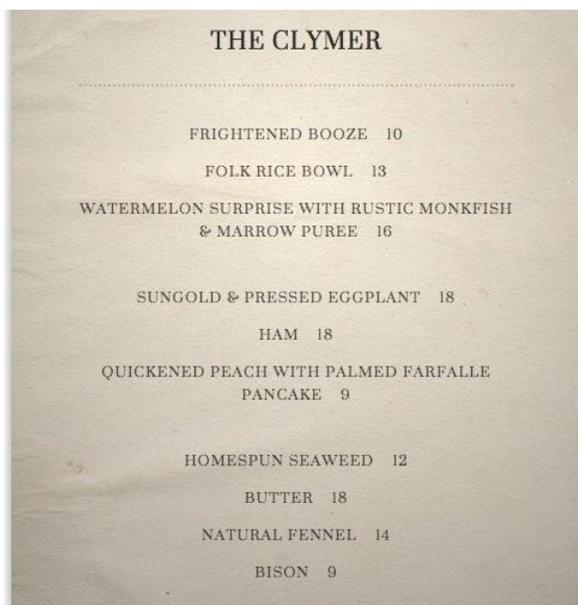


Millennials' Health & Wellness Tastes

Eating: Pretty much the only thing your phone can't do for you ... yet.

EDGE is an independent financial firm whose objective advice helps individuals and institutions realize their goals in the areas of investment management and corporate finance. The Edge Research Team's thoughtful and timely reports are based on extensive independent research and analysis of firms, financial developments and macroeconomic trends.

Have you been to the grocery store lately? Do the items on the shelves seem to be part of some large, elaborate hoax? How many times do you see the terms "organic," "locally sourced" and "all-natural" as you walk through the aisles? What about that hip new restaurant that just opened up downtown? Does the menu seem to read more like a Dr. Seuss book than a list of edible food items? What exactly is the difference between a farm-to-table tomato and a regular one? If you have had any of these thoughts recently, you are certainly not alone. Consumer tastes in restaurants and food in general are changing, and supermarkets and restaurants have begun changing in order to reflect these trends.



Example of increasingly common "artisan" restaurant menu.



Whole Foods Market perhaps taking the "local" trend a step too far.

While of course any new trend will be taken to its extreme in search of the boundaries, there is certainly a case to be made that the growing demand for artisan, organic and locally grown products is here to stay.

Every investor knows that consumer tastes can change extremely rapidly, and that businesses not only have to react to these changes but anticipate them if they wish to survive in an increasingly competitive marketplace. From CEOs to investment professionals, there has been a lot of talk recently regarding the transition from the baby boomer and Generation X consumers to the



EDGE Capital Partners
1380 W. Paces Ferry Road
Suite 1000
Atlanta, GA 30327
404.890.7707

AUTHOR

Stuart Huston

RESEARCH TEAM

Whit Davis
Stephen Halkos
Howell Hollis
Stuart Huston
Harry Jones
Brendan Keelan
Elizabeth Mackie, CPA
Jacobi Padgett
Dennis Sabo, CFA
Will Skeeane, CFA

Millennials' Health & Wellness Tastes

Eating: Pretty much the only thing your phone can't do for you ... yet.

millennials. While the effects of this transition have been seen throughout the entire economy, one sector in particular has shifted more drastically than others, thanks to the new-found purchasing power of millennials.

The health and wellness sector of the economy, one that is more notorious for fads than even your teenage music tastes, has potentially experienced a long-lasting psychological shift in its consumer base. The rise of Whole Foods, Trader Joe's, Sprouts and Kroger's Simple Truth brand solidifies the existence of this shift. Millennial consumers are undoubtedly more health conscious in terms of what and where they eat than prior generations. Is this newfound health consciousness a knee-jerk reaction to an older generation that fueled double-digit fast food and cola sales growth? Or perhaps it is a product of this generation's data revolution as millennials seek to understand all the ingredients in their food and analyze which ones are best for them. Whatever the cause, the facts are undeniable that millennials are shaping the health and wellness industry in a number of ways.

Naturals & Organics

When discussing the changes brought about by millennials' health and wellness tastes, the first thing that comes to mind is the constantly growing popularity of organic products. Organic agriculture, as defined by the USDA, produces crops using methods that preserve the environment and avoid most synthetic materials, such as pesticides and antibiotics. The produce that is grown in compliance with the USDA's definition of organic agriculture has fueled a revolution that is gaining more traction by the day. According to the Organic Trade Association, organic food sales increased from **\$3.6 billion** in **1997** to **over \$39 billion** in **2014**. Figure 1 shows the double-digit sales growth that has taken place during the coming of age of the millennial generation.

This sort of extreme sales growth clearly shows an increasing demand among consumers. The question to answer then becomes: which suppliers are taking advantage this growing demand and how? The first suppliers that come to mind when thinking about natural and organic (N&O) goods are the "natural supermarkets" like Whole Foods Market, Trader Joe's and Sprouts. In

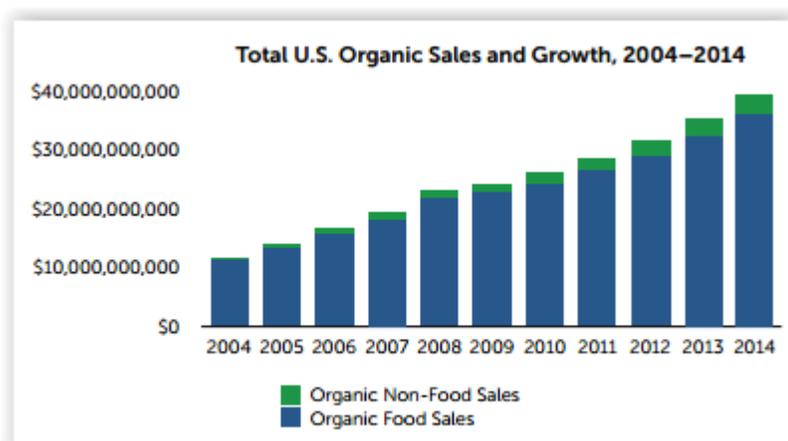


Figure 1 (source: Organic Trade Association)

Millennials' Health & Wellness Tastes

Eating: Pretty much the only thing your phone can't do for you ... yet.



Figure 2 (source: Sprouts Farmers Market Investor Deck May 2015)

aggregate these supermarkets represent over \$238 billion in sales and more than 1,400 locations. In the past decade these companies have experienced extremely rapid sales growth. Figure 2 shows the growth rate of Sprouts Farmers Market (NYSE:SFM) since 2008. During this period SFM's adjusted revenue increased to roughly \$3 billion. During that same time period, Whole Foods Market (NYSE:WFM), which was already a well-established company by 2008, experienced adjusted revenue growth of \$7 billion. In fact, in comparison to more traditional multi-outlet retailers such as Walmart and Target, natural retailers have vastly outperformed. Total channel sales growth among natural retailers was 11x stronger than that of conventional retailers during 2014. The same trend can also clearly be seen in unit growth and same

store sales growth (figure 3). These natural supermarkets have done an extremely good job of supplying this rapidly growing demand for N&O items. Perhaps more important, however, not only have these companies supplied the goods that satisfy the transitioning tastes, but they have created a strong value proposition that appeals to millennials: They offer brands that can be trusted. Consumers trust that the products in these natural supermarkets have been vetted and tested and held to a certain standard. This trust allows shoppers to experiment and try different products that they might not at a traditional retailer. This idea of experimentation and reaching outside of your comfort zone is one that has often been associated with the millennial generation. The combination of stocking the correct products and understanding the values of the generation has helped these retailers maintain impressive growth.



Figure 3 (source: SPINS Trend Watch)

While natural retailers have done a good job of catering to millennials' tastes, they may not have a worry-free path ahead. As the N&O market has matured, we have seen a response from the larger suppliers in the space. Recently Whole Foods and other specialty grocers have experienced sales growth declines as larger, more conventional outlets attempt to regain lost market share in the N&O market. A recent study conducted by SPINS Trend Watch (figure 4) reported that among conventional multi-outlets, including traditional grocers like Kroger and Walmart, there has been a huge transition toward N&O products. In 2013 and 2014, the N&O segments experienced double-digit sales growth while conventional products experienced low single-digit sales growth

Millennials' Health & Wellness Tastes

Eating: Pretty much the only thing your phone can't do for you ... yet.



Figure 4 (source: SPINS Trend Watch)

in 2013 and flat to negative sales growth in 2014. As Kroger expands its N&O shelf space and attempts to gain market share from the natural grocers, we have seen the P/E (price to earnings) ratios begin to converge. Since Kroger's release of its Simple Truth brand in 2012, we have seen Kroger's P/E ratio increase from 12 to 15, and during that same period have seen Whole Foods' P/E ratio decrease from 35 to 18. Many factors contribute to the convergence of valuations, but we believe the recapture of market share in the N&O segment by traditional grocers is a driving factor.

One clear example of a larger conventional multi-outlet running full speed into this space is Kroger with its Simple Truth and Simple Truth Organic brands. These brands have had double-digit year-over-year sales growth since their launch in September 2012. Kroger reported that sales for the brands in 2015 were over

\$1.5 billion, and in October 2015 Kroger stated that natural and organic products as a category accounted for more than \$11 billion in sales over the past 12 months, about 10% of its business. The category's growth will encourage competition in the N&O space from larger players in the future. Millennials will have to decide whether brand loyalty and trust can continue to outweigh the lower costs provided by the large retailers and their purchasing power. Regardless of the outcome, we can clearly see how millennials' values and desire for healthy, fresh and organic food are reshaping the grocery industry.

As millennials' purchasing power increases, grocers, retailers and manufacturers in general will need to make strong efforts to understand and connect with the needs and values of this generation. By doing so, companies will give themselves the best chances of staying dynamic and shifting their products and brands in ways that will help them maintain and capture market share. We recognize that consumer behavior and purchasing habits are not static but change over time as each new generation defines value in a new way. These shifts create investment opportunities for new companies and industries to emerge and warrant the broader attention of the investment community and entrepreneurs alike.

This material represents the views of Edge Advisors, LLC. This information is provided to discuss general market activity, industry or sector trends, or other broad-based economic, market or political conditions. This information should not be construed as research or investment advice, and investors are urged to consult with their financial advisors before buying or selling any securities. This information may not be current, and Edge Advisors, LLC, has no obligation to provide any updates or changes to such information. This material contains forward-looking projections, and there is no assurance that these projections will prove correct. Past performance is no guarantee of future results.