Reality Check: The Continued Rise of Non-Traditional, Alternative Grocers

By Scott Moses

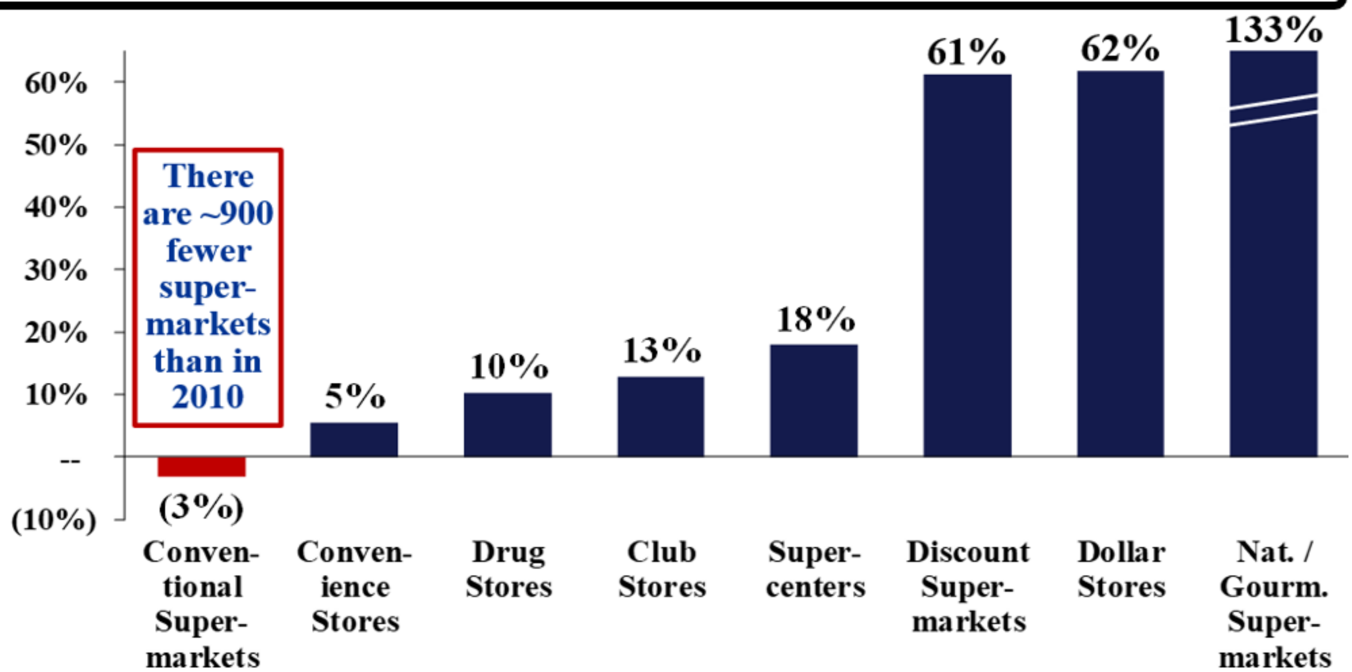
I've often discussed the heroic work traditional supermarkets have done feeding America during the pandemic, again proving they are pillars of thousands of American communities, as they have been for generations. Unfortunately, even after the great service their millions of essential teammates have provided the country during its time of need, supermarkets' place in the ever-evolving grocery landscape is often misunderstood and taken for granted.

I had a conversation recently with an important industry observer that astounded me. The observer suggested that traditional supermarkets still comprise the preponderance of American grocery sales, and that, non-traditional, "alternative grocers" beyond Walmart, namely Target, Amazon, Costco, Dollar General, Dollar Tree/Family Dollar, Aldi and Lidl are not true competitors to traditional supermarkets. After confirming my time machine was not set to 1991 or 2001, and putting away the groceries delivered to my home that day from four different online grocers (yes, four – all investment grade credits), I responded with a fairly strong reality check that I've summarized below.

Alternative Grocers Have Many More Stores and Generate Far More Grocery Sales Than Traditional Supermarkets

There are now 26,000 traditional supermarkets in the United States, roughly 900 fewer than 10 years ago. Regional supermarkets have been slowly eclipsed by the shadow of various extremely large, well-capitalized (investment grade), non-union and fast-growing alternative grocers. In fact, alternative grocers now comprise meaningfully more grocery sales than traditional supermarkets and are the primary grocery shopping outlet for 61% of customers, up from 19% roughly 20 years ago. The average consumer now shops for groceries every week at five banners, in four different grocery channels (e.g., supermarkets, supercenters, drug stores, discount/dollar grocers, club stores and various specialty grocers), according to FMI.

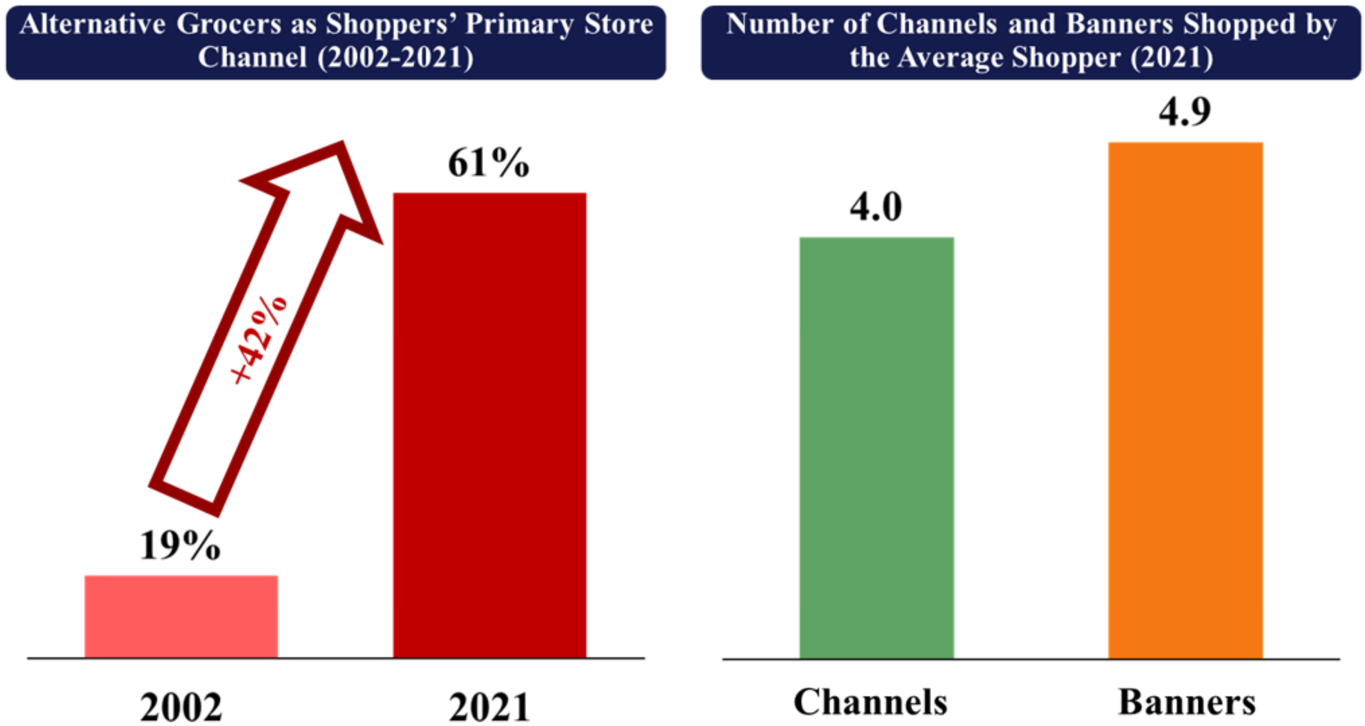
Non-Traditional, Alternative Grocers are Growing Rapidly as Supermarkets are Shrinking



	Conventional Supermarkets	Convenience Stores	Drug Stores	Club Stores	Supercenters	Discount Supermarkets	Dollar Stores	Nat. / Gourm. Supermarkets
2020 Stores:	26,065	153,405	21,465	1,378	5,723	3,860	32,721	1,018
2010 Stores:	26,919	145,473	19,458	1,221	4,852	2,395	20,229	436

Source: Progressive Grocer Annual Report of the Grocery Industry, Public Filings and PJ Solomon estimates.

Non-Traditional, Alternative Grocers Have Gained "Primary Store" Status; Consumers Shop at Multiple Channels and Banners Weekly



Source: FMI U.S. Grocery Shopper Trends, 2004 and 2021.

There are over 65,000 alternative grocers in the United States, many of which were not grocery competitors a generation ago, including: ~6,000 supercenters (Walmart, Target and Meijer); ~1,400 clubs (Costco, Sam's and BJs); ~33,000 dollar grocers (that's just Dollar General and Dollar Tree/Family Dollar), ~21,000 drug stores (that's just Walgreens, CVS and Rite Aid); ~4,000 discounters (Germany's Aldi and Trader Joe's, Grocery Outlet, Save-A-Lot and, more recently, Germany's Lidl);~1,000 natural and farmers markets (Whole Foods, Sprouts and Natural Grocers) as well as many Latino, Asian and other specialty grocers.

Walmart is widely known as America's leading grocer, with roughly 25% national market share, with over 50% market share in over 200 markets (according to ILSR) and as much U.S. grocery sales as Kroger (#2), Albertsons (#4) and Ahold Delhaize (#5) combined. However, many people do not appreciate that **most of the country's Top 10 Grocers are not traditional supermarkets**. Costco is ranked #3, Amazon/Whole Foods is #6 (and growing rapidly), Target is ranked #7, CVS is ranked #9 and Dollar General is ranked #10. This has significant competitive implications.

The average U.S. Costco (ranked #3) generates roughly $242mm in revenue, roughly 56% of which are the same groceries sold in supermarkets, just in larger pack sizes. That's $135mm of groceries per store, or $2.5mm in weekly grocery sales, which is ***three times an exceptional traditional supermarket and six times the average***.

The vast majority of sales at Dollar General (#10) and Family Dollar / Dollar Tree (#12) stores are the same groceries sold in supermarkets, just in smaller pack sizes. As a result, these chains have a $41bn combined estimated grocery business, which together would be ranked #9. Dollar General plans to add over 1,000 new stores this year and eventually double its storebase from over 17,000 to over 34,000 stores. Walgreens, CVS and Rite Aid have a $40bn combined estimated grocery business.

Most of the Top 20 U.S. Grocers are Alternative Grocers, Not Traditional Supermarkets

($ In Billions)

#	Company	Total US Sales[a]	# of US Stores	% Grocery	Grocery Sales	% of Total
1	Walmart / sam's club	$440	5,342	56%	$248	24.7%
2	Kroger	$132	2,742	79%	$105	10.5%
3	Costco Wholesale	$135	559	56%	$75	7.5%
4	Albertsons	$70	2,277	88%	$61	6.1%
5	Ahold Delhaize (USA)	$52	2,028	90%	$47	4.7%
6	amazon / Whole Foods Market	$232	611	20%	$46	4.6%
7	Target	$98	1,909	44%	$43	4.3%
8	Publix	$46	1,269	93%	$42	4.2%
9	CVS Health	$271	9,962	10%	$26	2.6%
10	Dollar General	$34	17,426	76%	$26	2.6%
11	H-E-B	~$31	384	80%	$25	2.5%
12	Dollar Tree / Family Dollar	$26	15,772	61%	$16	1.6%
13	Aldi	~$16	1,600	95%	$15	1.5%
14	Walgreens	$109	8,993	14%	$15	1.5%
15	Trader Joe's	~$15	488	90%	$13	1.3%
16	BJ's	$16	221	75%	$12	1.2%
17	giant eagle	~$12	475	85%	$10	1.0%
18	meijer[b]	$18	256	56%	$10	1.0%
19	Wegmans	~$11	104	90%	$10	1.0%
20	Southeastern Grocers	$8	425	96%	$8	0.8%
Total Supermarket Grocery Sales[c]					**$455**	***45%***
Total Alternative Grocery Sales[d]					**$547**	***55%***

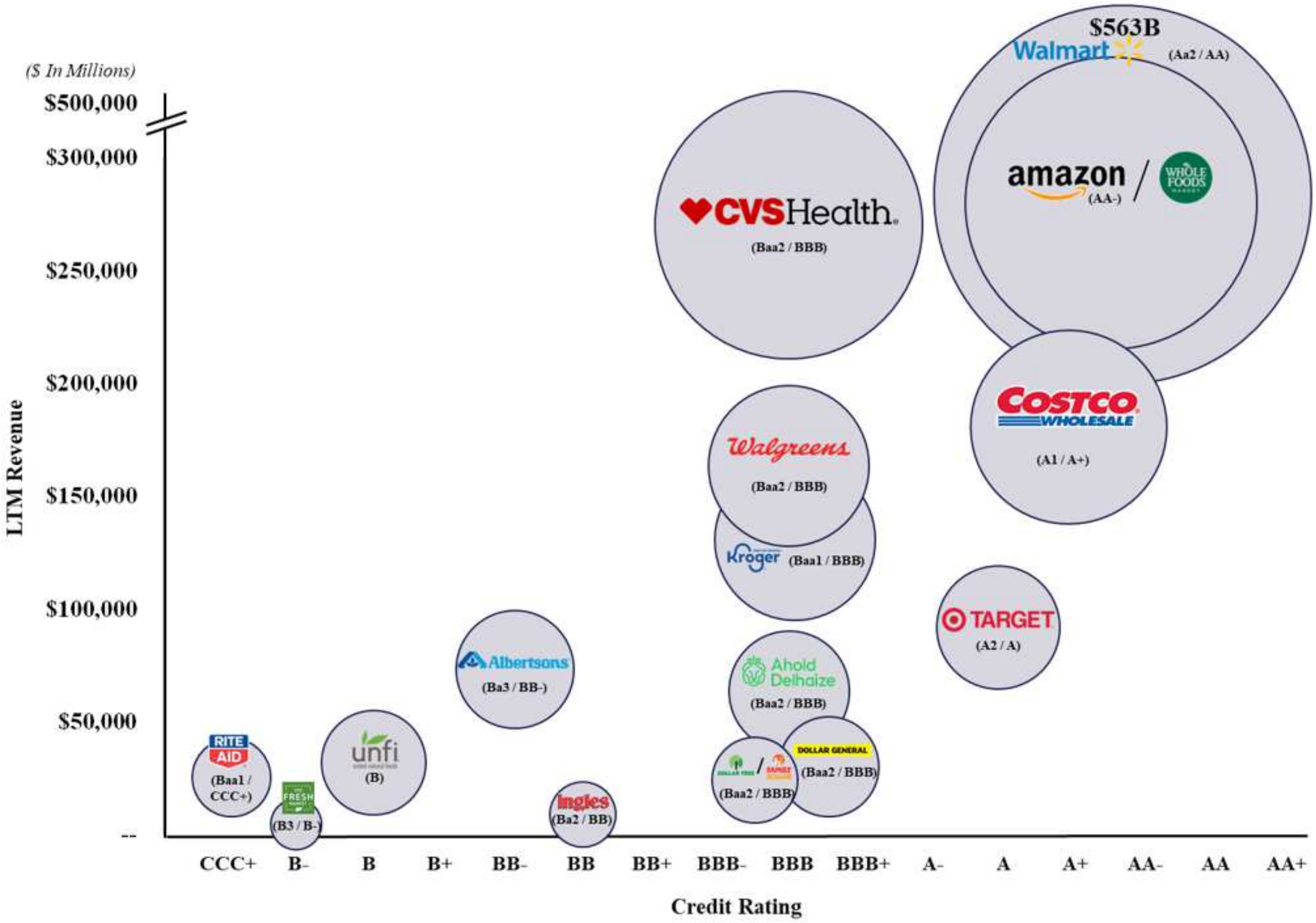
Source: Company filings and publicly available information.
Note: Food and consumables excludes pharmacy.
a) Total LTM June 2021 U.S. Sales.
b) % Grocery based on PJ Solomon Estimates.
c) Includes remaining U.S. supermarket sales.
d) Includes remaining U.S. alternative grocery sales.

<u>Alternative Grocers' Low Cost of Capital Facilitates Market Share Gains</u>

Walmart, Target, Costco, Aldi, Dollar General and Dollar Tree/Family Dollar have been driving their grocery market share for years with lower prices and significant operational investments, which have been facilitated by scale efficiencies, including lower cost of goods. This has, in turn, forced traditional grocers to lower their prices in order to retain some share of the average household's various weekly grocery trips. While the largest traditional grocers can endure some price investment, the vast majority of smaller regional supermarkets lost a significant percentage of their annual EBITDA in the few years before Covid trying to keep up. This decline meaningfully impacted these grocers' ability to match their larger peers' operational investments and continue to operate profitably, particularly as labor and technology costs have increased. This led to numerous grocery bankruptcies, including A&P (once the country's largest grocer, with over 15,000 stores), Bashas', Bruno's / BI-LO, C&K Market, Haggen, Central Grocers / Strack & Van Til, Earth Fare, Fairway, Kings Balducci's and Marsh Supermarkets, among others.

The key driver of this tsunami of alternative grocery competition is the strong correlation between scale and credit rating. Larger companies, statistically, have a better rating and a lower cost of debt, enabling them to make larger investments in price, wages, marketing, technology and growth to acquire and retain customers. Walmart generates over $560 billion in annual sales and has an AA credit rating; its 10-year notes yield under 2%. Traditional grocers' debt is generally much more expensive, particularly for smaller regional operators.

Larger Grocers Generally Have a Higher Credit Rating and Lower Cost of Capital Than Smaller Grocers



Source: Public Filings, Capital IQ as of June 2021.

Amazon is in a whole other league. It not only has an AA- credit rating, with 10-year notes yielding under 2%, but it has a market valuation over **$1.6 trillion**, which is far more than all publicly-traded traditional and alternative grocers, ***combined***. Its very low cost of capital and extremely high equity valuation give it a near-limitless ability to invest in its transformational Prime ecosystem that competes with all grocers, particularly supermarkets. The effect of these investments is cumulative and geometric. Amazon has 200 million Prime subscribers, whose membership generates $24 billion in cash (before they sell anything). When Amazon spends $1 billion per quarter on next-day delivery, it only costs them 6 basis points of their market value (that's 0.06%). It may be profitable, it may not be; it barely moves the cost needle for them but meaningfully changes the game and raises the bar – and the costs of customer acquisition and retention – for everyone else. Amazon's $8 billion MGM acquisition costs ~0.51% of its value, but Prime Video will be far more attractive for subscribers, who buy more goods from Amazon. They've quietly built an enormous network of fulfillment centers and have a $20+ billion annual R&D budget that only costs ~1.2% of its value. Amazon's relentless culture of "living in the future" drives them to experiment, iterate, learn, enhance and disrupt. Jeff Bezos has said he wants it to be "irresponsible not to have Prime;" these investments, driven by Amazon's low cost of capital, help effectuate that bold vision. As a result, Amazon's EBITDA has increased over $18 billion ***in the past year alone***, to over $55 billion. By comparison, Walmart's EBITDA is $36 billion; Costco's EBITDA is $8 billion, i.e., ***Amazon's one-year EBITDA increase is half of Walmart's total EBITDA and twice Costco's*** (and they both have grown their EBITDA significantly in the past year).

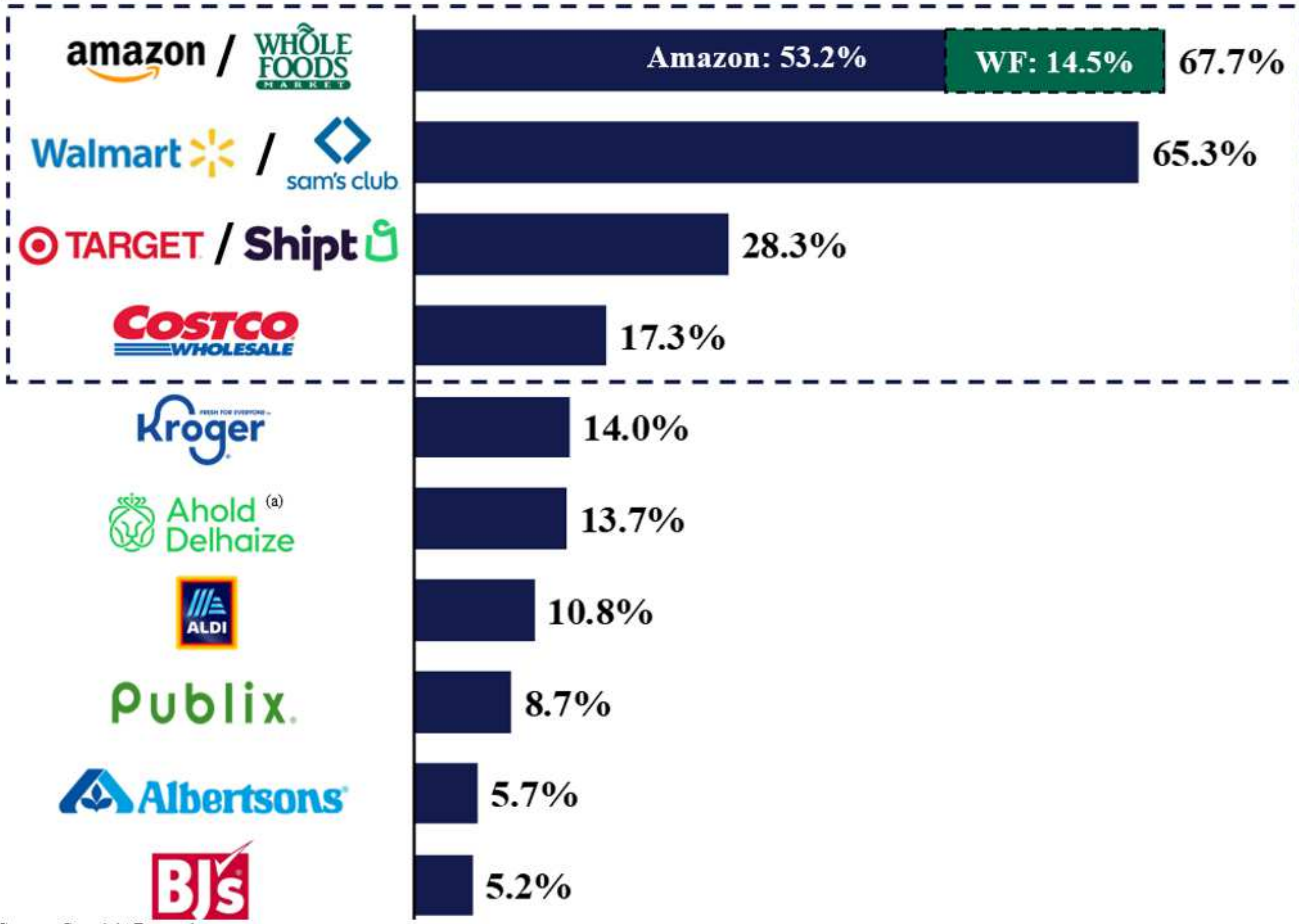
Amazon's Valuation Far Exceeds
All Major Public U.S. Food & Drug Retailers, Combined

Source: Company filings and Capital IQ as of June 2021.
a) Also includes Ingles, Weis, Village, Natural Grocers, SpartanNash, BJ's Wholesale Club, United Natural Foods, Rite Aid and Grocery Outlet.

Amazon's grocery investments are causing Walmart and Target to make extraordinary investments in their own online grocery operations. Like Amazon (with Whole Foods supporting its fresh branding), Walmart can ship food next-day to most of the country. Target's online grocery operation has soared since acquiring Shipt.

Notably, according to Coresight, 68% of U.S. internet users who bought groceries online have purchased from Amazon; 65% purchased from Walmart; 28% purchased from Target; 17% purchased from Costco. Aldi, Family Dollar, CVS, Walgreens and Rite Aid all use the same Instacart marketplace platform as dozens of regional grocers.

Amazon / Whole Foods, Walmart, Target and Costco Dominate Online Grocery

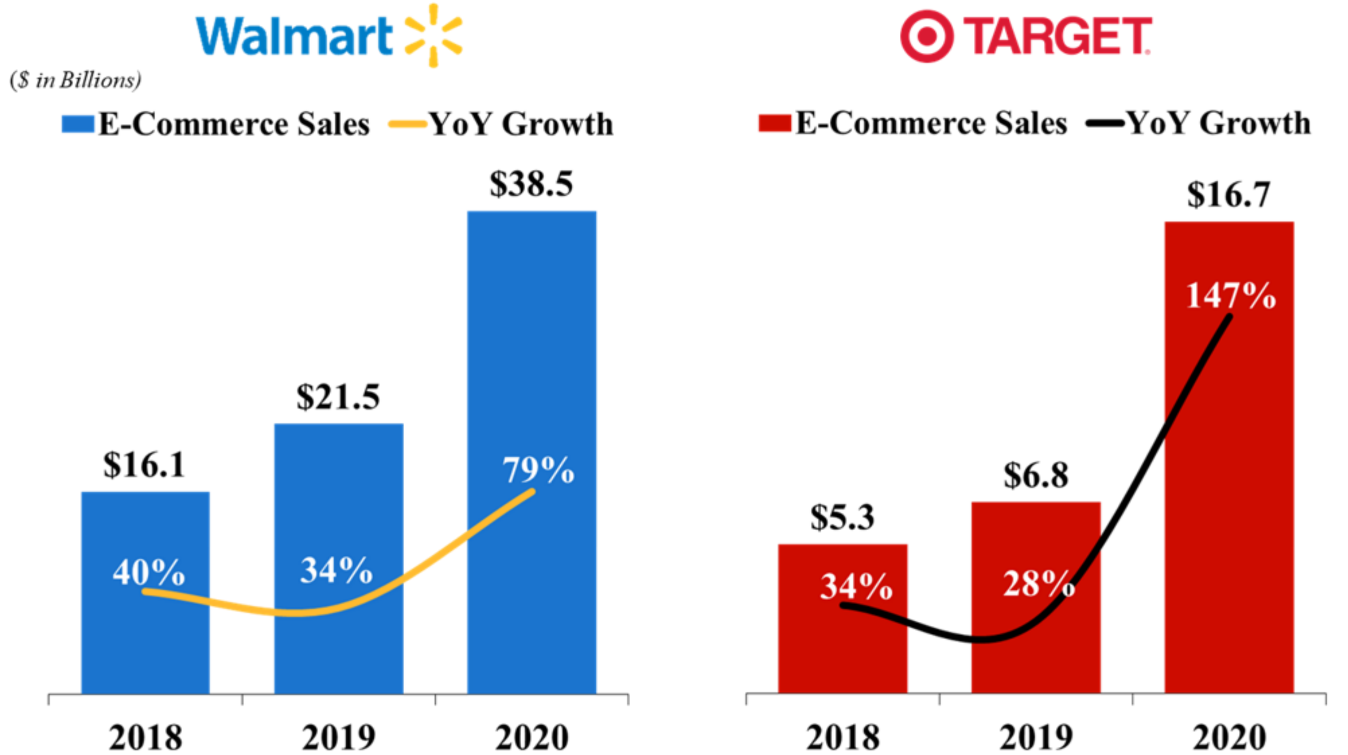


Source: Coresight Research.
Note: U.S. internet users age 18+ who have bought groceries online in the past 12 months, 2021 (% of Respondents).
a) Ahold Delhaize includes Fresh Direct and Peapod.

These dynamics are particularly important given online grocery doubled in 2020 to over 10% of total U.S. grocery sales and is projected to more than double again by 2025 to $250 billion, or 22% of sales.

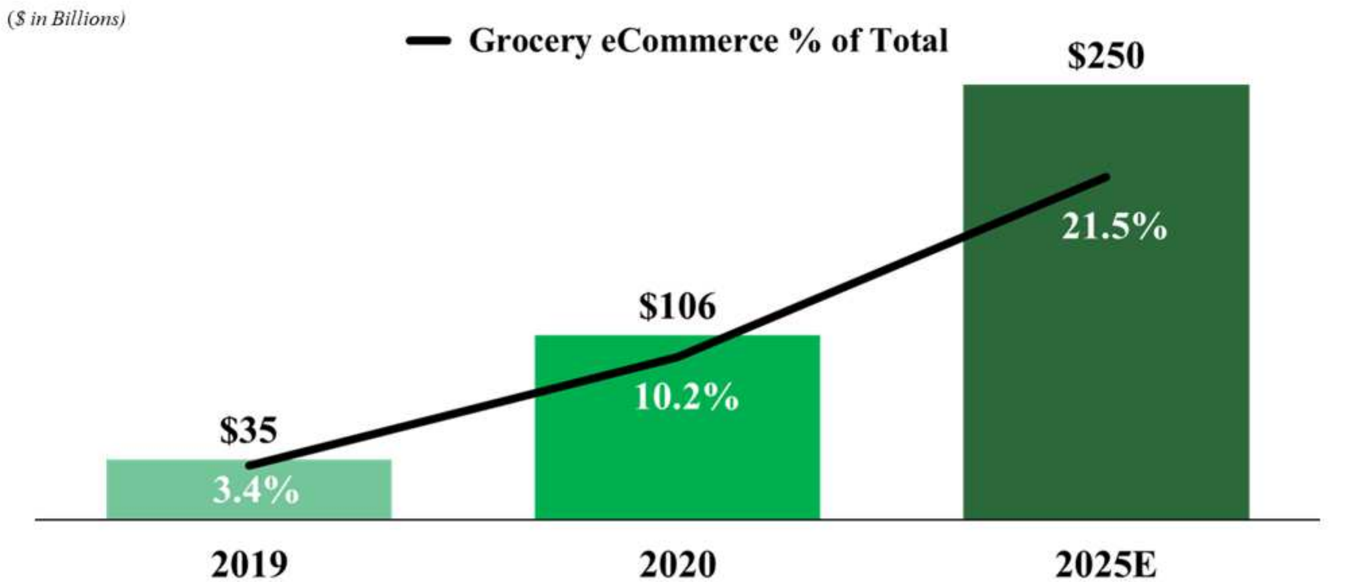
These sales are all coming from somewhere – mostly from supermarkets. In the long run, it is hard to see how this trend reverses absent more traditional supermarkets building the scale they need to afford similar investments.

Walmart and Target E-Commerce Sales are Growing Rapidly



Source: Company Filings. Walmart growth represents U.S. e-commerce sales.

Online Grocery Sales are Expected to Double Again by 2025 to $250 Billion (21.5%)



Source: FMI U.S. Grocery Shopper Trends, 2020 and Mercatus – The Evolution of the Grocery Customer, 2020.

While we unfortunately live in a surreal time when shameless people often try to undermine reality with "alternative facts" (which are really just lies), basic empirical economic data should not be controversial. The growing impact of alternative grocers on traditional supermarkets and the broader grocery competitive landscape is undeniable. This fact should be carefully considered by industry operators and observers alike when developing strategic plans and drawing important conclusions about the grocery sector and its competitive dynamics.

Key Alternative Grocery Competitive Realities

1. Alternative Grocers Generate Far More Grocery Sales Than Traditional Supermarkets
2. Average Customer Shops at Over 4 Grocery Channels and 5 Banners Per Week
3. Alternative Grocers are the Primary Grocery Outlet for 61% of Customers, Up from 19% in 2002
4. Walmart, Costco, Amazon, Target, Dollar General and CVS are Top 10 U.S. Grocers
5. Alternative Grocers' Growth Fueled by Much Lower Cost of Capital, Which is Driven by Scale
6. Amazon is Valued More Than All Other Grocers Combined and is Making Huge Grocery Investments
7. Amazon, Walmart, Target and Costco are the Leading US Online Grocers
8. Online Grocery is Expected to be Over 20% of All Grocery by 2025

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