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**P.O. Box 158**  
**Hinsdale, IL 60522**  
**Phone: 630-920-1844**  
**Email: [skp@plattretailinstitute.org](mailto:skp@plattretailinstitute.org)**  
**[www.plattretailinstitute.org](http://www.plattretailinstitute.org)**

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## **PRI MONTHLY RETAIL ANALYTICS**

“BRINGING RESEARCH TO RETAIL”

Third quarter preliminary GDP advanced 3.7%. Fourth quarter economic activity should be stable to slightly improved, resulting in a solid finish to the year. October durable goods orders fell -0.4%. Shipments of durable goods rose 0.6%. U.S. industrial production also rose 0.7% in October, as did capacity utilization rates. The producer price index increased 1.7% during October, the largest monthly move in 14 years. In the Federal Reserve's October Beige Book, manufacturers stated that prices remained elevated for input costs such as energy, metals, construction materials and plastics. Looking into 2005, we accept the GDP consensus forecast of a mildly-slowng economy. The U.S. Leading Index has now posted its fifth consecutive monthly decline. The Fed again raised interest rates in November.

Retail sales, excluding autos, rose 0.9% in October. On an annualized rate, retail sales, excluding autos, are up a strong 8.4% for the trailing 3-months and are up 8.5% for the trailing 12 months. Yet much of October's strength is attributable to rising gas prices. The good news is that high gas prices did not kill consumer spending, thus with gas price relief on the horizon and an improving employment picture, Christmas sales results should be encouraging. Early November retail sales results support this view. Payrolls jumped by 337,000 in October, another positive indicator. On the downside, the consumer price index rose 0.6% in October. Eventually, consumer spending, which continues to exceed income, will adjust to reflect trends in personal income. Standard & Poor's recently stated that absent some stimulus, such as a strong stock market, home values continuing to increase, tax refunds, etc., "2005 is likely to be a somewhat more challenging year for retailers".

While activity in the retail in-store development industry was stable during the third quarter, considering capital spending trends, anticipated 2005 retail store starts and retail construction being put-in-place, among other things, 2005's growth will be below 2004's.

In this issue, our research note highlights a method of determining marketing profits for purposes of allocating promotional dollars.

STEVEN KEITH PLATT, DIRECTOR

# I. ECONOMIC OVERVIEW

## MACRO ECONOMIC INDICATORS-BUSINESS:

(% change )	2000	2001	2002	2003	2004- 1 <sup>st</sup> Qtr.	2004- 2 <sup>nd</sup> Qtr.	2004- 3rd Qtr.	2004- 4th Qtr.
Real GDP	3.7%	0.5%	2.2%	3.1%	4.5%	3.3%	3.7%	%
Capital Spending (business equipment)	7.8%	-4.9%	-5.5%	6.4%	8.0%	14.2%	14.9%	%
Capital Spending (non-residential structures)	----	-2.3%	-17.8%	-5.6%	7.9%	-7.6%	5.6%	%
Personal Consumption Expenditures				3.3%	4.1%	1.6%	4.6%	
Corporate Profits	----	-6.2%	14.0%	16.8%	3.2%	-1.3%	%	%
Business Productivity	3.6%	1.8%	5.1%	5.7%	3.7%	3.9%	1.9%	%

**MACRO ECONOMIC INDICATORS-BUSINESS:**

(% change)	JN-04	FB-04	MR-04	AP-04	MY-04	JN-04	JL-04	AG-04	SP-04	OT-04	NV-04	DC-04
Durable Goods Orders	-2.6	3.9	5.9	-2.7	-0.9	1.3	1.9	-0.5	0.9	-0.4		
Durable Goods Shipments	-1.0	1.4	4.4	-0.8	-0.6	1.2	0.5	1.9	-1.1	0.6		
Leading Index	0.4	0.0	0.8	0.1	0.5	-0.1	-0.3	-0.3	-0.3	-0.3		
ISM Manuf. Survey (absolute)	63.6	61.4	62.5	62.4	62.8	61.1	62.0	59.0	58.5	56.8		
ISM Services Survey (absolute)	-	-	-	-	65.2	59.9	64.8	58.2	56.7	59.8		
Industrial Capacity Utilization	76.2	76.7	76.6	77.0	77.4	77.0	77.4	77.3	77.3	77.7		
Industrial Production	0.7	0.8	0.0	0.7	0.9	-0.4	0.6	-0.1	0.1	0.7		
Producer Price Index	-	-	-	-	0.6	-0.1	0.1	-0.1	0.1	1.7		
Chicago Fed. National Activity Index	-	-	-	0.42	0.65	-0.8	0.55	0.03	-0.04	0.52		

**MACRO ECONOMIC INDICATORS-CONSUMER:**

(% change)	JN-04	FB-04	MR-04	AP-04	MY-04	JN-04	JL-04	AG-04	SP-04	OT-04	NV-04	DC-04
Personal Income	0.5	0.5	0.5	0.6	0.5	0.2	0.2	0.3	0.2			
Personal Consumption/ Spending	0.5	0.4	0.4	0.0	0.6	-0.3	1.2	-0.1	0.6			
Savings Rate	-	-	-	-	-	1.4	0.4	0.7	0.2			
Change in Payroll Employ. (000)	159	83	353	324	208	96	85	198	139	337		
Unemploy. Rate	5.6	5.6	5.7	5.6	5.6	5.6	5.5	5.4	5.4	5.5		
Consumer Price Index (all items)	0.5	0.3	0.5	0.2	0.6	0.3	-0.1	0.1	0.2	0.6		

**MACRO ECONOMIC INDICATORS- RETAIL:**

Large Retail Corporations	2002-4th Qtr	2003-1 <sup>st</sup> Qtr.	2003-2nd Qtr.	2003-3 <sup>rd</sup> Qtr.	2003-4th Qtr.	2004-1 <sup>st</sup> Qtr.	2004-2nd Qtr.	2004-3 <sup>rd</sup> Qtr.	2004-4 <sup>th</sup> Qtr.
Operating Income Ratio	5.6%	4.3%	4.5%	4.4%	5.5%	5.1%	4.8%	%	%
After-Tax Profit Ratio	2.5%	3.2%	2.6%	2.6%	3.5%	2.9%	3.3%	%	%
Return on Equity (after taxes)	14.6%	13.4%	13.64%	13.3%	19.78%	15.43%	16.82%	%	%

(\$ millions)	1999	2000	2001	2002	2003	2004
Total Retail Sales (x auto)	\$2,385,029	\$2,559,985	\$2,634,858	\$2,717,331	\$2,860,985	\$
Retail Sales (% change; x auto) vs. last year	7.53%	7.34%	2.93%	3.13%	5.29%	%
Total Retail Gross Margin (x auto)	31%	30.7%	30.3%	30.8%	%	%

(% change)	JN-04	FB-04	MR-04	AP-04	MY-04	JN-04	JL-04	AG-04	SP-04	OT-04	NV-04	DC-04
Retail Sales (% change; x auto) vs. prior month	1.5	0.6	1.8	-0.2	0.9	0.2	0.4	0.3	0.8	0.9		

**MACRO ECONOMIC INDICATORS- RETAIL IN-STORE DEVELOPMENT:**

(% change)	JN-04	FB-04	MR-04	AP-04	MY-04	JN-04	JL-04	AG-04	SP-04	OT-04	NV-04	DC-04
New Buildings Put In Place-Multi-Retail	-0.2	4.1	1.3	2.7	1.0	-2.9	6.9					
New Buildings Put In Place-Drug, Building Supply, Other Stores	-1.0	0.5	1.6	14.0	.95	4.6	-19.5					
New Buildings Put In Place-Food and Beverage	-11.7	-5.3	-2.1	4.7	8.2	-3.7	-0.8					

**MACRO ECONOMIC INDICATORS- RETAIL IN-STORE DEVELOPMENT:**

	2004- 1 <sup>st</sup> Qtr.	2004-2nd Qtr.	2004-3rd Qtr.	2004- 4th Qtr.
Strip Malls:				
Asking Rent			0.9%	
Vacancies		7.0%	6.9%	
Absorption			6.6 million sq. ft.	
New Space			5.6 million sq. ft.	
Shopping Malls:				
Asking Rent			0.2%	
Vacancies (Source: Reis Inc.)		5.6%	5.5%	

(% change sq. ft.)	2000	2001	2002	2003	F. 2004
Retail Construction Starts (Source: McGraw-Hill Construction)	0	-10.0	-8.0	10.0	2.0

## **II. MAJOR RETAIL SECTOR TRENDS:**

### **BUILDING MATERIALS, GARDEN AND SUPPLY STORES**

Sales fell -1.1% in October. On an annualized rate, sales are up 0.4% for the trailing 3-months and are up 9.5% for the trailing 12 months.

Monthly % Change	JN-04	FB-04	MR-04	AP-04	MY-04	JN-04	JL-04	AG-04	SP-04	OT-04	NV-04	DC-04
Sales	0.6	0.4	9.8	-0.5	-1.2	0.8	0.1	0.2	1.1	-1.1		

### **FOOD AND BEVERAGE STORES**

Sales rose 0.3% in October. On an annualized rate, sales are up 8.1% for the trailing 3-months and are up 4.5% for the trailing 12 months.

Monthly % Change	JN-04	FB-04	MR-04	AP-04	MY-04	JN-04	JL-04	AG-04	SP-04	OT-04	NV-04	DC-04
Sales	1.7	-0.5	0.9	0.0	0.8	-0.2	-0.2	1.0	0.7	0.3		

### **HEALTH AND PERSONAL CARE (DRUG) STORES**

Sales rose 0.5% in October. On an annualized rate, sales are up 5.0% for the trailing 3-months and are up 4.4% for the trailing 12 months.

Monthly % Change	JN-04	FB-04	MR-04	AP-04	MY-04	JN-04	JL-04	AG-04	SP-04	OT-04	NV-04	DC-04
Sales	0.6	-0.5	2.1	-0.4	0.2	0.9	-0.3	0.5	0.2	0.5		

	OCTOBER COMP. STORE SALES
Walgreen	8.1%
CVS	5.4%

### **CLOTHING AND ACCESSORY (APPAREL) STORES**

Sales rose 3.0% in October. On an annualized rate, sales are up 13.2% for the trailing 3-months and are up 6.7% for the trailing 12 months.

Monthly % Change	JN-04	FB-04	MR-04	AP-04	MY-04	JN-04	JL-04	AG-04	SP-04	OT-04	NV-04	DC-04
Sales	2.1	0.9	0.8	-2.1	1.1	-0.9	0.2	-0.9	1.0	3.0		

	OCTOBER 2004 COMP. STORE SALES
Chico's	9.3%
Gap	3.0%
Limited Brands	14.0%

### **GENERAL MERCHANDISE STORES**

Sales rose 0.9% in October. On an annualized rate, sales are up 8.9% for the trailing 3-months and are up 7.4% for the trailing 12 months.

Monthly % Change	JN-04	FB-04	MR-04	AP-04	MY-04	JN-04	JL-04	AG-04	SP-04	OT-04	NV-04	DC-04
Sales	1.0	1.4	0.7	-0.8	1.0	-0.6	0.8	0.0	1.3	0.9		

	OCTOBER 2004 COMP. STORE SALES
Costco	8.0%
Dollar Gen.	3.0%
Target Stores	6.0%
Wal-Mart (consolidated)	2.8%

### **DEPARTMENT STORES**

Sales rose 0.5% in October. On an annualized rate, sales are up 4.3% for the trailing 3-months are up 0.5% for the trailing 12 months.

Monthly % Change	JN-04	FB-04	MR-04	AP-04	MY-04	JN-04	JL-04	AG-04	SP-04	OT-04	NV-04	DC-04
Sales	-	-	-	-	0.6	-1.0	0.4	-0.7	0.9			

	OCTOBER 2004 COMP. STORE SALES
Federated	4.0%
Sears	1.9%
JC Penney	2.1%
Dillard's	-5.0%
Kohl's	6.0%

### **III. RESEARCH NOTE**

#### “Accounting Profits versus Marketing Profits: A Relevant Metric for Category Management”

Marketing Science, Volume 18, No. 3, 1999

By Yuxin Chen, New York University, James D. Hess, University of Illinois at Urbana-Champaign, Ronald T. Wilcox, Carnegie Mellon University, and Z. John Zhang, University of Pennsylvania

The allocation of promotional dollars should be directed at those merchandise categories that contribute the most to a retailer’s profit. Yet relying on single-category accounting profits for allocating promotional dollars may not optimize the investment. To address this, the authors advance a methodology for determining marketing profits. The advantage of relying on marketing versus accounting profits is that marketing profits considerer cross-category purchases and profitable, with the result that more informed category-level promotion decisions are made that can improve a retailer’s profitability.

The metric advanced for determining marketing profits focuses on consumers and their store choice behavior. By quantifying the way that consumers focus upon primary categories, on the one hand, and how retailers allocate shelf-space assortment, on the other, a model is constructed that determines marketing profits. A major advantage of the methodology advanced is that it relies on readily available data including sales, shelf-space allocation, and merchandising costs, rather than requiring expensive primary research.

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