

COMPANY DEEP-DIVE

Former Senior Director Is Skeptical About VITL Management's Goal to Achieve ~\$1 Billion in Net Revenue by 2027

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19 Apr 2024	17 Apr 2024	Former	Investor-Led (Buy-Side)	VITL
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Transcript Highlights

- The expert believes the ~8,000 retail locations that VITL is targeting will offer limited velocity.
- The expert thinks **VITL is insulated from diseases** that impact more commoditized eggs.
- In the expert's opinion, **VITL excels at storytelling and has a clearly superior product.**

Table of Contents

Evolution of the food and beverage industry landscape.
Factors enabling Vital Farms to command high price points.
Profile of a typical Vital Farms consumer.
Long-term retail expansion prospects for Vital Farms.
Role of Vital Farms’ packaging in a consumer’s purchasing decision.
Long-term sustainability of Vital Farms' pricing model.
Replicating Vital Farms' marketing and branding.
Growth opportunities for Vital Farms beyond retail expansion.
Gaps in Vital Farms' structural and commercial capabilities.
Stringent requirements for partner farms as a possible challenge to Vital Farms.
Optimism for Vital Farms’ future.

Expert Bio

Expert was a Senior Director at Vital Farms, responsible for leading portfolio expansion within eggs and butter as well as expanding into new categories, building a growth strategy and commercialization plan for all new products, and overseeing a project management team. Expert reported to the C-suite.

Interview Transcript

Analyst 00:00:00

First, this call will be recorded so 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 that 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 details of your current employer. Do you agree with this?

Expert 00:00:35

I agree.

Analyst 00:00:36

Okay. That's perfect. Thank you so much. Great. I have your bio, but can you please give me an overview of your background and career progression in your own words?

Expert 00:00:48

Yes. I have spent the last 15 years in marketing largely focused on the food and beverage industry, starting in the advertising agency world. In the last decade, I focused my career in-house in brand and general management companies like Nestlé, Tyson Foods, Vital Farms, and most recently have been operating as an independent brand consultant for emerging brands in the health and wellness space.

Analyst 00:01:26

Okay, yeah. That's a great overview. That's perfect. Great. As you know, my goal today is really to learn more about Vital Farms. First of all, I think you've been in the industry for number of years. Like you mentioned, you've been in marketing and branding positions. From your perspective, how has the landscape really changed or evolved at a high level during this period of time?

Expert 00:01:57

Yeah, I think especially post-pandemic, there's been a much greater influence on health and wellness and the growth in the macro trend of food as medicine. I think consumers have realized that what they put into their bodies really has an impact on their long-term health. I think the pandemic also led to more consumers doing a lot of their own cooking in home, as well as the growth in the breakfast occasion, which **a lot of people skipped in their commutes.**

Expert 00:02:35

Now, obviously, some of that has reversed as there's been more return to office, but a lot of those activities like cooking at home have retained because consumers learned how to cook for themselves and learned more about food. I think the food as medicine macro trend and emphasis on health and wellness has pervaded more at home. **Cooking has grown,** and I think the younger generation, when you think about Gen Z, they place much more of an emphasis on voting with their dollars and investing in brands that have a bigger value add.

Expert 00:03:17

As you think about sustainability and the environmental and people impact, the brands with something like a B Corp certification, that really stands out to that younger generation of consumers. I think that will continue to influence the food and beverage landscape. I think very recently, **inflation and the higher cost of goods and specifically grocery goods has put a lot of strain on consumers.**

Expert 00:03:43

There are higher-household-income consumers who have not been as impacted because they have much more discretionary income. It is those lower- and middle-class consumers **that have had to make some really tough choices.** I think that's where **you've seen a lot of growth in private label and consumers,** frankly, making a choice of if they are going to invest in something that's organic, they're going to be picking and choosing. It's not an all-or-nothing for most consumers today.

Analyst 00:04:15

Okay, yeah. That's a great answer. That's a great overview. That's perfect. Great. If we look at Vital Farms, I think what's really striking about this company is that consumers pay a very hefty premium when it comes to their eggs. My question would be how can Vital Farms command such high price points, in your opinion?

Expert 00:04:44

Yeah. I think it starts with their stakeholder model and their storytelling of how they really invest in ensuring that farmers are adequately paid for the work that they're doing, as well as the fact that the birds themselves have 108 sq. ft. per bird and can act as nature intended and have room to roam a pasture and pick at bugs, etc.

Expert 00:05:15

I think it starts with that storytelling about being really mindful about positively impacting people, planet, and animals while growing the profitability of the business. It's purpose and profit, and that stands out to consumers who want to vote for brands **that are doing positive things in the environment with their dollars.**

Expert 00:05:40

I think where Vital Farms really excels beyond that storytelling is the product itself is far superior. That's what keeps consumers coming back to the brand. Not only is it about storytelling, but you can see the rich golden yolks. You can see how the yolks are much thicker and less runny than some other eggs. You can feel how **the eggshell itself is much stronger,** and you can see now the value you have as a consumer in investing in higher-quality goods. I think it's the tandem of the storytelling, as well as the superior product that keeps consumers coming back.

Expert 00:06:22

When you look at the cost of protein in totality, **eggs themselves are a relatively low-cost source of protein for especially larger growing families.** It's quite a bit more on a per-pound basis to have a steak dinner versus breakfast for dinner for a family of six. I think people can make that trade-off because **protein is important and continues to be one of the leading attributes** that consumers are looking for. **This, in the grand scheme of things, is a lower-cost protein source.**

Analyst 00:07:02

Okay, yeah. That's a great answer. Maybe couple of follow-up questions. What kind of consumers really are buying eggs from Vital Farms? What is the typical profile [inaudible] demographics, for example?

Expert 00:07:17

Yeah, it's going to be a higher-household-income consumer, which typically tends to be a household that's making at least \$75,000 annually because they have the discretionary income to spread their dollars and invest those dollars in higher-quality premium goods. It's going to be a consumer that largely shops at higher-end retailers that may be in the natural channel, like Whole Foods or Sprouts where Vital Farms has a very dominant presence. It also can include mainstream retailers like Target which tends to have a higher-household-income shopper.

Expert 00:07:59

I think the growth that Vital Farms has seen in recent years is in the ability to expand into more mainstream retailers like the Walmarts and the Targets of the world where they can get exposure to broader set of households because I also think that you're seeing that consumers in the last couple of years, especially because they have to be more choiceful about how they spend their dollars in this inflationary environment, they're shopping at more retailers, whereas years ago, they might have done all of their shopping at a Target or at a Whole Foods.

Expert 00:08:35

Now, they may be recognizing the lower prices at a variety of retailers, so you even see some of those higher-household-income consumers shopping at a Walmart because they see the value that they can get and it's essentially the same goods. It's going to be a consumer that's very educated, that sees the value in investing behind pasture-raised.

Expert 00:09:01

The egg category can be incredibly confusing, with cage-free, free-range. It's really hard to know what's the best standard, and is there truly a difference between cage-free and pasture-raised? I think Vital Farms continues to help to educate consumers, but it's going to be those consumers with a college degree that understand the difference and see the value in that.

Expert 00:09:26

I think because of our more educated consumers, they get a lot of their news from sources like NPR, etc., that are going to be continuing to build their knowledge base. These are consumers that are going to be seeking out the latest trends in knowledge who are looking to continuously improve their knowledge base, which also **I think is part of the tension in the consumer landscape** today. There's a lot of information out there, and it's hard to know what's true, what's accurate, what's the best.

Analyst 00:09:59

Okay, yeah. That's perfect. That's a great answer. In 2013, Vital Farms were in 5,000 retail locations. Ten years later, they're in more than 25,000. Do you think they'll be able to maintain this level of growth long term or do you think we will start to see growth flattening or plateauing a bit for a while?

Expert 00:10:26

Yeah, I think **they've seen incredible growth,** now being in over 24,000 grocery retailers. I think from their latest press release, they've shared that they have aspirations to grow into another 8,000 grocery retailers. If you look at grocery retail, there's about 46,000, give or take, retailers. It is a big aspiration. My hunch would be that those next 8,000 retailers are probably going to be less of a perfect fit with the Vital Farms brand and consumer target. While they may be productive, **they're likely to be less** productive than their current retailers.

Expert 00:11:16

That's naturally what happens with any brand. You're going to start with the retailers that are the best fit for your product portfolio and your consumer. As you scale, naturally it becomes less of a fit. That doesn't mean that your target consumer isn't shopping there. There's probably fewer of your consumers that are shopping there. I think it's aspirational. I think there's still opportunity upside for sure, but my question is whether those will be as productive of retailers for the brand.

Analyst 00:11:56

Maybe a bit of a marketing question. I was looking at some market research data, and one thing that consumers really look at when buying eggs is really the packaging. I think it's fair to say that Vital's packaging is really trendy and eye-catching compared to lot of other brands. Do you think this really plays a key role in the consumer's ultimate buying decision or not really? I'm just curious.

Expert 00:12:27

Yes, absolutely. **I think the largest drivers of any brand's success** is going to be mental availability, so how top of mind is the brand, and physical availability, "Can I actually find the product I'm looking for in the stores that I shop?" When you think about mental availability, packaging plays a key role because it's the only marketing vehicle that 100% of your consumers will see. It can be incredibly [inaudible] impactful because it is harder and harder to reach consumers with marketing today, but at shelf, you can always reach them with your packaging.

Expert 00:13:09

Their packaging definitely does stand out. Black generally conveys more premium in the category, and they certainly have a distinctive look and feel with the egg caricatures and things like the Vital Times, the little inserts that's within the eggs itself. Consumers love to collect those, and it makes the brand feel smaller than it perhaps is today because it is a personalized little leaflet that highlights a bird of the month each month. It serves as an educational tool for parents and their kids as well because it usually highlights something about the behind the scenes of the farmers, etc.

Expert 00:13:58

You have seen a lot of brands start to copy the Vital Farms branding. You think about brands like Happy Egg and Nellie's. You're seeing more and more of them use those cute chicken caricatures and brighter colors to stand out at shelf. I think it was incredibly distinctive years ago, especially among a sea of commoditized eggs that were primarily plain cartons, but now that more branded players have entered, **it's less distinctive but still a very strong asset for the brand.**

Analyst 00:14:36

Okay, yeah. That's a great answer. I know we discussed pricing earlier, but **I think one constant criticism of Vital Farms** is that **their pricing model is not sustainable long term.** I know obviously, **you discussed the impact of inflation and macroeconomics.** Maybe really long term, do you think that the pricing model is sustainable, especially that now there are more market entrants or not really? How do you look at that essentially?

Expert 00:15:17

Yeah, I think consumers will continue to have a higher willingness to pay for the pasture-raised credentials. The question is what is the limit to that price point? I don't know what that limit is and how much upward range the brand has. **I think the benefit that Vital Farms has is that they are less impacted by external environmental factors like avian influenza because of their pasture-raising model because the birds do have much more space and are not clustered in a farm like more traditional cage-free environment, and so they've been less impacted by things like that** that have caused commoditized egg prices to raise in the past.

Expert 00:16:18

I do think they have that insulation, but there is going to reach a limit of what consumers are willing to pay. It is possible as more retailers offer their own private-label pasture-raised eggs that you could potentially see consumers start to trade down because they see the same standard for a dollar or two less from a retailer brand.

Analyst 00:16:49

Okay, yeah. That's a great answer. Obviously, you mentioned earlier the whole storytelling aspect of Vital Farms' business. How hard or how easy is it to replicate this sort of narrative and all the marketing and branding that comes with it?

Expert 00:17:10

I think Vital Farms has done a fantastic job of building a moat around their brand, and a moat is something that is hard to cross because you need to not only talk the talk, but walk the walk, and so you can't fake a direct relationship with the farmers, like the traceability program that Vital Farms launched a couple of years ago, where on every single carton of eggs, it lists the actual farm where those eggs were sourced from, and you can actually go on their website to see a feed of that actual farm. That's incredibly hard to replicate because that takes a direct relationship with all of the farmers.

Expert 00:18:05

Vital Farms has a pretty broad network of farmers. I believe it's 200 or 300 small family farms that they partner with, so you can imagine just the time, commitment it would take to install cameras at each of those farms and get buy-in from the farmers to make that installation and to build the website infrastructure to feature that and to make sure that you having the tracking capabilities to

guarantee that the eggs in that carton came from that farm. There is much more of a consumer desire to see where their food comes from.

Expert 00:18:42

I think Vital Farms excels at not only telling, but showing you what they're doing. I think there's a lot of small activations like that. They have an incredible social media community and following as well. That takes time to build community, especially in an engaged community. You can certainly buy a community by doing lots of giveaways, etc., but are those really quality community members who are invested in your brand?

Expert 00:19:16

I think **the brand has some strong insulation**, given that it takes time to build those organic communities, and those organic communities lead to even greater loyalty because you brought them into the portfolio based upon that storytelling and less so based upon pricing. These are consumers who aren't trying to necessarily save 50¢ or \$1 and are willing to switch. These are consumers that have a higher propensity to walk out the store if Vital Farms is not on shelf.

Analyst 00:19:52

Okay, yeah. That's a great point. That's perfect. Obviously, management at Vital Farms have been obviously open about how they see growth coming from in the future. One part was really getting into more retail locations which we've already discussed. The other part is really to develop new product lines in existing retailers that have the same sort of segmentation or the same sort of vibe, essentially. One of them is butter. Other than that, what opportunities do you see here? I know it's a very broad and vague question, but I'm curious to see how you think about that.

Expert 00:20:47

Yeah. I think what's interesting is that a significant proportion of Vital Farms' revenue is derived from their shell egg business. Butter is still a very small proportion of their business. It has been successful. It's a bit less differentiated. I think that's where they've found challenges is to drive that differentiation. We spoke about how the pasture raising of eggs leads to that higher quality that beautiful golden yolk, that thicker shell, the less runny eggs, so it has a direct product impact.

Expert 00:21:26

I think **they've been challenged to show** that product superiority with a pasture-raised butter, and that's in part why that portfolio hasn't grown as much as I think they had hoped. I know when Vital Farms IPOed, **they spoke of entering and disrupting other commoditized categories**, like a further expansion into dairy and/or poultry. That obviously has not come to fruition as of yet.

Expert 00:21:59

From my vantage point, I think **they will be challenged to become** a billion-dollar brand by 2027 like they've stated that they aspire to without expanding into new categories. I have a hard time connecting the numbers because it would reflect, I think, 30% year-over-year growth, which is pretty significant. We already talked about how those 8,000 new stores that **they're targeting may be less** productive. When I say less productive, I mean lower velocity. Achieving 20 million new households is also **an incredible aspiration**. It's not impossible, but it's a big aspiration without deriving a lot of your revenue from new products.

Expert 00:22:50

It'll be interesting to see if the brand does pursue new categories. Many have seen that **Cooks Ventures just went under in the fall because of a lot of challenges** financially and with management. It is a very complex model, but Vital Farms has shown an ability to build complex models in the past, being one of the first pasture-raised brands in the U.S. They've shown a propensity to do it, but it also takes time.

Analyst 00:23:33

Okay, yeah. That's a great answer. In terms of Vital Farms' structure and commercial capabilities, do you see any major weaknesses or gaps or not really?

Expert 00:23:54

They have a sizable in-house marketing team, as well as in-house creative team, which enables that much more agility. They also have an external agency that they work with for their marketing, but I think that in-house creative capability provides them with a leg up versus other players and being able to react to the market and continue to put organic content out into the marketplace. They've been, I think, building out the team in the last several years and having credible management to know where the gaps reside. I don't see any gaps from a personnel standpoint.

Expert 00:24:48

If they are planning to pursue new categories, there may be additional expertise required because despite the fact that poultry is still chickens, it's a different type of chicken, and there are additional complexities of full-bird utilization. You are not generally

selling the full hen. You are piecemeal-ing it out into the breast and the thighs, and there's a lot of other parts that generally go to the pet food industry. It is significantly more complex than a single staple like eggs.

Analyst 00:25:33

Okay, yeah. That's perfect. You mentioned earlier the requirements that farms need to really have in order to work with Vital Farms, and obviously, they need to really make big up-front investments to meet the company requirements and standards. Do you feel that this could be, at some point, a barrier or a challenge for Vital Farms because **they will struggle with supply or you don't think it's a valid concern** at all?

Expert 00:26:08

I think as long as the value proposition is there, which is Vital Farms' intent to provide these farmers with a livable wage and compensate them for the less productive that their farms would be with a pasture-raised operation versus a commoditized cage-free production because obviously, when you have the requirement of 108 sq. ft. per bird, you can have the same land mass but fewer birds. Vital Farms speaks to compensate farmers for that lower production capability of the land that they have.

Expert 00:26:51

It could be challenging depending upon interest rates in the economic environment for farmers to achieve the capital to start up some of these farms. Many of the farmers that Vital Farms have brought on are doing this for the first time, so there is a significant investment in building out these capabilities, especially knowing pasture-raised had not been the standard and still is not necessarily the standard in the U.S. There are fewer farmers who are already doing that that Vital Farms could build a relationship with.

Expert 00:27:35

I think the other challenge is more broadly, the number of farmers in the U.S. has continued to decline year over year because it is a challenging financial proposition and there are fewer generational farms. I know Vital Farms continues to recruit on that basis. I think with the right lead time, **they can be successful in the right value proposition**, but it's possible. **It could be challenging**, depending upon the ability to secure capital.

Analyst 00:28:20

Okay, yeah. That's a great answer. That's perfect. Great. This is my last question. Given everything we've discussed so far today, how optimistic are you about the future of Vital Farms, both short term but also long term?

Expert 00:28:43

I think **Vital Farms has a lot of upside potential in the future and has proven to demonstrate growth in their existing categories**, specifically shell eggs. I think there is a growing contingency of consumers who are looking behind the tent to see where their food comes from and to desire for a higher quality. Today, the U.S. consumers, on average, spend far less on their food versus other Asian countries **who spend more on their high-quality food and have lower medical expenses**. I think more and more consumers are connecting those dots, that **quality of food is critical to preventing long-term health issues**.

Expert 00:29:41

I think **that's going to continue to be a growing** trend. As I mentioned earlier, Gen Z is very focused on the broader impact of businesses, and they are voting with their dollars for brands that are B Corp that are focused on sustainability. I think **Vital Farms has a lot of tailwinds with some of those macroeconomic trends** that will bode in their favor.

Expert 00:30:09

I question whether they can achieve that billion-dollar aspiration in three years that they've stated just from shell eggs. I think that may be more achievable if Vital Farms does pursue some of those other categories that **they had mentioned in their IPO, but entering those categories also brings with it a lot of risk versus growing the existing portfolio**. I think there's also upside opportunity to spend more on marketing.

Expert 00:30:47

As **I was looking at some of the numbers, its single-digit percentages of net revenue, up in recent years**. Most growth-driven or growth-stage companies that I've seen have been spending 10%-20% of their net revenue on marketing, so I think that could also help to grow their household penetration because **that is another source of growth** that the brand has stated that could help to broaden awareness for pasture-raised eggs.

Expert 00:31:24

I think the fact that pasture-raised is the standard in Europe gives some proof of concept that it could one day be the standard here in the U.S., and there are more and more regulations that are banning commoditized eggs, so regulations are orienting in the favor of Vital Farms as well.