GfK Audits & Surveys

REPORT TO RETAILERS & MARKETERS

August 2007

2007 GfK Audits & Surveys' National Retail Census

Some call it revenge of the bricks and mortar stores. Online commerce, once thought to threaten most traditional forms of retailing, continues its growth – but at a decidedly slower pace. Just as no tree grows to the heavens, no form of commerce grows 25% a year forever. Online growth has slowed dramatically in major categories, such as books, health and beauty supplies, computer peripherals and office supplies.

Dell was a classic example of an Internet pure play retailer to consumers. Its computers and peripherals were once only available to consumers online. Dell's online direct sales model has its efficiencies but, as it learned painfully, it also has its limits. Dell lost its top PC sales ranking to Hewlett-Packard, in no small part because of H-P's long and deep relationships with traditional retailers.

In an attempt to regain the PC crown, Dell is making deals with the very bricks and mortar stores it once took pride in shunning. Today Dell products are being carried by Wal-Mart and Costco, among others.

Much of Apple's comeback can also be attributed to its creative retailing. When Apple computers were 3% of the U.S. market, retailers had little incentive to give them prime shelf space or train sales staff about their features. So Apple opened its own stores and was widely ridiculed for doing so at the time. But its stores were every bit as stylish as its products and shoppers responded positively.

About GfK Audits & Surveys' National Retail Census

GfK Audits & Surveys' National Retail Census, now in its 54th year, is the largest in-person distribution measurement program conducted in the U.S. It is the most established and comprehensive source of reliable information on the number and kinds of stores in the country selling various product categories and specific brands. The National Retail Census provides manufacturers with the most accurate measurement of their product penetration and that of their competitors in every type of retail outlet carrying their product category. It's based on data gathered through in-person store visits to a national probability sample of all kinds of retail and service establishments throughout the country.

The truth of the matter is that the best retailers have always responded creatively to challenges and opportunities.

Montgomery Ward was one of the nation's biggest retailers fifty years before it opened its first store. It started as a mail order company when the country was still rural and many consumers were hard to reach. There were no cars or trucks, but there were the railroads and the Post Office and Ward made the most of them. Montgomery Ward was the largest retailer in the world in the 19th century.

A young railroad agent named Richard Sears also saw the potential of mail order. He stopped hawking watches on the side of the station and decided to sell full-time. Like today's Internet-only retailers, Ward and Sears had no stores then and no desire for any.

But as more Americans lived in cities than rural areas, the most efficient means to move merchandise became stores. Ward's and Sears' confidence in storeless selling was shaken by a one-third owner of a tiny store in Wyoming. His name was James Cash Penney. By 1920, J. C. Penney had 300 successful outlets. Sears, then Ward, saved themselves only by following Penney's lead.

The simple fact is millions of Americans like to shop and overwhelmingly do most of their shopping in bricks and mortar stores. Only 5% of retail sales take place online and even the best projections of future growth anticipate e-commerce's share of retail sales in the single digits for the foreseeable future.

The best retailers have overcome the relative sterility of e-commerce by making in-person shopping more pleasurable. While too many fail to live up to their potential, stores are uniquely able to provide shoppers with an entertaining escape. For many shoppers, sitting in front of a computer and keystroking is just a little too much like work.

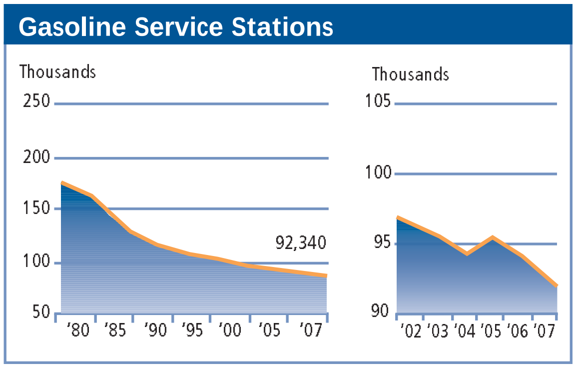
With few exceptions, today's most creative retailers are not the Internet pure plays, but those "clicks and mortar" merchants who offer shoppers the best of both worlds. Apple CEO Steve Jobs wanted his stores to sell not merely products, but also instant gratification. "When I bring something home to the kids," he said, "I want to get the smile. I don't want the U.P.S. guy to get the smile."

Automotive

The internal combustion engine was not invented in the U.S., but no country is more dependent upon automobiles for mobility. One consequence of this is that more than 12% of the total retail outlets of all retail establishments sell, supply and/or service vehicles.

Gasoline Service Stations

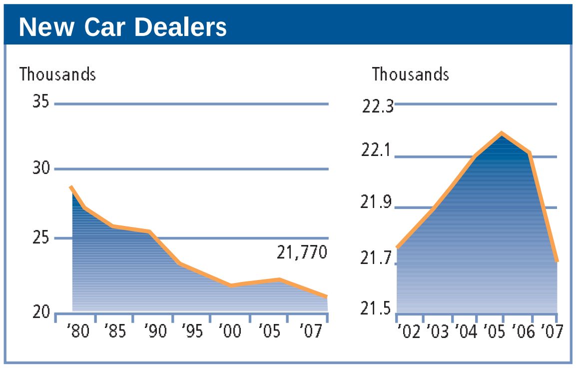
Despite an all-time high in auto ownership, gasoline service stations have lost 58% of their outlets since 1970 and 4% in the last five years alone. Some left the category by converting their service bays into convenience stores because the increased popularity of leasing, extended dealer warrantees and franchised repair shops have cut into the service side of the business. There have also been recent signs that some gasoline service stations are having their petroleum profits so squeezed that they've stopped selling gas.

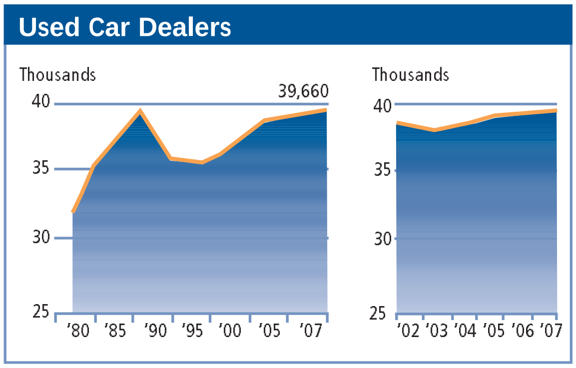


New & Used Car Dealers

The number of new car dealer outlets has remained relatively stable for the last five years and the National Automobile Dealers Association expects moderate consolidation to continue. But the fairly consistent outlet count masks a significant shift within the sector. Car sales of U.S.-headquartered manufacturers are down more than 5% in 2007 to date while sales of foreign-based cars are up nearly 8%. Light truck sales are displaying a similar pattern.

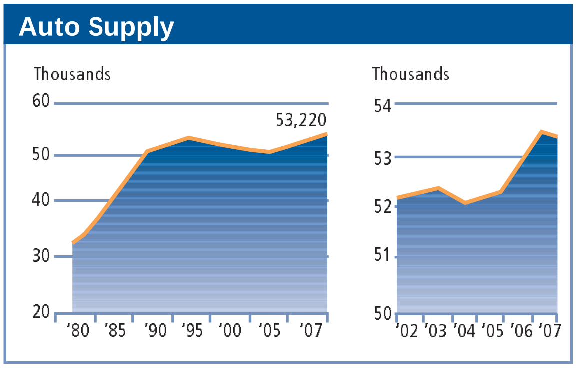
Internet sales continue to transform the used car business. Traditional used car dealers have increased their outlet by 39% since 1970 and 4% in the last five years. eBay Motors alone now links millions of potential purchasers and has created a national marketplace for new and used vehicles. CarMax, the nation's largest used car retailer, also has an extensive online presence.





Auto Supply

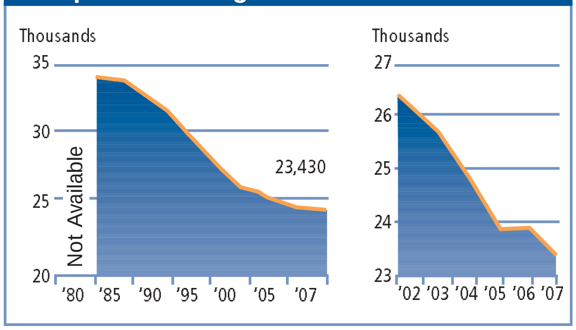
Stores selling primarily batteries, auto parts and accessories declined 2% since 1990, but have increased 2% in the last five years. Still, there are few signs of continued growth because vehicles are becoming increasingly complex and require specialized diagnostic equipment, putting many do-it-yourself repairs beyond reach of even experienced tinkerers. As a result, the market is shrinking and retail dealers and service stations are better positioned to repair late-model vehicles than auto supply stores.



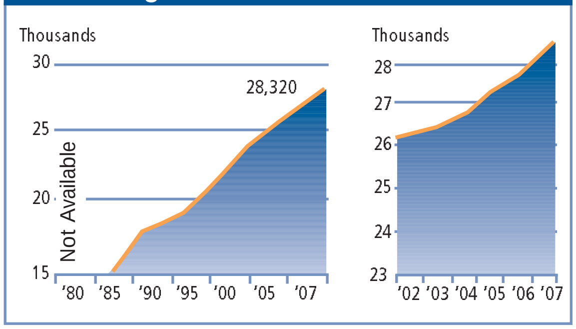
Drug Stores

Independent drug stores once dominated the category, but since 1980 the segment has lost 36% of its outlets, during which time chain pharmacies more than doubled theirs. Both chains and independents have lost sales to mail order pharmacies. That's why CVS agreed to purchase Caremark Rx, a pharmacy-benefits manager, for $21 billion. Further evidence that large chains are determined to play a greater role in healthcare is the introduction of in-store clinics staffed by nurse practitioners and physicians' assistants. They offer vaccinations and often treat uninsured patients for ailments such as ear infections, colds and rashes for less than physicians would charge. Many drug retailers fear a cut in the list prices of branded drugs as a result of industry litigation. While most retailers sell pharmaceuticals for less than list prices, the suggested prices are used as benchmarks for reimbursing stores under private and public insurance programs.

Independent Drug Stores



Chain Drug Stores



Eating & Drinking Establishments

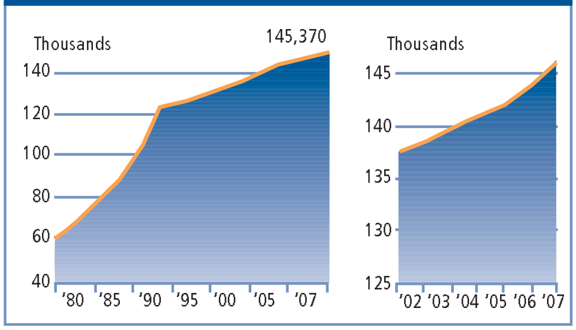
The U.S. restaurant business is huge. Collectively, restaurants and taverns employ nearly 13 million people, making this sector the nation's largest nongovernmental employer. Paradoxically, eating and drinking establishments are also small. More than seven out of 10 are independent operations with fewer than 20 employees. There are more than 410,000 eating and drinking establishments nationwide. The sector is projected to generate $537 billion in annual sales in 2007, according to the National Restaurant Association. The restaurant industry's share of the food dollar is estimated at 46%, up from 25% in 1955.

Fast-Food Restaurants & Luncheonettes

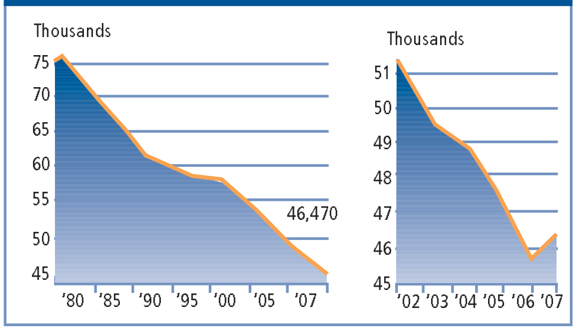
The number of fast-food restaurants increased 190% since 1970 and 21% since 1990. On any given day, about one-quarter of the U.S. adult population visits one. But over-building has taken its toll. "Quick Serve" outlet growth has dropped to below 1% a year. Hamburger restaurants appear to be growing more slowly than other outlets. The public is demanding more fresh food and variety than ever before. Fulfilling either request poses daunting operational challenges to the fast-food chains, Nevertheless, McDonald's is moving closer to adding espresso-based drinks nationally.

Luncheonettes lost 39% of their outlets since 1975 and 14% since 2000. Their continued decline is virtually certain.

Fast-Food Restaurants



Luncheonettes

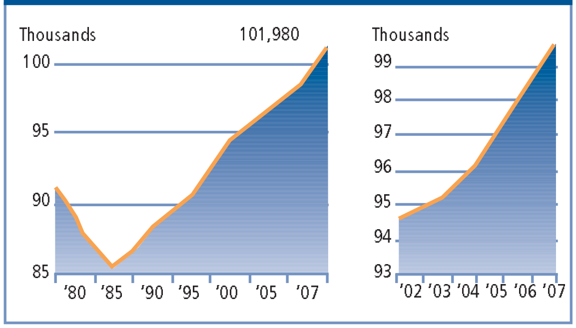


Restaurants, Taverns & Bars

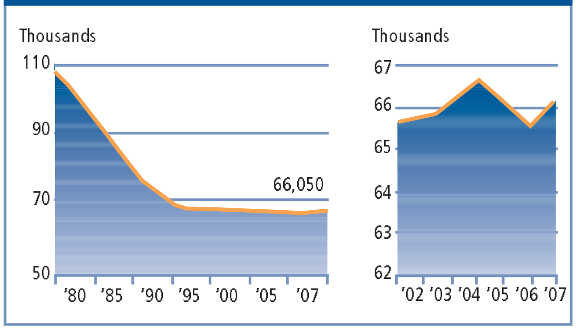
The number of restaurants has increased 17% since 1980 and 8% in the last five years alone. But higher gas prices are taking their toll on consumers' appetite for dining out. Some restaurants, particularly family dining chains and those in the Midwest, report difficulties as a result of would-be diners reigning in their discretionary spending to pay for soaring gasoline bills.

Taverns and bars lost 41% of their outlets since 1970, but the sector's numbers are virtually unchanged in the last five years. Many of those that remain fear the continued spread of smoking bans.

Restaurants



Taverns & Bars



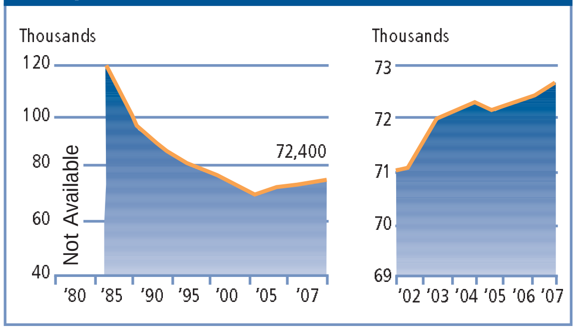
Food Stores

Groceries, Supermarkets & Convenience Stores

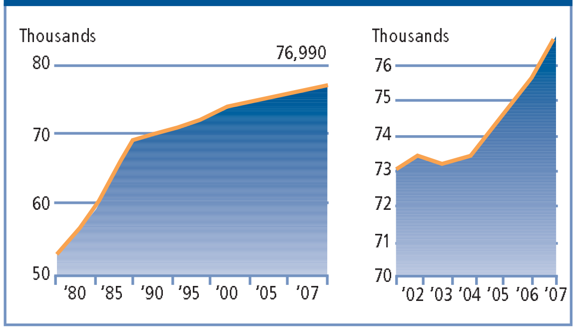
Groceries, supermarkets and convenience stores lost 34% of their outlets since 1970. Much of the reduced outlet count is a result of increased average supermarket size, which now tops 48,000 sq. ft., a 29% increase in the last 10 years, according to the Food Marketing Institute (FMI). But the success of warehouse clubs and the growth of chain drug stores, which are often effectively convenience stores with a pharmacy in the back, are also important factors. As in other sectors, chains are faring much better than independents. Independents account for less than 10% of sector sales. Independent food stores lost 38% of their outlets since 1980 while chain outlets have increased 48% during the same period.

Supermarkets continue to be among the most efficient retailers in the nation. They have to be. Their net profit after taxes is less than 1%, according to the FMI. High-end supermarket chains, such as Whole Foods, are borrowing a page from banks by introducing queue managers to direct customers to the next available cashier to speed up checkout and eliminate the frustration of being on a slow-moving line.

Independent Food Stores



Chain Food Stores



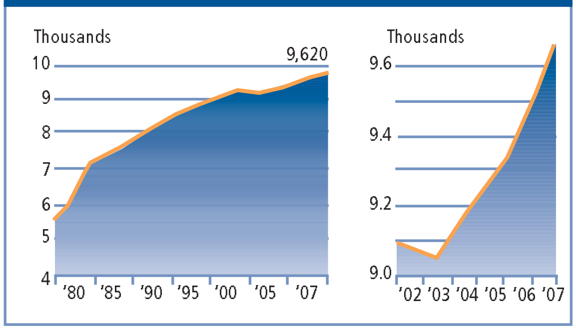
General Merchandise

Discount & Department Stores

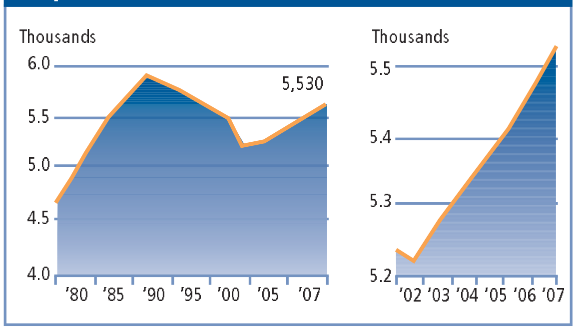
Discount chains are among the most successful channels in retailing. They increased their outlets by 131% since 1970, while conventional department stores grew only 24% in the same period. Department stores are losing younger shoppers, who tend to favor big-box discounters and specialty boutiques because department store merchandise is widely available elsewhere and service levels have slipped.

One sign of the sector's fall from grace is the increased willingness of shopping centers to sign restaurants, discounters, big-box stores or hotels to anchor spots once exclusively reserved for department stores. But department stores, if not making a comeback, have at least held their own in the last five years. Discount and department stores have each increased their number of outlets 6% since 2002.

Discount Stores



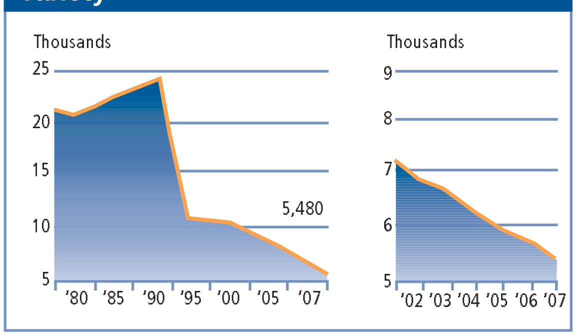
Department Stores



Variety & General Merchandise Stores

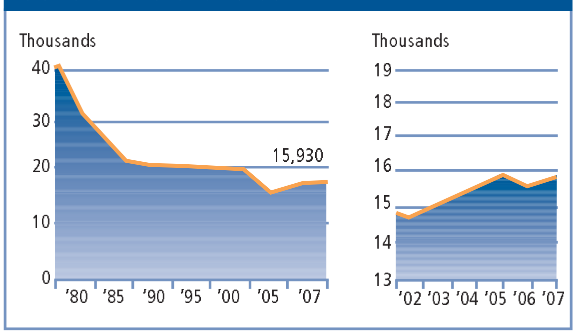
ariety stores, which sell a diverse inventory of products, and general merchandise stores, which sell linens, dry goods and other items continue down the path of virtual extinction. The sector lost 75% of its outlets since 1970 and 20% in the last five years alone.

Variety



General merchandise outlets declined by 59% since 1970, but have made something of a comeback, increasing their outlet count by 8% in the last five years. Much of the historic decline of both sectors may be traced to the success of discount stores.

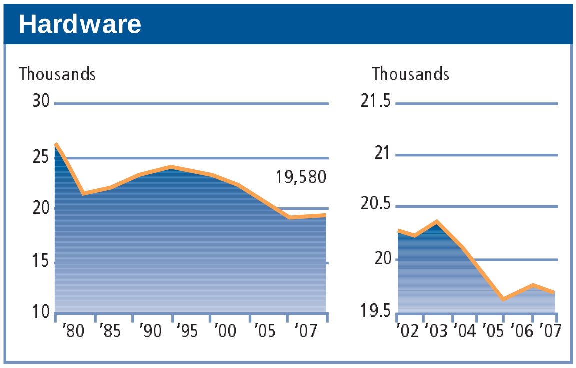
General Merchandise



Hardware & Building Materials

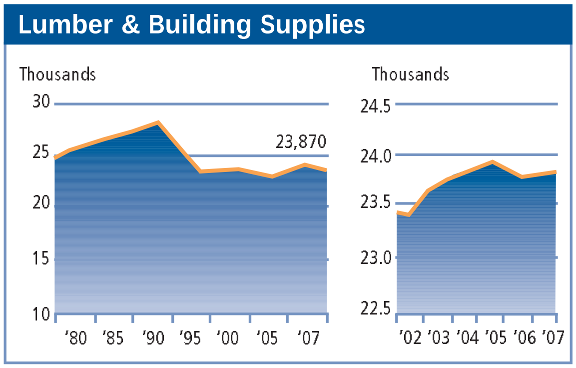
Hardware Stores

Traditional hardware stores continue to decline in number, losing 33% of their outlets since 1970 and 3% in the last five years. While some closings happen because of retirement or an inability to make new capital investments to stay competitive, many reflect the success of large home improvement chains, some of which have ventured beyond their big box facilities to open smaller stores in town.

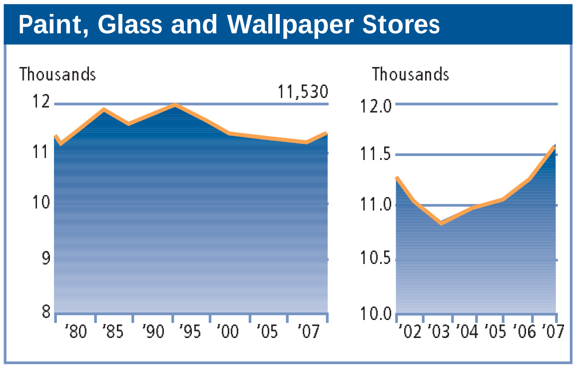


Lumber & Building Supplies and Paint, Glass & Wallpaper Stores

Lumber and building supplies stores have also suffered at the hands of home centers, but far less than have independent hardware stores. By concentrating on providing a high level of service to professional contractors, their largest and most important customers, lumber and building supply stores have managed to lose only 8% of their outlets since 1970 and gain 2% more outlets in the last five years.

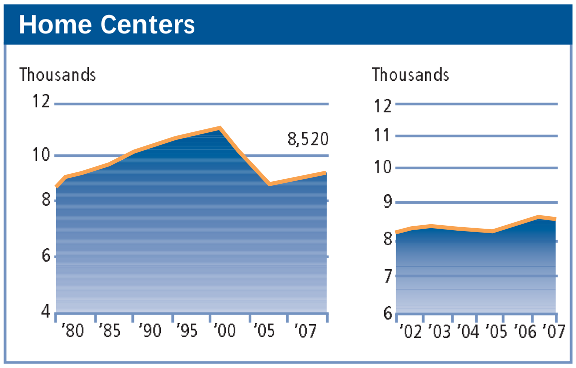


Paint, glass and wallpaper stores lost 2% of their outlets since 1970, but increased their outlets 4% in the last five years.



Home Centers

The years of double-digit home center consolidation in the 1980s and 1990s is over. The number of home centers has increased 2% in the last five years, but the housing starts and sales, which track closely with home center revenue, have slowed and reached a plateau in many markets. The Home Depot's expansion into wholesale distribution has not worked as well as planned. It will sell its HD Supply unit to a group of private equity firms.

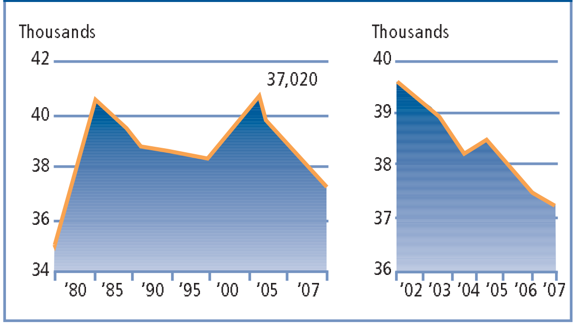


Household Furnishings

Furniture Stores

The number of furniture stores is down 7% in the last five years, despite the low mortgage rates that had, until recently, helped buoy the housing sector. U.S. furniture retailing boasts about $45 billion in annual sales, but remains highly fragmented – few retailers top $100 million in yearly revenue. The vast majority are single-store enterprises. Competition from retailers in other classifications, including discount and department stores, office supply stores, specialty household stores and even online sales have diminished the prospects of traditional furniture stores. Rising fuel and raw material costs are likely to put further pressure on this sector.

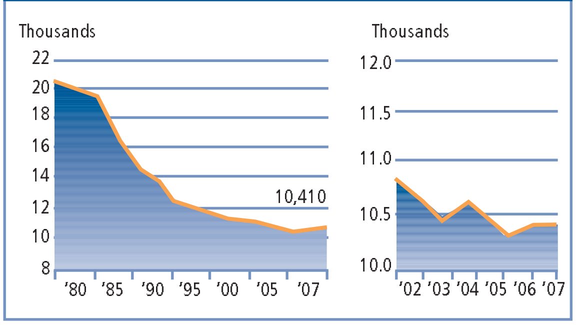
Furniture Stores



Household Appliance Stores

Household appliance stores have lost 46% of their outlets since 1970 and 2% in the last five years, despite the growth of new households, because they too have faced significant cross-sector competition. Major appliances are being sold in many types of stores, including discount and department stores, warehouse clubs and, increasingly, in home centers.

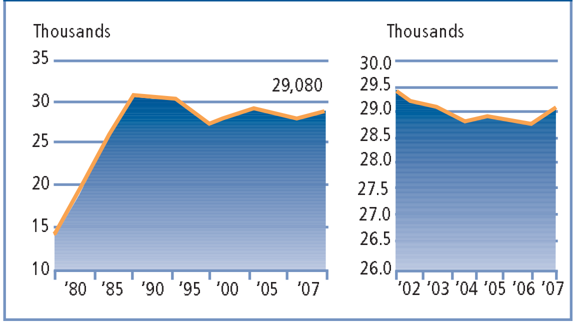
Household Appliance Stores



Radio-TV, Audio & Electronics Stores

Radio, television, audio and electronics stores have increased in number 146% since 1970. One reason for their relative success is the products they sell are faster-changing and more complicated than those sold by other types of retailers. As a result, consumers want and are willing to pay for a more knowledgeable sales staff. But the 3% decline since 2000 suggests this historical rate of growth may no longer be sustainable. Falling prices of flat-screen TVs continue to generate sales but pinch profits and Wal-Mart made a big push into the segment last year. But the outlet count for this sector may stabilize as sector giants Best Buy and Circuit City intend to shrink the size of most of their new stores by 30% to 40% because some products have gotten smaller and because music sales are increasingly done online.

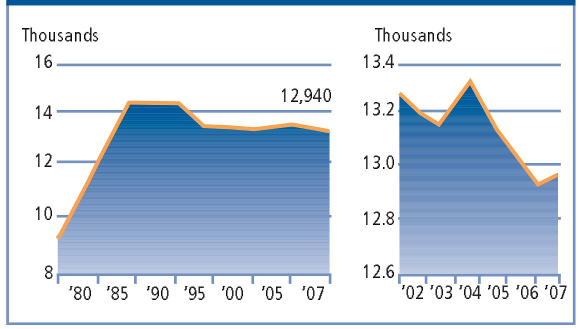
Radio-TV, Audio & Electronics Stores



Record & Musical Instruments Stores

The fundamentals of traditional music stores are bleak. Online piracy remains a major challenge, but so do legitimate online purchases. Sales of CDs have declined and are expected to continue their descent, as consumers buy only the tracks they want. CD sales dropped 4% in the first half of 2006 while online sales soared 77%, according to industry figures. One high-profile casualty of the shift to digital distribution was Tower Records, which sold its bricks-and-mortar stores in December, 2006.

Record & Musical Instruments Stores

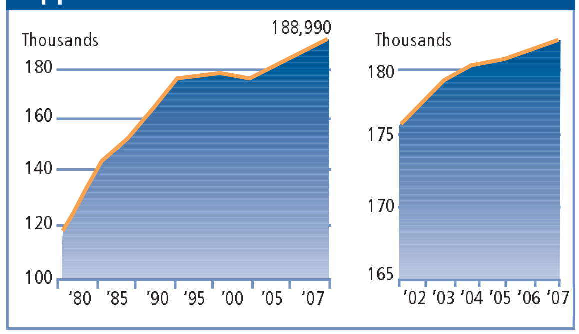


Miscellaneous Retail

Apparel Stores

U.S. apparel stores rang up about $295 billion in sales in 2006. Despite heightened competition from discount stores and online sales, specialty apparel retailers increased their outlet count by 65% since 1975 and 8% in the last five years alone. Their recipe for success includes convenient locations, a shopper-friendly sales staff and the ease with which busy shoppers can buy what they want without waiting a long time. Apparel stores have responded to the demand for constantly refreshed stock by shortening the lifespan of products to respond to ever-changing consumer trends.

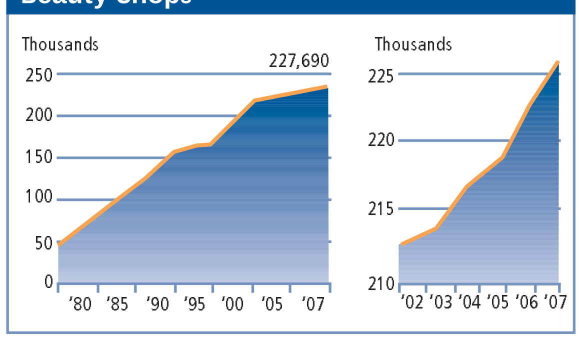
Apparel



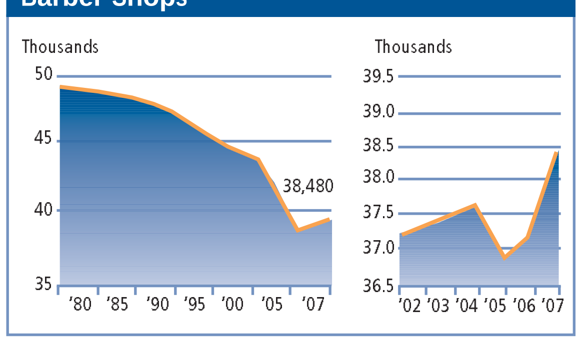
Beauty Shops & Barber Shops

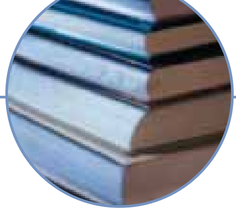
Barber shops have lost 22% of their outlets since 1990 while beauty shops increased the numbers by 18% during the same period. Beauty shops, which are defined as establishments offering permanent waves and hair coloring, in addition to the usual cutting and styling, once catered exclusively to women. Not anymore. Men increasingly get their hair cut at unisex stylists still classified as "beauty shops" by the U.S. Census. Beauty shops added 7% more outlets in the last five years. Barber shops grew only by 3% in the same period.

Beauty Shops



Barber Shops

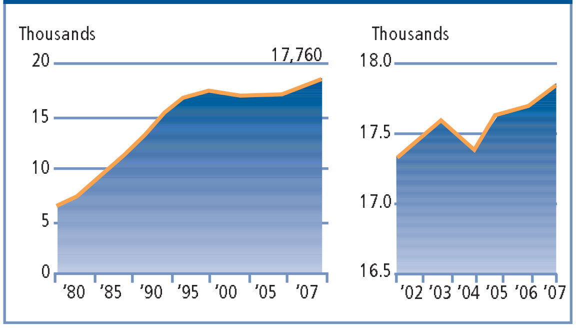




Book Stores

The number of book stores more than tripled since 1975, but the days of dramatic outlet expansion are over. Book stores increased their outlets only 2% in the last five years. The Association of American Publishers estimates that U.S. publishers had net sales of $24 billion in 2006. The first half of 2007 saw a year-over-year sales slump. Many booksellers are hoping the last volume of the phenomenally successful Harry Potter series will help save the year.

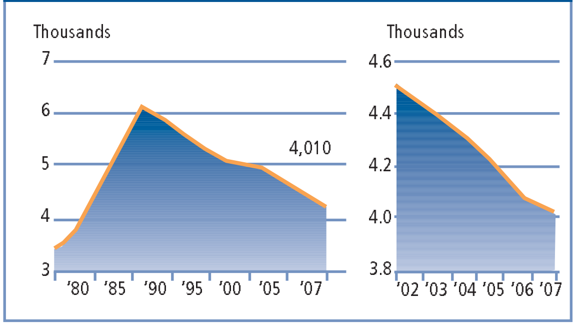
Bookstores

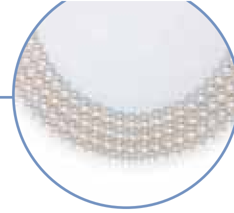


Camera & Photo Supply Stores

Camera and photo supply stores lost an alarming 36% of outlets since 1985 and 10% in the last 5 years alone. Yet photography is more popular than ever. The Photo Marketing Association estimates that digital cameras will account for more than 90% of all cameras sold. Since digital cameras are effectively computers with lenses attached, other retailers may have as much expertise as camera stores. The same issues apply to manufacturers. One casualty of the shift to digital is Konica Minolta, the venerable manufacturer that marketed Japan's first branded camera in 1903. Konica Minolta left the camera business and sold its patent and digital SLR technology to Sony. The growing popularity of digital SLRs help camera stores several ways – profit margins are higher and they can provide more ongoing revenue as shutterbugs buy lenses and accessories to give their cameras additional capabilities.

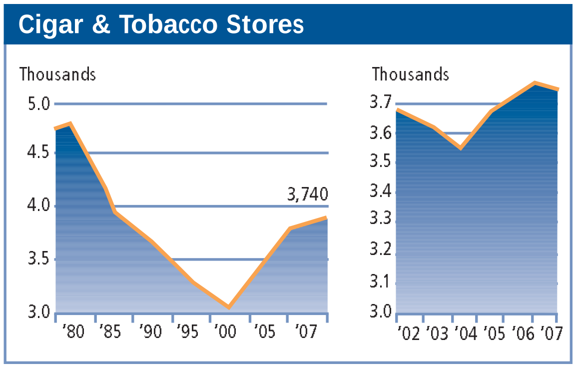
Camera & Photo Supply Stores





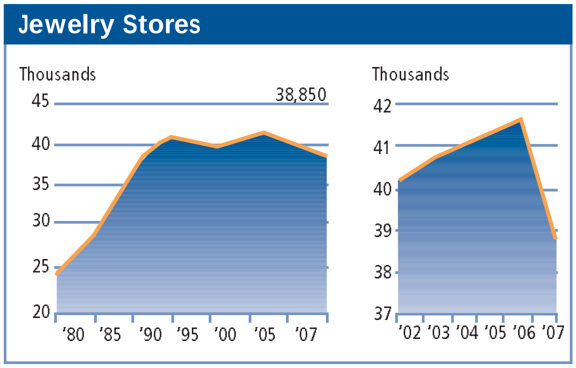
Cigar & Tobacco Stores

Small in number and one of the last domains of independent retailers, cigar and tobacco shops are affected by trends almost exclusively out of their control, yet they have done surprisingly well. As states and municipalities raise taxes on cigarettes, some smokers decide to quit, but those who do not become even more price-sensitive. Since tobacconists devote nearly all their space to tobacco products, they carry a larger selection of products including more from discount manufacturers. Their outlets have grown 27% since 1995, but only 1% in last five years.



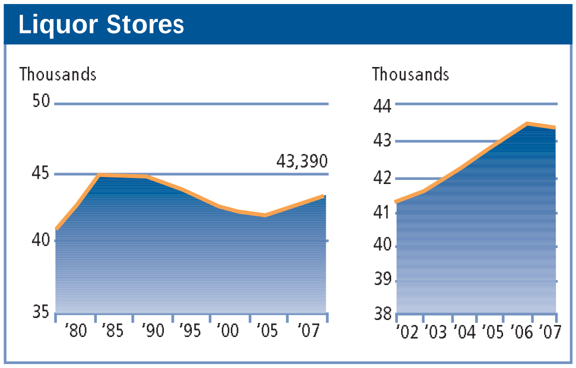
Jewelry Stores

Jewelry retailing remains very fragmented. The top 10 jewelry chains collectively claim less than one-quarter of the market. No jewelry stores made it onto the 2007 list of the Top 100 retailers in North America, published annually by the National Retail Federation's Stores magazine. But three jewelry retailers made it to the NRF's Hot 100 list of fastest-growing retailers. Tiffany was number 81, Finlay Enterprises was 94, but the fastest-growing jewelry retailer was Blue Nile at 25. Blue Nile sells online exclusively, a potentially ominous trend for traditional jewelry stores.



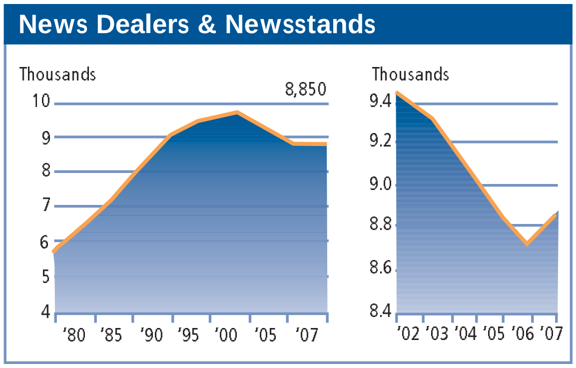
Liquor Stores

Liquor store numbers remain little changed since 1990, but grew 5% in the last five years. The stability of the outlet count masks a raging public policy debate that could rock the sector. The biggest wine seller in the country is Costco and it is pressing for reforms that would largely eliminate the industry's powerful middlemen, mandated in many states after Prohibition was repealed, ostensibly to discourage overconsumption of alcohol. The market is in upheaval because its many barriers are starting to crumble. Recently, a Seattle federal court struck down state rules forcing retailers to buy through wholesalers at pre-established prices. Several states are lifting rules that prevent consumers from buying wine directly from out-of-state producers and retailers. One result is that wine sales are booming, by many of those sales are not made in traditional wine and liquor stores.



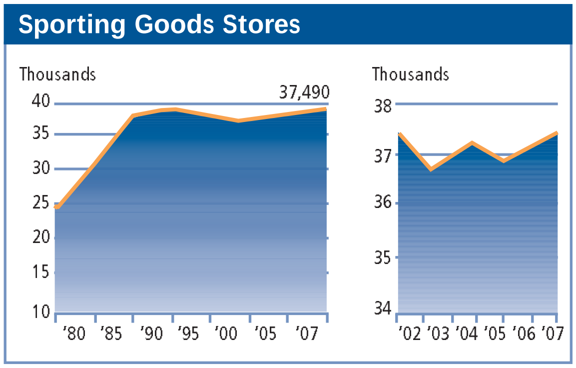

News Dealers & Newsstands

There are 65% more news dealers than there were in 1970, but 7% less than there were five years ago. Ironically, news dealers have done better than newspapers themselves. Newspaper circulation has been declining since 1984 and the pace of decline has quickened as cable news and the Internet compete for consumers' attention. Traditional newspaper ad revenue is also falling as department stores, which have been major advertisers, are consolidating and cutting their newspaper ad spending while Craigslist and eBay are eating away at classified ad sales, which can represent of one-third most paper's revenue. Magazines are faring much better. The Publishers Information Bureau reports magazine ad revenue increased 6% in the first half of 2007.



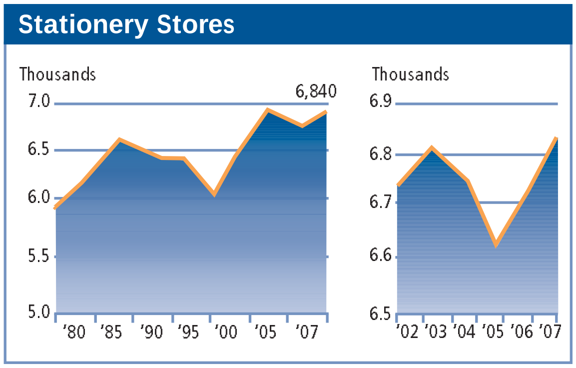
Sporting Goods Stores

There are 4% fewer sporting goods outlets than there were in 1990, but about the same as there were five years ago. Retail sales of sporting goods (including footwear, clothing and equipment) are projected to approach $54 billion in 2007, according to the National Sporting Goods Association. Among equipment categories with sales of more than $1 billion in 2006, golf and camping showed the greatest increases, with 6% gains in both categories.



Stationery Stores

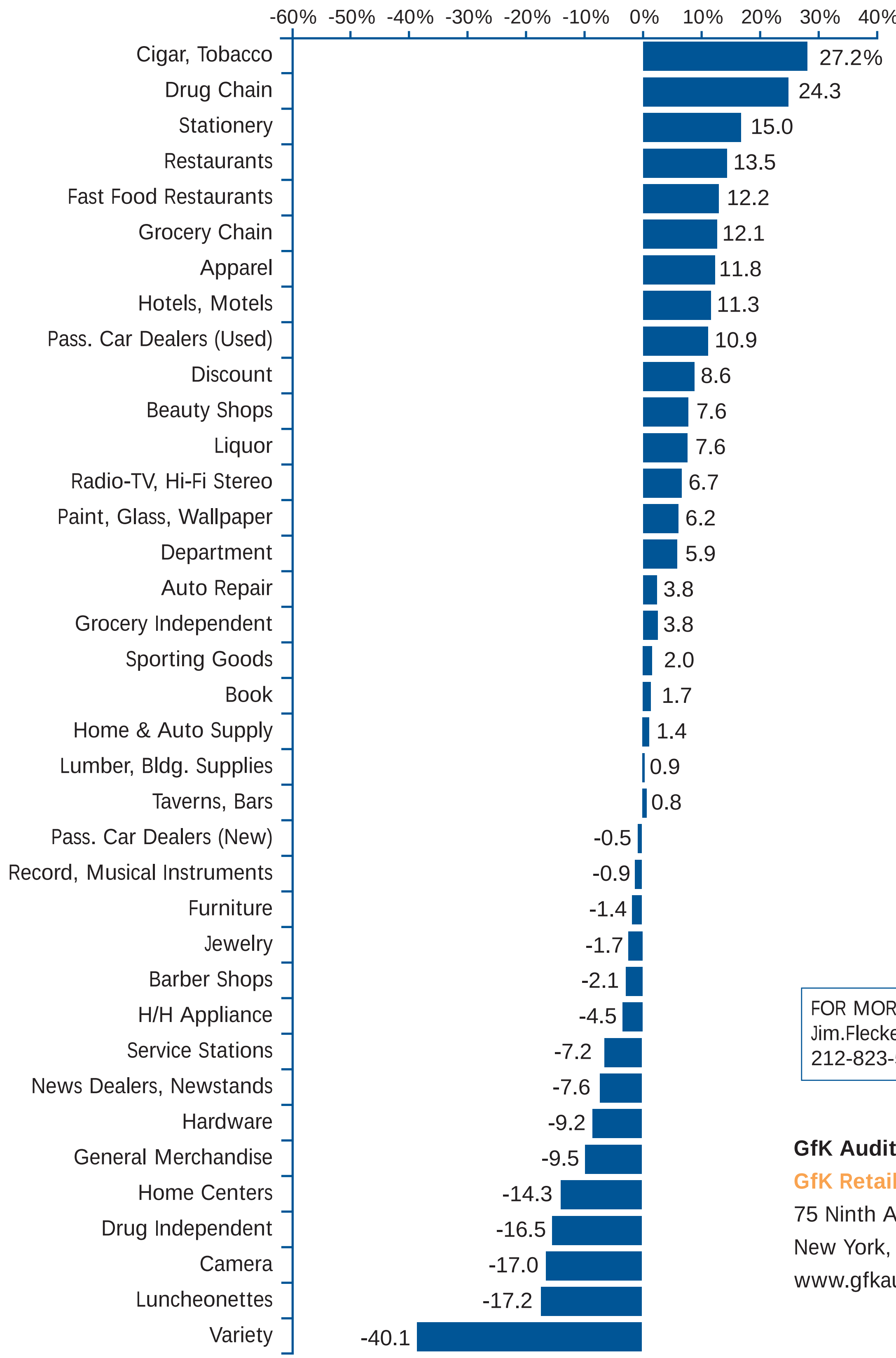
IIn many respects stationery stores, which sell paper and paper products, pens, and sometimes offer printing and engraving services, have been battling technology ever since the telegraph and telephone were invented. Personal letters, or "household-to-household" correspondence, now account for less than 1% of the first-class mail that the U.S. Postal Service handles each year. While there are 18% more stationery stores than there were in 1970, the number of traditional stationery stores is up 1% in the last five years, proving competition from technology and big box office supply stores, like Staples and Office Depot, can't be resisted forever.



A Decade of Change

2007 vs 1997

Percentage Change in Number of Establishments



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