

TIMES & TRENDS

A Snapshot of Trends Shaping the CPG Industry

CHANNEL MIGRATION: A NEW TURNING POINT IN CONSUMER SHOPPING PATTERNS



July 2006

- 02 Executive Summary
- 03 Introduction
- 04 CPG Industry Overview
- 06 Food & Beverage
- 10 Non-Foods
- 14 Consumer Segments
- 16 Conclusions
- 17 Resources





TIMES & TRENDS

A Snapshot of Trends Shaping the CPG Industry

EXECUTIVE SUMMARY

- ▶ CPG channel migration has reached a turning point as grocers maintain share, and supercenters pull heavily from traditional mass merchandise stores
- ▶ High-ticket, stock-up and impulse purchases characterize the most “hotly-contested” cross-channel categories, which include candy, coffee, batteries and cold/allergy/sinus tablets, among others
- ▶ Private label has a relatively minor role among categories with a high degree of channel fragmentation (with the exception of healthcare categories); consumers appear to look for deals on national brands
- ▶ Consumers who are “heavy channel migrators” (allocate no more than 40% of CPG spending to any one channel) skew towards smaller households in the older Baby Boomer age brackets
- ▶ Non-food categories, particularly general merchandise, beauty/personal care and healthcare, should be the cornerstone of cross-channel competitive strategies; non-foods represent a high proportion of heavy channel migrator spending and have the highest levels of channel share fragmentation



INTRODUCTION

CPG channel migration has reached a turning point.

“One-stop-shopping” has clearly become an outdated term: three-quarters of today’s consumers shopped in five or more channels this past year to meet their CPG needs.¹ Multi-channel shopping is now the norm.

Consumer drive for convenience and value pricing, coupled with the industry’s increased points of access and aggressive price/promotion strategies have fueled channel migration for the past decade.

The result has been sizable consumer spending shifts across channels for several years running – with the dominant flow from grocery and traditional mass merchandisers to supercenters.

These steady, long-term trends have reached a turning point. Channel migration is showing signs of slowing. Supercenters appear to be pulling share predominantly from traditional mass merchandiser stores, while grocers have successfully maintained share.

This report takes an in-depth look at historical and emerging channel migration trends and the categories and consumer segments that are most heavily impacted.

The assessment is designed to provide CPG manufacturers and retailers with new insights required to:

See new opportunities and risks resulting from changes in channel migration trends

Act on these insights with speed and confidence and

Win at the shelf.

1. IRI Consumer Network®; 52 weeks ending 5/15/06



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CPG INDUSTRY OVERVIEW SHARE SHIFTS

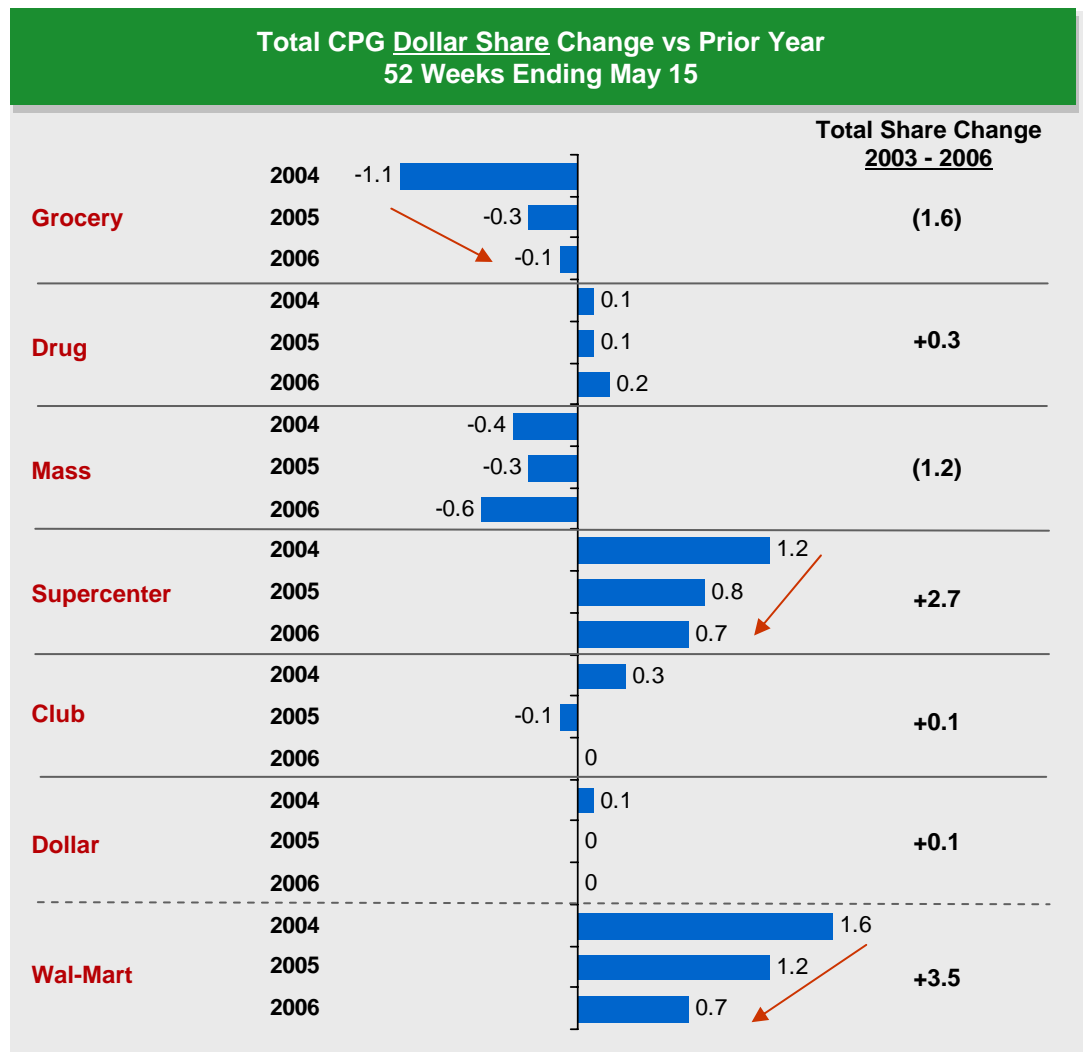
Supercenter share gains have slowed, as grocers hold their own.

Increasingly saturated supercenter markets and successful grocery re-positioning efforts, including new upscale formats and increased focus on fresh foods, have slowed supercenter CPG share gains.

Over the past year, supercenter gains have come primarily at the expense of traditional mass merchandisers -- in part

due to continued mass to supercenter store conversions -- while grocery share loss was minimal.

As detailed throughout this report, while these trends highlight changes in consumer shopping patterns overall, it is critical to also track brand/category and store-level changes which may deviate from total industry trends.



Source: IRI Consumer Network®



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CPG INDUSTRY OVERVIEW TRIP SHIFTS

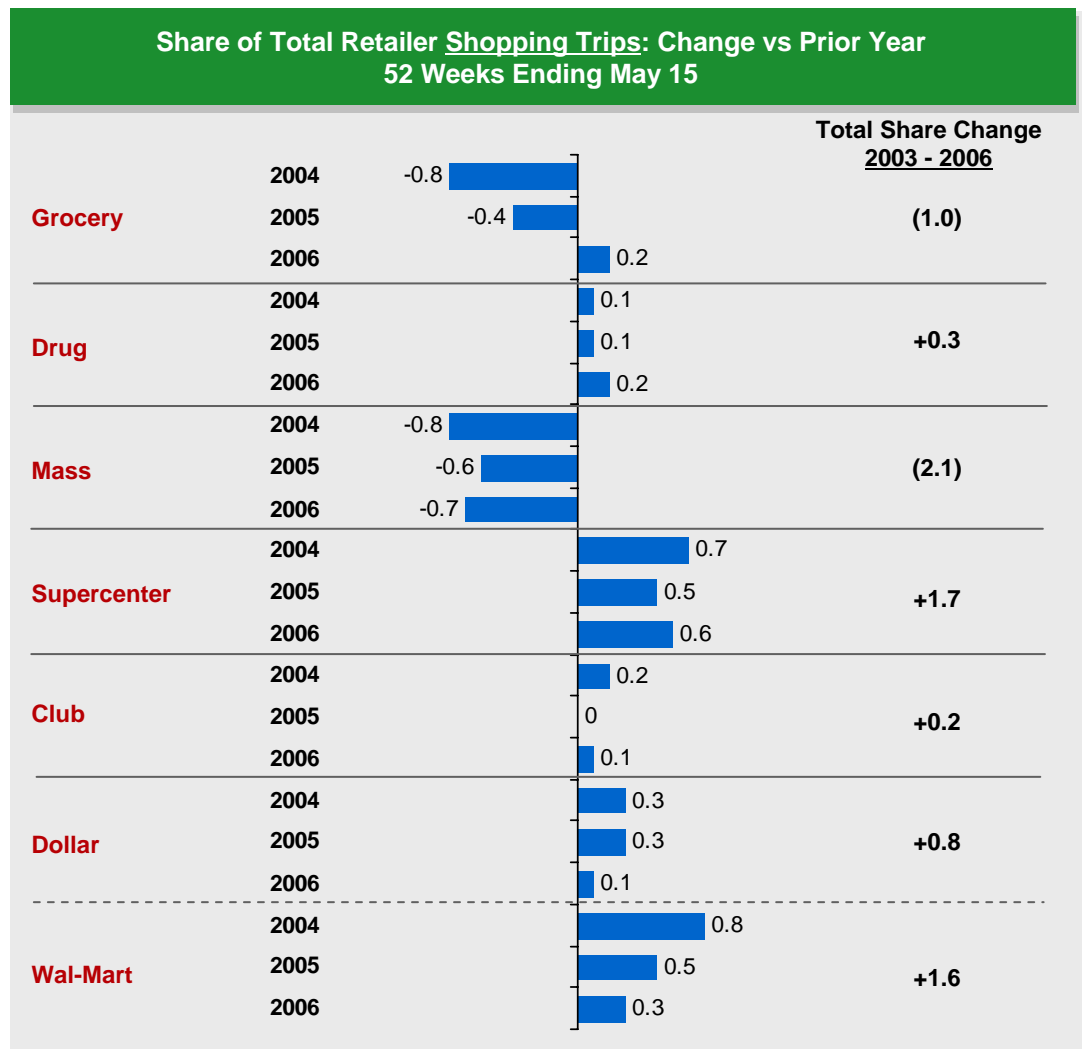
Grocers successfully maintained share of trips this year.

While consumers' trip shifts have been less dramatic than share changes, they have followed a similar pattern.

Over the past three years, grocers have lost 1% of total shopping trips (which equates to just under half a trip), while supercenters have gained. Traditional mass merchandisers have lost 2% of trips.

Throughout the past year, however, grocers have successfully kept consumers in their stores – a major win in the face of intense cross-channel competition.

Grocers will seek to protect this position while increasing focus on initiatives to grow basket size.



Source: IRI Consumer Network®



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FOOD & BEVERAGE CHANNEL SHARE MIX - DEPARTMENT

Snacks and beverages have the highest degree of channel fragmentation.

As highlighted in the chart below, despite years of extensive channel migration, grocers continue to capture the vast majority of consumer spending across food and beverage departments. Grocers are clearly in the defensive position versus other channels within food and beverages.

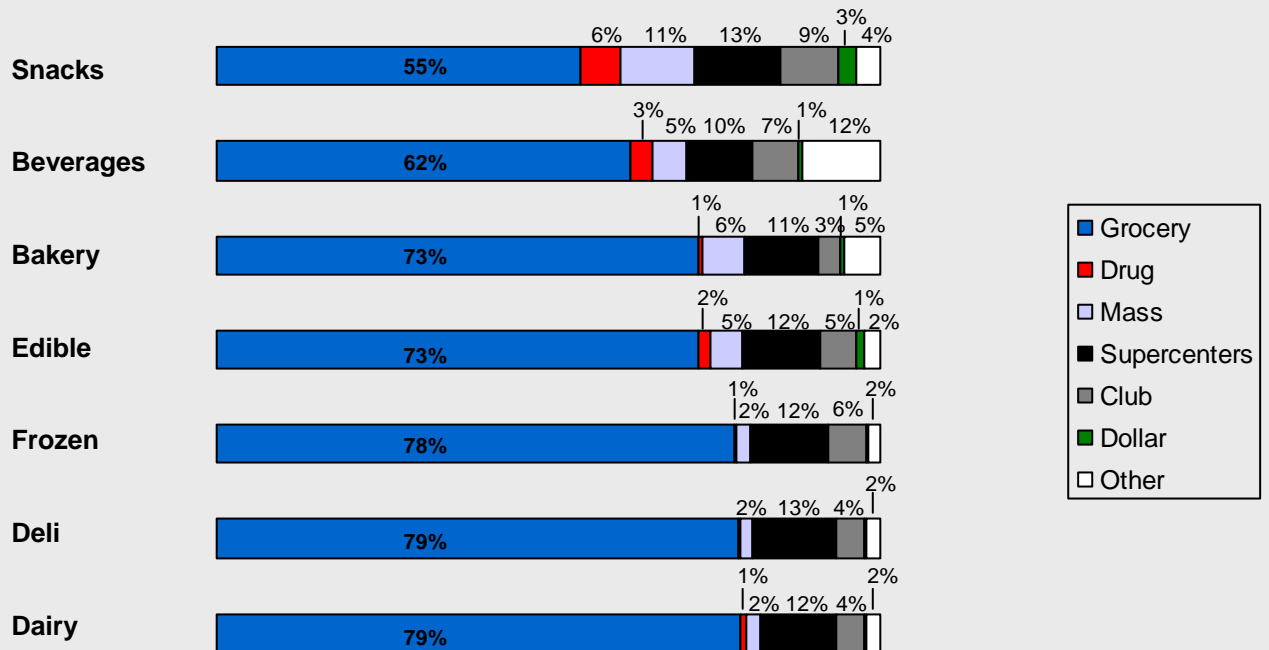
Given the ability to purchase products across a wide range of outlets, snacks and beverages exhibit the highest degree of channel fragmentation.

Within snacks, chocolate and non-chocolate candy – heavy impulse purchases – have the most widespread channel share mix.

Wine and spirits have the least share concentration among beverages.

These two departments should be considered important components of retailers' cross-channel competitive marketing and merchandising strategies.

**Channel Dollar Share by Department (Based on All Outlet Sales)
52 Weeks Ending 5/15/2006**



Source: IRI Consumer Network®



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FOOD & BEVERAGE CHANNEL SHARE MIX - CATEGORY

Cross-channel battles are most intense across both high-ticket and impulse food and beverages.

Eleven of the thirteen most “hotly-contested” food and beverage categories (those in which no one channel has greater than a 65% dollar share) belong to the snack and beverage departments. Two frozen poultry categories (cooked and uncooked) round out the list.

A relatively high average unit price appears to be a primary factor encouraging consumers to shop around in roughly half of these categories.

For others, such as bottled water and candy, impulse, immediate need and access appear to be driving cross-channel shopping.

As retailers seek to capture share in these highly competitive categories, they should not under-estimate the power of brands – private label holds a relatively low share.

Manufacturers within these categories should assess multi-channel distribution levels to ensure adequate presence.

Consumers are likely shopping multiple channels for deals across high-ticket categories...

But do not appear to be looking for private label (with a few exceptions.)

FOOD & BEVERAGE: Hotly-Contested Categories		
Categories in Which Dollar Share is Below 65% for Any One Channel		
Average Unit Price and Private Label Share Indices vs Total CPG (FDMx; 100 = Average)		
Category	Unit Price Index	Private Label Dollar Share Index
Beer	324	1
Bottled Water	81	134
Chocolate Candy	57	11
Coffee	189	59
Cookies	92	73
Frozen Poultry (Uncooked)	219	253
Frozen Poultry (Cooked)	189	74
Non-Chocolate Candy	53	42
Snack/Granola Bars	92	34
Snack Nuts/Seeds	118	201
Spirits	584	32
Sports Drinks	76	4
Wine	340	0

Source: IRI Consumer Network®; IRI InfoScan® Reviews



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FOOD & BEVERAGE CHANNEL SHARE SHIFTS - DEPARTMENT

Share shifts vary substantially across food and beverage departments.

While significant share shifts continue across all food and beverage departments, the extent and composition of the shifts vary.

For instance, within beverages, grocers incurred a sizable share loss, which went to supercenters and club. Grocery share declines were most significant in shelf-stable and refrigerated juices; these losses were mitigated by gains in wine and bottled water.

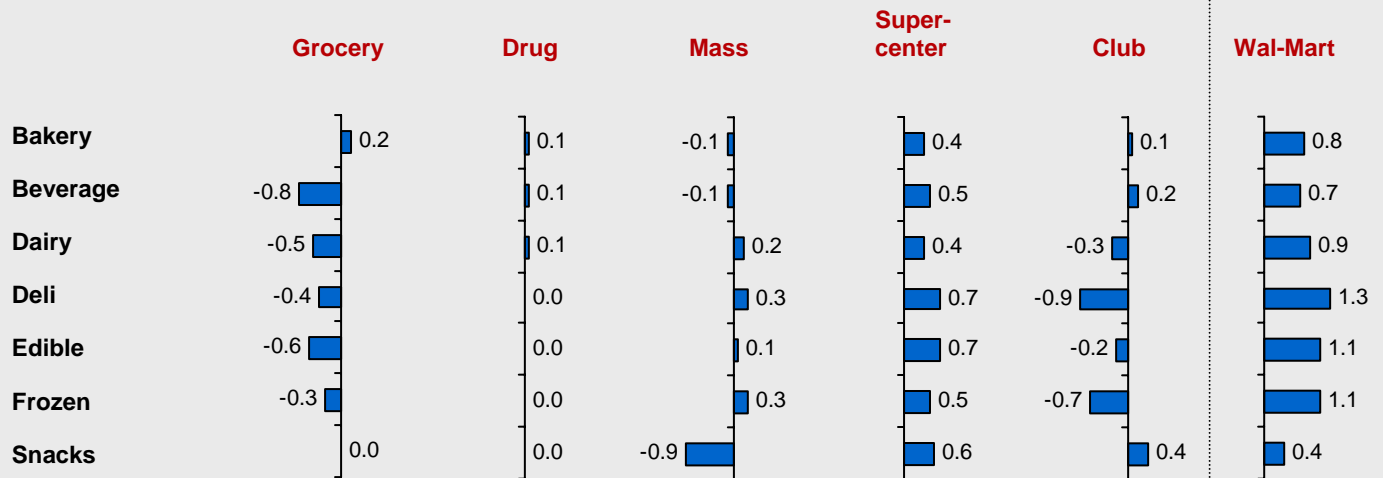
By contrast, in snacks, grocers held onto share this year, but mass merchandisers were hit with a major loss as supercenters and club gained.

The club channel is also experiencing other major changes, as consumers shift spending from club stores in deli (frankfurters, breakfast meats) and frozen foods (poultry, seafood, novelties.)

Department-level share shifts highlight emerging changes in consumer shopping patterns and may reveal new growth opportunities for both manufacturers and retailers.

However, as category and brand-level shifts may differ from department-level changes, it is critical to track shifts at the lowest level possible, as highlighted in the next section.

**Channel Dollar Share Change by Department (Based on All Outlet Sales)
52 Weeks Ending 5/15/2006 vs Prior Year**



Source: IRI Consumer Network®



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A Snapshot of Trends Shaping the CPG Industry

FOOD & BEVERAGE CHANNEL SHARE SHIFTS - CATEGORY

Category dynamics play a huge role in determining the extent to which channel migration will occur.

A number of food and beverage categories are experiencing channel share shifts that far outpace the total CPG average.

As illustrated in the chart to the right, category dynamics play a huge role in determining the extent to which channel migration will occur.

Over the past year, the largest shifts cut across a broad range of departments, including refrigerated, frozen and shelf-stable and included both basics and more discretionary purchases.

Further, major share shifts were not limited to the historically "hotly-contested" categories presented on page 7.

Clearly, category events, such as substantial price increases (eg. sugar average price increasing 9.4%) and increased merchandising activity (eg. grocery channel frozen poultry percent volume with merchandising increasing from 43% to 55%) influence channel selection.

Categories with Sizable Channel Share Shifts Dollar Share Point Change 52 Weeks Ending 5/15/2006 vs Prior Year		
	From	To
Beer	Grocery (-1.9)	Supercenter (+0.9)
Bkfst Meats	Club (-2.1)	Grocery (+1.1)
Eggs	Grocery (-1.9)	Supercenter (+0.9) Club (+0.6)
Fz Apps/Snacks	Club (-2.5)	Grocery (+1.9) Supercenter (+0.7)
Fz Bkfst Foods	Grocery (-3.0)	Supercenter (+1.2) Club (+0.8)
Fz Plain Vegetables	Grocery (-1.8)	Club (+0.8) Supercenter (+0.7)
Fz Poultry (Uncooked)	Club (-3.9)	Grocery (+4.2)
Pasta	Club (-1.8)	Supercenter (+0.9) Grocery (+0.8)
Peanut Butter	Club (-2.5)	Supercenter (+1.0) Drug (+0.7) Grocery (+0.6)
Rfg Meat/Poultry	Grocery (-2.5)	Supercenter (+1.8)
Sugar	Grocery (-3.6)	Supercenter (+2.1)

Source: IRI Consumer Network®



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A Snapshot of Trends Shaping the CPG Industry

NON-FOODS CHANNEL SHARE MIX - DEPARTMENT

Consumer spending is much more widely dispersed across channels among non-food categories.

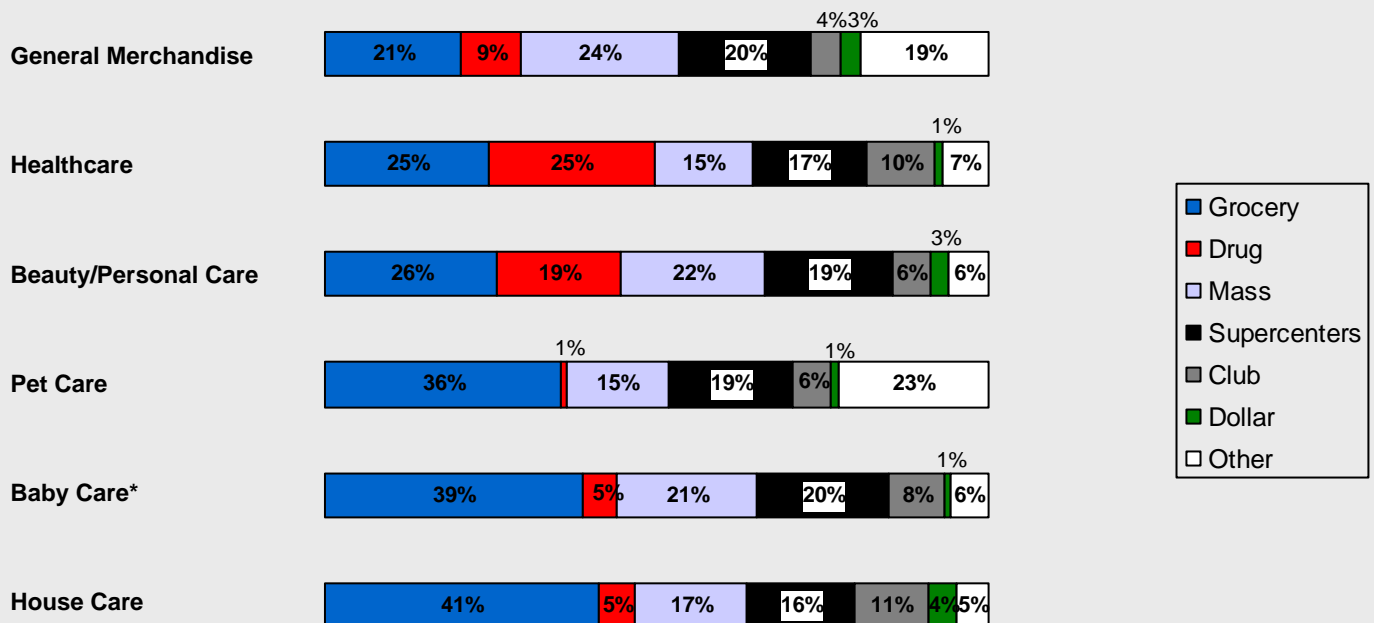
Within non-foods, the cross-channel battle for share is particularly intense. Consumer spending is much more widely dispersed across channels among non-foods vs food and beverages.

As many non-food categories are well-suited to stock-up and advanced purchase, consumers appear to be more likely to purchase these products when they see a good deal.

As there is no dominant channel within any of these departments, retailers may have a greater likelihood of securing incremental share gains through marketing and merchandising initiatives in non-foods vs food and beverages.

On the flip side, retailers have significant vulnerability within these departments given the wide product availability across channels and must invest to protect their position.

**Channel Dollar Share by Department (Based on All Outlet Sales)
52 Weeks Ending 5/15/2006**



Source: IRI Consumer Network®

* Baby care includes baby food and formula/electrolytes



TIMES & TRENDS

A Snapshot of Trends Shaping the CPG Industry

NON-FOODS CHANNEL SHARE MIX - CATEGORY

Price and promotion appear to be critical tools in the cross-channel battle for non-foods.

Non-food categories with the most significant cross-channel competition (ie. categories in which no one channel has a greater than 40% dollar share) are relatively high-ticket purchases. Consumers are likely driven to shop multiple channels to get a deal.

Despite deal-seeking behavior, consumers are not gravitating to private label – with the exception of healthcare. Name brands appear to be an important component of retailer initiatives to capture share within these categories.

Non-food categories with strong cross-channel competition are typically high-ticket items for which consumers seek deals....

But, consumers have not turned to private label (except in healthcare.)

NON-FOODS: Hotly-Contested Categories		
Categories in Which Channel Share is Below 40% for Any One Channel		
Average Unit Price and Private Label Share Indices vs Total CPG (FDMx; 100 = Average)		
<u>Category</u>	<u>Unit Price Index</u>	<u>Private Label Dollar Share Index</u>
Batteries	191	81
Blades	306	37
Cat/Dog Litter	212	91
Cleaning Tools	228	64
Cold/Allergy/Sinus Tablets	280	162
Deodorant	122	3
Diapers	503	97
Dog Food	103	63
Gastrointestinal Tablets	286	125
Internal Analgesics	226	152
Light Bulbs	115	97
Pet Supplies	175	108
Sanitary Napkins/Tampons	151	53
Shampoo	140	17
Skin Care	292	17
Soap	114	37
Toothbrush/Dental Accessories	149	48
Toothpaste	128	11
Vitamins	341	187

Source: IRI Consumer Network®; IRI InfoScan® Reviews



TIMES & TRENDS

A Snapshot of Trends Shaping the CPG Industry

NON-FOODS

CHANNEL SHARE SHIFTS - DEPARTMENT

Traditional mass merchandiser to supercenter shifts dominated non-food share changes.

At the department level, larger share shifts are evident in non-foods than were seen in food and beverage.

Across the board, large shifts occurred between traditional mass merchandise stores and supercenters, but there were also sizable shifts within specific departments that impacted other channels.

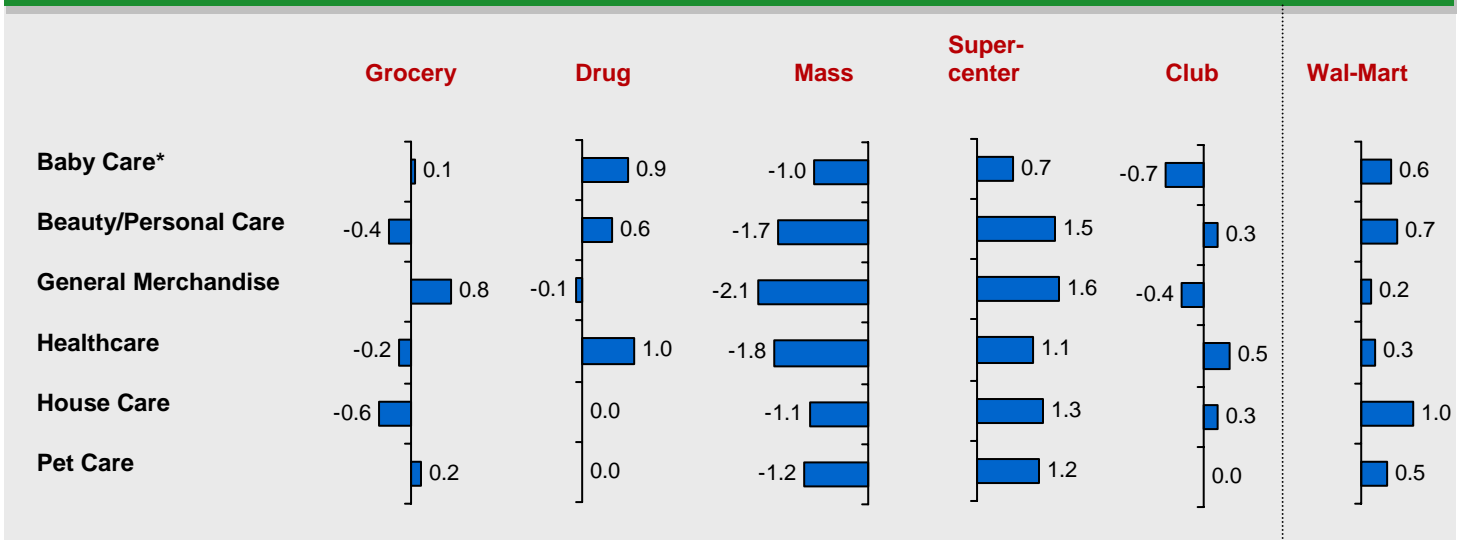
For instance, consumers are increasingly turning to drug stores for product needs across baby care, beauty/personal care and healthcare.

Grocers' large share gain in general merchandise, which included increases in children's art supplies, photography supplies, tights/socks, and kitchen storage, significantly contributed to grocers' ability to maintain total CPG share this past year.

Non-food manufacturers should explore the extent to which these emerging shopping trends are impacting their categories and brands.

Retailers should benchmark store-level sales trends versus industry shifts to identify emerging opportunities and risks.

**Channel Dollar Share Change by Department (Based on All Outlet Sales)
52 Weeks Ending 5/15/2006 vs Prior Year**



Source: IRI Consumer Network®

Note: Baby care includes baby food and formula/electrolytes



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A Snapshot of Trends Shaping the CPG Industry

NON-FOODS CHANNEL SHARE SHIFTS - CATEGORY

Share shifts continued among non-food categories that already have the most fragmented channel share.

Over the past year, the most significant share shifts among non-food products have occurred predominantly among the “hotly-contested” categories identified on page 11 – ie. those categories in which no one channel holds a 40% or greater share.

Among these categories, consumers appear to be very willing to switch channels if price and convenience needs are met.

These categories should be strongly considered in retailers’ promotional efforts to capture incremental non-food share – these are the categories in which share is most in play.

Manufacturers within these categories should partner with leading retailers to develop cross-channel competitive marketing and promotional strategies and align distribution strategies with emerging channel shifts.

Categories with Sizable Channel Share Shifts Dollar Share Point Change 52 Weeks Ending 5/15/2006 vs Prior Year		
	From	To
Air Fresheners	Drug (-1.6) Grocery (-0.9)	Supercenter (+2.0)
Batteries	Mass (-2.5)	Drug (+1.0) Club (+0.9)
Cold/Allergy/ Sinus Tablets	Grocery (-1.6) Mass (-0.6) Club (-0.6) Dollar (-0.6)	Drug (+2.1) Supercenter (+1.2)
Cat/Dog Litter	Mass (-1.3) Grocery (-1.0)	Supercenter (+2.2)
Cleaning Tools	Mass (-2.4)	Supercenter (+2.3)
Diapers	Mass (-2.1)	Grocery (+1.0) Drug (+1.0)
Gastrointestinal Tablets	Grocery (-2.1) Mass (-2.0)	Supercenter (+1.9) Drug (+1.4)
Tights/Socks	Mass (-3.3)	Supercenter (+1.4) Grocery (+0.7)
Toothbrushes/ Dental Accessories	Mass (-2.2) Grocery (-0.9)	Club (+2.1) Drug (+0.9)
Weight Control Liquid/Powder	Mass (-2.1)	Supercenter (+1.2) Drug (+1.1)

Source: IRI Consumer Network®



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A Snapshot of Trends Shaping the CPG Industry

CONSUMERS

HEAVY VS LIGHT CHANNEL MIGRATORS - DEMOS

Heavy “channel migrators” tend to be smaller households led by older Baby Boomers.

Two distinct consumer groups were studied to identify characteristics and shopping behaviors of those who are more inclined to shop multiple channels versus those who are not.

For this analysis, “heavy” vs “light” shoppers were classified per definition in the upper right box. Roughly one-quarter of consumers fall into one of these two groups, with the balance in the middle.

Contrary to conventional wisdom, which suggests that large families with large grocery bills are doing the most channel hopping, the heavy channel migrators are actually smaller households led by Baby Boomers. These consumers spend roughly 4% less per buyer on CPG products than “light” channel migrators, who skew towards larger households.

It is important to note that even light channel migrators allocate their CPG spending across multiple channels: two-thirds shopped at four or more channels for CPG products last year; however, the dollars spent outside their dominant channel are relatively small.

Given the massive growth of the age 55+ segment that is expected over the next decade, the pace of channel shifting may accelerate as the 45-54 year-old consumers cross into the 55+ lifestage; however, the aging of the 55-64 year-old segment into seniors may counteract this effect.

For a detailed analysis of current and expected future purchase behavior among 55+ consumers, please see the June *Times & Trends* issue.

Shopper Group Definitions	
Heavy Channel Migrators	Allocate a <u>maximum</u> of 40% of total CPG spending to <u>any one channel</u>
Light Channel Migrators	Allocate a <u>minimum</u> of 85% of total CPG spending to <u>one channel</u>

Household Size: Buyer Index By Channel Migration Segment (100 = Average)		
# In Household	Heavy	Light
1	114	90
2	113	88
3	93	99
4	84	124
5	60	128

Source: IRI Consumer Network®

Age: Buyer Index By Channel Migration Segment (100 = Average)		
Age Head of Household	Heavy	Light
18-34	88	110
35-44	97	109
45-54	106	96
55-64	126	84
65+	91	94

Source: IRI Consumer Network®



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A Snapshot of Trends Shaping the CPG Industry

CONSUMERS

HEAVY VS LIGHT CHANNEL MIGRATORS – PURCHASE BEHAVIOR

Non-food categories comprise a high share of heavy channel migrators' CPG spending.

As highlighted earlier in this report, cross-channel competition is most intense within non-food categories.

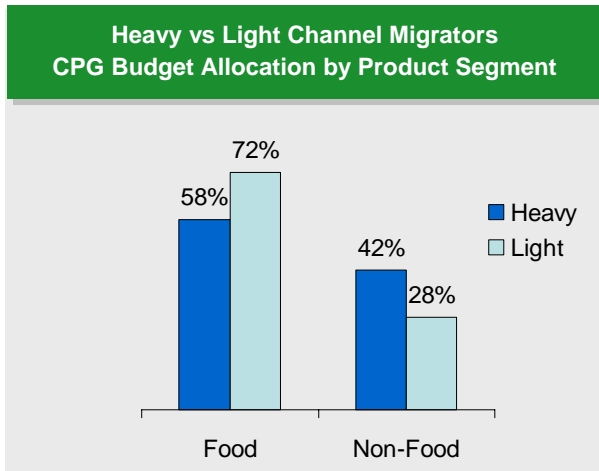
The strong competitive presence of multiple channels within non-foods is a powerful driver of heavy channel migrator shopping behavior, as these consumers allocate a significantly higher share of their CPG spending to non-foods - particularly beauty/personal care, general merchandise and healthcare - than light channel migrators.

Retailers seeking to capture a greater share of spending among these “channel hoppers” should strongly consider non-food categories as the cornerstone of targeted marketing and merchandising initiatives.

To gain a deeper understanding of shopping behavior and specific growth opportunities within each segment, retailers should also explore dominant trip types (eg. immediate need vs stock-up trips) and build product placement and targeted promotions around these trip types.

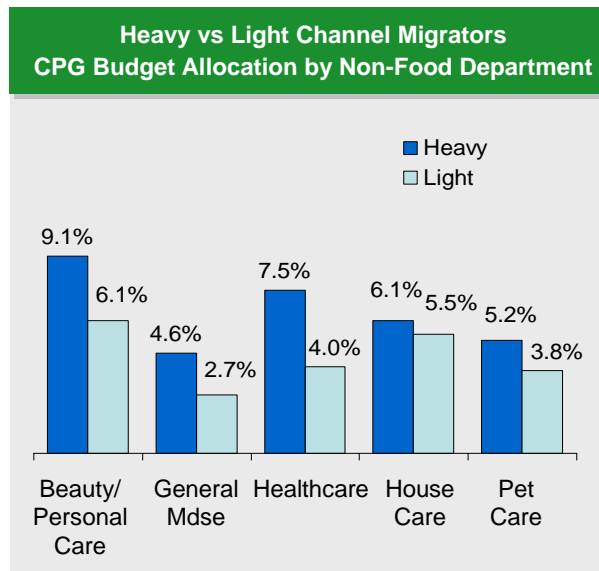
Manufacturers have an opportunity to drive incremental growth by partnering with retailers in these initiatives.

Non-foods comprise a large share of heavy channel migrator spending.



Source: IRI Consumer Network®

Differences in budget allocation are most pronounced in beauty/personal care, general merchandise and healthcare.



Source: IRI Consumer Network®



CONCLUSIONS

Manufacturer

To protect and grow share as channel migration evolves, CPG manufacturers should consider the following:

- ▶ Align distribution strategies with emerging channel shifts; benchmark brand channel shifts vs category and industry-level changes to identify potential missed distribution opportunities
- ▶ Evaluate price, promotion and placement strategies
 - Identify the level of cross-channel competition for category/brand
 - For brands in “hotly-contested” categories, collaborate with leading retailers to ensure competitive pricing and promotion and placement in high-traffic areas and/or adjacent to other high-index heavy migrator categories
 - Demonstrate the value of national brands vs private label in winning intense cross-channel category battles to retail partners
- ▶ Partner with leading retailers in the creation of targeted marketing and merchandising initiatives for heavy vs light channel migrators

Retailer

To protect and grow share as channel migration evolves, CPG retailers should consider the following:

- ▶ Align cross-channel competitive strategies with emerging channel shifts; track store-level cross-channel share shifts at the total store and category level; build store/store-cluster level competitive strategies with a focus on categories with the highest channel share fragmentation and largest shifts
- ▶ Evaluate price and promotion strategies among the most “hotly-contested” cross-channel categories versus competing retailers and address gaps; ensure that these categories are placed in high traffic areas and/or are adjacent to other high-purchase heavy channel migrator categories
- ▶ Create targeted marketing and merchandising strategies for heavy vs light channel migrators
 - Identify mix of heavy vs light channel migrators within consumer base and store-level competitive threats for both segments; identify and cater to dominant trip types (eg. immediate need vs stock-up) within each segment
 - Feature non-foods in advertising and in-store marketing targeting heavy channel migrators
 - Leverage loyalty marketing initiatives to protect share among highly valuable light channel migrators



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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 Shopper Insights™

IRI Shopper Insights™ solution segments and analyzes stores, shoppers, trip types, and products to uniquely define target markets; this solution integrates IRI panelist demographics with Personix segmentation and panelist purchase behavior.

IRI MarketInsight™

Proprietary model-based sales tracking service providing superior coverage of channels, including Wal-Mart, for which point-of-sale data are not available. Reflects sales across IRI InfoScan® Reviews 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.



INFORMATION RESOURCES, INC.
150 NORTH CLINTON STREET
CHICAGO, IL 60661
Telephone: (312) 726-1221