

SUPPLY SIDE

Name Brands vs. PL: Which Has the Most Equity Now?

By Kurt Jetta

The economy is in a hypoxic state, with no liquidity to spur investment, and everyone is running for cover. Retailers and manufacturers alike are wary of the economy's impact on their businesses. The Consumer Confidence Index fell to an all-time low of 38 in December (versus 100 in 1985) and the Short Term Outlook, as measured by the Conference Board and TNS, also displayed continuing pessimism, with nearly a third of consumers feeling business will worsen over the next six months.

But are these sentiments relevant to the vitamin and nutritional supplements (VNS) category? Typically, when a product category is under broad economic attack, there are specific markers that signal a need for strategic realignment, such as dedicating more space to private label items. The question that we need to answer is, "Are we there yet?"

To assess the category broadly, we should look at a host of indicators. First, we need to determine if the category is contracting, so we look at absolute dollar and unit sales. Then we look at share shifts between private label and branded products, assuming that a first line of consumer defense would be to switch to less-expensive private label offerings.

We also need to know if an increased level of competition is driving down retail prices so we look at average retail price erosion. And, lastly, we will look at the relative productivity of brands versus private label by segment: If private label goods are significantly more productive than their branded counterparts then stocking more private label would be a good thing.

Share Shift

The VNS category is definitely not contracting. According to data from Information Resources Inc. for sales through food, drug and discount stores (excluding Wal-Mart Stores Inc., or FDMx) over the 12 weeks ended December 28, 2008, vitamins were up 9% in dollars, whether looking at year over year, or quarter over quarter. Unit volume gained 7% for the quarter versus a year ago.

One of the core segments is experiencing any hint of contraction, and that is joint relief, which is down just 2% in dollars versus for the year-earlier quarter. But how these gains are allocated across the category is more revealing. In every case the private label portion of the category is accelerating faster than the branded equivalent, resulting in a tiny share shift toward private label and away from branded offerings.

Pricing Erosion

A predictable side effect of broader economic pressure is increased competition. As of now, there are no price erosion

indicators: Pricing for either branded or private label items has not shifted meaningfully.

Productivity

Typically, branded items yield a higher dollar contribution per SKU, while private label items deliver a higher unit contribution. Here is where branded items have the edge in the vitamin category. For many segments branded items are contributing more dollars and units than their private label counterparts.

Looking at joint relief, for example, branded items have a larger share and are more productive in both dollars and units than private label.

The same relationship holds true in herbals, multivitamins and specialty supplements. It deviates at calcium supplements, where private label items match branded products.

Brands maintain a strong productivity advantage when they can boast true innovation and/or brand equity. Commoditization is the first step toward brand extinction.

So Are We There Yet?

What have the markers shown us? The category is not contracting, although private label goods are outpacing branded items in sales growth. Some segments (specialty supplements, lettered vitamins and multivitamins) are showing growth for both brands

disproportionate allocation of new items to private label instead of brands. Clearly, branded manufacturers will need to pay very close attention to their offerings and their performances over the next several quarters, as the indicators point toward more private label penetration. The burden

industry may be the health food store whose retail prices are typically much higher than those of mass market retailers.

Has the economy left the category in a state of disrepair, needing a strategic overhaul? Not at this point. The indicators do suggest, though, that caution is warranted when it comes to the decision to expand private label offerings at the expense of brands.

Once national brand equivalency has been attained within a private label program, the dollar and unit productivity of private label offerings plummet. This means that the risk of deleting niche brands with a following is compounded by the potential failure of private label line extensions. We will be releasing additional research about the credibility and incremental contribution of second-tier private label items later in the year.

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INNOVATION: Diet & Nutrition

and private label. It is probably no coincidence that these segments are leaders in innovation (for example, Natrol Inc. and Nature's Bounty Inc. in specialty supplements), and brand recognition (Pharmavite Inc.'s Nature Made and Nature's Bounty in lettered vitamins, Bayer Corp.'s Centrum in multivitamins).

But retail prices have yet to reflect any of the broader economic trends. We are seeing the first indications of a shift in share from brands to private label. It is very small, and partially fueled by a

of real innovation and value is squarely upon branded manufacturers as retailers are likely to apply more pressure on redundant items in their assortments.

A good portion of the growth in FDMx is likely coming from other channels, notably health food stores. Our research from last year showed a marked decrease in the number of outlets being shopped by the average vitamin consumer, with a clear migration away from health food and toward FDMx outlets. The first economic victim in the VNS

Sales Estimates Are Frequently Exaggerated

SHELTON, Conn. — In many product categories, there is an inherent interest in overstating total sales. The vitamins and nutritional supplement category (or VNS, or vitamins, for short) is no exception.

The Nutrition Business Journal (NBJ), for example, estimates category sales at \$20 billion or more per year. Is this accurate? Simply put, no. It is greatly overstated.

Let's take a look by building a sales estimate by channels from data we can regard with a high degree of confidence and from estimates using less precise — but still valid — data sources.

Both Information Resources Inc. (IRI) and Nielsen Co. agree that the VNS category totals roughly \$2.7 billion in food, drug and discount stores excluding Wal-Mart Stores Inc. (FDMx).

We also know that these services track about 90% of the actual food, drug and discount universe; they do not include very small stores in their sample. So adding the remaining 10%, we are now at \$3 billion, a solid number.

Now let's tackle Wal-Mart. Through various externally available sources — primarily consumer survey data — we estimate

Wal-Mart's VNS sales at about 50% of FDMx, or \$1.5 billion. We have corroborated these numbers with such other sources as household panel data available from both IRI and Nielsen.

Using a similar methodology, we can be reasonably sure that VNS sales through membership warehouse clubs are about \$1.1 billion, which brings us to \$5.6 billion for the FDMC (food/drug/mass/club) universe.

Using publicly available information and corroborating it with retail space allocation information, a good estimate for the nutritional specialty store

channel (the three main players are GNC, Vitamin World and Vitamin Shoppe) is about \$1 billion in sales. Our total is now \$6.6 billion.

This is where the data becomes a little shakier, because it is no longer based on traditional syndicated data sources. Using consumer survey data and some proprietary modeling, we can still create a reasonably reliable estimate for the remaining secondary channels, which include natural food stores, online/catalogue marketers, multilevel marketers and dollar stores.

Multiple surveys conducted by the TABS Group have shown that only 20% of all category buyers and about 33% of the heavy category buyers claim to purchase VNS products "most often" at these secondary outlets. The heavy buyers represent about 15% of category buyers and about 50%-55% of sales (a number that can be validated with household panel data).

Rather than these secondary channels accounting for two-thirds of VNS retail dollars, as the NBJ estimate would require, with some basic algebra we can calculate that the secondary channels represent no more than 25% of total category sales. That gives us category sales of about \$8.2 billion to \$8.8 billion dollars — less than half of the NBJ estimate.

We can see from this exercise that through various data sources and modeling techniques, channels that were formerly an analytical "black hole" can now be estimated with a reasonably high degree of certainty.

Innovation Can Be Quantified

SHELTON, Conn. — One of the key ways for a niche brand to maintain its shelf position and market presence in the face of retailer shifts toward private label products is to establish a track record of successful innovation. Getting credit for such innovation, though, is a challenge.

Can innovation be measured? The answer is especially relevant in the vitamins and nutritional supplement (VNS) category, where innovation is a significant factor in market growth.

The answer is a resounding yes, innovation can, for the most part, be measured.

Using standard syndicated retail sales data from Information Resources Inc. (IRI) or the Nielsen Co., TABS Group has created an Innovation Index. This Index measures the quantity, quality and uniqueness (as measured by

incremental sales) of new-product activity relative to some category benchmark.

Take, for example, one retailer with whom the TABS Group worked that wanted to be first to market on major innovations in the VNS category. The Innovation Index gave the category buyer and his management the necessary information to determine whether they were acting according to their stated strategy.

In probiotics — a segment that has been growing at a 20% clip annually over the last four years — they found that almost 20% of the total sales in this segment were coming from new products (We define "new" as having been in distribution for less than one year). Yet less than 5% of their own probiotic sales were coming from new items.

However, we found that the

retailer's average new probiotic items were actually outselling its other probiotics by more than 20%. So this buyer was making quality decisions in selecting new products.

Finally, we looked at uniqueness and used segment growth — incrementality — as a proxy for judging this feature. The assumption being that, if a new product is truly unique it will create new users or generate additional sales from previous purchasers.

Both in the market as a whole and for this retailer, sales of established items actually grew slightly, so the sales of the new items were 100% incremental on both levels. The Innovation Index reflected the fact that the buyer was not bringing in many new probiotic items, but the ones that were added were winners.