

# TIMES & TRENDS

A Snapshot of Trends Shaping the CPG Industry

## CHANNEL MIGRATION 2007

### A NEW CROSS-CHANNEL BATTLEGROUND EMERGES



#### July 2007

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## EXECUTIVE SUMMARY

- ▶ While total CPG share shifts across channels have moderated, the cross-channel battles for consumer spending rage on; the new competitive battles are played out at the category and consumer-segment level
- ▶ This was a watershed year for drug stores; the channel secured the largest CPG share gain in recent history as strategies to build front-end sales gain traction
- ▶ Capturing incremental shopping trips has become exceedingly challenging as a growing number of retailers vie for the same shrinking trip base, but supercenters, club stores and drug stores are winning trips despite these challenges
- ▶ Maturation of the supercenter format combined with successful grocery differentiation strategies have leveled off the dollar flow from grocery to supercenters; the grocery channel's toughest category-level battles this year were with the club and drug store channels
- ▶ The big mover and shaker of the future may be small-format, express stores; Tesco's Fresh & Easy stores are likely to kick off an industry transformation



### INTRODUCTION

**A new cross-channel battleground is emerging – one that is just as intense but far more complex.**

For over a decade, supercenters reigned supreme in the cross-channel battle for consumers' CPG dollars, winning large share gains year after year.

Competing retailers put new strategies in place to protect and grow share, from broadening assortment to developing entirely new formats catering to specific consumer segments.

As the supercenter format matures, and competing retailer strategies take hold, supercenter share gains are shrinking, and a new cross-channel battleground is emerging -- one that is just as intense, but is far more complex. The range of strong competitors has grown, their strengths are varied, and the battles are more targeted – being played out to a much greater extent at the category and consumer-segment level.

Total CPG share swings were modest this year, but shifts across categories and consumer lifestage segments were significant.

In this new, emerging battleground, retailers who deliver distinct shopping experiences and targeted marketing and merchandising that address their consumers' most pressing needs are winning.

Drug stores are a prime example. While the channel holds only a 5.6% share of CPG spending, it secured the largest CPG share gain of any channel. As detailed in this report, this remarkable feat resulted largely from a staunch focus on delivering healthcare and beauty solutions to consumers.

For both CPG retailers assessing competitive strategies and manufacturers assessing distribution strategies, this new environment requires a more refined, granular analysis of cross-channel competitive opportunities and risks.

And, just as industry players gain traction within this market, it is likely to change. Over the next 3-5 years, an entirely new format, express stores, is expected to gain sufficient mass within the U.S. to garner sizable CPG share.

This new format has the potential to dramatically change the way consumers shop. A new industry shakeup may be on the horizon. Get ready.



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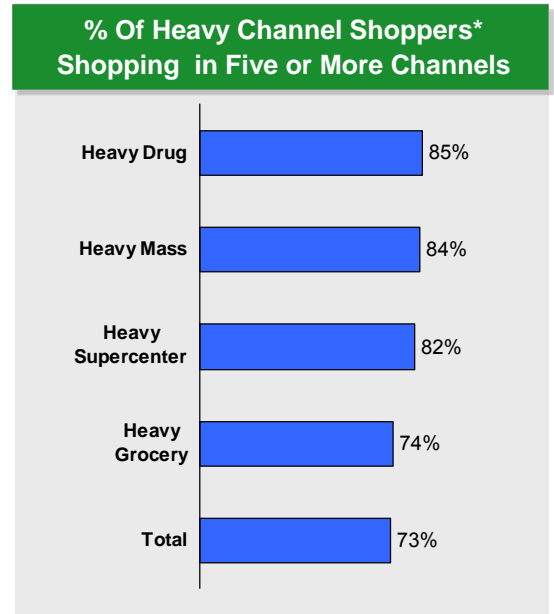
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## CPG SHOPPING TRENDS CHANNELS SHOPPED

**Consumers have become shopping strategists, visiting 5+ channels to meet their CPG needs.**

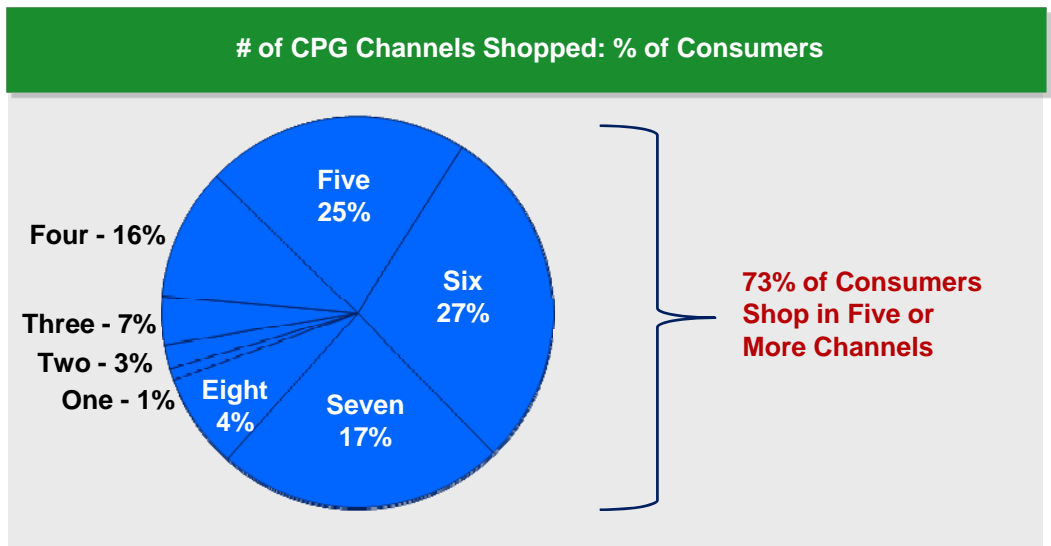
Consumers have become shopping strategists, developing a plan of attack to maximize the incredible array of shopping options now available to them. As a result, roughly three-quarters of consumers now shop at five or more channels just to meet their CPG needs.

As illustrated in the upper chart, heavy shoppers of non-grocery channels tend to shop around even more than the average consumer. Loyalty programs and continual analysis of competitive threats will be particularly important in these channels, as retailers are likely more vulnerable to loss among their heaviest shoppers as they fill unmet needs across other retailers.



Source: IRI Consumer Network™  
52 weeks ending 5/13/07

\*Note: Heavy shoppers are the top one-third by spending



Source: IRI Consumer Network™; 52 weeks ending 5/13/07



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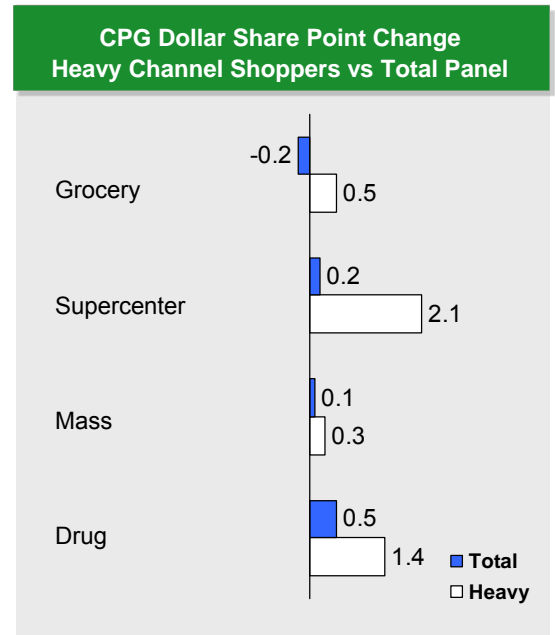
**Despite modest total CPG share changes this year, cross-channel competition rages on.**

## CPG SHOPPING TRENDS CHANNEL SHARE SHIFTS

Share changes at the total CPG level were relatively modest this past year. Continuing a trend that first emerged in 2006, supercenter share gain and grocery's corresponding loss were minimal. Supercenter expansion has begun to cannibalize existing stores, and grocery retailers' differentiation strategies are moving the needle in their favor.

Further, programs across all major channels to protect and grow business within their core consumer base are paying off, as illustrated in the top chart.

However, intense cross-channel battles are far from over. As outlined throughout this report, the drug channel's sizable share gain and large swings across categories and specific consumer segments reveal a new era of competition among channels.



Source: IRI Consumer Network™  
52 weeks ending 5/13/07 and same period prior year

## CPG Dollar Share by Channel

<u>Channel</u>	<u>2007 Share</u>	<u>Point Change vs 2006</u>
Grocery	56.3%	(0.2)
Supercenter	13.3%	+0.2
Mass	9.2%	+0.1
Club	7.3%	(0.1)
Drug	5.6%	+0.5
Dollar	1.2%	0.0
Wal-Mart	18.0%	+0.4

Source: IRI Consumer Network™; 52 weeks ending 5/13/07 and same period prior year



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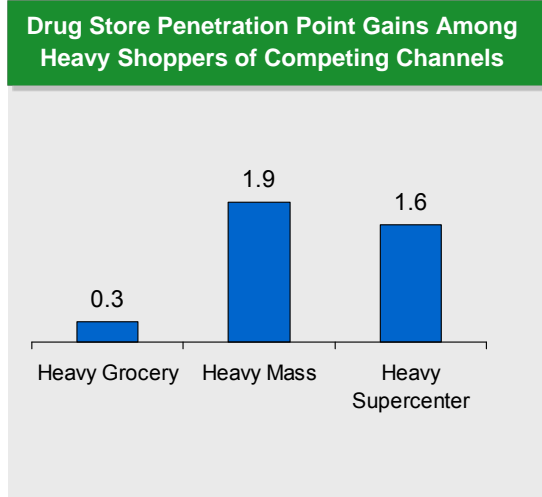
## CPG SHOPPING TRENDS CHANNEL PENETRATION

**Value channels experienced losses in household penetration.**

Winning a net new customer is one of the most challenging tasks in business, and losing one is perhaps the most painful.

As reflected in the chart below, while the grocery channel maintained household penetration last year, and drug stores enjoyed a small increase, value channels experienced penetration losses. Fewer households shopped in value channels last year, and while the change is not drastic, it could signal the start of an important new trend.

While both the supercenter and mass channels were successful in holding onto penetration among their heaviest shoppers, drug stores did secure sizable penetration gains within these heavy shopper segments, illustrating drug stores' growing appeal across consumer groups.



Source: IRI Consumer Network™  
52 weeks ending 5/13/07 and same period prior year

## % Households Buying by Channel

Channel	2007 Penetration	Point Change vs 2006
Grocery	99.2%	0.0
Supercenter	60.1%	(1.8)
Mass	85.6%	(1.4)
Club	49.4%	(1.3)
Drug	77.4%	+0.3
Dollar	53.5%	(1.4)
Wal-Mart	80.0%	(1.6)

Source: IRI Consumer Network™; 52 weeks ending 5/13/07 and same period prior year



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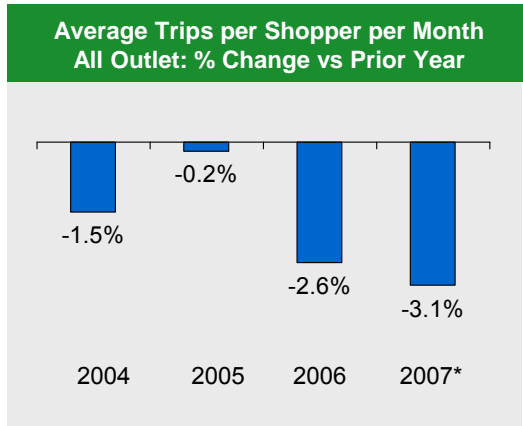
## CPG SHOPPING TRENDS SHOPPING TRIPS

**More competition for fewer trips is driving a critical need for targeted trip-building strategies.**

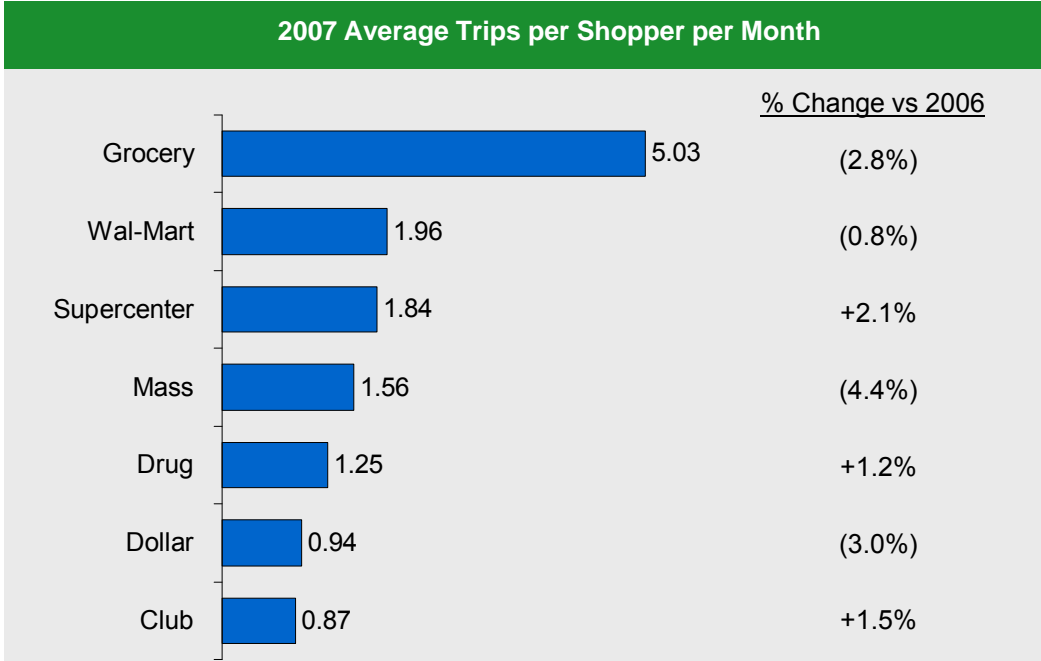
Bringing consumers into the store is a huge part of the retail growth puzzle, and that task is getting a lot harder. Not only are more and varied retailers vying for the same trips, but the total number of trips available continues to decline.

Yet, not all channels have been impacted equally. The success of supercenter, club and drug stores in increasing trip frequency may be attributed at least in part to explicit trip-building strategies, with healthcare as a strong focus area. (See the April issue of *Times & Trends* for additional detail.)

In response to these trends, retailers will likely step up efforts to attract and build specific trip types that offer the greatest growth potential for their stores.



Source: IRI Consumer Network™  
\*52 weeks ending 5/13/07



Source: IRI Consumer Network™; 52 weeks ending 5/13/07 and same period prior year



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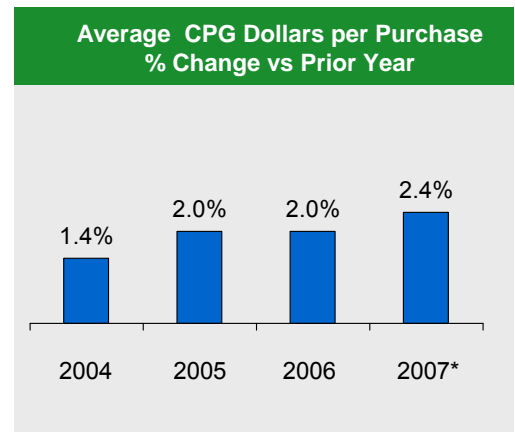
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**Retailers will increasingly look to partner with manufacturers in developing basket-building strategies.**

## CPG SHOPPING TRENDS BASKET SIZE

For many retailers, the most promising path to growth will be via increasing basket size among existing consumers. As consumers have consolidated trips, baskets are growing, and all major channels except club (which earned trip gains) are experiencing increases.

Retailers will increasingly look to partner with manufacturers in creating basket-building strategies, including ensuring a relevant assortment for core and target consumer segments, implementing multi-unit promotions, enhancing in-store marketing, and linking high-growth departments, such as the pharmacy, to the rest of the store through cross-merchandising.



Source: IRI Consumer Network™ (All Outlet)  
\*52 weeks ending 5/13/07



Source: IRI Consumer Network™; 52 weeks ending 5/13/07 and same period prior year



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## FOOD & BEVERAGE CHANNEL SHARE MIX

**Cross-channel competition is most intense among snacks/desserts and beverages.**

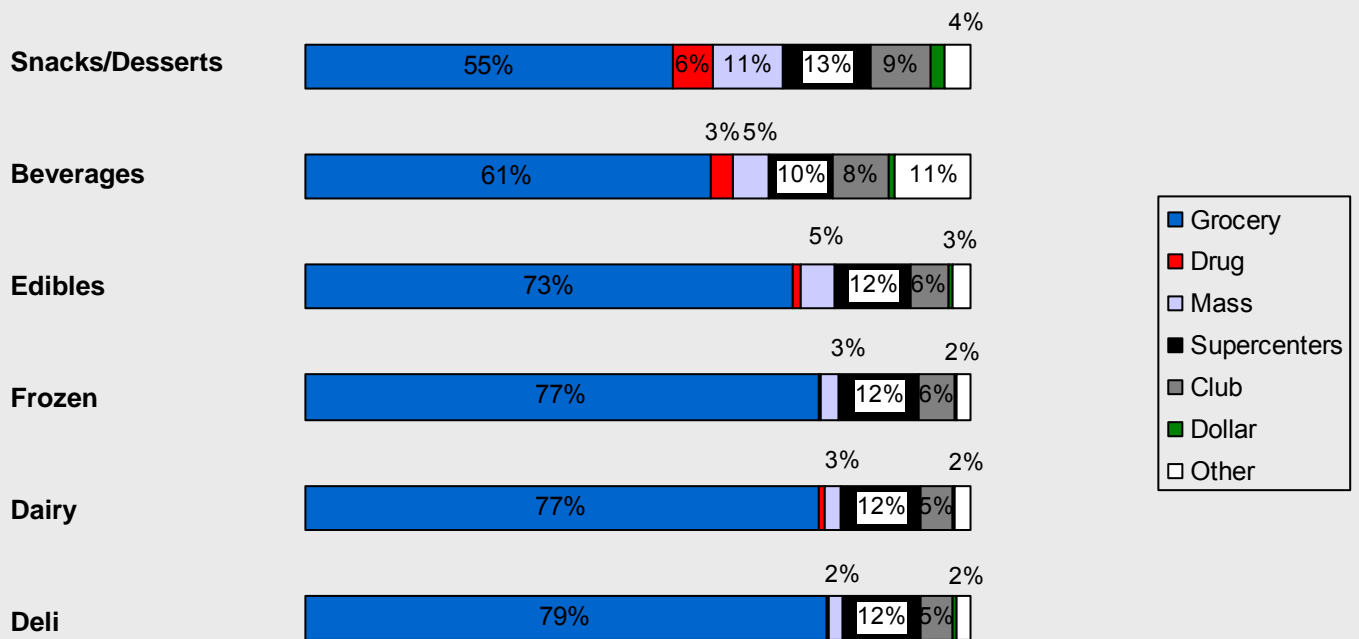
While the grocery channel still holds a majority share across all food and beverage departments, increased availability of food and beverage products has enabled other channels to stake a sizable claim.

Cross-channel competition is most intense across snack/desserts and beverages, which is not surprising, given the ubiquitous availability of these categories, but grocers are losing significant share within staple categories, such as dairy and edibles, as well.

Beverages	(0.8)
Dairy	(0.7)
Edibles	(0.6)
Snacks/Desserts	(0.6)
Deli	(0.5)
Frozen	+0.1

Source: IRI Consumer Network™  
52 weeks ending 5/13/07

### Channel Dollar Share by Department (Based on All Outlet Sales) 52 Weeks Ending 5/13/07



Source: IRI Consumer Network™



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## FOOD & BEVERAGE CHANNEL SHARE SHIFTS

**Competition is heating up between club and grocery channels among food and beverage categories.**

Despite relatively moderate total CPG share shifts this year, there were major share shifts across specific food and beverage categories, as illustrated in this chart.

The category-level analysis reveals heightened competition between grocery and club stores. Club gains occurred in both dairy and center store categories, while the grocery channel secured large gains in “center-plate” frozen foods including poultry and seafood.

The club channel’s trip growth is likely at least in part responsible for share growth among more frequently-purchased categories, such as butter. Further, while the club channel’s total penetration has declined overall, club retailers have succeeded in increasing penetration among the categories here in which they have enjoyed share gains.

By contrast, as consumers make fewer, larger trips to grocery stores, they are likely more inclined to purchase products such as frozen poultry that may be kept on hand for longer periods without fear of spoilage.

Categories with Sizable Channel Share Shifts Dollar Share Point Change 52 Weeks Ending 5/13/2007 vs Prior Year		
	From	To
<b>Baking Needs</b>	Club (-2.3)	Grocery (+1.1) Mass (+0.9)
<b>Butter</b>	Grocery (-2.3)	Club (+1.8)
<b>Cookies</b>	Grocery (-2.0)	Multiple Channels
<b>Fz Pizza</b>	Grocery (-2.0)	Mass (+1.3) Supercenter (+0.9)
<b>Fz Poultry (Processed)</b>	Club (-3.5)	Grocery (+3.7)
<b>Fz Poultry (Un-Processed)</b>	Club (-4.9)	Grocery (+4.4)
<b>Fz Seafood</b>	Club (-2.7)	Grocery (+2.8)
<b>Hot Cereal</b>	Grocery (-2.8)	Club (+1.1)
<b>Ready-to-Drink Tea/Coffee</b>	Grocery (-2.3)	Club (+1.5)
<b>Snack Nuts</b>	Club (-1.4) Mass (1.0)	Grocery (+2.6)

Source: IRI Consumer Network™



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## NON-FOODS CHANNEL SHARE MIX

**Consumers are particularly inclined to shop around for non-foods.**

Well-suited to stock-up and advanced purchase, and available across an even broader range of outlets than most food and beverage categories, non-foods exhibit wide share dispersion across channels.

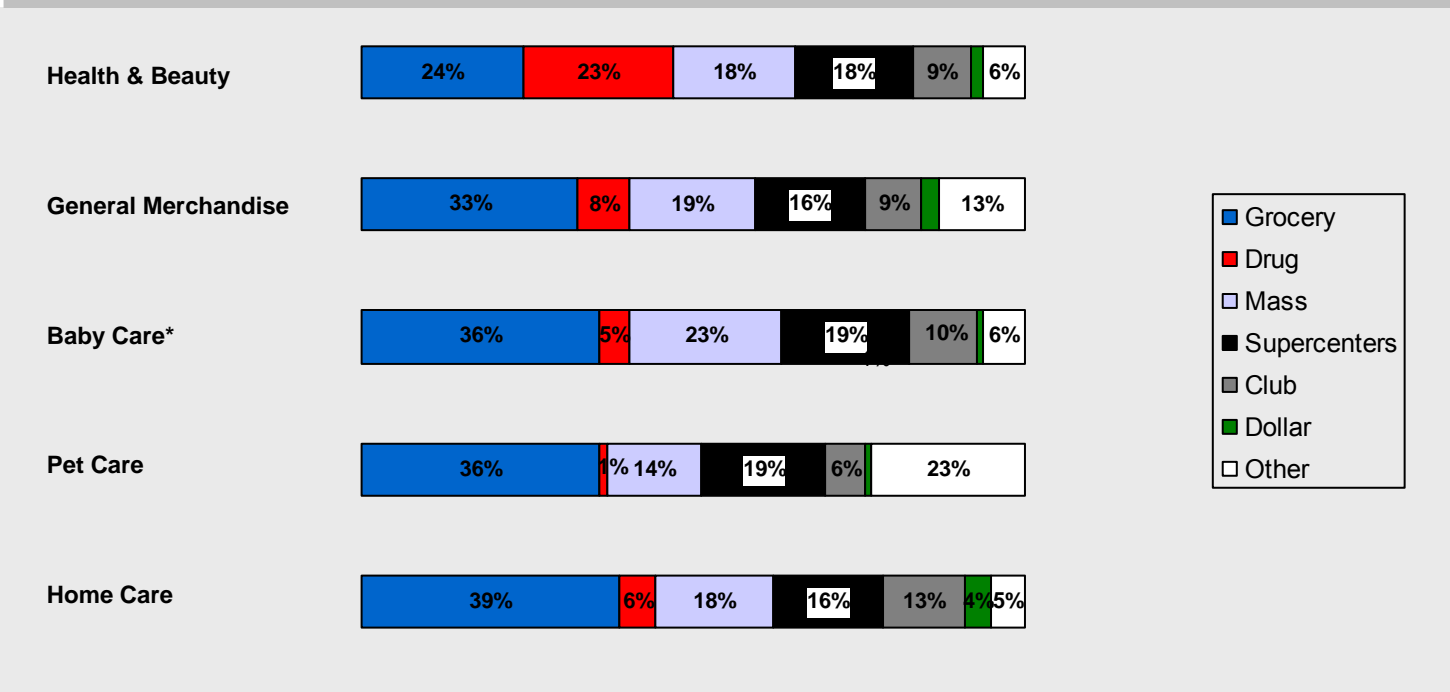
As a result, while the opportunity for share gain may be greater in non-foods, as no one channel is entrenched, the risk of share loss is also greater, as consumers are more inclined to shop around.

These categories will play a prominent role in cross-channel competitive strategies.

Baby Care	(1.4)
Health & Beauty	(0.9)
Home Care	(0.9)
General Merchandise	+0.9
Pet Care	+1.4

Source: IRI Consumer Network™  
52 weeks ending 5/13/07

### Channel Dollar Share by Department (Based on All Outlet Sales) 52 Weeks Ending 5/13/2007



Source: IRI Consumer Network™

\* Baby care includes baby food and formula/electrolytes



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## NON-FOODS CHANNEL SHARE SHIFTS - CATEGORY

**Drug stores secured major gains in health and beauty care categories.**

Drug stores dominated non-food share gains last year, securing increases in nine of the ten categories with the largest share shifts. These gains were sourced largely from grocery, supercenters and mass retailers.

Leading drug retailers have invested heavily in healthcare and beauty care marketing, merchandising and private label development to protect and grow their position as a health and beauty care destination, and these initiatives are paying off.

Drug store healthcare programs have included Medicare Part D outreach to seniors, and expansion of in-store health clinic availability.

In beauty, major players have added upscale, European beauty lines, such as Walgreens' European Beauty Collection and the availability of the Lumene brand at CVS.

Drug retailers have also been at the forefront in carrying and promoting new products. In hair care, for instance, a segment that holds four of the top ten spots on IRI's non-food New Product Pacesetters-to-Be list for next year – drug stores successfully captured a large share of the growth driven by innovation.

Categories with Sizable Channel Share Shifts Dollar Share Point Change 52 Weeks Ending 5/13/2007 vs Prior Year		
	From	To
<b>Cold/Allergy/Sinus Tablets</b>	Grocery (-2.4)	Supercenter (+2.2)
<b>Facial Tissue</b>	Grocery (-1.2)	Drug (+2.2)
<b>Hair Color</b>	Mass (-1.8)	Drug (+2.6)
<b>Hair Conditioner</b>	Grocery (-2.0) Mass (-0.9) Supercenter (-0.7)	Drug (+5.9)
<b>Internal Analgesics</b>	Grocery (-1.0) Supercenter (-0.6)	Drug (+3.1)
<b>Razor Blades</b>	Grocery (-1.2) Supercenter (-1.2)	Drug (+2.2)
<b>Sanitary Napkins/Tampons</b>	Grocery (-3.6) Mass (-1.3)	Drug (+5.7)
<b>Shampoo</b>	Grocery (-2.0) Mass (-0.8)	Drug (+4.5)
<b>Toothpaste</b>	Mass (-1.3) Club (-0.8)	Drug (+3.0)
<b>Weight Control Liquid/Powder</b>	Grocery (-2.8)	Drug (+2.9) Supercenter (+2.0)

Source: IRI Consumer Network®



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## CONSUMER SEGMENTS CHANNEL SHARE SHIFTS

**Large spending shifts are occurring across consumer segments.**

Over the past several years, retailers have become increasingly savvy in identifying distinct consumer segments and tailoring marketing, merchandising and assortment to grow sales among those segments offering the greatest growth potential.

A combination of these initiatives, as well as underlying market and consumer trends have resulted in significant channel share shifts across consumer lifestage segments.

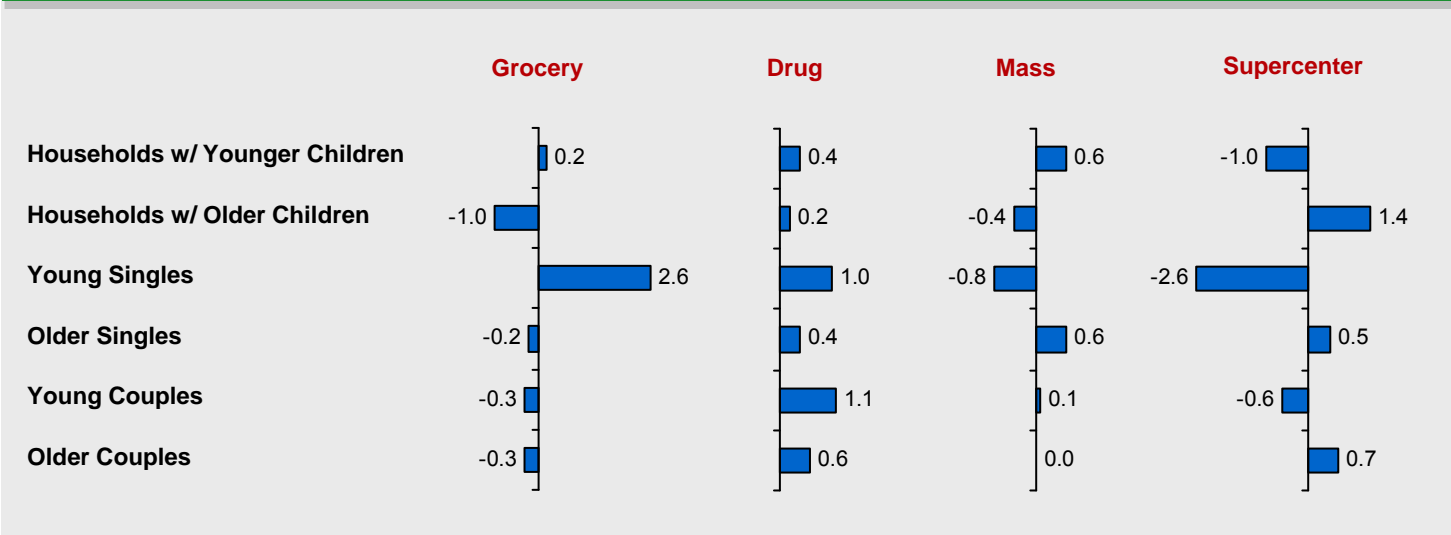
As depicted in the chart below, for instance, grocers have gained share among young singles, at the expense of supercenters. While young singles spend less than the average household on CPG

products, the grocery gain is significant, as forming a strong relationship now may bode well for grocers as these consumers move into prime spending years.

Supercenters' share gain among older couples and singles is an important win, as the channel has historically been under-developed in this segment. However, supercenters lost share within one of their strongest segments – households with young children, as this segment reduced supercenter trips.

Drug stores' ability to maintain or grow share across all major lifestage segments is further evidence of the channel's strong performance.

**CPG Channel Dollar Share Point Change by Consumer Segment (Based on All Outlet Sales)  
52 Weeks Ending 5/13/2007 vs Prior Year**



Source: IRI Consumer Network™



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## HISTORICAL CHANNEL SHIFTS GROCERY VS SUPERCENTERS

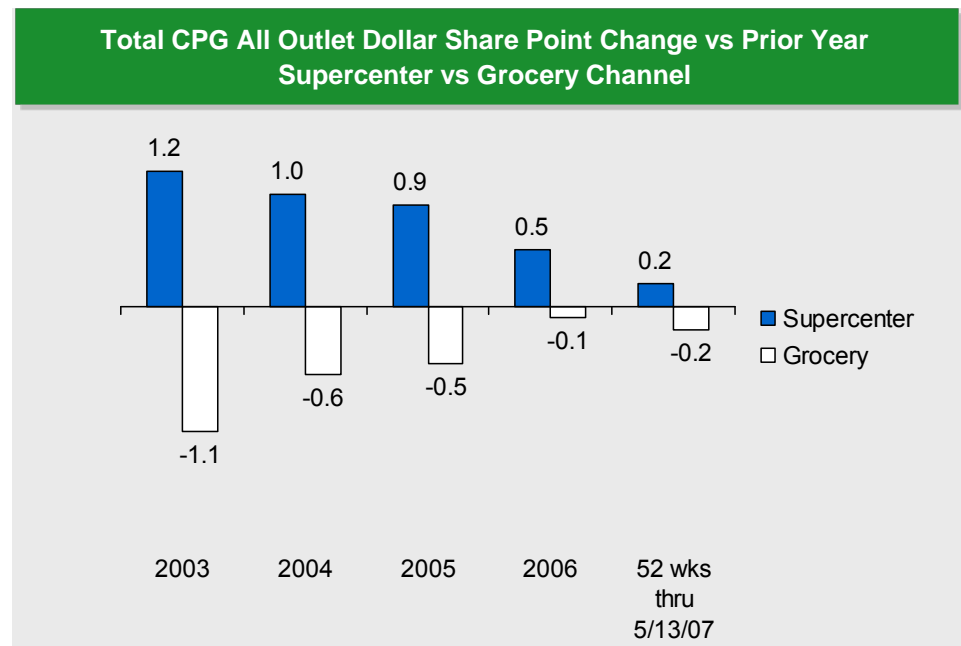
**Maturation of the supercenter format combined with successful grocery differentiation strategies have minimized share shifts.**

Despite continued aggressive supercenter expansion, large share shifts between supercenters and grocery stores have tapered off.

As the supercenter channel matures, and real estate limitations continue to hinder expansion in urban markets, new stores are increasingly cannibalizing existing stores. As a result, while U.S. supercenter expansion will remain a cornerstone of Wal-Mart's growth, the company has announced that it will be more selective in its location strategy to avoid cannibalization and has put plans in place to drive trips and basket size among existing stores.<sup>1</sup>

Grocery retailers have also played a large role in creating this turn of events. In the face of intense price competition from supercenters and other value retailers, many leading grocers have pursued successful differentiation strategies, including increased focus on organics and premium products, new services, such as in-store cafes, and technology to streamline the shopping experience.

We can expect this positive momentum to fuel additional experimentation among grocers, resulting in truly unique shopping experiences.



Source: IRI Consumer Network™

1. Company Press Release



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## HISTORICAL CHANNEL SHIFTS DRUG STORES

**Score one for drug stores in the battle for CPG spending.**

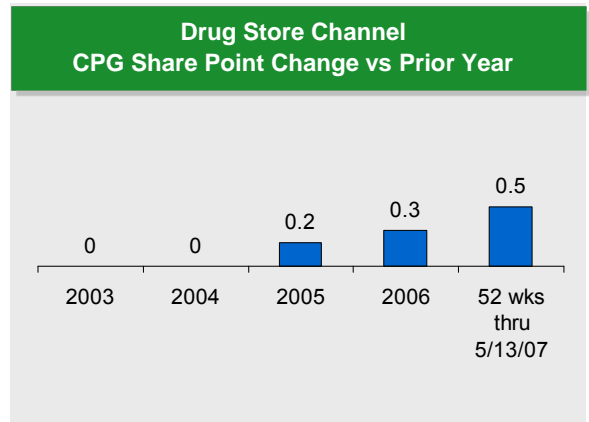
Drug stores have long recognized the opportunity to improve total store growth rates by building front-end sales. Yet, while the channel successfully defended CPG share from competing channels, share growth was elusive.

This past year represents a real turning point for drug stores. Share increased a half point (which is remarkable on a share base of 5.6%), and the channel has promising momentum in play with favorable trends in penetration, trips and basket size, as detailed throughout this report.

Part of this growth is clearly due to store expansion -- Walgreens alone will open 500 new stores by the end of fiscal year 2007 -- but major drug store retailers have also driven impressive same store sales growth. Front-end comparable store sales for the most recent fiscal quarter were up 5.6% at Walgreens and 6.6% at CVS/Caremark.<sup>1</sup>

While the channel maintained or increased share across all major departments, the real growth story is in health & beauty care.

As highlighted on page 12, drug stores are reaping the benefits of health and beauty trip and basket-building strategies. CPG manufacturers across these categories should explore opportunities to tap into these initiatives to drive brand growth.



Source: IRI Consumer Network™

**“Mass merchants, deep discount drugstores, food/drug combo stores, mail service prescriptions, Internet drugstores, pharmacy benefits managers – since the 1970’s, each of these formats has been cited as our death knell. We have prevailed.”**

– Walgreens Annual Report

Baby Care	+0.1
Beverages	+0.2
Dairy	0.0
Deli	0.0
Edibles	+0.2
Frozen	+0.1
General Merchandise	+0.7
<b>Health &amp; Beauty Care</b>	<b>+2.0</b>
Home Care	+0.4
Pet Care	+0.1
Snacks/Desserts	+0.5

Source: IRI Consumer Network™

1. Company press releases



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## FUTURE CHANNEL MIGRATION EXPRESS STORES

**The big mover and shaker of the future may be small-format stores.**

Over half of consumer shopping trips for CPG products are quick trips. Consumers want to pick up a few items and get in-and-out of the store quickly on these excursions.

While consumers visit a range of channels to fill their quick trip needs, there is a market gap: few outlets in the U.S. offer easy in-and-out shopping for fresh produce and prepared foods.

That gap may soon be closing.

Tesco, the U.K. market leader in grocery, will be entering the U.S. market later this year with a new format specifically targeting this gap.

According to Tesco CEO Tim Mason, the new Fresh & Easy stores are “designed to draw customers back to their local neighborhoods by offering high quality, fresh and nutritious food at affordable prices.”<sup>1</sup>

Tesco’s entrance is likely to spawn development of similar stores by major U.S. players. Giant Eagle is an early innovator in this space, recently announcing plans for a prototype Express store. At 13,000 square feet, these units will also feature gas pumps and a drive-through pharmacy.

While it will take some time for a new express channel to develop and acquire sufficient scale to make an industry-wide impact, we are likely to see meaningful share gains within three to five years – sooner in markets that Tesco is targeting for initial entrance.

Grocery and convenience stores will be most heavily impacted; however, those with an already strong presence in prepared and fresh foods will likely be better positioned to weather the storm.

**“After years of hype about “big box” retailing, we see an increasing number of small format success stories...the interest in small formats will soon extend to the United States.”**

- Booz, Allen, Hamilton

Tesco Fresh & Easy Stores at a Glance	
<b>Size:</b>	10,000-15,000 Square Feet
<b>Locations:</b>	Initial locations planned for Los Angeles, Phoenix, Las Vegas & San Diego
<b># Stores:</b>	100+ within the U.S. by February 2008
<b>Assortment:</b>	Heavy mix of fresh foods and prepared meals
<b>Investment:</b>	Over \$400 million per year for the next five years

Sources: *The New York Times*, 6/6/07; *The Orange County Register*, 4/26/07

1. *The Orange County Register*, 4/26/07



## CONCLUSIONS CPG MANUFACTURERS

Manufacturers seeking to capture new growth opportunities and minimize risks associated with channel migration trends should consider the following action items:

- ▶ Identify new growth opportunities and risks through category and brand-level channel migration analyses
  - Benchmark channel share shifts among your brands vs total category and key competitors to identify potential missed or emerging distribution opportunities
  - Track changes in channel shopping patterns among core and target consumer segments
  - Work with retail partners to identify cross-channel competitive threats at the market/store level for your categories and brands
  
- ▶ Develop distribution, marketing and merchandising strategies aligned with channel migration patterns
  - Modify distribution strategies, as required to capitalize on emerging changes in consumer shopping patterns across channels (eg. significant drug store increases among health & beauty care categories, grocery share gains among young singles)
  - Tap into existing retail partner cross-channel competitive initiatives (eg. healthcare-focused trip-building programs at drug stores, supercenters and club stores; trip-mission-based strategies)
  - Among brands in categories with intense cross-channel competition (eg. snacks, beverages, healthcare, beauty), partner with retailers in the development of targeted marketing and merchandising plans to capture share from channel competitors
  
- ▶ Plan now for the next phase in channel migration
  - Assess fit for your brands with the emerging express format; where a solid fit exists, move now to secure position and capitalize on the impending growth wave before competitors



## CONCLUSIONS CPG RETAILERS

Retailers seeking to capture new growth opportunities and minimize risks associated with channel migration trends should consider the following action items:

- ▶ Identify new growth opportunities and risks through category and consumer-segment-level channel migration analyses
  - Benchmark cross-channel share shifts among your stores vs total channel and key competitors to identify potential missed or emerging competitive threats and opportunities
  - Track changes in channel shopping patterns among core and target consumer segments and by category
  - Identify specific shopping trip types in which your stores have or can develop an advantage vis-à-vis competitors
  
- ▶ Develop marketing and merchandising strategies aligned with channel migration patterns
  - Develop targeted cross-channel competitive strategies, versioned, as required, by market/store-cluster
  - Build strategies at the category and consumer-segment level, as channel migration patterns vary substantially
  - Develop and implement targeted marketing and merchandising plans to capture a greater share of the specific shopping trips that offer the strongest growth potential for your stores and represent a distinct advantage vs cross-channel competitors (see the June 2007 issue of *Times & Trends* for additional detail)
  
- ▶ Plan now for the next phase in channel migration
  - Continually track the rollout of the Tesco Fresh & Easy stores and other express formats
  - Identify required changes in assortment, store layout, marketing and merchandising to compete effectively with this format
  - Evaluate the market potential of developing express-style stores



## 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](mailto:sheila.mccusker@infores.com) with questions or comments about this report.

### ABOUT IRI

IRI is the world's leading provider of consumer, shopper, and retail market intelligence and insights supporting 95 percent of the FORTUNE Global 500 consumer packaged goods (CPG), retail and healthcare companies. Only IRI offers the unique combination of integrated market information, automated and predictive analytics, innovative enabling technologies, and domain expertise. With IRI, leading retailers and manufacturers are able to quickly discover breakthrough insights driving smarter decisions and actions across the enterprise for breakthrough results. Companies around the world depend on IRI for improved productivity, stronger brands, and dramatic revenue growth. For more information, visit <http://www.infores.com>.



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