

2018 U.S.
*Grocery
Tracker*

Grocery outlook

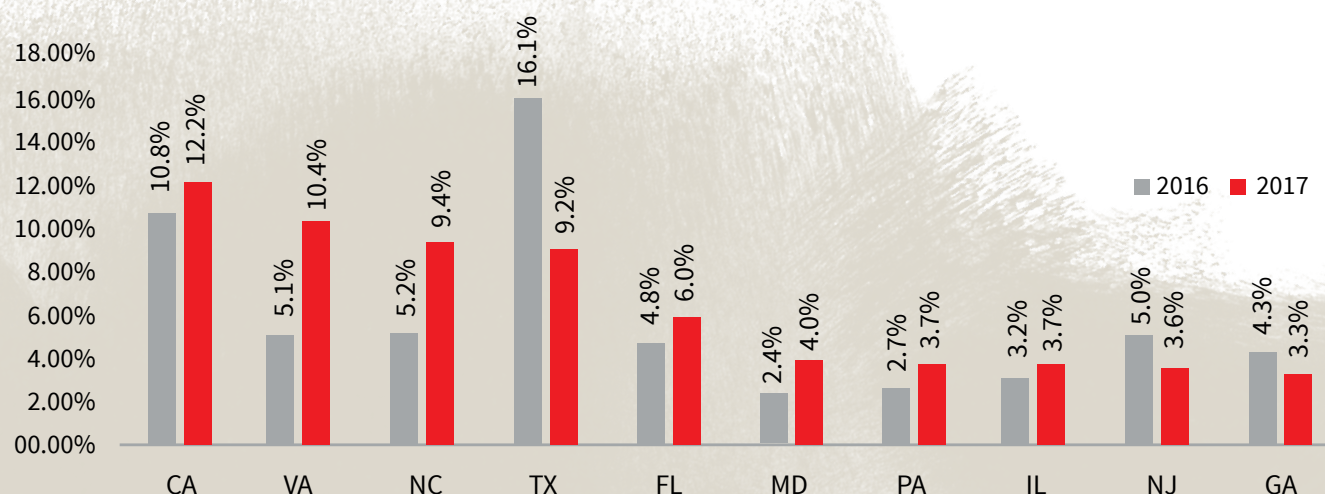
Grocery expansions slowed in 2017 as brands took a step back to examine existing footprints and reevaluate company strategies. Grocers that performed well in 2017 focused on healthy foods, affordable offerings, private labels, and improving digital platforms.



A year of cherry picked expansions

Grocery openings were down 28.8 percent from 2016 as some grocers reined in expansion plans. However, grocers still expressed confidence in California's markets, with 1.6 million s.f. of new store space. Virginia and North Carolina each saw strong growth, with approximately 2.7 million s.f. opening across both states. While Texas was still one of the hottest states for grocery expansion, the amount of new supermarkets in the state tapered this year to 1.2 million s.f. down from 3.0 million s.f. in 2016.

Percentage of total new grocery space by square feet



Three keys to grocer success in 2017

Grocers that saw success in 2017 focused on the shopper experience by offering fresh, healthy and affordable products, elevating brand loyalty through private labels, and investing in digital platforms:

- **Fresh, healthy and affordable:** Gluten free and vegan-only diets aren't going anywhere any time soon. Grocers like Aldi, Lidl, and Grocery Outlet are showing shoppers that quality doesn't have to come with a high price tag.
- **Private labels:** Private labels allow brands to quickly respond to market changes while eliminating third party costs. Grocers are debuting private labels and adding items to existing product lines to build brand allegiance and improve margins.
- **Online and mobile integration:** Grocers are focusing on online shopping, grocery delivery, and click and collect digital platforms to appeal to shopper's desire for convenience and multi-channel shopping options.

Grocery-anchored centers are still an attractive property for investors

Investment into grocery-anchored centers in 2017 increased by 5.3 percent. It was one of the only retail sectors to see growth in a year of low transaction volume. Grocery-anchored centers remain a safe bet for investors as overall transaction volumes for retail have been down, indicating that the asset remains a stable sector.

Fresh and frugal consumers fortify California

Unlike 2016, California surpassed Texas with more openings in 2017, accounting for 12.2 percent of the new square footage across the U.S. This was partially thanks to the openings of Grocery Outlet and Sprouts which comprised 47.7 percent of California openings. These grocers announced continuing ambitious expansion plans for 2018 as well. Sprouts has benefitted from the demand for fresh and healthy food and has seen success both on the West Coast and in the Southeast. 2018 expansion includes an emphasis on the Mid-Atlantic. Grocery Outlet will continue to focus on existing markets by providing bargain offerings and its community-oriented mission to underserved neighborhoods.

¹ Nielsen, *Organic products are showing up more places – and for less money*, 2017.



In 2017, organic sales grew by **9.8%**¹

Lidl's launch benefits Mid-Atlantic

Lidl launched its first stores in the Mid-Atlantic and expanded rapidly in those markets, working up towards New Jersey. As a result, Virginia and North Carolina combined accounted for 19.7 percent of all new grocery square footage for the past year.

Despite an ambitious rollout strategy, almost 50 stores in 2017, Lidl may have experienced a rocky start in the U.S. and could be rethinking its real estate strategy. This is evidenced by the fact that several construction projects have been halted and 2018 projected openings are a fraction of those the year before. Lidl will most likely see long term success in the U.S. evidenced by European shoppers' loyalty to the Lidl brand, but will require a slower and more tailored real estate strategy going forward.

Aldi is all about value and vegan

Aldi focused this year's growth in California, Virginia, and Texas, although many other communities across the U.S. also saw an Aldi open this year. Part of the appeal is the commitment to shopper value. The Aldi price point has generated significant interest from consumers and is expanding its market share by offering more healthy food options to attract an even broader audience. Aldi plans to invest \$3.4 billion in store expansions over the next four years while also focusing on remodeling 400 existing properties to focus on the shopping experience.

Aldi also recently launched a vegan line of foods called Earth Grown, adding to their lengthy list of private labels, 200 of which received awards last year. Aldi has clearly proved to shoppers the quality of the Aldi brand and as consumers become more interested in healthy eating, Aldi is able to quickly develop a trusted product line to appeal to the changing demands.

Private labels pump up profit margins

Private labels allow brands to differentiate products that are at the end of the day mostly the same. A strong private label cultivates brand and store loyalty which is key considering the multitude of options shoppers have when buying groceries. Grocery margins can often be single digit numbers, but once private labels are introduced, margins can more than double. Private labels allow grocers to quickly respond to changing demands by controlling every step in the supply chain, which in the current competitive environment is crucial.

In 2016, private label goods accounted for 17 percent of U.S. sales but expect that percentage to grow rapidly considering expansion plans of both Aldi and Lidl. Both are grocers that rely mostly on private label and impact competitor's prices and offerings. Lidl's presence in a given market compels nearby grocery stores to lower prices up to 55 percent ² and others have increased private label offerings in response to Aldi's market entrance.

² UNC, [The competitive price effects of Lidl's entry in the US grocery market](#), 2018.

Organic growth

Albertsons will have grown its private label, O Organics, by 50% as it recently hit \$1 billion in sales and saw a 15% increase after adding 200 products to the line in 2017.

Kroger's Simple Truth line with natural and organic products reached \$2 billion in annual sales.

Omnichannel options boost business

One of the most talked about mergers of 2017 was Whole Foods and Amazon. This new partnership demonstrates the value of an omnichannel strategy for grocers. Amazon is now able to benefit from an extensive network of established physical stores across the country and Whole Foods in turn becomes a more easily consumable brand. The 365 private label is now available on Amazon.com and has pushed AmazonFresh sales by 35 percent ³.

This acquisition will give Whole Foods the ability to test new ideas and concepts within the grocery industry with more frequency and speed, forcing competition and innovation in an industry that until recently, has not seen much change.

Kroger has shown serious digital commitment in recent years and recently announced Kroger Edge which communicates with smartphones' shopping lists to help guide customers to desired products. The high tech shelf display will also display pricing and nutritional information and is anticipated to be in 200 stores by the end of 2018.

Additionally, Kroger expressed interest in acquiring Boxed, the online bulk provider recently valued at \$470 billion. Despite Boxed's rejection of the offer, the appeal of this kind of partnership is the potential for Kroger to acquire an established e-commerce and distribution network without having to develop programs from the ground up.

Despite major deals in 2017 reflecting significant investment in digital and e-commerce platforms, only 5 percent of people are even interested in shopping for groceries online, and online penetration for the sector is incredibly low at 0.8 percent ⁴. The push for an omnichannel strategy speaks to shopper's needs for convenience and flexibility, especially for commodity items, and while digital integration will be tenet of success in our growing digital world, is not a prediction of the fall of physical grocers.

³ [Wall Street Journal](#)

⁴ Internet Retailer



Kroger opened its 1000th ClickList store, its curbside pickup concept, and has seen digital sales more than double since launching the program.

Trends to watch in 2018



Smaller and more focused stores

Smaller footprints have more opportunities in urban locations and in mixed use projects. Grocers like Aldi and Trader Joe's benefit from the flexibility to take smaller spaces in vertically integrated projects. HyVee recently announced that while traditional-sized stores will still be rolled out, smaller format stores of 10,000 s.f. will be a focus.

Some brands will continue expanding footprints, but traditional and legacy grocers may begin focusing on existing inventory and investing in improving the shopper experience



Data driven technology

As shoppers demand more digital integration, retailers have new access to unprecedented amounts of data. Restock Kroger, Kroger's most recent innovation strategy, will tailor stores to the shoppers that frequent it, customizing shelf displays, store layouts, offered products and operations based on the preferences of local shoppers.



Blockchain

Blockchain is a digital technology that has been talked about at length in the media, but also tough to easily explain. For the grocery industry, blockchain has the capability of improving food safety, allowing products to be recalled more quickly, and improving inventory management. With blockchain's ability to improve data management between stakeholders in the supply chain, the grocery industry is prime for integration. To learn more about the promise of blockchain technology, read our report, [Another link \(or block\) in the supply chain.](#)



Partnerships and consolidations

Kroger is not only looking to acquire Boxed but has been reportedly in discussions with Ace Hardware to allow the hardware supplier to have pop-up kiosks in Kroger stores. The acquisitions with the greatest implications will occur between grocers and non-grocery companies that focus on innovation and technology that can build upon digital networks, logistics, delivery, and customer engagement.



Rapid checkout

Expect grocers with existing rapid checkout technologies to continue to roll out programs across the country and for others to join the ranks of Kroger, Walmart and Amazon who have been testing checkout free concepts. Walmart is expanding Scan & Go mobile checkout to 100 more stores and Kroger's Scan, Bag and Go will be in 400 stores in 2018, and to much fanfare, AmazonGo opened to the public in the beginning of 2018.

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