

INDUSTRY OVERVIEW

CEO of a Competitor Believes Pasture Raised Eggs Have Substantial Market Share Growth Ahead

DATE PUBLISHED	INTERVIEW DATE	EXPERT PERSPECTIVE	ANALYST PERSPECTIVE	PRIMARY COMPANIES
05 Aug 2024	29 Jul 2024	Competitor	Investor-Led (Buy-Side)	VITL
OTHER COMPANIES				
CALM	COST	HAPPY EG...	KIRK	EGGLAND'...

Transcript Highlights

- The expert believes shoppers tend to purchase based on category and make brand choices on the shelf.
- The expert thinks **large integrated producers will likely continue to shift to cage-free due to state rule-making, but will not penetrate the premium category** given differences in business models.
- In the expert's opinion, **the premium egg industry is highly competitive and trade promotion** is a key tool for maintaining volume.

Table of Contents

Secular trends in the egg industry.
Types of buyers in the space and the factors they consider before buying eggs.
Extent and power of branding as a way to differentiate.
Possibility for premium eggs to sit beside the likes of Kirkland.
Feed curves and how it affects economics for folks in the premium category.
Brand loyalty and what it is doing with branding.
Premium egg brands operating in the same horizontally integrated or non-vertically integrated manner.
Insulating the egg farmers from all feed-risk, feed prices.
Possibilities for independent egg guys to sign contracts for two suppliers at once.
Views whether the targets set by the egg industry are achievable or not.
Effects of the avian flu to the whole egg industry.
Flocks getting culled due to the avian flu.
Reasons why Cal-Maine is not greatly affected by the avian flu.
Actions taken by the integrated guys in response to the rise of the premium segment.
Eggland's best approach in the egg industry.
Global markets or export opportunities for the egg industry.
Reasons why the egg markets are not an international market today.

Expert Bio

Expert is a Chief Executive Officer at Pete and Gerry's Organics, responsible for day-to-day business operations.

Interview Transcript

Analyst 00:00:00

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 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, please feel free to 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 ▶ 00:00:30

I agree. Yes.

Analyst ▶ 00:00:33

Fantastic. All right. I mentioned in the pregame three topics to go through. Not in any particular order, but just a premium and pasture-raised egg segment, Vital Farms, the only publicly traded company in the sector, and **then general industry issues** of which there are a couple I'm thinking of. To get started, I think what might be interesting given where you sit and the perspective you have would just be any key issues that you're thinking about, high-level, that we might want to circle back to. Things that maybe might not be on my questions list, but might be interesting to come back to after some of the specific topics. Want to delve into.

Expert ▶ 00:01:27

Okay. I'm sure **you've got in your list of questions to touch on avian influenza, the expected impact on that.** We'll get to that. By the way, when you said that Vital's the only publicly traded company in the sector you're excluding Cal-Maine because they're a different animal I assume?

Analyst ▶ 00:01:51

I'd love to hear your thoughts on Cal-Maine and I actually do have some questions on them. I categorized them in my head as not in the premium segment. I'd actually be interested in hearing your thoughts on what the big integrated guys are doing as far as the premium segment.

Expert ▶ 00:02:10

Yeah. Okay. We can touch on that and then we'll probably get to just, **I'll call it, specular either headwinds or tailwinds for premium eggs.**

Analyst ▶ 00:02:22

Would love to hear all about that. Yeah.

Expert ▶ 00:02:24

Just keeping the tide moving in the right direction if you're a premium egg player. We'll talk about some of that stuff as well if that's helpful.

Analyst ▶ 00:02:34

Absolutely. That sounds fantastic. Actually, I think that would be a great place to start. I'd love to hear your thoughts on the secular trends and then I can double-click on things as they coincide with things that I'm thinking about.

Expert ▶ 00:02:50

Yeah. For every investor or private equity firm or whoever out there thinks about investment thesis and whether they want to lean into a category as it's getting traction or before it takes off, and that was certainly the theory here for the investment in this business. I would tell you that now, two years into it, I've been here since August of 2022. **The sense that people had about just the groundswell of interest in premium protein and in premium eggs, we're seeing that really gain speed, gain momentum.** We think there are a couple of things behind those trends.

Expert ▶ 00:03:50

The biggest thing right now, we think, is demographics playing a huge role in the popularity of whether it's the move away from caged animals in states like Massachusetts and California to at a minimum cage-free, in some cases mandatory outdoor access if you're going to go that far. Also, I would say not to course a picture on it, but if you think about there are four primary generations right now, there's Boomers and Gen Xers at one end and then Millennials and Gen Zs at the other. They're about the same size in terms of people, of roughly 150 million of those two buckets, cohorts of two different generational groups.

Expert ▶ 00:04:47

As Boomers and Gen Xers, they grew up eating 99¢ eggs. The eggs were cheap. They were buying by the dozen. There's not really a whole lot to think about. Just like you didn't really think about where your beef or your broiler chicken or your fish came from. The interest coming up from Gen Zs and Millennials, animal welfare and humane animal treatment, and a firmly held belief that one, it's the right thing to do. Two, it results in a better-tasting product and worth paying for. I saw this trend [inaudible] liquor business of basically drinking less but better as premium cocktails etc. took off.

Expert 00:05:42

I'm seeing the same thing now in food. It's especially relevant now when everybody has [inaudible] every time they walk out of the grocery store. The categories that really, I think, can offer a reason to pay up, they're getting the attention. **I think Vital is benefiting from that and we're benefiting from that.** That's certainly one piece. I think the second piece is just when retailers think about driving traffic, which is critical to their growth, same-store sales, all that stuff that they report out on.

Expert 00:06:23

The ones that we see that really get it, they know that consumers know what they paid for basically milk, eggs, and bananas. That's what they remember [inaudible] prices for and they don't really think about much else. Even premium eggs, they'll remember if **they got a good deal or got a harsh deal on premium eggs.** When you look at the retailers we see really driving a lot of shareholder value today, like Costco and Walmart they are two retailers they do a lot of things really well.

Expert 00:06:53

From our perspective, **we think there's some of the best egg retailers** out there. They offer a very good product at a very compelling price and that, among a bunch of other things, drive traffic to their stores. We look at their shareholder returns versus other players out there who tend to want to take high 30s percent to mid-40% margin on the egg section. Their same-store sales is not comping the right way. Third, just general trend around clean ingredients, protein in general, but then clean proteins and clean label that **we think continues to resonate with consumers.** They don't want stuff that they can't pronounce in their stomach.

Expert 00:07:46

There's not really a much simpler ingredient panel than eggs. It's just eggs. You can't really adulterate it. You can't play around with it. You can have organic or conventionally fed, etc. You can do things, we'll talk about this later, that'll enhance the quality of the egg and the way the birds treat access to outdoors and everything. That again, it's noticeable. The consumers who notice have a hard time going back. We're seeing all those trends go in favor of eggs. We think it's only the beginning of that.

Analyst 00:08:28

Yeah. **It's certainly interesting to see the proliferation of these premium egg categories on the grocery shelves in the last few years especially, really exploded.** I'm curious. Let me see where to start. I'd be interested in your thoughts on buyer behavior. Vital has this number out where I think on one of their earnings calls they threw out this number, \$34 is the average spend for our customer.

Analyst 00:09:02

I didn't have a good way to think about how that breaks down. Is it you have this group of hardcore, all their eggs are pasture-raised and then a few trial people? Are there a lot of people that are opportunistically buying it when it's on sale? \$34 is maybe, what, four to six cartons a year at their prices? How do I think about the different buyers of the product today and how will that change?

Expert 00:09:41

Yeah. There's a couple of ways to segment that. One is just in terms of just consumer usage segments. We think about it along two axes basically, how the hen is fed and how she's treated. Feed them either with conventional grains or you can feed them with organic. In terms of treatment, they can either have access to the outdoors or they get no access to the outdoors at all which we create for your cage. Put them to the side.

Expert 00:10:21

When we look at the consumer out there today, we see there's five segments in total. One is very interested in organic because that's their shortcut to, "I know that I'm not going to have pesticides and poisons and everything else in there. I know that the animal was treated well, but I also know that it's going to be the best thing I can put in my body." There's consumers that are hyper-focused on animal welfare. That is, in particular, hen welfare. They probably are people who they'd break for squirrels. They're literally not going to hurt a fly. They believe everything needs to be [inaudible], etc. That's your pasture-raised consumer.

Expert 00:11:07

There's a third group, which we just think about that consumer as a list checker. They want to do everything. They want to feed their family the best they can, stay within a budget. They care about animal welfare. They care about this, they care about that. That tends to be more of a traditional, conventional, free-range consumer. The two others that **we don't worry** about is there's a price the consumer which we don't care about. They're always going to buy the cheapest egg. There's actually a customer who just doesn't care. They just literally will walk up to the section and whatever drops in price, drops in their cart. They just don't care. I can't really do anything.

Expert 00:11:46

Now, within that group, our research shows that roughly 80% of decisions are made at the shelf. The consumer might have eggs on their list. They might say, "If I'm a pasture-raised consumer, I'm going to only buy pasture but which pasture I buy, I'm going to determine that when I get to the shop." It might be on sale, it might be they don't want private label so they're going to do only

branded. The same thing will be for an organic consumer where they're going to go and they're going to look in the organic section. They haven't really decided yet.

Expert 00:12:30

Now, I will tell you that **Vital absolutely has higher brand loyalty than any other branded egg company** out there. They've worked very hard at it. I literally tried to hand a consumer at a shelf. Doesn't happen very often, but I'll hand them a coupon for three dozen eggs if I see them with Vital in their hands. They'll say, "No, thank you. I'll take my Vital." They're that convinced that that's the right brand for them. Now, that's, again, a small number of consumers are that committed to it. A bigger number than would be committed to really any other egg brand out there. Most consumers are going to go out there and they're going to shop it by type of pasture or free-range or organic or price. They're just going to go figure out the best solution for them when they're at the shelf.

Analyst 00:13:32

What do you think is the extent of branding as a way to differentiate? How powerful can it be? Of these consumers that you talked about, how much does discounting matter when they get to the shelf and they think about which one within this category they want to buy?

Expert 00:13:54

Yeah. Again, most consumers, if they're not a price consumer, the discounting will [matter] within their, call it, preference type. Within organic, if they're looking for eggs, they're likely going to buy the organic egg that is the lowest price. Again, they go all the way down to private label organic because they've had an experience with private label that says, "The shells are thin. Yokes don't look too great. Egg didn't really taste like [inaudible]." You can absolutely affect the way the egg tastes and the experience the consumer has with it by the way you're treating the hand-up strength.

Expert 00:14:45

They might just say, "I'm going to buy the best price branded organic egg." Won't be Vital because Vital's pasture organic is among the most expensive stuff on the shelf. It might be [Pete & Gerry], it might be Happy Egg, it might be Farmers Hen House. It's going to depend. When they get to the shelf, they'll say, "Okay. This is my consideration so I'm going to pick that one because I like the price." Again, there are some others who just say, "For whatever reason, I like the branding on a [Pete & Gerry] or on a Happy or certainly on a Vital. Regardless of price, I'm going to pay an extra \$1 or \$2 more because I think it's worth it." They'll do that for sure.

Analyst 00:15:36

Interesting. I think it's really cool that Walmart is carrying Pete & Gerry's, Vital, and some of the other brands. Unless I'm missing something, it doesn't look like it's penetrated clubs. Do you think that eventually the branded eggs will also sit next to Kirkland and things like that?

Expert 00:16:02

Yeah. I don't think they'll sit next to a Kirkland. I think **Kirkland is a very strong brand in and of itself**. Most people who shop, and I'm one of them, understand that "I don't care if it's golf ball or if it's bourbon or if it's eggs." Kirkland has a reputation. **Costco has a reputation of basically getting stuff** that's as good as, if not better than, the branded product at a fraction of the price. They'll do an organic pasture, \$8.99 for 24 count, which is \$4.50 a dozen. You can't even go to Trader Joe's and get organic pasture for \$4.50 a dozen. I think they're \$6.49 a dozen. Even the gas, you go there, their regular gas isn't that much of a discount to Main Street.

Expert 00:17:00

You go to that they're 93 octane and it's down left [inaudible]. It's a very compelling model. I don't know that why they would put it at risk by putting a branded player next to it and giving up some of that volume. Their margins are so thin anyway. It's just a really tough one to make work. I will say that the only club player today that does have branded is [inaudible]. They actually co-brand with us. You'll see Wellsley Farm, Nellie's Free Range, Pete & Gerry's organic and pasture. Sam's will not do it. Costco will not do. Not to say that they'll never do it, [there's] reason for them to do it.

Analyst 00:17:46

Those are interesting insight. You said that **private label in consumers' minds tends to be inferior to the** branded for mass and grocery channel because of the quality in eggs.

Expert 00:18:08

Yeah. In eggs it can be. If you go to those big players, the Cal-Maines, the Rose Acres of the world, there's a lot you can do in terms of not just access to the outdoors, but also if you think about the way a hen is fed, whether they get outdoors or not, they're given a diet that is primarily corn and soybean meal. By the way, 50% of the cost of a dozen eggs could be the grain that you're feeding the hen to produce that egg. It's an important piece. If you look at the economics of a ration of feed, about 1/3 of the cost, not 1/3 of the volume, but 1/3 of the cost is what they call ingredient packet or a nutrition packet.

Expert 00:19:13

Depending on what you put in that, whether it's magnesium or calcium or all the vitamins that the hen needs to lay a better egg, to make a thicker shell, to have a yolk that's more intact or stands more proud, the age of the bird. How old is the bird during its [top-laying]? If you drive them too far, you can get thinner shells. You'll get lower-quality egg in the process. There are definitely things you can do that cost money. There are things that you can do to improve the experience with the consumer with that egg.

Analyst 00:19:55

Since you mentioned feed, it was one of my questions. If you look at the future's curve for grains, obviously, it shows quite some improvement from a feed cost perspective. Pretty far out. How does that feed through to economics for folks in the premium category?

Expert 00:20:20

Yeah. Our four biggest cost levers or cost items are one is feed. The second is trade spend. We can talk about that in a little bit if you'd like, but just how much you're counting or what your plan is with your different retailers on various weeks. The third is diesel because these eggs have to be driven from the farm and then delivered from the processing facility. The fourth is labor, do all that work. Once it's past that, packaging isn't all that much. Certainly, it's not a high-overhead business. It's not super expensive factories that you have to build to process fairly straightforward grading lines. Those are your big inputs.

Expert 00:21:13

Grain right now, you're right, the curves are favorable for us. They've, really just in the last year, gotten favorable. They were very unfavorable for a while. I'm by no means a grain expert, but my experience on commodities is they tend to follow, depending on the commodity, real global stock. Barring any sort of a global stock, which in the case of premium eggs was when Russia invaded Ukraine and they basically took the world's breadbasket out of commission. Like anything else, you got to plant the season before in order to make up for shortfall.

Expert 00:22:04

For a year there, grain was very expensive. It more than doubled. That plus the fact that diesel spiked and we had big labor inflation, those are the reasons why the premium egg companies ended up taking price like a lot of other players did over the course of the end of 2022-2023. Commodity egg play, while feed is important for them, they are hyper-efficient. Feed doesn't really matter because everything is in line. It's all laid in the facility and then processed and packaged and never leaves the building until it's a finished product. The reason that their price went from \$2 a dozen to \$5 or \$6 was purely or almost exclusively avian influenza.

Expert 00:22:59

When there were 50 million birds were put down in 2022 and there were about 25 million over the course of 2023 and 2024 this year, so about half as many, but still a meaningful number of birds out of a population of about 320 million were taken out. When that happens, commodity egg prices will absolutely spike. The gap between them and branded players, it shrinks or sometimes it goes away altogether and branded could be even proven commodity. In that period of time, they went from, say, \$2 like I said, to \$5 or \$6. We went up about 15%-18% as did viable, but it was purely to cover our input costs. It wasn't anything else.

Expert 00:23:48

We obviously know the benefit of taking volume out. You can't shrink our product. It's a price increase. You can't take one egg out of the package and charge the same amount. People won't go for that. We don't have that lever, which a lot of other consumer packaged goods did. Ours was straight 18% and it made up for that grain spike plus all the other input spikes. Now, your next question is going to be, "Well, now the grain has come back down. What do you do?"

Expert 00:24:21

What we do is we end up spending it back on more trade because it goes back to being a very competitive market again, where you have to be on promotion to remain relevant with the consumer and the retailer to support the brand. Our margins are better now as are Vital's. I know Vital's are a lot better now partly because of that cost input benefit. There's also a lot more being spent in other parts of the business.

Analyst 00:24:54

I want to come back to that topic because that's pretty fascinating. On the topic of pricing, everywhere I look, Vital has a premium pricing and of Pete & Gerry's and a lot of the other branded names. Do you think that can persist just given what you mentioned about the brand loyalty and what they're doing with branding?

Expert 00:25:19

Yeah. I think it will continue, but it will narrow the [inaudible]. When we entered the pasture-raised space with Pete & Gerry's pasture, which was in March of 2023, Vital's average selling price was about \$7.50, \$7.55, I think a dozen. They are now at \$7.09. Sell stuff you can get out of Nielsen, but we came at about \$7.49 when they were usually at \$7.89, \$7.99. We wanted to be 50¢ below

them. As we have promoted more, average price has come down. Our prices come down. They've had to promote more in their price down.

Expert 00:26:28

Now, that hasn't been the case for organic pasture because there's really no competition there today. They're not going to touch Costco, the example I gave you before. They don't look at that as competition. There's no other big branded organic pasture players in the space today. That doesn't seem to be the case in the future but right now, they're enjoying that. I would imagine like everything else, when competition comes, you have to respond or you'll get lapped.

Analyst 00:27:07

Do all the premium egg brands operate in a similar, I don't know what the right term is, horizontally integrated or non-vertically integrated manner primarily?

Expert 00:27:23

Meaning some...

Analyst 00:27:27

Yeah. In terms of sourcing from independents.

Expert 00:27:33

Yeah. **Our model and Vital's model are similar a little, but just with a slight nuance.** We both contract with independent farmers. We don't own the farm. We process the eggs, package them, sell them into the marketplace. One is we have three processing facilities, Vital has one. They say that they're going to build the second one. The second is Vital sources out of what they call the pasture belt, which goes from Missouri and Arkansas over into Tennessee and Kentucky where we source because we have organic, free-range, conventional free-range and pasture. We source from that area, but we also source from basically Oklahoma to Maine and then over to Georgia and all the way up to Wisconsin for our farms.

Expert 00:28:38

It's a more dispersed farmer network. The third difference is how we end up treating our farmers from a feed and a risk perspective. **For our direct farmers, we will tend to take the grain risk from them and the bird risks.** We will supply the birds. We will supply the grain and we're just paying them for the rate to literally collect the eggs every day on [class]. We pick them up and off they go. It's a simpler model. Vital's, they have to make their own grain choices. They do this, they do that. It's a little bit different model. It's a little more, I'd say, fair for the farmer themselves.

Analyst 00:29:28

Right. Their model, I think they mentioned that they do a price adjustment periodically for the feed commodities. Does that average out to be something similar to what you do, where you insulate the farmers from all feed-risk, feed prices, or do you think that it leaves them more at risk than your model?

Expert 00:29:57

Yeah. I think it might be a difference without a distinction, however you say it. I don't know it intimately, but as I understand their model, the farmer really just returns or turns in a receipt or an invoice for their grain. If they have that arrangement, Vital will refund. They'll just refund them for that invoice. That's different because you're not getting any scale economies for buying your grain.

Expert 00:30:38

The reason that processing facilities are located pretty close to the farms and the farms are located pretty close to the grain is because **it's a whole lot cheaper to transport finished eggs** than it is to transport grain. If you ship grain far, then the basis in it is it can run significantly. I don't think there's any control outside of Vital as to where the farmer buys the grain. They can be buying grain from 300 mi away and Vital's going to pay the bill. That's the part that I think I understand, but I haven't actually seen it in action out with the farmer.

Analyst 00:31:21

Related question, for the independent egg guys. Do they sign exclusive contracts or can they be both supplying somebody like a Pete & Gerry's and Vital at the same time?

Expert 00:31:31

No. Not that I'm aware of. I don't believe that there are farmers out there that do both. I know none of our farmers are allowed to service folks.

Analyst 00:31:49

Okay. Interesting. Let's see. Here's one. You might have seen their numbers out there. \$1 billion in revenue by 2027, 35% gross margins, 12%-14% EBITDA margin as being achievable. What do you think about those targets to the extent you have any reaction?

Expert 00:32:13

Yeah. As I understand it, they are going to do that on just shell egg. They're not contemplating entering another category. If you start with what is the available market for eggs in total, it's about \$3 billion and about \$9 billion in revenue at retail for the U.S. shell egg market. What's happened over time is that \$3 billion hasn't gone up. Matter of fact, **per capita egg consumption is [inaudible] are slightly down** but the mix of who's buying. I

Expert 00:33:06

That's shifting. Caged used to be about 80% of the total. Now, it's down to about 60%. Cage-free is about 1/4 of it and the remainder 13% is free-range and pasture-raised. We think that will continue to shift in favor of a bigger portion of premium. We think cage will be, say, 50% of the total in a few years time. Which means today pasture-raised and free-range are 13% of \$9 billion, which is something like, I don't know, \$1.2 billion or something, \$1.3 billion in total revenue. If cage goes to 50%, my guess is that free-range and pasture-raised will be the big winners there. **They're growing faster than the other two segments.**

Expert 00:34:07

If caged gives up another 10% percentage points and free-range and pasture-raised is now 25% of that \$9 billion, now you're talking about \$2.5 billion total market that you can go after. All that is background. Could Vital be 40% of the premium market today? If free-range and pasture-raised is \$1.2 billion today and they're doing \$500 million of revenue, they're tracking at about, what is that, 40%, 45%. I don't see why they wouldn't maintain that fair although we're coming after the pastures. It may give some of that up. The billion-dollar number, it's achievable.

Expert 00:34:59

The gross margin number, there are some things going on right now if they want to continue to grow that quickly. I think they're about \$5 a dozen if they're about 100 million dozen on \$500 million of revenue. If they're still \$5 a dozen, that means they're going to double revenue. They're going to have to double their volume which means double their number of farm if you're not going to build mega-farms. Today there are 300+ family farms. They don't have to find another 300 farms. That's three cycles between now and 2027. That's 100 farms here. That's a lot which means you probably have to [inaudible].

Expert 00:35:42

We're seeing **the cost to bring a pasture-raised farmer go up** so that the cost per dozen, you pay them to get them to do your eggs versus somebody else's is going up. The capital that you give them upfront is going up. The price that you're going to be able to get for those eggs, **we think there will continue to be just competitive pressure from anybody** else. When you win the Super Bowl the hardest thing to do the next year is to win it again because everyone's trying to knock you off the podium. Everyone's coming after Vital. **They have competition from a lot of different places.** It doesn't mean they won't do well.

Expert 00:36:25

I think they're going to have to spend money to do that, which **I think will put pressure on their margins.** Whether they can maintain or they end up dropping to 30%, I don't know. I actually think that probably the safest number on there, if they can get the revenue, is going to be their EBITDA because they spent a lot of money in marketing. Their actual numbers in total are big. They can always go back in there and scale. **You get the scale benefits.** They don't add a lot of headcount to grow that. They'll go ahead and lever their FTNAs, their fixed costs.

Expert 00:37:13

Their marketing, they could always curtail that, protect that EBITDA number at the bottom line. If there's one number and probably the most at risk, it would be that gross margin number of 35%. My old company is public now. That's a process called premium salty snack manufacturers, but not as premium as Doritos or [Frito]. **They're pretty [inaudible] and struggled** to maintain 35% gross margins but they have a DSD network. My point is mid to high 30s percent on consumer goods is pretty typical. These guys are basically that close to the farm product with really very few levers to differentiate. They're going to be demanding industry-average to better-than-average margins at the gross level, **which is going to be tough to build.**

Analyst 00:38:16

Okay. Yeah. Very insightful. Let's see. This might be a good point to switch over to the HPAI issue, avian flu, love to hear your thoughts on what it means for the egg category as a whole and then also for premium category. **We certainly solve the spread between premium and commodity eggs really close and be a significant tailwind over the last few years.** Curious what happens now and in fact, even what **you're thinking about with regard to these new fears of avian to mammal transmission and attainment.**

Expert ▶ 00:39:06

Yeah. I think a couple things. First of all, I think it's here to stay. I think the last time it was here with any meaningful presence was 2015, 2016. It went away for a while. Now it's been here. I've been with the business for two years and it's been here for two years, two different cycles. The second cycle was different from the first cycle. To behave is it would be transmitted, and then usually the summer heat would kill the virus and you wouldn't see it pop-up anymore. It was literally a phase that wasn't identified yesterday. I think they might have been wildfowl, I don't know if they tested them or whatever, but in Florida, they found positive avian influenza.

Expert ▶ 00:40:03

This thing is definitely mutating. You could ask, "Well, why isn't there a vaccine for the birds?" The reason there's not a vaccine for the birds is the broiler industry in this country is bigger than the egg industry. In order for it to work, you have to vaccinate all the chickens. You can't just vaccinate layers versus broilers. If you vaccinate a broiler, it's going to trigger an AI. A lot of this meat is exported. It will trigger AI at the border and **that'll kill their business**. I don't think it's going to be any vaccine anytime soon.

Expert ▶ 00:40:49

The fact that it's now mutating to be able to be spread from bird to mammal, and there have been a couple of, I think, four human cases. Nobody's died from it or maybe one person did die from it. One person did die, but they were quite compromised. There has not been a rash of deaths since then. The fact that it's getting to that level, I think you're going to see a lot more, call it, lab attention to figure out how we can keep this thing from spreading. Are there mRNA vaccines or something else that you can give into other animals in order to limit the spread? That's what we're seeing from that perspective.

Expert ▶ 00:41:43

In an unusual way, I certainly wouldn't wish it on anybody. **We've had one of our barns hit by it in 2022**. It was devastating small 16,000 organic pullets. It was very hard to see but you had to just euthanize the whole barn. I wouldn't wish it on anybody. I will also say that given our supply chain and how geographically dispersed it is and the fact that we don't have any farms with more than 20,000 birds on it, and we have over 5 million birds, that **our supply chain is not at risk of the hits** that could knock out 5 million birds. It's difficult to do.

Expert ▶ 00:42:35

It actually improves the economics for the premium players because of what we talked about a few minutes ago, which is when there's no gap to be blindfolded, but if you taste-tested 10 consumers or 100 consumers on a regular cage white egg versus a premium, I would bet you eight out of 10 of them can tell the difference and would choose the premium egg. They just don't want to pay for it. Some do, some don't. When the price gap goes away, they're going to pick our eggs. They're going to pick whatever eggs are on the shelf actually.

Expert ▶ 00:43:16

If you're in supply and your competitor isn't because they were wiped out, you're going to sell more eggs. We actually don't have much when avian influenza has that impact on conventional eggs as well. You can't keep in stock as it is, so why pour trade dollars on it to make it even harder to keep in stock? Exactly for a period of time, it's not horrible for the economics on the business. I just think **it's not great for the farmers, and the people end up having to lose their flocks**.

Analyst ▶ 00:43:57

Yeah. It's really quite tragic. Do you have any sense what would happen? CDC's getting involved now on top of the FDA. This go around with AI seems to be not following the regular seasonal pattern with bird migrations, and surviving the summer here in the U.S. They're doing better in Europe, I'm not sure. Maybe you don't want to speculate or I'm happy if you would, but does it lead to more flocks getting culled this time? Does **it result in a slower comeback of repopulation**? Could we see this just getting to be a very different avian flu, or pandemic's the right word, but [spelled] in the past?

Expert ▶ 00:45:00

I will say that there is an absolute rush right now to repopulate flocks and replenish birds. Where that all starts is you can't get birds out of a hatchery right now for months if you hadn't pre-reserved them. It's a race to get the birds on because the price people are getting for eggs right now is pretty darn good. Not as good as it was a year and a half ago. Especially the cage-free eggs, there's a lot of cage-free capacity.

Expert ▶ 00:45:49

At the beginning of the year, organic came out. A lot of organic flocks were hit and then it became a lot of cage-free flocks that were hit. That affects just about anybody out there who's using cage-free eggs or not. If you are, you're getting paid very well for your cage-free eggs if you happen to have some supply. People are rushing to populate that so they can cash on this before the market drops out again. It's the classic [inaudible] cycle. No different this time.

Analyst 00:46:29

This is a good segue to maybe Cal-Maine and the big integrated guys. Maybe just on the AI issue, Cal-Maine always seems to just get this massive tale when every time there is an avian flu upsurge. I'm curious, is there something about their sourcing, where their farms are located, the diversity of their farms that allows them to capture this benefit where **they don't get disproportionately hit by AI culling versus the price benefit** that they get?

Expert 00:47:13

Yeah. I think there's a couple of things. They're very good options. They are the 800-pound gorilla in the space. Vital were pretty big and influential on the premium side. Those guys are scale-wise, 10X bigger, just the number of birds and everything else. I think the reason **they got a tailwind** is, I think, at least twofold. One is I believe that even though they have massive cage facilities and massive [inaudible] facilities and campuses with hundreds of thousands of birds, millions of birds on them, basically, **their hygiene practices are very good.**

Expert 00:48:12

They are washing their trucks. They're not allowing people on the farms or into the barns that don't have to be in there. The ones that do go in there, there's a lot of [inaudible] that's going around for them which we do as well. That's the reason, touch wood, we haven't gotten hit very hard, nor has Vital. Other players that are just not as careful, I think **some Rose Acres Farms got hit.** I think, by the way, one or two Cal-Maine facilities did get hit this time around but still, as a percentage of total, not devastating. I think they're just very careful.

Expert 00:48:55

There are others that are not as careful. I think the other reason is they're just so darn big that if the market moves up a nickel, a dime to 25¢ a dozen X all the dozens that they sell, **it's pretty impressive.** Fifty million birds will lay over \$1 billion dozen eggs in a year. If prices improve by a dime for them, that's \$100 million swing. I think that even if they do get hit, they're so big that **their size and their ability to tap into the improved economics** works anything else.

Analyst 00:49:51

What are the integrated guys doing in response to the rise of the premium segment? I know there's been a move toward CapEx investment for cage-free for them. Do you think they get more into premium? Do you think they keep investing in cage-free? What do you think? What are you seeing as their future path?

Expert 00:50:17

Yeah. I think cage-free is where they're likely to go, especially because California's 40 million people. They'll eat a lot of eggs. I don't know how many people are in [Massachusetts], probably 10 million, 12 million. It's a big state. When you look at the ones that are coming, Colorado, Washington State, New Mexico, I think Arizona, Michigan, there's some big states coming that are going to outlaw cage. They're not going to outlaw cage-free.

Expert 00:50:48

Our business model is so different. I don't think they could pivot and just adopt our business model. Meaning fowl family farms which are by nature less efficient transporting eggs, a truck at a time, back from farms from one location, it's just so different for them, even Egglard's Best if you know how Egglard's Best is set up. They are a franchise operator. You did franchise territories to northeast, Mid-Atlantic, southwest, wherever. Usually, one of the big commodity players will buy the franchise and distribute the eggs on their own when they deliver to their retailers.

Expert 00:51:43

We've actually seen **their share for premium eggs continue to decline.** I don't know why. I don't know if consumers aren't buying what they're selling. I don't know what it is, but they're not benefiting from the premium upsurge that we are. Vital is and Happy and others. Again, I can't tell you why that hasn't really worked for them. What do they do going forward? Again, I think they continue to bank on the fact that a lot of consumers believe cage-free and free-range are the same thing. We're trying to disabuse consumers of that notion that they are different, that cage-free birds don't get outside and that's not really great for the bird. That [inaudible] will be between us and the bigger guys.

Analyst 00:52:56

Interesting. Just out of curiosity, does Egglard's promote their pasture under a different brand or how do they approach that segment?

Expert 00:53:10

Are you talking about Egglard's?

Analyst 00:53:12

Yeah. I don't know that much about their model. I'm just curious. You definitely pointed out that they're not really getting traction, but I'm curious how they approach this market.

Expert 00:53:26

Yeah. They have a cage-free. They have organic. They have pasture-raised. They have free-range. They got it all but they will continue to, I'll call it, bang along on their bread and butter eggs, which is they call it classic. They're caged eggs. That's what their business model is. Again, regardless of which region you're in or which territory who has it, everybody who sells this is going to have a comparable offering.

Analyst 00:54:15

Right. All right. We're about toward the end of our hour. It's been an absolutely fascinating and insightful conversation for me. Any parting thoughts on anything we talked about?

Expert 00:54:28

I don't know. We didn't talk much about why this is not a global market or will export markets ever open up to, say, a Vital. I'm not sure if that's of interest to you. Interestingly, next month, in September, there is a global egg conference. All the egg players will be together. That is, by the way, where I'll probably get an update on how AI is doing in other markets.

Expert 00:55:05

To me, it's interesting that every experts where I've been to, that everybody gets together globally, but it is not a global business because very few people are shipping eggs overseas. It's not just because of the transport. It's high potential for breakage, but it's a very local business. It's global business that's very local. One of the things that we didn't really talk about is something called in-ovo sexing. Are you familiar with that?

Analyst 00:55:35

I am not. No.

Expert 00:55:37

Okay. That's a potential trend in the industry that might be a point of differentiation for players. Genealogy and genetics are what they are. About 50% of the eggs that are laid by layer hens are male. A male egg isn't worth much if you're trying to raise that bird to lay eggs. Those birds typically and usually, you can't tell. The easiest way to tell is to let them hatch. The [inaudible] male. **I think it's a very cruel part of the industry.** Really, you'd have roosters running around all over the place if you let them live. It's actually technology in place right now where you can determine before the bird is hatched whether it's a male or a female.

Expert 00:56:35

If it's a male, it gets destroyed ahead of time before at least it's able to hatch. There's something that you might [inaudible]. There's a brand out there that will buy eggs from hatcheries that use that technology. **The real question is, over the next few years, we're getting pressure from different groups** to demand that upstream of our hatcheries. It's more expensive. A lot more expensive and whether the consumer will really pay for it, we'll have to do some work on it. Probably the only chicken or hen trend that we didn't really touch on is something that's a factor, and we're just not sure which way it's going to go.

Analyst 00:57:25

Yeah. That is fascinating. I understand the issues there. When you said the word it was like, "Oh, that's an interesting direction for things to go." Real quick, is there a quick answer to why the egg markets are not an international market today? I should let you go.

Expert 00:57:46

Yeah. I don't think there's a quick answer. I think it's basically because there's not that many barriers to entry to do it at a local level. The cost to move the product, **I think, is probably a whole lot higher** than basically having your own [inaudible].