

COMPANY DEEP-DIVE

# Competitor Believes Intensifying Competition and Rising Input Costs Will Compress Pasture-Raised Egg Margins Going Forward

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EXPERT PERSPECTIVE  
Competitor

ANALYST PERSPECTIVE  
Investor-Led (Buy-Side)

PRIMARY COMPANIES  
VITL

OTHER COMPANIES

- HAPPY EG...
- CALM
- EGGLANDS...
- AMZN
- PETE & G...

## Transcript Highlights

- The expert believes new branded and private-label pasture-raised egg competition is taking retail market share from VITL.
- The expert thinks VITL is ultimately a commodity product with no material advantages or differentiators vs. new competitors in the space. The company is reliant upon branding/marketing spend to defend share.
- In the expert's opinion, VITL will likely struggle to add ~250 new farms to its supply chain over the next ~3 years given existing supply chain attrition levels and increasing competition.

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## Expert Bio

Expert is a President at Egg Innovations, responsible for setting the company vision and providing resources to teams.

## Interview Transcript

Analyst

First, this call will be recorded so that it can be transcribed. Second, you understand the definition of material non-public information and agree not to disclose any such information or any other confidential information during this interview. Third, you confirm you do not have a non-disclosure agreement or any other type of agreement or arrangement that would prevent you from speaking about any of the companies that may be discussed during this call. If you can't answer any question I ask, just let me know and we'll move on. Finally, you agree not to discuss specific details of your current employer. Do you agree with this?

Expert

I agree.

Analyst

All right, excellent. Look, just to recap for the transcript today, we're going to be talking about Vital Farms and really just get a better understanding of their business, competition space, that kind of stuff. Before I dive into my specific questions, why don't you go ahead and just give me a real quick background on yourself, your experience in the industry?

Expert

I was born into the industry. My dad had a very small egg operation, but I've been around chickens since I was born. Went to a land grant university, University of Wisconsin, received a bachelor's degree in agronomy with a minor in poultry science. I have a master's degree in poultry science and nutrient manipulation of shell eggs. I have a PhD received in 2020 in poultry science and avian ethology. I'm the founder of Egg Innovations and its CEO, and we focus exclusively on animal welfare in the egg-laying space. All of our hens are either free-range or pasture.

Analyst

All right, excellent. Perfect. Maybe just to start, I was wondering if you could make sure I have a good understanding of what exactly a pasture-raised chicken is. From the research I've done, it seems like all that really comes down to Certified Humane and their standards. Is that correct understanding?

Expert

There's two certifiers. One is Humane Farm Animal Care. The other is American Humane. On pasture production, their standards are very, very similar. In general, pasture production that is third-party-certified will require 108 sq. ft. per hen outside. If you have 20,000 chickens, you would multiply 20,000 X 108 sq. ft. to decide how big your pasture is. You also need to give the birds access 365 days a year other than a couple of exceptions, inclement weather, disease risk, etc.

Analyst

Okay. You mentioned 20,000 chickens. Is that an industry standard for one barn or coop, for lack of a better word?

Expert

The pasture operations that were built for them three or four years ago might be in the range of 5,000-20,000 chickens. Most new production is 20,000-30,000 chickens, and that is the cap. There's another rule in pasture that is, the farthest fence post has to be within 1,200 ft. of the building, and mathematically, you can't get more than 75 acres within 1,200 ft. of a building, which caps you at a 30,000-bird barn, but most new production is 20,000.

Analyst

Okay. That's really helpful. This is a tricky question, I suppose, but I'm just curious, when the chickens are inside the barn, not mathematically but how much space do they really have? How does that really compare to a cage-free or a free-range setup?

Expert

We live in a world of NGO third-party certifications. These things are not regulated by the government. To be American Humane-certified, if you have what's called an aviary, which is like a jungle gym, a playground that's three-dimensional, there's 1 sq. ft. per

hen inside the building. If you have a traditional single-level building, then it's 1.2 sq. ft. per hen inside the building.

Analyst

Okay. The difference for pasture-raised is really just about having that access to the outdoor space and then also, I think, spending a minimal amount of time outdoor every day. Are those actually the key differences?

Expert

Yes. Compared to cage-free, the inside of the barn would look very similar whether it was pasture, cage-free, or free-range.

Analyst

Okay. All right. Very helpful. One of the things I wanted to ask about was Vital Farms talks a lot about the pasture belt in the U.S. and how there's only a certain part of the country that is really suitable for pasture-raised chickens because they need to be outside and whatnot. I'm curious if that is true, and if it's not true, how does one meet the requirements in colder climates?

Expert

There's no truth to it. There are pasture birds in South America. There are pasture birds in Canada. The pasture belt is purely a marketing use of words. The standards remain the standards, as long as you have 108 sq. ft. per hen outside, as long as they have access 365 days a year. Birds are very heat-tolerant and birds are very cold-tolerant. There can be 10°F outside, 20°F outside, and birds will choose to go outside. It's the same as go to the Deep South, it's 100°F outside and birds will go outside, so the pasture belt is a myth.

Analyst

Okay. Very interesting. The other thing I was noticing is in the Certified Humane labeling, they had a seasonal pasture definition, which seemed to create acceptance for if there's a bunch of snow on the ground or something. I was just curious if that is the correct understanding of that, that's for colder weather climates, and also if that is something that would need to be distinguished on consumer packaging, meaning you wouldn't be able to label it just pasture-raised, you'd have to call it seasonal pasture-raised, or is there no difference?

Expert

The seasonal pasture is really geared towards smaller farms, farm markets, those types of things. When you look at commercial producers like ourselves, Vital Farms that are putting our eggs on display at Kroger, Safeway, whoever, Whole Foods, we're all going to be pasture, period. We're not going to present seasonal pasture.

Analyst

Okay. That makes sense. All right. The other thing I want to ask about was the size of the market. To the extent that you have any data on this, it'd be really helpful to get specific numbers, but if not, just ballpark it. I'm curious if you can give me a sense of how the market breaks down either by dollars or unit numbers in terms of conventional eggs, cage-free, free-range, and pasture-raised.

Expert

I'll present it in the amount of chickens percentage of the national flock. In the national flock, we have currently about 310 million hens, right around one hen for every human. Of that, at this point, 60% is caged, 40% is some form of uncaged. Pasture is within that 40%. We would say, good educated guess, because there's no industry statistical resource, it's in the neighborhood of 3%. We think there's approximately 10 million pasture birds across the United States.

Analyst

Okay, that's helpful. One of the things I think Vital has disclosed, they said that approximately, call it, 20% of egg sales are specialty, so that's cage-free, free-range, and pasture-raised. It seems like that hasn't really changed over the last, call it, five years. That made me wonder if **pasture-raised is not really growing the overall specialty segment versus conventional eggs.** It's more maybe just taking share from free-range eggs. Do you have any thoughts on that?

Expert

If that's what they published, we would disagree with that data. We see conventional declining. Let's take the first bucket, cage-free, which is all the variations of cage-free. In the last five years, **that's grown from 30% market share to 40%.** Within that subset, pasture is the fastest-growing, but remember, it's starting from a small space.



Expert

Pasture in the last three years has grown at about 30% annually. Free range is more mature that's growing at about 2%-3% annually. Cage-free has been confounded because of avian influenza, but at this point, again, it's at 40% market share where it has been going through a steady march. It will continue to march forward simply because of state mandates that are already on the books and approved for implementation. The whole subset of uncaged eggs is growing, and pasture is growing as well.

Analyst

Okay, very helpful. Just to make sure I correctly understand, that's market share of dollars, and within that, you're saying the whole specialty category in terms of dollars is taking share from caged eggs. Am I understanding that right?

Expert

I am presenting in terms of headcount, and so you have to multiply by the retail price. I'm doing it more from the production side of how many chickens are there and how many have moved into the different styles of production. The growth of cage-free percentage and all those would be larger because they have a higher retail.

Analyst

Right. Okay. Let me ask, do you have any sense of brand market share? Really, the one I'm most interested in is just Vital Farms' share of pasture-raised. It seems like, from the numbers they've put out, that they're somewhere in the 80%-85% range.

Expert

We see it in the 80% range and declining.

Analyst

The decline in market share, is that just a recent phenomenon or something that happened over the past couple of years? The numbers they put out make it look like their market share has actually increased from, I want to say, they basically implied it was 85% in 2022 up to 89% in 2023.

Expert

This is one where you have to parse apart what the language is. In total pasture, they're declining significantly because of private label. In brand pasture, they have a slight decline because of new competition to the marketplace. Vital Farms was the first of the market in a significant way in pasture, so they grabbed the lion's share of the market. Once they proved out the market, there's significant competition that is developing. We have Helpful Hens and Handsome Brook has a brand and Pete & Gerry's has a brand. Competition that wasn't there before is now there, but the biggest competition is private label. That has moved the landscape significantly.

Analyst

In your experience, when would you say that that competition started to really intensify and start to take some of their market share?

Expert

In the last 24-30 months.

Analyst

Okay. Just one more one on that high-level piece, and obviously, this is a tricky speculation, but I'm just curious what your sense would be. If you had an idea of where you think, I don't know how you want to frame it, but either pasture-raised as a segment or specialty eggs as a whole category might top out in terms of as a percent of total egg consumption.

Expert

Do you want to include cage-free as special?

Analyst

I think it's easier to exclude them if you can.

Expert

Yeah. I would say my general thesis is within five years, cage-free will be a commodity. It's just going to be normal for there to be cage-free. The premium category is you would look at as free-range and pasture. I would say, on a volume basis, I could see them getting to be probably 20% of the market in terms of headcount of chickens, obviously, a much bigger number in dollar sales because these are the [high-ring] eggs.

Analyst

Right, of course. Okay, that's helpful. All right. You mentioned that Vital Farms was the first mover, and they created the pasture-raised category. I'm curious if there's anything else **that sticks out to you as a key competitive advantage** that they have. The two things they've really talked about are, one is just brand value and their company values aligning with consumer values.

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Analyst

The other one they talk about is the traceability of their eggs, the fact that every carton you buy, you can then look up what farm specifically those eggs came from, and you can see a video of the chickens. Do you think any of those things really matter? How would you frame why **they've been so successful, what their key advantage** is?

Expert

I've been around since the inception of that company. Roots were John Mackey, CEO of Whole Foods, and I forget now the founder of Vital, they're good friends. John Mackey gave him company corporate exclusivity for almost 10 years at Whole Foods. Whole Foods initially was an investor.

Expert

I would tell you **that was their advantage**, and then what they did is they leveraged it well. I think they have excellent packaging, stands out. They've stayed consistent. If you look at it at the level I do, you'll see minor changes, but to the average consumer, that black carton is very recognizable. I think they take several liberties with their marketing.

Expert

We all can trace back eggs. We all can talk about the [wellness] of our chickens. Their marketing programming, whether it's rebates or what have you with retailers. I don't have insight into the specific dollars and the arrangements, but I do know that it has to be attractive for the amount of support that they have at retail. Those are the key issues.

Expert

The consumer, I think, is finding that there's a lot of other options now. They were the first in town, so as long as they don't screw it up, a lot of people are like, "If it ain't broke, don't fix it." **That's the challenge of competitors**, is to distinguish themselves from Vital Farms, but right now, Vital Farms is the bellwether of the category.

Analyst

Okay. That makes sense. Let me just ask a clarifying question there because the connection broke up a little bit. You said **they have very strong trade relationships with the retailers**. Help me make sure I understand, that's either because they have longer histories selling these products or because they may be more aggressive in terms of the rebates they're offering to retailers.

Expert

Sure. More on the latter. The rebates that are being offered, the incentives that are directed to the category managers, the amount of money that we're willing to spend on ads, the rebate programs, all of that helps a category manager achieve his goal, which is, "How much money do I generate as profit in my category?" We all have programming. They just do a good job of they deploy a lot of dollars back to their category managers.

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Analyst

Got it. Okay. The other thing I want to ask about was the color of the yolks. I talked to a number of consumers about this and that seems to be the thing that people always hit on. One of the things that I noticed that so far, I went and bought a whole bunch of different brands of pasture-raised eggs, and the only brand that seem to have really matched the orange color that Vital does is Pete & Gerry's. What I could tell, looking into it, it sounded like it's some combination of adding marigold petals, turmeric, or paprika to the feed, and that's how you get that. Do I understand that correctly? What do you think of that color aspect to it?

Expert

**I'm disappointed** that you didn't buy Helpful Hens because we would have that same number. That was sarcasm, by the way. That's my brand. We all measure yolk score on a Roche scale. Ourselves, Vital Farms, Pete & Gerry's are all doing a yolk score of 12. **It is impossible to achieve** that yolk score on a commercial basis with any consistency without supplementing the diet with pigments. That's just the statistic. That's just a factual statement. We all put in marigold or one of the variety of pigments that are out there.

Expert

Now, the fuzzy part is Vital makes a very strong statement that that comes exclusively from being on pasture, and the science would not support that. The science would say it comes exclusively from putting it into the diet. Regardless, consumers have adopted that belief. The interesting part is any brand of pasture can do what Vital does. There's no magic.



Expert

I do a lot of private label. We offer it through our private label people and we say, "Here's what it costs." Initially, what we're seeing is they're pennywise and pound-foolish. They're going, "Well, I don't want to spend that extra for the pigment," but then they would see how **they lose market share to Vital Farms**, and we're seeing more and more private label begin to adopt pigment in the yolk.

Analyst

Very interesting. Just ballpark it, how much does that change the cost from a production standpoint to add pigment to the feed?

Expert

On an organic basis, about 10¢ a dozen. On a nonorganic basis, about 4¢ a dozen.

Analyst

That's helpful. This is a funny question, but I was just curious. Could you do the same thing to a free-range egg and then, I don't want to say trick, but get the same effect for consumers like, "Look, our free-range eggs have the same yolks that you've come to associate with pasture-raised eggs"? Do you think it's too late?

Expert

I would tell you that we at Egg Innovations do that. We put pigment in all of our flocks, and so the answer is yes, you can. The history of that is, so I have a science background. I had no desire to supplement the pigments. **We would receive, on a regular basis, email and consumer traffic that basically said, 'You're cheating.'** Your birds don't go outside, and it's obvious because you can look at the yolk. That's how I know you're cheating."

Expert

When we supplemented the diet, then the flow of communication for consumers did a 180°. "We love your product. **We're glad that they get outside, etc., so there is this incorrect perception by consumers.**" I don't know that that's ever going to change but that is their perception, is that going on pasture all by itself gives that [yolk's color].

Analyst

Interesting. Okay. Just a high-level one about the pasture-raised category in general, I'm curious if you had to speculate a little bit about how market share is going to change out over time, do you think that Vital Farms remains the dominant pasture-raised player and that they're still going to maintain maybe not 80% share but like 60% share, or maybe they'll have a slight, call it, 50¢, \$1 a dozen premium over other pasture-raised brands? How would you see that shaping up in the next, call it, three to five years?

Expert

I think they will be the dominant brand over the next five years, over 50%. I'd say that of any brand who establishes a category. **The first one there that proves out a category tends to enjoy a long run** of being number one. I would say **the competition is getting a lot stiffer**, and I would say yes, their percentage will drop. I would probably align with your thinking of from the low 80s percent to the low 60s percent over time, but they'll still be the major brand. They won't lose volume. They're going to not grow at the pace of the category on a forward basis.

Analyst

Right. On the pricing side, you can come up with this maybe two ways. One is, right now, **they seem to have a significant price advantage over both conventional eggs and the other branded and private label competition** I've seen. How much of a premium do you think **they could maintain given whatever strength** their brand does have? Maybe the other way to come at it would be, where do you think **normalized pasture-raised egg prices will fall** relative to conventional once the market reaches an equilibrium state of competition?

Expert

Pasture eggs right now, on the low end, would be a private label at like an ALDI could be about \$4.50-\$5, to the high end, which is viable at Erewhons in California, at \$10. I would tell you over the next three years, other than adjusting for inflation, you're going to see those \$10 prices drop back. Let me put it this way. I don't know that retail is going to drop them back, but I think at a wholesale level, those prices are going to drop more than \$1 a dozen.

Analyst

Okay, very interesting. This might be getting a little bit too specific, but can you give me a sense of where maybe the floor is for pasture-raised? Just thinking about it from a producer standpoint, and obviously, assuming an industry-standard profit margin, is it \$4 an egg or something, or just maybe ballpark it a little bit?

Expert

Forget all the market, just the production side, to produce a pastured egg and deliver it to retail, to take transportation, processing, farm pay, all that is going to be in the neighborhood of \$2.50-\$3. Now, we call it MAP, marketing and advertising and promotions, what each individual company adds for MAP varies dramatically. Let's just call it \$3 for a really true cost and assume that retail is going to take a 50% markup, you're not going to see pasture eggs go much lower than what ALDI is doing right now to date. That's probably the floor.

Expert

Two things are going to happen on the brands. One is **the spread will collapse**, but there'll be less brands too. Just over time, the premium category of eggs is consolidating, and retailers really don't need 20 labels out there in their premium set. We really see three or four companies being relevant on a forward basis other than regional, local, that kind of thing. If you take Pete & Gerry's, Vital Farms, Happy Egg and us, you pretty much have every type of egg that can be produced, and then why do you need Hen House or Nature's Yoke or these other companies?

Analyst

Yeah. That makes a lot of sense. That actually is a good lead into, I was going to ask about Cal-Maine. Obviously, being the thousand-pound gorilla in the room, they don't really talk about pasture-raised that much so it doesn't sound like they do a little bit of pasture. I'm curious if you think that they will be involved in a more meaningful way in the segment and how that might show up and how that might impact things.

Expert

One of the things you always have to look at is the culture and the DNA of these companies. Nothing we are talking about or doing is proprietary. Anybody can make a pasture egg. Anybody can make a cage-free egg, but it's really what does that specific company focus on. In the case of Cal-Maine, what they focus on is purely execution and fulfillment. They are absolutely agnostic on cage-free, free-range, pasture, caged. That's just not how they see the world. They see the world as, "We need to provide the retailer whatever they want, and we have no opinion on what they want." You will not see Cal-Maine in the next five years say, "Let's push a pasture brand," or any kind of brand.

Expert

If they're going to do any brand work, they're going to do that through Egglad's Best as the largest franchisee. Egglad's Best will say to them, "We want a brand of pasture eggs." All Cal-Maine will say is, "That's fine. You guys go develop it. We just fill orders. We don't view Cal-Maine as a competitor. We see them a lot of private label. They do Publix and Walmart and whatever. We could see them having their own pasture birds, but it's going to really be for private-label order fulfillment.

Analyst

Okay. That's another good leading because I really want to ask about Egglad's Best. It seems to me that, like you said, they're the only big brand in this space. I have a lot of questions about them. The first one was just if you have any background on how they succeeded as being what seems to be the only standalone brand in what is otherwise a commodity category.

Expert

Again, you always got to go back to the roots. Egglad's Best started as Heartland's Best in the 1980s, and it started at the board of directors of United Egg Producers. What **Egglad's Best had as an advantage** is the franchisees has a supply chain. The original Egglad's Best franchisees were the biggest companies in the nation doing commodity eggs, so they had an ability to force out Egglad's Best, and they had an ability to make it difficult for other brands.

Expert

**They went through a challenging early years with their initial CEO.** He was very controversial, then they brought in their current CEO who's been there now probably 20 years. He was a Procter & Gamble guy, and **he did an excellent job of saying, "We're done litigating.** We're done fighting. We're done doing all that. Let's just get back to brand-building." Their advantage is there weren't any other significant brands in the 1980s and '90s and early 2000s.

Expert

Land O'Lakes attempted to compete with them. Other smaller brands, Giving Nature, tried to compete with them, but because of their horsepower of owning the supply chain, they were able to flex that muscle. On the other hand, we really don't see them as significant competition in the welfare space because they don't have that reputation. **Their reputation to their consumer** is nutrition.

Analyst

Yeah, that was the other thing I was going to ask about. I was curious how big of a role that whole proprietary diet research and the clinical studies and everything and the marketing, how much of a role that played in the success. It sounds like, from your telling, it's more the supply chain side but that also was a big piece at least in building the brand.



Expert

Correct, and they did it in a vacuum where there wasn't competition. They built it, established it, built a loyal following. Again, you can manipulate eggs nutritionally. That's not the challenge. I have patents on reduced-cholesterol eggs. **The challenge** is the marketing side and the supply chain side, and that's their strength.

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Analyst

Right. One of the things that struck me was, and I don't know if technically they correctly described everything to us, but it sounded like they were cooperative, and at least if not them, that there's a number of cooperatives in this industry. I was just wondering why that's the case. Is that in any way a risk for Vital Farms that they don't have that model and they're competing with people who do have that model, and maybe it makes **it more challenging** for them to expand their supply chain?

Expert

When you had the early growth, let's look at the big three premium eggs that are welfare, Pete & Gerry's, Vital Farms, Happy Egg. They all went through tremendous growth curves between 2010 and 2020. They did that in what we would call an asset-light model because you either needed a ton of cash to grow the business that big or you needed someone else to carry that cash, and so what they did is they all built models where their farmer owned the chickens.

Expert

To own a chicken is about \$10 a bird. If they wanted to add on 1 million chickens, that would be \$10 million. The way they did that is they said to the farmer, "You put up a barn. We're going to give you this nominal premium for producing the eggs," but **the farmer bore all the risk and the financial capital of building the supply chain for those three companies**. That worked very well when the category was in hypergrowth and you were forgiven for maybe having expensive production. Now, what we're seeing is the move to vertical integration because now the category is getting more mature.

Expert

You take companies like us. I own my own pullet facilities, my own feed mills, my own egg plant. **I have a much lower cost of production than any of those three companies. Their advantage** is they have the market share because they went out there first. My advantage is it's easy for me to get market share because **I have a lower cost of production**. What we see as the next evolution of the premium space is all three of those companies are going to have to pivot from buying eggs. In some manner, **they're going to have to solve** that because buying eggs is going to make them very expensive in their supply chain.

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Analyst

Interesting. Okay, awesome. Let me just ask one more about Egglard's Best specifically. I'm curious if you have a sense of what kind of price premium they're able to command with their brands. It seemed to me, just in retail, they seem to have, call it, 50¢-\$1 price premium relative to the same category. I'm curious if you had a thought on that.

Expert

I'd say that's about right on the price premium, and the cost of producing Egglard's Best was under 5¢. Now that it's established, it's a great program. It struggled for the first 10 years, but now it's mature, it's running smooth, **it's got good margins** back to the franchisees, it's a well-run program. We've seen **it endeavor to go into a lot of different line extensions with not a lot of success**. Our core thing is we're a white nutrition egg.

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Analyst

Right. Let me ask, and if you don't have a sense, that's fine, but I was just curious, is that maybe the way to think about Vital, that they might be like an Egglard's Best? If so, what gross or operating margins, or whatever easy metric you can think of, would that put them at? Vital, for reference, has said that they think **they could be a 35% gross, low double-digit-adjusted-EBITDA margin company**. Maybe help me just frame that if you can.

Expert

They should, and the wild card is cost of grain because that's our biggest input for all of us in the industry. If I was on their board, **I would be disappointed if they weren't** at 10%, 11% EBITDA consistently. It'll waver a little bit depending on how much they put into marketing and where does the price of corn and soybeans go each year, but they should be able to reliably do, and not much more than that. I don't see them to be in a 15% or anything like that, but they should be between 9% and 11% very consistently.

Analyst

Is that something that you think is achievable with the current asset-light business model, or would that require them to take it to the next step and vertically integrate and consolidate that supply chain?



Expert

That is making an assumption that they are going to adapt to a new norm and change their supply chain and that **they're going to have price compression, but they're going to offset the price compression with vertical integration.**

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Analyst

Okay, that's very helpful. All right. The other thing I want to ask about, and I understand your insight on this piece might be a little bit limited, but I'm just curious to extent you have any information about what Vital's contracts look like with farmers. One of the things I've heard is that they're exclusive lockup for four to five years, the payment is tied to the feed cost, and maybe it's an X-dollar premium per egg relative to some egg index or something like that. Can you help me get a better understanding of that piece?

Expert

Your background is fairly good. I would tell you this is one of the areas we view as a significant **Achilles** heel of Vital Farms. When they were growing significantly, there weren't a lot of other options for farmers. Now, there are plenty of options. At a producer level, **the Vital Farms' contract is not viewed favorably** because they put all the disease risk and the grain risk on the farmer.

Expert

In a classic integrator model, my model, I own the chickens, so if the birds get sick, **I potentially lose my capital investment of chickens**, the farmer loses his egg revenue. In the Vital model, **the farmer loses both**, and farmers are beginning to leave Vital Farms because they view that as an unreasonable risk.

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Analyst

Okay. That makes sense. Just on the cost to produce the egg, I know earlier you were giving a sense of the all-in cost, I'm curious if it's possible to maybe break that down a little bit in terms of how much of that is feed, how much is inbound freight and cold storage, packaging, outbound freight, that kind of stuff.

Expert

I'll build it out in a stacked manner, and then understand that the Vital model, they're paying the farmer a flat number, let's just call it \$2 a dozen. I don't know what it is personally, that's not proprietary, but I'm just saying these are the bills the farmer is going to have to pay. Just for the chicken, it costs 25¢-30¢ a dozen of eggs.

Expert

To raise that bird, to amortize that bird over the life of it, and knowing the amount of dozens they produce, it's about 25¢-30¢ a dozen. To just run the farm, labor, utilities, all that kind of stuff is 50¢ a dozen. To transport from the farm to the cold storage, or depending, each company is a little bit different, it's 15¢-20¢ a dozen, then you have all sorts of smaller cost, quality assurance, maintenance, etc., to run the egg packing plant. That can be 40¢, 50¢ a dozen. The Vital Farms package, because we use the same company, same manufacturer, that black carton is going to be about 28¢ a dozen. Those are the big costs that you have to get it to the loading dock.

Analyst

Okay. For transport from the processing facility to retailers, I assume that's a producer cost, and that's probably in a similar about 15¢, 20¢ a dozen range as the inbound transport.

Expert

That is generally Vital's cost. Vital buys what we call a naked egg. They buy an ungraded egg, and they take ownership when their truck pulls up and they pick up the eggs. From the egg plant to either the warehouse or the grocer or whatever is generally going to be about 20¢-25¢ a dozen. That's going to be a function on how full the semi is because even with Vital, as much volume as they're doing, they have very few semis that are 100% full.

Analyst

Okay, that's helpful. Just real quick on that feed because I was trying to model this amount, is the right way to think about feed being, call it, two-part-corn-to-one-part-soybean meal?

Expert

Yeah, two parts corn, one part soybean. Ballpark, corn is going to be about 60% of the diet, soybean meal is going to be about 27% of the diet, and then everything else, salt, calcium, minerals, vitamins is going to be the balance.

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Analyst

Okay. That's helpful. All right. That's all the cost questions. Let me just ask a broad industry question. Obviously, with bird flu, there was **a huge shortage**, and then we saw egg prices driving up a ton. I'm just curious, **Vital Farms has obviously reported pretty record margins**. Am I right in thinking that **that's primarily a result of getting that pricing tailwind from them** raising prices related to bird flu and everything? At the same time, it looks like **all the costs were declining at the same time**, am I thinking about that the right way?

Expert

Yup, pretty close. Vital isn't reporting anything exceptional. **All of us are having record years**. The reason we're having record years is in quarter four of 2022, commodity eggs were off the charts. All of us in the premium space use that for a big price increase, over \$1 a dozen, and we could do it because the comparison was exceptionally high.

Expert

**What happened is our cost side, our number one cost, corn and soybeans, collapsed but none of us** lowered our retails. We're sitting in this very short-term, wonderful window where corn went from \$7.50 a bushel down to \$4, soybean meal from \$550 a ton down to \$300. **Our cost of productions were dropping 15¢**, 20¢ a dozen on nonorganic, and upwards of 30¢, 40¢ on organic, and none of us lowered our selling prices.

Expert

Two things are going to happen that this is not going to go on forever. **One is we're making too much money so competition's going to come in**. I've got money to work with. Vital has got money to work with. Pete & Gerry's has. We all got healthy wallets right now, so we're going to fight. We're going to try and grab market share. The second thing that's going to happen is the price of grain isn't going to stay low forever. When it goes back up, we think **it's going to be very difficult to get** another price increase. 2024 is a very generous year to us in the premium egg space, all of us.

Analyst

Interesting. On the soybean and corn costs, do **you have a sense of how big of an impact egg production** is on that meeting? Was the fact that there was bird flu and there was a whole bunch of chickens that [had to get culled] because of that, do you think that played any significant role in driving down those feed costs, or are those two larger markets said like, "This isn't a big enough impact"?

Expert

Correct. No, the latter. The thing that bird flu did is we live in an elastic relationship with commodity eggs. When commodity eggs go up in price, a portion of consumers trade up to premium eggs. When commodity eggs are cheap, a portion of consumers trade down. Bird flu didn't affect the grain price, but it does influence a portion of consumers who bounce back and forth.

Analyst

Yeah. That makes sense. All right. Just the last couple of ones here. I'm curious if you have a sense of, and frame this one of two ways, either where Vital Farms is or perhaps the whole pasture-raised category in terms of retail expansion. Just to give you a little context, Vital has said they're in, say, 24,000 stores, and they think they can add another 8,000 within the next four, five years. Give me your sense of how reasonable that sounds or how much room there is to run for them or the category.

Expert

I'm going to say two things **that are going to be in conflict**. To their credit, they have done a good job of generally meeting their forecast over time. We view that projection as an incredibly challenging task. We believe the 8,000 stores they're not in, there's probably a good reason they shouldn't be in those 8,000 stores. Those are low demographic, low-economic, club stores, what have you.

Expert

We don't think their sales force has been lazy the last 10 years. We think most of the places they can get placed, **they've done a good job** of getting placed. We think their growth is maybe they can get more shelf space, maybe there's line extensions, but we don't see their growth coming from adding 8,000 more doors.

Analyst

The shelf space thing was the other one I wanted to ask about because I think they've said on average they have, call it, 2.7 SKUs per store, and they were talking about maybe getting that up to four or five. Just curious if you think **that seems reasonable or maybe there's pressure** there because you have a bunch of other competing pasture-raised brands coming in. How would you think about that piece?

Expert

We would view that as very unreasonable. **We just see way too much competition in the space.**



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Analyst

Okay. Thinking about line extensions, I've seen them, and I think a couple of other people, do regenerative, and I believe it might be you guys to have a carbon-neutral egg. I'm curious if you think, one, is there an obvious next thing that **you think could be a big growth piece** after pasture-raised, and is there any reason to think that Vital Farms would have an advantage in any new categories that do pop up?

Expert

I think there will always be new ideas that will get traction. I've been in this long enough. Organic wasn't a thing and then free range wasn't a thing and pasture wasn't a thing. This year, it's regenerative. I don't know what it is, but in two years, three years, there will be the next trend. That I don't doubt. **I would say Vital Farms has no inherent advantage in developing products for that market.** We do not view them as very deep bench strength in poultry science. We think they can market, we think they can sell, but we don't really think they're going to create new technologies.

Analyst

That makes sense. What they've done is **they're just a good branding marketing business, and that's their core strength as opposed to anything on the production side.**

Expert

Correct. As an example, we were doing regenerative a year before restorative came out, but they have enough bandwidth that once they get behind the line, they got those 24,000 stores to go talk to.

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Analyst

The last one would just be about potential other categories they could move into. It's something that they've talked about, but they've never really suggested exactly what they would do. They did the egg bites thing which didn't really work out. They did butter, which is, call it, neither here nor there. I'm just curious if you have a sense. What would they move into if they were to do something, and what would be your sense of how likely they are to succeed in another category?

Expert

You're correct, and there's other ones they have moved in and out of. They had a new protein bar, that kind of thing. They have been very adamant that their world is pasture, and we have not, in the last 10 years, seen them have any significant success. **The closest thing they have is their ghee butter, but we just haven't seen a lot of significant success beyond shell eggs.**

Expert

We were always surprised that they don't do free-range and they let Pete & Gerry's and Happy Egg do that space, but that might go to the culture of the company. Even at the board level, they may say, "We're just a pasture company. That is our destiny." We've watched the same thing in Eggland's Best. Just because you found your lane on one item doesn't automatically anoint the next five products you try to launch.

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Analyst

Yeah. No, that makes sense. All right. Great. That's most of my specific questions. Is there anything that I haven't asked about, anything that's maybe overlooked just that I should keep in mind or focus on as I think about Vital Farms and trying to assess their business prospects and everything?

Expert

What I always tell people is what I would put my energy in, **they're a good sales and marketing company**, no question about it. If I was watching out for an Achilles heel, it would be their supply chain because I believe **they're losing about 5% of their producers** annually. When they say they want to add on X amount of new producers, that's a big lift in and of itself, but they also have to make up for the ones they're losing, and **I see their supply chain as being vulnerable.**

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Analyst

Interesting. Okay. Is there a CapEx or a cash cost to Vital when it comes to either acquiring or retaining farmers that are in their supply chain?

Expert

Let me put it this way, to put up a barn is \$60 a bird. Right now, they say **they want to expand into Indiana**, in Seymour, they want to add X amount of farms, etc. Whether they put up the barn or the farmer puts up the barn or whoever puts up the barn, it's \$60 a bird. They say they want 1 million more birds, that's \$60 million, somebody has to put out, and it's about another \$5 a bird for all the

supplies, support, semis, trucks, everything else. Whether it's their model and the farmers are doing that, and then they just have to pay more for the gig to reimburse the farmer, or whether they choose to go vertically integrated, it doesn't change that \$65 a bird to put up a building.

Analyst

Right. Okay. One way or the other, someone's bearing that cost. The question is, just as **things get more competitive** and as they try to grow faster, how much of that shifts between the farmer versus them?

Expert

Correct.