

Something to Think About



OAKWORTH
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COMMON CENTS

This past Tuesday, we had lunch with a client who is a business owner. His business has been growing nicely over the last couple of years. As a result, he is understandably a little more sanguine about the economy than most of the people I know. Without divulging what his company does, let me just say it is a niche, and he has also tweaked his business model and delivery channels to meet changing market conditions. By his own admission:

"If we were still doing what we had always done, focusing solely on X, I would probably still be hustling to cut costs like I was in 2008 and 2009."

In a lot of ways, his recent success sort of reflected, to me, what I have been sort of pontificating about for some time. 1) the most successful companies compete on either product or price; everyone else is 'stuck in the middle,' and; 2) as Larry Langford, the imprisoned former mayor of Birmingham, used to say: "If you always do what you always did, you will always get what you always got."

Increasingly, I am seeing more companies looking to differentiate themselves in some form or fashion. They have to do so in order to survive. One of my favorite examples is the Winn-Dixie on Montevallo Road here in town.

For years, this place was a depressing place to shop. It couldn't compete on price with the Wal-Mart a mile or so, if that, down the road, and it couldn't compete with the Publix on product. It was 'stuck in the middle,' and there was absolutely no reason to shop there. Frankly, I didn't understand how it stayed open, and was shocked when the construction crews showed up.

Yep, despite the financial woes the parent company has had, the powers that be decided to take a gamble on this particular store. It was a lost cause, in my opinion; putting lipstick on a pig. To top it off, work on the project was slow, painfully slow. This made shopping there that much more depressing, as exposed ductwork and concrete floors gave the place a certain 3rd World charm without any of the character, if you catch my drift.

Finally, they took the tarps away.

They did a good job refurbishing the place. The produce section is much more inviting; the deli is certainly more robust, suggesting a bistro like experience; the freezers for the frozen items are sparkling; the fresh meat selections appear to be of a higher quality, and, well, the beer selection is what you might expect in a more upscale store than a Winn-Dixie, whose slogans in the past have been along the lines of 'the Beef People,' and 'Low Price Leader.'

All told, it is a much more pleasant place than it was, and, perhaps not surprisingly, the employees seem a little more energized and helpful than they were previously. To hear my sister tell it, my nephew thinks it is the 'nicest grocery store' in Birmingham. While I think the Whole Foods has a pretty solid lock on that, the point is clear: Winn Dixie is trying hard to change its brand, at least in this market, and compete on product as opposed to price. Hey, Wal-Mart is going to win the price battle, but there is no reason to blithely hand the 'product battle' to Publix. Right?

Well, being encouraged by the company's willingness to take a gamble on a store I thought was

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**For changes to be of any true value, they've
got to be lasting and consistent.**

Tony Robbins

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doomed for closure, I decided to give the deli a try. I hadn't purchased anything at the Winn-Dixie deli, anything, in quite literally years, but I figured if they had spent so much money fixing up the place, maybe the quality would be better.

So, I walked up to the counter, and ordered a container of the mustard potato salad from a worker in a chef's outfit and apron. Oh man, this was going to be good, and I have since forgotten what else I having for lunch, but the potato salad was going to be the topper.

I put a little pepper on it; got a nice forkful, and shoved it in my mouth. Hmm. It was the same old 'stuff' they had always sold, complete with that artificial relish aftertaste. You know the sort; made in heaping quantities in Jacksonville, FL; packaged in plastic tubs, and sent to the stores. NOW, instead of selling it in those old tubs, they displayed it in a serving dish, complete with parsley garnish, etc., and sold it for a few pennies more. Good for them.

You know, I suppose there is really only so much you can do with industrial potato salad, and I was hopelessly naïve to believe they were boiling potatoes in the store every day. That wouldn't be cost effective, particularly with what they were charging for the stuff. Come on; a bunch of Winn-Dixie employees actually going to the trouble of making potato salad in the store, fresh that day? Keep dreaming; but, at least, they were attempting to upgrade the perception of the stuff, the value.

Not so their competition, Publix.

My son loves macaroni & cheese, and, for years, I could placate him with a container of the 'homemade' stuff from the Publix. In truth, it was/is ultimately more satisfying than Kraft Macaroni & Cheese dinner; most things are. However, that all changed about a month ago.

I don't know how I ended up in Publix around mealtime, but I did. John wanted some of his favorite side dish, and that was just fine by me. Unfortunately, they were out of the stuff at the steam table, and the disappointment was etched all over the boy's face. When he came over to me, I told him: "go ask the guy behind the counter if they have any more. It is too early in the day for them to be completely out of mac & cheese. I am sure they have some more in the back."

So, he went back over to the counter, and asked the fellow working there if there was more. He nodded his head, and walked to the back about as slowly as a human being can move. Then, he pulled what appeared to be about a 10-gallon plastic bag of macaroni & cheese out of a steam drawer, and walked back up to the front. He produced a pair of scissors; cut an opening at one end of the bag, and poured the glop into the appropriate receptacle. He took the bag, with its remaining contents, back from whence it cometh in his inimitable, meandering fashion, and returned, just as slowly, to the steam table. Then, he stirred up the stuff, and filled up a container for my son.

The expression on John's face was as though someone had just told him there was no Santa Claus. He looked at the Styrofoam container of the stuff, and then looked at me. I shrugged my shoulders, because I didn't really know what to say. Deep inside, I knew the folks at Publix weren't making macaroni & cheese everyday; but I was still a little surprised by what I had seen. To say it was unappetizing would be a colossal understatement. So much so, John no longer eats the stuff, and even told me it was gross. Go figure.

Now, nothing either store did was out of the ordinary. It happens all the time. Do you think your side dish at Applebee's is made fresh each day? Or even the entrée with the special sauce? And it isn't just Applebee's; try just about every franchised restaurant chain and every grocery in the country. How else can you guarantee consistency? How else would or could the chicken pot pie at the Cracker Barrel in Moody, Alabama taste the exact same as the chicken pot pie at the Cracker barrel in Ocala, Florida? They aren't making 100+ different pot pies at each location each day; trust me.

But, if there is so much product homogenization and standardization in the US economy, how can large companies hope to compete on product? It would seem the larger a company gets, the more it has to compete on price due to economies of scale and, again, product standardization, right? I mean is the sirloin at Logan's Roadhouse really any different than the one at Applebee's or Outback? Naw, not really.

As such, all these companies have to differentiate their products in some meaningful way. For restaurants, you eat good in the neighborhood, or fancy yourself eating what they eat in the Australian bush. For grocery stores? Well, you display

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your premade salads and whatnot in attractive serving dishes, and outfit your employees in chef's garb...to make it look as though it was made fresh. You don't expose the truth by bringing the 10-gallon plastic bag of macaroni & cheese to the steam table! After all, perception is often reality.

You are paying for the belief the potato salad or the macaroni & cheese was or is homemade. Otherwise, I can go get a Stouffer's frozen meal, and save a little money. I can get the prepackaged potato salad in the meat or dairy section. Again, you are paying for a perception of value, whether there is any value or not. However, if you believe there is value, well, then there is. When my kid saw how they really 'made' the macaroni & cheese, the perception of value went out the window.

As a result, when many companies compete on product, they are really competing on service and perception. It reminds me of a discussion I had long moons ago with the CIO of my employer in Baltimore. He was explaining how the hamburger at the Oak Room in Manhattan was an eye-popping \$17.95 (in 1992). Even today, that is still a lot of money for a burger, and I told him I couldn't envision spending that much on one. He looked at me, and said: "John, you don't think you are really paying for the hamburger, do you?"

The same could be said for my father and the Williamsburg Inn. He loves to go to the bar there and have a Beefeater's gin martini. However, he complains about the price, and says he can make them far cheaper at home. So, do you know what I have asked him in the past? "Dad, you don't think you are really paying for the martini, do you?" To which he responds: "No, I guess I'm not." Indeed.

Still, we have a lot of companies in this country that can't figure out how they should compete. Is it price or is it product? Is it on service? What is the perception of the company? Are people willing to pay for the brand? What are the distribution channels?

There is no quicker way to compete on price than to be a supplier for Wal-Mart. Period. As soon as you go down that route to increase sales, your branding is kaput. You are in the bin, and there is no way out. The same could be said for just about any big box, discount retailer. However, that isn't necessarily a bad thing, if that is your business model. On the flipside, those companies which control the distribution of their products get to control their branding, and thereby get to set their price a little more effectively. Blue jeans are a perfect example.

What is the real difference between a pair of Wrangler's and a pair of Seven For Mankind jeans? Is it the fabric? Naw, at least not enough to explain the vast differential in price. So, if it isn't the fabric, what is it? Well, where can you find Wrangler jeans? Where can you find Seven For Mankind? Exactly. They don't sell Wrangler at Saks, and they don't sell Seven For Mankind at Wal-Mart. Period. The jeans themselves? Come on. You would be hard pressed to sell me the value differential in the quality of the denim is 6x or more.

In the end, I would argue much of our economy's problem is we aren't sure how we can compete, in aggregate. Price or product? Standardization or specialization? Service or 'do-it-yourself'? What is the American brand? Is it quantity or quality? After all, when you think of China, you think of quantity. When you think of Germany, you think of quality. What of us? What of our workers? What of our nation's core business model?

In truth, I think we have been trying to compete on price when we should have been trying to compete on product. Slowly, ever so slowly, American businesses are coming to this realization: they have to compete on product, and they have to change their distribution channels and business models. Hey, the emerging markets can eat our lunch on price, but there aren't the same barriers on the other side of the equation. After all, you can't control what your competition charges, but you ARE in control of your brand.

As a result, I am hopeful we will increasingly see a marked improvement in the overall quality of the service and products available to American consumers, as American companies get away from the bin mentality, and start to specialize and differentiate their products. Hey, we might have less stuff than previous, but they will be of higher quality...or at least we will believe they are, which really is the meat of the matter anyhow.

Important Economic Releases

Release	Survey	Actual	Prior	Comments
ISM Manufacturing (June)	52.0	49.7	53.5	<p>The data was neither here nor there this week. For every decent report, and there were a couple, there was a less than stellar one. All told, it would appear as though the economy cooled a little in June....but we already knew that anyhow.</p>
Construction Spending (May)	0.2%	0.9%	0.6%	
Factory Orders (May)	0.1%	0.7%	-0.7%	
Initial Jobless Claims	385K	374K	388K	
ISM Non-Manufacturing (June)	53.0	52.1	53.7	
ICSC Chain Store Sales YOY (June)		0.2%	1.7%	

Tables & Data Points

<u>STOCKS</u>	Dow Industrials	S&P 500	NASDAQ	Russell 2000	Nikkei 225 (¥)	DJ STOXX 50 (€) Price
12/31/10	11,577.51	1,257.64	2,652.87	783.65	10,228.92	2,792.82
12/31/11	12,217.56	1,257.60	2,605.15	740.92	8,455.35	2,216.55
6/14/12	12,651.91	1,329.10	2,836.33	762.34	8,568.89	2,148.21
6/21/12	12,573.57	1,325.51	2,859.09	764.83	8,824.07	2,199.42
6/21/12	12,602.26	1,329.04	2,849.49	775.89	8,874.11	2,157.62
7/4/12	12,943.82	1,374.02	2,976.08	818.49	9,104.17	2,312.41

<u>BONDS</u>	3-Mo UST	6-Mo UST	2-Yr. UST	5-Yr. UST	10-Yr. UST	30-Year UST
12/31/10	0.13	0.19	0.60	2.01	3.30	4.34
12/31/11	0.01	0.06	0.24	0.83	1.88	2.90
6/14/12	0.10	0.15	0.30	0.74	1.64	2.74
6/21/12	0.08	0.15	0.30	0.72	1.62	2.69
6/28/12	0.08	0.16	0.30	0.69	1.58	2.68
7/4/12	0.08	0.15	0.30	0.70	1.63	2.74

<u>OTHER</u>	Prime	Fed Funds	3-Month LIBOR	Gold/troy oz.	Oil— WIT/brl.	\$/Euro	JPY/\$	\$/GBP	CAD/\$
12/31/10	3.25	0.25	0.30	1,421.40	91.38	1.337	81.19	1.559	0.994
12/31/11	3.25	0.25	0.58	1,566.80	98.83	1.296	76.99	1.551	1.017
6/14/12	3.25	0.25	0.47	1,618.40	83.91	1.263	79.35	1.556	1.023
6/21/12	3.25	0.25	0.47	1,564.50	78.20	1.254	80.28	1.559	1.030
6/28/12	3.25	0.25	0.46	1,550.40	77.69	1.244	79.45	1.552	1.033
7/4/12	3.25	0.25	0.46	1,621.80	87.66	1.253	79.88	1.559	1.013

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