categories; all outlet share

Source: IRI Consumer Network®

2005 Dollar Channel Share of All Outlet Spending* and Point Change vs 2004		
	Share	Change
General Merchandise	2.6	0.0
Beauty/Personal Care	2.6	-0.1
Healthcare	1.2	-0.2
Food & Beverage	0.9	0.0
Total CPG*	1.4	0.0

*Across IRI Reviews categories; all outlet share

Source: IRI Consumer Network®



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DOLLAR CHANNEL SHOPPERS SHOPPING TRENDS

Consumer shopping trends bode well for continued dollar store growth.

Dollar stores are not only extending their reach among consumers but have also increased basket size and trip frequency – the “triple crown” in retail.

Dollar stores have surpassed club stores in trip frequency and are not far behind drug stores. Shoppers are now in dollar stores just over once per month, on average.

For manufacturers, dollar stores now offer significantly greater exposure to their products: more consumers are exposed to dollar store products more often. For competing retailers, dollar stores are now potentially converting trips and are certainly impacting basket size to some extent.

Dollar Store Shopping Trends			
	2005	2003	
% Shopper Penetration	63.2%	60.9%	▲
Trips/Shopper/Month	1.05	.98	▲
Average Dollars per Trip	\$12.37	\$11.35	▲

Source: IRI Consumer Network®

Dollar stores have surpassed club stores in trip frequency.

2005 Average Trips per Shopper Per Month		
		% Change vs 2004
Grocery	5.43	(0.8%)
Wal-Mart	1.96	+1.3%
Supercenter	1.82	+5.5%
Mass	1.72	(5.0%)
Drug	1.27	+3.3%
Dollar	1.05	+4.0%
Club	0.84	+1.6%

Source: IRI Consumer Network®



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DOLLAR CHANNEL SHOPPERS HEAVY SHOPPERS

One-third of dollar store shoppers – predominantly low income consumers -- represent 85% of channel sales.

The dollar channel's heaviest buyers – the top one-third of shoppers – represent 85% of channel sales. And, dollar stores hold a 5.3% share of total CPG spending among these shoppers, versus a 1.4% share among all households.

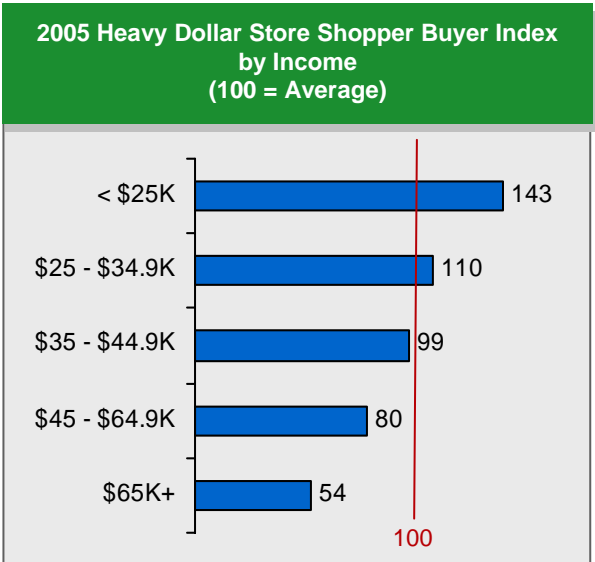
Heavy dollar store shoppers skew lower income and over age 35.

While dollar stores continue to broaden their consumer reach, this core consumer group is critical to industry sales, and it is imperative that product assortment is aligned with these consumers' needs.

The dollar channel is an ideal growth venue for brands targeting this consumer segment and is a formidable competitive outlet for retailers with a high mix of lower income consumers across their stores. Heavy dollar store shoppers allocate a higher than average share of spending to supercenters (15.0% vs 13.2%) and a lower share to grocery retailers (52.6% vs 57.4%).

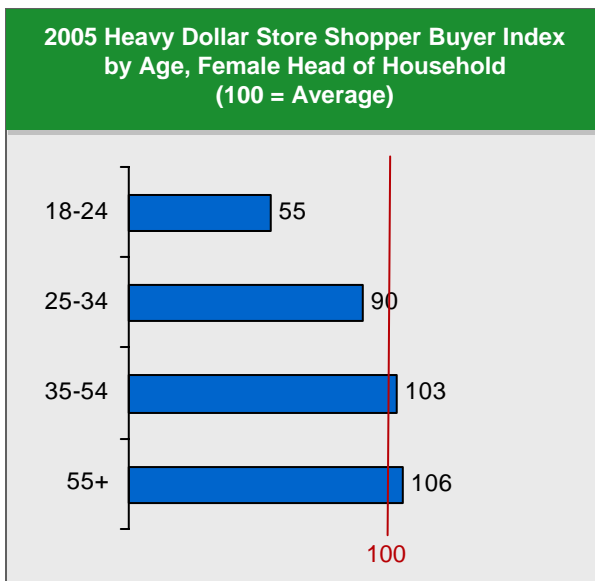
The Category Opportunity section of this report highlights categories that are already well-developed within this core segment in dollar stores. In these categories, brands should consider a dollar store presence. This section also highlights categories that are ripe for development.

Heavy dollar store buyers skew lower income...



Source: IRI Consumer Network®

..and age 35+



Source: IRI Consumer Network®



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CATEGORY OPPORTUNITY WELL-ESTABLISHED DOLLAR STORE CATEGORIES

Manufacturers should explore brand development opportunities within well-established dollar store categories.

Within the categories below, dollar stores have an above-average share among heavy shoppers.

Manufacturers within these categories should explore developing their brands' dollar store presence and should evaluate brand performance and shelf

space allocation versus competitive brands.

Competing retailers should consider featuring these categories in dollar promotions (eg. 10 for \$10) and "dollar store" sections, as they have proven success within a dollar format.

Category Development Heavy Dollar Store Shopper Share Index: Category vs Department*			
<u>General Merchandise (> 150)</u>		<u>Food & Beverage (> 150)</u>	
Lighters	228	Non-Chocolate Candy	477
Foil Pans	217	Gum	380
Rug/Uphol/Fabric Treatment	213	Canned Meat	318
Household Cleaner	205	Chocolate Candy	304
Furniture Polish	184	Cookies	250
Fabric Softener Sheets	178	Miscellaneous Snacks	221
Household Plastics	177	Spices/Seasonings	199
Air Fresheners	168	Bakery Snacks	198
Candles	164	Salty Snacks	177
Dish Detergent	167	Snack Nuts/Seeds/Corn Nuts	172
Sponges & Scouring Pads	164	Shelf Stable Bottled Juices	170
Foils & Wraps	162	Shelf Stable Dinners	152
Office Products	156	Dried Meat Snacks	152
<u>Beauty/Personal Care (> 120)</u>		<u>Healthcare (> 120)</u>	
Cotton Balls/Swabs	196	Cough Syrup	174
Home Perm/Relaxer Kits	191	First Aid Treatment	173
Soap	158	Internal Analgesics	165
Facial Tissue	144	Gastrointestinal Liquid	145
Hair Spray/Spritz	136	External Analgesic Rub	141
Sanitary Napkins/Tampons	129	Cold/Allergy/Sinus Liquids	140
Bath Products	126	First Aid Accessories	126
Deodorant	126		

* Note: Share index = dollar store channel share of all outlet category sales/dollar store channel share of all outlet department sales among top one-third of dollar store shoppers; 100 = average.



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CATEGORY OPPORTUNITY UNDER-DEVELOPED DOLLAR STORE CATEGORIES

There are significant category development opportunities among under-developed dollar store categories.

Dollar store sales are under-developed in the categories below, as represented by significantly lower-than-average share among heavy shoppers.

Manufacturers in these categories should explore partnering with leading dollar store retailers in category

development initiatives— optimal assortment, marketing and merchandising programs.

Competing retailers can feature under-developed dollar store categories in marketing and promotional initiatives targeting core dollar store shoppers.

Category Development Heavy Dollar Store Shopper Share Index*: Category vs Department (Categories with Indices < 80)			
<u>General Merchandise</u>		<u>Food & Beverage</u>	
Cleaning Tools	76	Pickles/Relish/Olives	79
Pantyhose/Nylons	71	Dry Packaged Dinners	77
Light Bulbs	68	Pasta	74
Pet Supplies	64	Sugar	74
Motor Oil	60	Shortening & Oil	72
Tights/Socks	60	Sports Drinks	69
Blank Audio/Video	55	Dry Fruit Snacks	68
Photography Supplies	50	Aseptic Juices	67
Dog Food	48	Salad Dressing	65
Cat Food	41	Rice	62
		Pastry/Doughnuts	59
		Fresh Bread & Rolls	42
		Refrigerated	37
		Frozen	27
		<u>Healthcare</u>	
		Gastrointestinal Tablets	77
		Vitamins	50
		Nasal Products	41
<u>Beauty/Personal Care</u>			
Moist Towelettes	78		
Facial Cosmetics	75		
Lip Cosmetics	74		
Women's Fragrances	71		
Shaving Ltn/Men's Fragrance	62		
Skin Care	57		
Adult Incontinence	48		
Denture Products	47		
Hair Coloring	34		

* Note: Share index = dollar store channel share of all outlet category sales/dollar store channel share of all outlet department sales among top one-third of dollar store shoppers; 100 = average.



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PRIVATE LABEL SHARE TRENDS

With the exception of healthcare, private label is a relatively minor force in dollar store CPG.

With an historic focus on second and third tier CPG brands, dollar stores have not developed CPG private label to levels seen within other CPG outlets, as highlighted in the chart below.

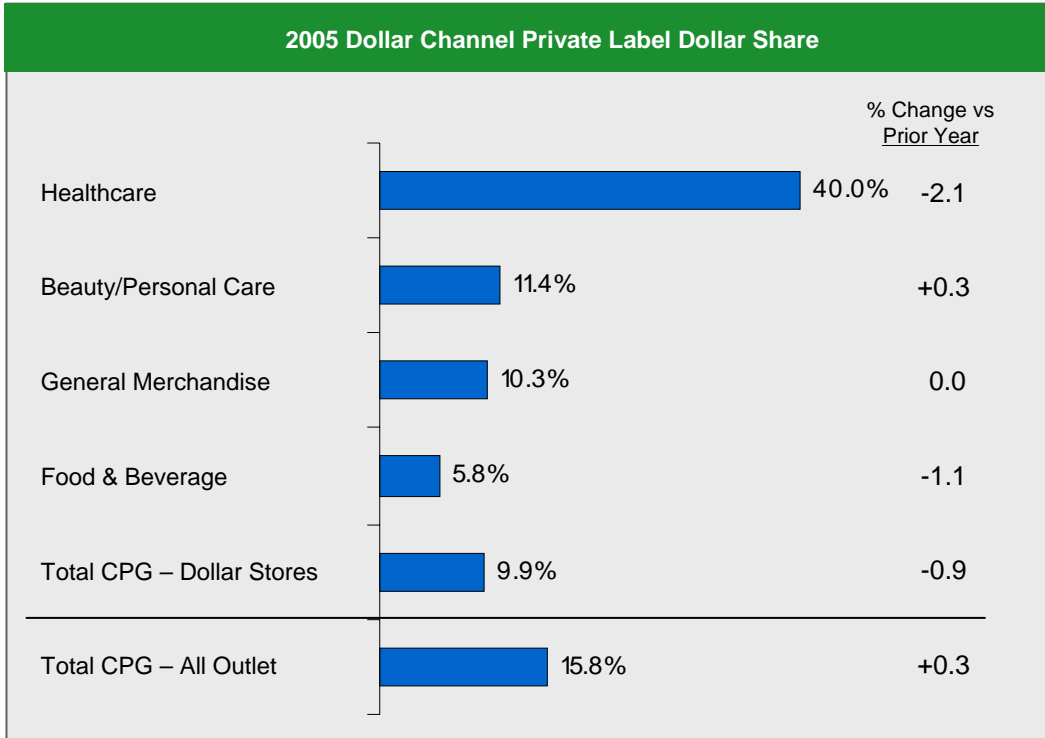
Healthcare is one exception. 40% of dollar store healthcare sales are comprised of private label products. The channel's heavy focus on private label within healthcare may reflect a need to maintain store pricing schemes among relatively high-ticket healthcare products.

While many analysts expect an increased focus on dollar store private label longer term, as companies seek margin enhancement opportunities, over the next several years, private label share may actually decline, as was evident this past year.

Dollar store chains are likely to increase the presence of major national brands in recognition of their power to drive traffic, increase basket size, and create a positive store image.

"You want to have the nationally advertised brands at very competitive prices so that the consumer recognizes the good value you offer, and that brings traffic into the store."

George Mahoney
EVP Family Dollar Stores
(DSN Retailing Today, 3/24/05)



Source: IRI Consumer Network®



CONCLUSIONS

- ▶ Despite dollar stores' small share of CPG spending, the dollar channel warrants serious consideration by manufacturers as a viable growth venue and by retailers as a competitive threat
- ▶ Non-food retailers with an existing dollar store presence should monitor shelf space allocation as dollar store retailers increase focus on food and beverages; manufacturers should partner with leading retailers to determine optimal space allocation based upon brand contribution to sales, margin and store value perceptions
- ▶ Within under-developed dollar store categories (eg. pet food & supplies, dry packaged dinners, cosmetics and vitamins), manufacturers should explore category development opportunities with leading dollar store retailers; competing retailers should feature these categories in marketing initiatives targeting lower income consumers
- ▶ Within well-developed dollar store categories (eg. household cleaners, candy, soap and cough syrup), manufacturers should consider developing or increasing brand dollar store presence; competing retailers should feature these categories in dollar promotions (eg. 10 for \$10) and "dollar store" sections
- ▶ Major national brands should explore leveraging the dollar store channel to drive trial and incremental purchases among core dollar store lower-income shoppers



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RESOURCES

To gain insight into opportunities and risks across specific categories, consumer segments, channels or retailers, contact your IRI client service representative regarding custom analyses leveraging the following resources:

- | | |
|--|---|
| IRI Consumer Network® | Nationally representative panel of households tracking purchases with hand-held barcode scanners; extensive demographic profiles enable in-depth analysis of purchase behavior across standard or custom-defined consumer segments across channels. |
| IRI Dollar Store Tracking Service | Scanner-based, UPC-level tracking service among leading dollar store retailers; delivers data and insights on sales, share, distribution, and pricing across CPG categories. |
| IRI AttitudeLink | IRI's custom survey capability that can be executed via mail, telephone or Internet; the ability to link attitudes with actual purchase behavior enables clients to track sales across custom attitudinal segments. |



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MORE INFORMATION

Please contact Sheila McCusker at sheila.mccusker@infores.com with questions or comments about this report.

ABOUT IRI

Information Resources, Inc. (IRI) is the world's leading provider of enterprise market information solutions and services, empowering its clients to grow their business profitably in a complex marketplace. Driving the transformation of the consumer packaged goods (CPG), retail and healthcare industries, only IRI provides a unique combination of real-time market content, advanced analytics, enterprise performance management software and professional services. The company's portfolio of services, solutions and technology enable leading retailers and their suppliers around the globe to see what they are missing, act faster and with greater confidence and win at the shelf. Ninety-five percent of the FORTUNE Global 500 in CPG and retail leverage IRI to power their business. For more information, visit www.infores.com.



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