

WAL-MART FOOD FIGHT

By *CHRISTOPHER BYRON*

November 18, 2002 -- WOULD you like to know what life is going to be like in America more or less a decade from now?

Well, if things keep going the way they have been lately, and if the economy keeps weakening on its present track, then just head for the nearest Wal-Mart and look around. You'll find yourself face to face today with the Tomorrow-land of consumer shopping, and it won't be a pretty sight - though it will be one from which you might make a few bucks, especially if you're able to suck it in and start buying Wal-Mart on the dips.

The future as we see it? Get ready for whole armies of the semi-retired elderly - tens of thousands of them - all dressed in blue smocks and Smiley Face buttons, standing at the doorways of thousands upon thousands of vast Wal-Mart "supercenters" to greet the millions of America's cash-strapped and working poor as they shuffle in to search for bargains in the one place left in town where they can still afford to shop.

In many parts of America, the future is here already. And last week brought another reminder of just that, as the unstoppable Arkansas juggernaut known as Wal-Mart Stores Inc. announced its latest quarterly results, unfurling a 23 percent increase, to \$1.82 billion, in year-over-year earnings for the third quarter.

These numbers, more appropriate to some software tech stock during the boom 1990s than to a discount retailer in a slumping economy, gain yet more impact when weighed against the performance of Wal-Mart's largest single competitor, Kmart Corp., which is currently thrashing about in bankruptcy in a desperate struggle to avoid outright liquidation.

WAL-MART'S stock actually sold down a bit on the news of its remarkable performance, mainly because the company warned that its 11 percent jump in revenues, year-over-year, would slow in the fourth quarter. But the sellers missed the larger message in the company's news: In a slow-growth world that teeters day to day at the precipice of deflation, victory goes to the fleetest afoot in the race to the bottom - a race Wal-Mart has already won.

The company's customers are the people we used to dismiss, back in the self-satisfied 1990s, as America's "working poor" - the people whose family incomes hadn't yet broken "Mach-1," \$100,000 per year. These were the folks still scraping by on \$30,000 and \$40,000 a year - whose total household net worths were typically no more than their gross incomes.

FOR decades, America's marketing elites ignored these people. Advertisers didn't want to reach them because they couldn't afford to load up on Bang & Olufsen stereos, BMW 320s or \$300 alligator belts from the Ferragamo shop in Bal Harbour, Fla.

These were the people in the big square states in the middle of the country, who just got up and went to work, and who somehow made do with paychecks that were never quite up to the job. And for 40 straight years none of the bicoastal marketing people gave them the time of day - no one, that is, except Sam Walton and the crew at Wal-Mart's Ozark headquarters in Bentonville, Ark.

They alone saw the gold in what others dismissed as a played out mine, and in the process they fashioned the fly-over demographics of America into the tectonic base of a marketing onslaught that is now changing the face of the entire U.S. economy.

With 4,600 stores now ringing the globe - half in the United States and half abroad - Wal-Mart has become such a force in consumer retailing that the company can no longer simply be described as the biggest competitor in the discount retailing field. As was said of IBM 40 years ago, when Big Blue dominated the mainframe computer industry, Wal-Mart has morphed from retailing's "company to beat" into the actual environment in which the rest of retailing must now compete.

This company is now so big its daily revenues equal an astounding 2 percent of the country's entire gross domestic product. In some states and regions, the impact is even greater. In North Carolina, Wal-Mart sales equal close to 5 percent of the state's GDP. Ditto in Georgia.

The profits from its activities are simply staggering, especially when you consider the competitive, low-margin business that retailing really is. Wal-Mart's cash-registers now rake in 20 percent of all the profits of America's entire retailing sector - and when you factor in money-losing operations like Kmart and Rite-Aid, the percentage is even higher.

This one company is now generating twice as much in total net profits each quarter as the entire rest of the discount retailing sector combined: twice as much as all department stores combined; three times as much as all clothing retailers; five times as much as all drugstore chains; and more than the home improvement sector, more than the food sector. And, relentlessly and methodically, it is moving deeper into each and every one of those sectors, dragging down margins while gobbling up market share.

AMERICANS spend more of the family budget on food than on any other single thing, so food retailing is where Wal-Mart is now making its big push. The Kroger Co., with \$51 billion in revenues, is generally thought to be the biggest food retailer in the country, followed by Albertson's and Safeway.

Wal-Mart doesn't specifically break out its food sales as a separate reporting segment. But industry analysts say Wal-Mart's total company-wide food sales now exceed \$80 billion, making Wal-Mart by far the country's largest food retailer already.

Much of those sales are being pushed through the company's 1,243 "supercenters," which are Wal-Mart stores so enormous you can see them from the Hubbell space platform. Inside these supercenters you'll find entire food supermarkets as big as any Stop & Shop or Safeway store - and they'll typically occupy only a fraction of the floor space.

Not for nothing does food retailing expert Richard Kochersperger call the supercenters Wal-Mart's "Trojan horse" for the food industry.

With the company having already announced plans to open more than 200 additional such facilities in the year ahead, it's hardly surprising that the stock prices of all its major rivals have lately tumbled. Kroger is now selling at its lowest price in five years, Safeway hasn't been cheaper in seven years and Albertson's is trading at its lowest price in more than a decade.

What could derail this freight train? Financially, it's hard to see a problem anywhere. Its financial statements are clear, clean and easy to read. There are no tranches of preferred stock, no confusing classes of "A" shares and "B" shares.

ALL there is is money - lots and lots of money. The company has \$2 billion in cash, \$86 billion in tangible assets, nearly \$30 billion in tangible net worth, and virtually limitless borrowing power.

About the only vulnerability is its sheer size and visibility. The company has been sniped at regularly at the state level in recent years, mainly for price-fixing and other antitrust-type issues. And though the cases haven't come to much, the company is an obvious target-of-opportunity if serious abuses were to gain national attention.

Last week, reports circulated of an analyst's study showing that Wal-Mart has been pricing its food merchandise 30 percent below the competition's in Texas. With the entire industry selling goods at a typical 1 percent margin, this would suggest severe anti-competitive price cutting by Wal-Mart. But efforts to obtain a copy of the report proved fruitless.

So, for the meantime, Wal-Mart seems one stock that is set not simply to survive the period ahead but to flourish as rarely before. We'll come back and look at it a year from now and see if we have to eat these words.

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