



Lidl & Kaufland

Hard discounters 2012: the winning format

On track to become Germany's and the EU's biggest retailer by sales, the threat to Tesco

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November 2012

AN INSIDER VIEW OF LIDL

Schwarz Gruppe is not just the driving force behind Lidl's remarkable success story over recent years, but is also behind Kaufland – currently the most successful hypermarket business in the EU. The Kaufland operation is separately run from Lidl but managed according to identical, strict discount principles and the compact hypermarket format's performance in Germany and CEE is outstanding. The reason behind Schwarz's success is a relentless focus on price and slow and steady adaptation to changed shopper needs paired with first class execution.

Whereas Kaufland demonstrates that strong growth is possible for a hypermarket format, even when most competitors are struggling against the tough macro economic backdrop, Lidl has transformed itself into the leading European retailer with the highest store count in the largest number of countries of the EU. ResearchFarm predicts that with the combined turnover of Lidl and Kaufland, Schwarz will also become the leading EU retailer by sales generated in the EU in 2013, overtaking Tesco, Metro Group and Carrefour. It will be a closely fought race though.

“ Schwarz: Lidl and Kaufland are on track to becoming Germany's and the EU's biggest retailer by sales in 2013 ”

In France, Lidl's most important foreign market, the discount format will see a major update of the formula. Over coming months management will import Lidl's latest cutting edge thinking from other markets, upgrade the in store presentation, extend the branded ranges and deepen the crucial focus on fresh produce. Lidl's convenience outlet is an adaptation of the traditional hard discount



AN INSIDER VIEW OF LIDL

format, featuring a number of innovations - and is characterised by the absence of non food. That said, we believe that non food represents a major opportunity for Lidl, as Germany's transactional online operations showcasing a huge branded non food presence can be rolled out internationally.

While much change is afoot at Lidl, the core strength will remain the private label proposition and as such there will be a clear limit for brands in store. As the first mover Lidl serves as a clear template for Aldi. Past experience at Lidl, ranging from Super Saturdays, outstanding footfall generation to the innovative promotional stance - and the gentle move away from EDLP suggests what the future could look like at Aldi and crucially what probably will not work.

Lidl is also further ahead than Aldi in terms of private label segmentation and unlike its rival in vertical integration, as these have become key strategic objectives for the retailer. For Schwarz vertical integration also means optimising the supply chain and utilising spare capacity efficiently. Schwarz' supply chain optimisation, bundling smaller suppliers' deliveries has really driven down costs and the initiative is now also copied by Aldi.

Schwarz now needs to prepare for the attention its new status as the EU's biggest retailer will bring. We believe that focusing on making its business future proof - by securing supply through vertical integration and by attracting top talent and shop floor staff through offering better compensation than much of the competition will be the first steps on its exciting journey over the coming years.



This report...



- analyses the complex interplay between relentlessly optimised and standardised business principles, extremely lean ranges, leading to fewer production runs, leaner supply chain, smaller floor space requirements and less shop floor staff



- explains the strengths of a unique private label proposition, that disables easy price comparison and often sets the bar in terms of quality/price ratios, winning accolades from consumer watchdog organisations



- shows how a honest and simple offer that builds long term loyalty and customer relationship founded on lowest possible price and highest possible quality works without couponing, special offers and loyalty cards



- demonstrates how a product centric discounter can outperform the leading customer centric retailers without much cutting edge technology, by operating according to the principle that less is more, reducing complexity and by flawless execution and timely exploitation of trends

ARE YOU GOING TO BE ON THE SIDE OF PROGRESS OR WILL YOU SAY NO?

Lidl's rise as a threat to retailers

- Find out what Lidl's strategy is to update its formats - what kinds of stores will others have to compete with going forward? What will be in these stores? What will happen online?
- Uncover Schwarz' private label strategy - around brand architecture, health, fair trade. What product ranges will others have to compete with?
- Where will the discounter go next? What is the expansion strategy - what markets are being targeted? Where will the discounter become a threat to other retailers?
- Kaufland is making the hypermarket format work as the competition is struggling - identify the secret success factors.

Lidl's rise as a threat to suppliers

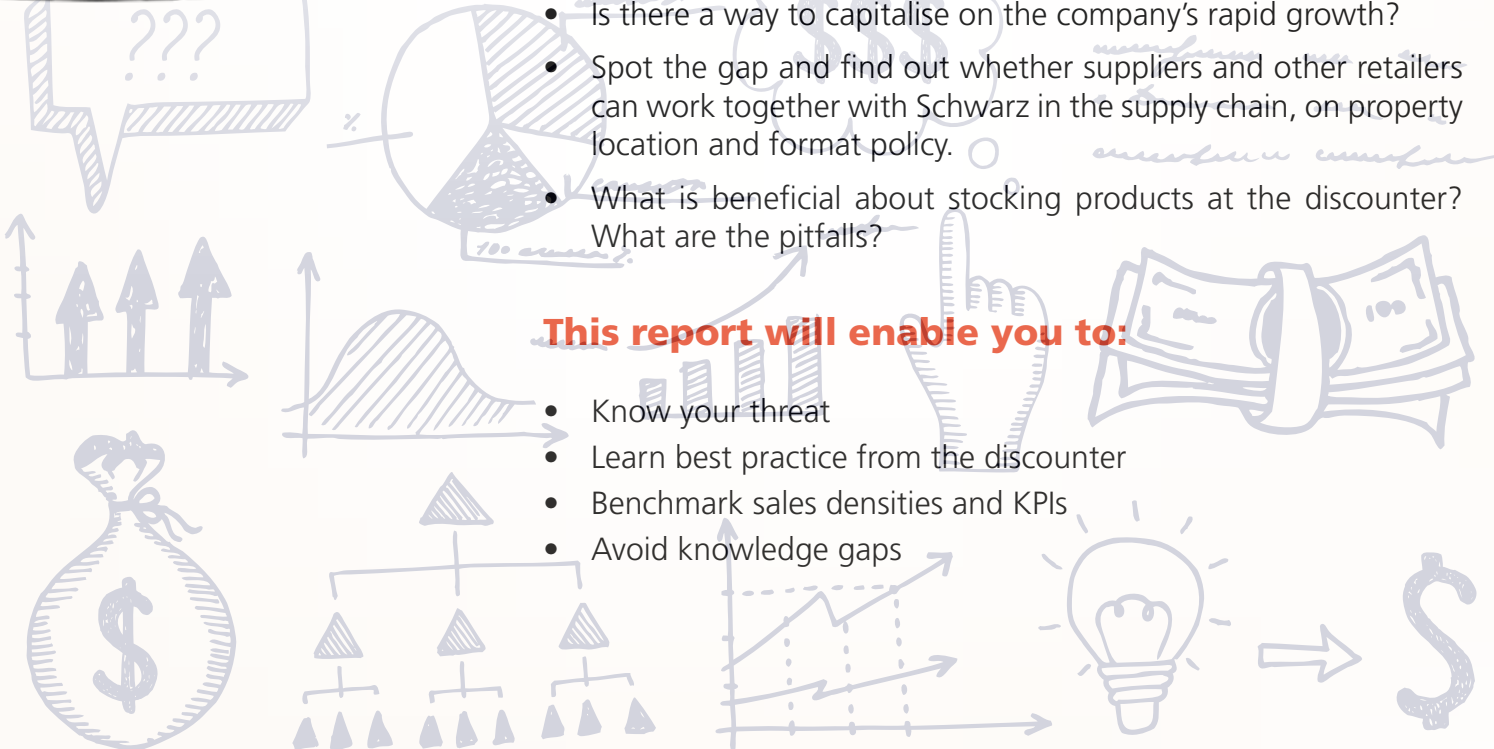
- Find out where the vertical integration strategy is headed and whether there will be space for your products on Lidl's shelves in future.
- Discover how Schwarz helps to drive down costs in the supply chain and whether this is good or bad news for suppliers.
- Learn how to approach Kaufland about new product developments and launches.

Opportunities

- Is there a way to capitalise on the company's rapid growth?
- Spot the gap and find out whether suppliers and other retailers can work together with Schwarz in the supply chain, on property location and format policy.
- What is beneficial about stocking products at the discounter? What are the pitfalls?

This report will enable you to:

- Know your threat
- Learn best practice from the discounter
- Benchmark sales densities and KPIs
- Avoid knowledge gaps



FIND OUT...

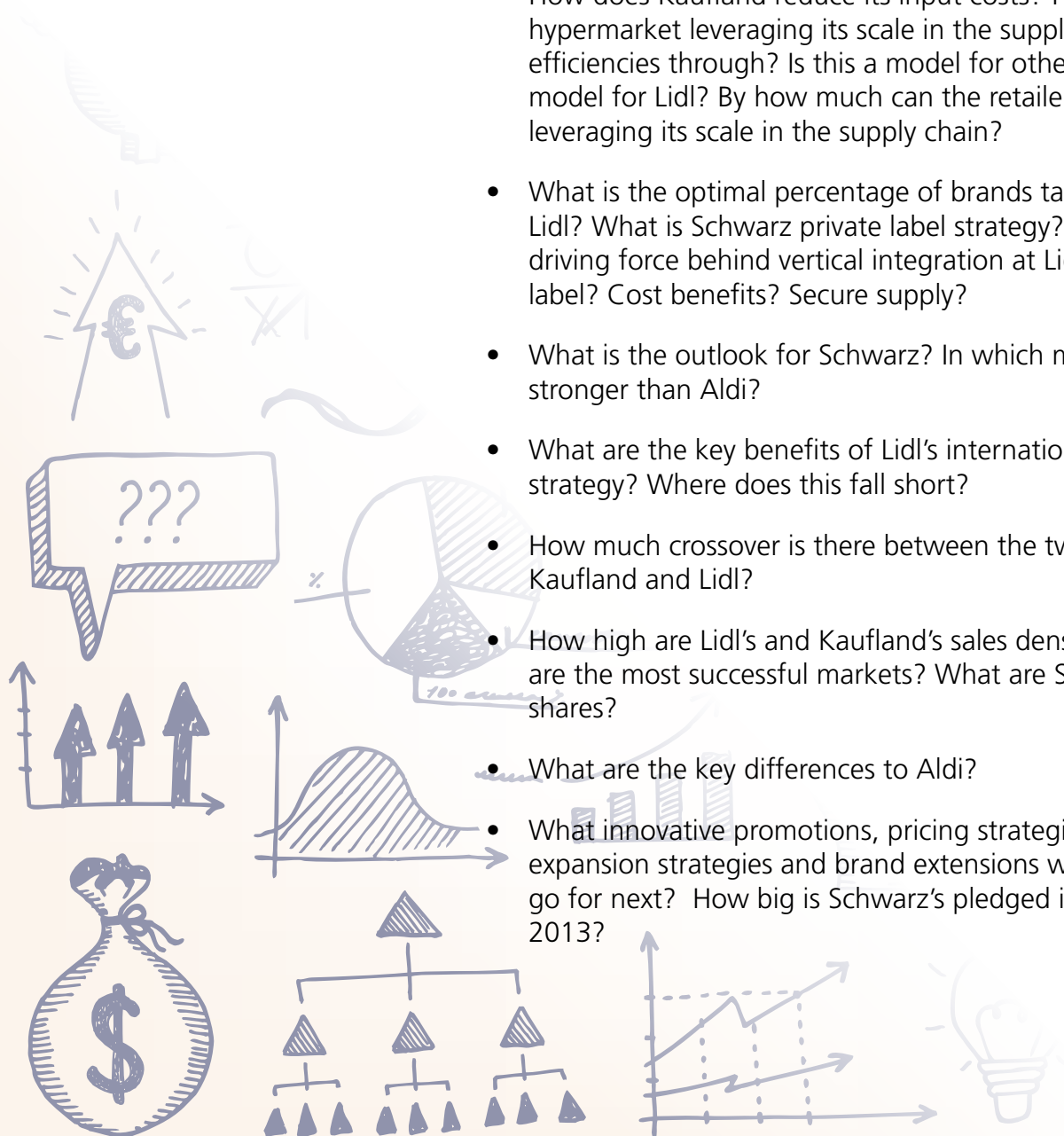
ABOUT LIDL'S GROWTH OPPORTUNITIES

- An unprecedented growth story is unfolding, as austerity bites across the west and food price inflation will filter through into higher retail prices next year. One format that stands to benefit hugely from this changed macroeconomic environment is the hard discounter.
- This data rich report from the EU's premier experts on hard discounters goes behind the facade and analyses the business model and the poorly understood proposition and success factors of the discounters, with key insights and learnings for other businesses.
- The report also contains a chapter on Europe's macroeconomic outlook and grocery markets and the general context the discounters operate in.



KEY QUESTIONS ANSWERED

- Why is the retailer becoming a threat to Tesco?
- How does Kaufland manage the introduction of small scale private label new product developments? Why is shopper insight crucial at Lidl but not to the same extent at Kaufland? What exactly is the concept of Warendruck?
- What are Lidl's plans to propel the outlet forward? What changes is the retailer making in store to drive greater footfall, increase loyalty and frequency?
- What are the plans for Kaufland?
- What are the plans for the transactional non food website operations in Germany? Will this be rolled out internationally?
- How does Kaufland reduce its input costs? How is the hypermarket leveraging its scale in the supply chain to drive efficiencies through? Is this a model for other markets? Is it a model for Lidl? By how much can the retailer reduce prices by leveraging its scale in the supply chain?
- What is the optimal percentage of brands taking shelf space at Lidl? What is Schwarz private label strategy? What is the main driving force behind vertical integration at Lidl? Unique private label? Cost benefits? Secure supply?
- What is the outlook for Schwarz? In which markets is Lidl stronger than Aldi?
- What are the key benefits of Lidl's international sourcing strategy? Where does this fall short?
- How much crossover is there between the two businesses, Kaufland and Lidl?
- How high are Lidl's and Kaufland's sales densities? Which are the most successful markets? What are Schwarz's market shares?
- What are the key differences to Aldi?
- What innovative promotions, pricing strategies, store formats, expansion strategies and brand extensions will the discounter go for next? How big is Schwarz's pledged investment for 2013?

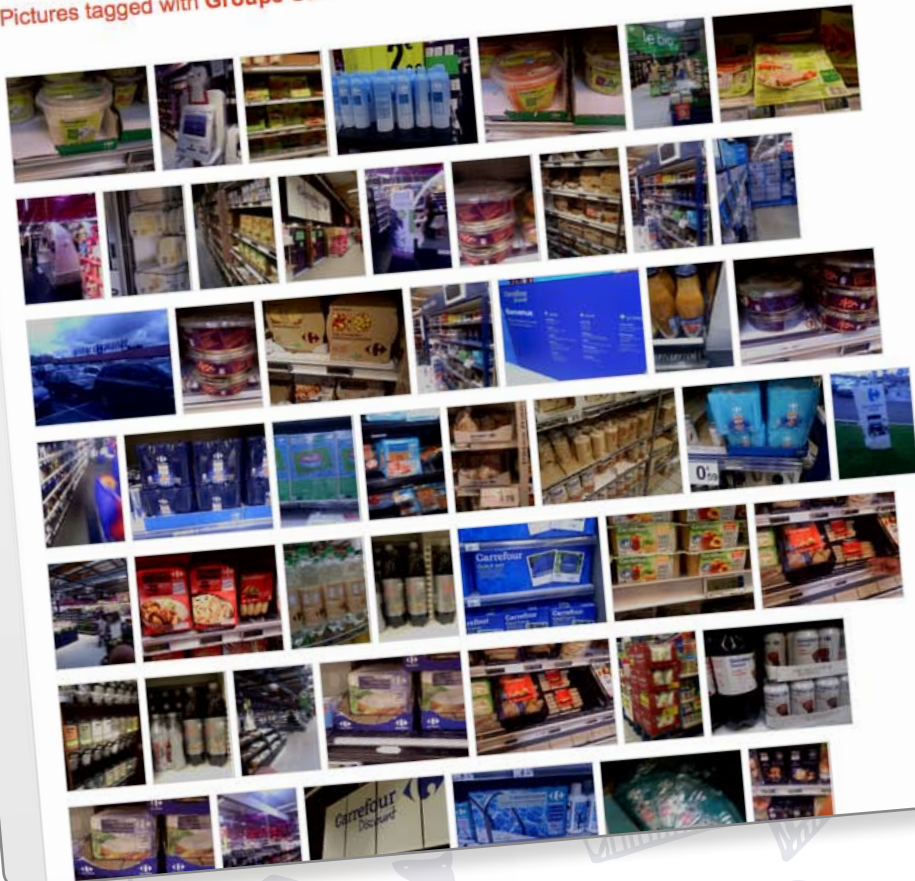


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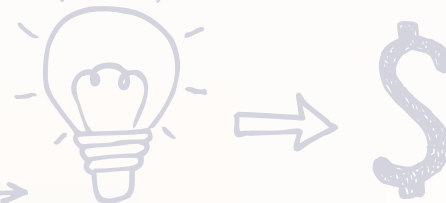


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«Your publications have been extremely useful so far especially because you are giving real life examples. those are really helpful so we can benchmark ourselves against others and see what works and what does not.» (Retailer)

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«The content is very interesting to us, as we look after many of the largest shopping centres and we also represent many international retailers entering our market. There is plenty of food for thought.» (Property consultants)

«It was helpful. It helped me to persuade my boss to take on a project about e-commerce research. I was really surprised by the importance of legal issues. I never read that elsewhere before.» (Government)

«On DLF's (Danish Association of Fast Moving Consumer Goods Manufacturers) New Years Conference on the 20th of January 2011 we had the great pleasure to hear ResearchFarm speak about future trends in online grocery retailing. The feed back from the conference participants was very positive as they gave ResearchFarm's presentation the highest score of all speakers, finding the analysis about the key success factors of chosen EU and US online retailers both very interesting and inspiring. We can therefore give ResearchFarm our best recommendation.»

Dagligvareleverandørerne – Danish Association of Fast Moving Consumer Goods Manufacturers



Lidl: OSA and Warendruck, operational independence for Lidl and Kaufland

Both businesses, Kaufland and Lidl, are run as strictly separate units but both follow the discount principle – to keep the model as simple as possible and to cut down on complexity. As a result of this strict operational independence there are hardly any synergies between Kaufland and Lidl, neither in buying, pricing or in terms of properties and logistics.

On shelf availability (OSA) questions are absolutely critical for both Schwarz Group's fascias Lidl and Kaufland, even trumping considerations about costs and efficiencies in certain cases. The thinking behind this principle goes, if a product is not available on shelf, a sale cannot be made. The German term for this philosophy is called Warendruck, or pressure generated by products. When entering the premises a shopper should almost be pressured by the variety of goods on shelves to make a purchase. Or looked at from a different perspective – if a product is OOS, a sale can not be made and the shopper might just not return.

That said, the retailer tries to balance its focus on OSA with a keen eye on logistics costs. Both Lidl and Kaufland are trying to work with suppliers to share loads and cut down on trucks running empty on the return trip – by picking up raw materials, ingredients or outsourcing the space to others. While other retailers in Germany such as Metro Group have operated such a system for years, this is still work in progress for Schwarz Gruppe.



Lidl: France, most important foreign market, a success story

Lidl leads the discount segment in France, operating from 1,620 stores in the country, where Lidl is much stronger than Aldi Nord and Carrefour's Dia.

France is both Lidl's and Aldi Nord's most important foreign market, but the clear discount leader in the country is Lidl. In recent years legislative changes have made it easier to expand in France and the LME (law of the modernisation of the economy) has facilitated the opening of smaller scale stores (up to 1,000 sq m, where permits are easier and more straight forward to obtain). There is strong competition in the discount sector between Aldi and Lidl on the one side and Dia and Casino's Leaderprice as well as ITM's Netto on the other side.

Since the turn of the century there has been strong growth in sales and outlets in the discount sector. Two issues played in the discounters' favour: the loi Galland and the loi Raffarin. The loi Galland set price floor restrictions on brands (and has since been reformed as well) – but this did not cover private label products, the standard proposition of discounters. This meant that discounters could undercut their competition without the hypermarches being able to lower prices.



Kaufland: K-classic, a hugely successful private label line, vertical integration



Similarly to Lidl Kaufland has embarked on a vertical integration strategy by operating a number of FMCG production sites. This strategy enables the retailer to pocket the margins to be had in food production, means the retailer produces exclusive private label products that are not easily price comparable, in the best cases creating a real footfall driver product and point of differentiation, allows for greater independence and flexibility in the supply chain, as production runs can be managed instantly and puts the retailer in a stronger negotiation position with other suppliers.

In 2009 Kaufland invested €85m in Heiligenstadt in East Germany to build a meat processing plant by 2013. The company plans to have around 400 employees processing 100,000 tonnes of meat annually to exclusively supply Kaufland hypermarkets.

Kaufland has also jumped on the organic band wagon and in 2009 launched the private label line extension K-Bio, certified by an independent body and according to EU regulations, which comprises around 100 products. The K-Classic private label itself was launched in 2003 with a clear value positioning and has succeeded in tying shoppers to the retailer.

Lidl: Countries, benchmarks, sales, stores, space, sales densities in 2011 2/2

Table 14

Year to December 2011	Total Sales €m	Outlets	Sales per outlet (€m)	Selling space (sq m)	Average space (sq m)	Sales Densities (€/sq m)
Netherlands	1,200	25	48	12,000	480	100
Poland	1,200	150	8	100,000	667	12
Portugal	900	240	3.8	12,000	50	76
Romania	500	100	5	10,000	100	50
Slovakia	500	100	5	10,000	100	50
Slovenia	100	10	10	1,000	100	100
Spain	1,400	150	9.3	12,000	80	116
Sweden	700	100	7	10,000	100	70
Switzerland	100	10	10	1,000	100	100
United Kingdom	1,200	100	12	10,000	100	120
Total	6,400	1,000	6.4	100,000	100	64

Lidl now has a presence in 25 foreign markets – with a lot of the growth being financed by debt – through sale and leaseback deals on property for example.

With an estimated €4,449 in 2011, Schwarz Group achieves a high sales density, something it shares with most other discounter operators. Average sales per outlet at around €4.5m also look healthy. While over the past selling space growth has significantly outpaced sales growth, inflation and the decision to

introduce a higher percentage of branded products into their stores has narrowed the gap somewhat.

The group is seeking larger footprints for its Lidl stores to showcase its non-food ranges effectively and extend its food offer. This is a main reason why the company is looking for more OOT opportunities as land and rents are cheaper in these locations than on the high street.

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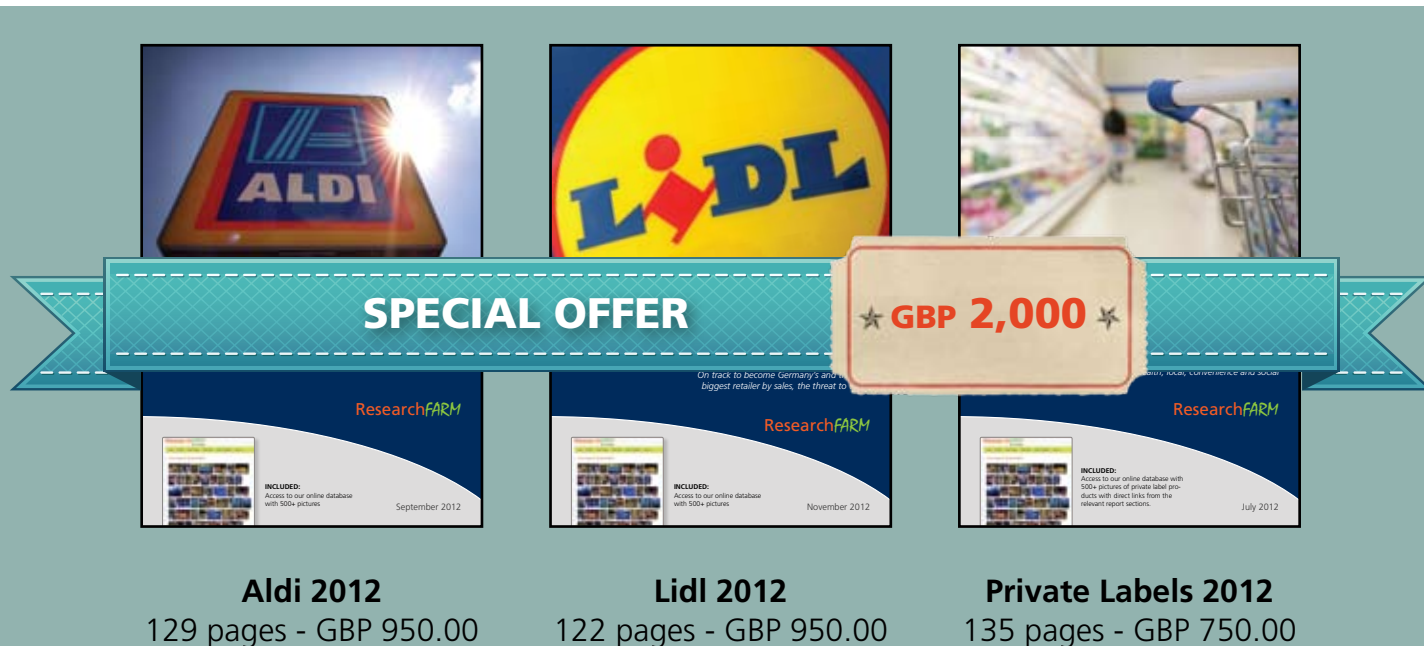
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Report Title	Month	Pages	Price (GBP)
Aldi 2012	September 2012	129	950.00
Lidl 2012	November 2012	122	950.00
Private Labels 2012	July 2012	135	750.00

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CONTACT

ResearchFarm Ltd
Suite 12154 - 2nd Floor
145-157 St. John Street
London EC1V 4PY (UK)

Phone
Email
Web

+44 (0)845 052 1168
sales@researchfarm.co.uk
www.researchfarm.co.uk