Healthy Lifestyles

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2015 Natural Food Survey: Shifting Consumer Trends and Lessened Brand Importance Are Evident

- **Our survey of 600+ consumers indicated the movement towards better-for-you natural organic products remains robust.** Retailers and manufacturers in the natural food landscape have faced volatility as investors have attempted to navigate concerns including both category and competition growth. Despite increasingly tough comparisons, our online survey of over 600 consumers continues to indicate strong overall trends for natural/organic food consumption, with over 45% of consumers increasing consumption rates y/y and ~78% of total consumers purchasing natural/organic items over the last twelve months.

- **Responses suggest price is important, but *not* the only driver of consumer preferences...** Across all age groups, price broadly was a notable consideration when selecting products and grocers, but consumers cited health benefits and availability as the two other key drivers of changing purchase patterns for natural/organic foods of late. When asked to rank attributes, respondents ranked quality *ahead* of price in a 1-5 ranking, followed by selection, availability, and store attributes. We believe this suggests an ongoing shift of consumer preferences towards a willingness to dedicate a higher portion of income to quality food and beverages. Further, when asking just consumers that shop at WFM and SFM, quality was more important and price was less important, compared to the results for the overall population.

- **… but remains an impediment.** That said, when asking why consumers *don't* buy more natural/organic products, just over half of respondents cited price versus other options such as availability, routine, health benefits, etc. Furthermore, when asked more directly how important price is when buying natural/organic products versus buying traditional products, roughly 40% of respondents cited more important (~30% less, ~28% indifferent). To us, this contradiction between stated purchase catalysts and actual changes in behavior shows consumers always have price at top of mind but may be more affected by availability and quality of items, each of which have accelerated through competitive activity.

- **Consumers acutely aware of store changes; now basing shopping patterns on multiple factors.** Just under half of respondents noted some form of new store openings in their close proximity within the last twelve months, including ~19% citing specialty grocer openings. This more than outweighs ~10% of respondents that noted *closings*. Furthermore, consumers noting a *change* in shopping habits actually cited quality most often as the key driver (~28%), followed by availability (25%), rather than price (16%) or selection (19%) as the reason for recent changes to shopping habits. Looking at these points together, we remain concerned at this level of store openings versus closures is unsustainable and believe consumers will continue to migrate from specialty grocers without distinct selection/experience advantages towards traditional/mass/club retailers who continue to add natural/organic space.

- **Continued preference for manufacturers maintained, but brand-ownership-agnostic consumers are concerning.** Nearly 60% of surveyed consumers were agnostic to the owner of a brand. In our opinion, this further validates the structural threat posed by the increasing amount of natural/organic private label offerings as well as the increased presence in the space from major CPG's (CPB, GIS, K, etc.) that we have seen over the past several quarters.

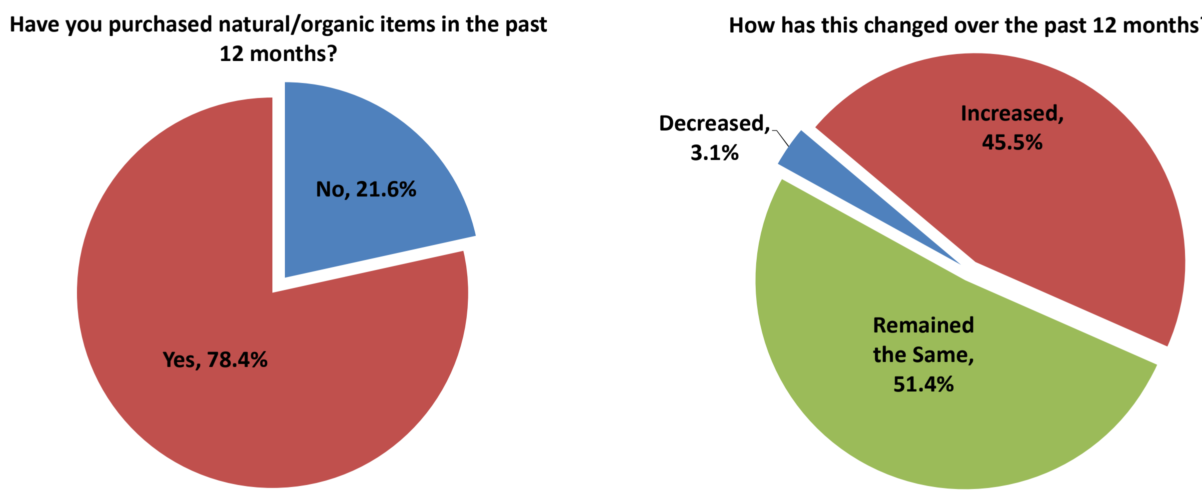
- **Online shopper experiences relatively positive to date.** Over 20% of consumers from our online survey indicated purchasing natural foods through an online medium (Instacart, Amazon, etc.). Although convenience earned higher marks from a satisfaction standpoint, consumers were relatively mixed in terms of satisfaction around both price and selection/quality.

Overview

We view our findings indicative of ongoing strength in interest in natural/organic foods, but fairly agnostic voice from consumers regarding *where* and *who* they buy products from.

From a purely consumption standpoint, we came away confident consumers continue to structurally migrate into natural/organic specialty food offerings. A disproportionate number of respondents noted new stores or increased offerings at nearby retailer's versus closures, while roughly over 45% of consumers increased natural food purchases over the last twelve months. Furthermore, respondents cited health benefits as the number one reason for recently increased purchases, trailed at a distance by availability and price (showing trends are not solely driven by continued lower-priced private label introductions at KR, etc.). That said, ~60% of consumers were agnostic to brand-name ownership, leading us to believe large-cap CPG players and especially private label offerings are likely to successfully compete with pure-play natural/organic food brands going forward (in contrast to the theory that natural/organic food consumers don't trust "big business").

Figure 1: Strong Organic/Natural Food Consumption Trends (left) Continue to Gain Momentum (right)

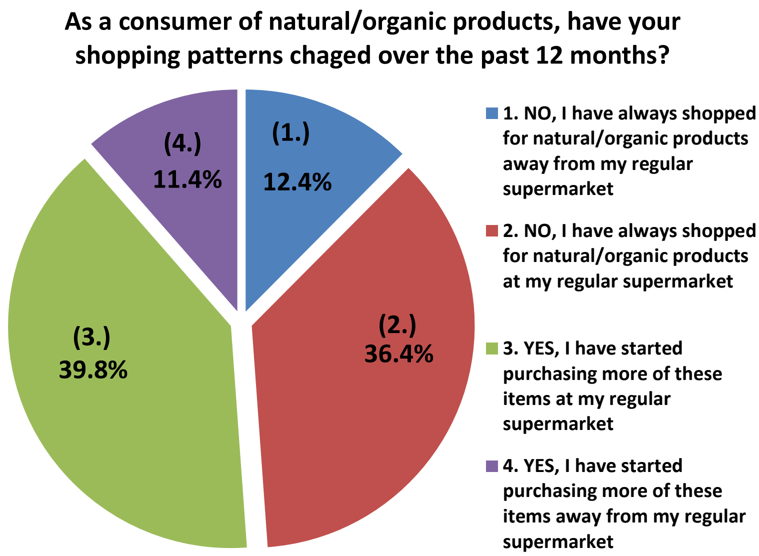


Source: Wedbush Securities, Inc.

Retailing of natural/organic remains highly competitive from openings, consumers continue to ramp total places shopped for natural/organic.

On the retail front, consumers broadly were not surprisingly expanding their shopping patterns, with over 50% of consumers reporting that they have changed their purchasing habits as it relates to natural/organic products over the past 12 months. Of this 50%, ~40% have reported purchasing more natural/organics at their regular supermarket while the other ~10% reported going somewhere other than their regular grocery store to purchase these items. With a net of consumer respondents specifically noting more openings then closings of neighboring new stores and a balance focus across shopping attributes (price, quality, availability, selection, etc.), we remain concerned consumers will continue to migrate from specialty grocers without distinct selection/experience advantages towards traditional/mass/club retailers who continue to add natural/organic offerings.

Figure 2: Consumers Changing Purchasing Trends Reveal Increased Natural/Organic Purchases at Regular Supermarket

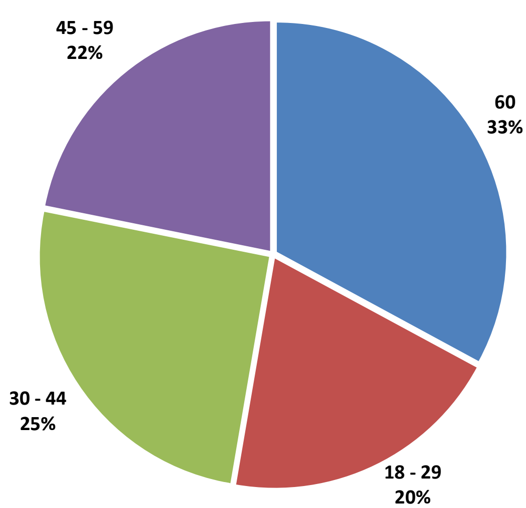


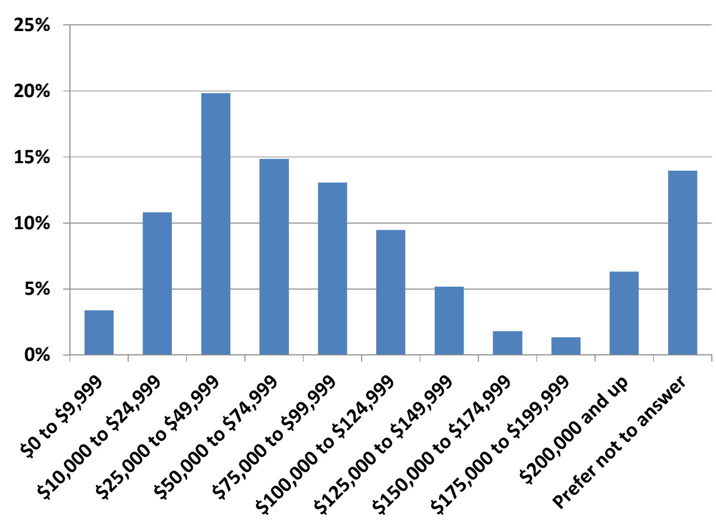
Source: Wedbush Securities, Inc.

Methodology

We surveyed over 600 consumers to judge preferences and participation in the natural/organic food industry. Our online survey composed of a wide range of demographics completed over the course of August. Just over half of respondents were female (~53%), while age and income were also fairly evenly distributed.

Figure 3: Respondent Breakdown by Age (left) and Income (right)





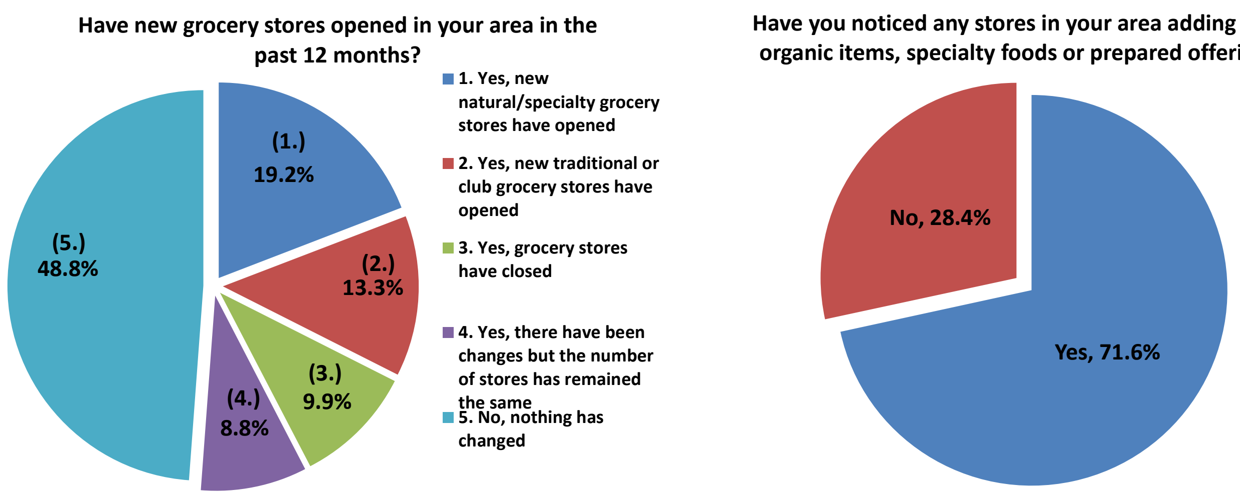
Source: Wedbush Securities, Inc.

Key Topic Questions

1. **Shoppers are noticing both competitive new store openings and increased natural/organic offerings at existing stores.** Roughly ~one-third of respondents noted new store openings in their area during trailing twelve months, with the majority of the openings occurring from specialty grocers rather than traditional or club stores. A number of consumers noted some closures (~10%), and openings with an equal amount of offsetting closings (~9%), while just under half of total respondents noted no changes. Meanwhile, ~72% of consumers indicated they noticed stores in the area adding more organic/specialty foods of late.

   Wedbush Take: Retailers are most definitely remaining aggressive with *net* new store openings, primarily from specialty stores at even a higher rate than we'd expect. Furthermore, the fact that consumers acutely noticed openings as well as a ramp of specialty foods at stores in the area show consumers are fairly aware that they have an increasing number of options for specialty foods.

Figure 4: Higher Competitive Store Openings (left), More Organic and Specialty Offerings (right)

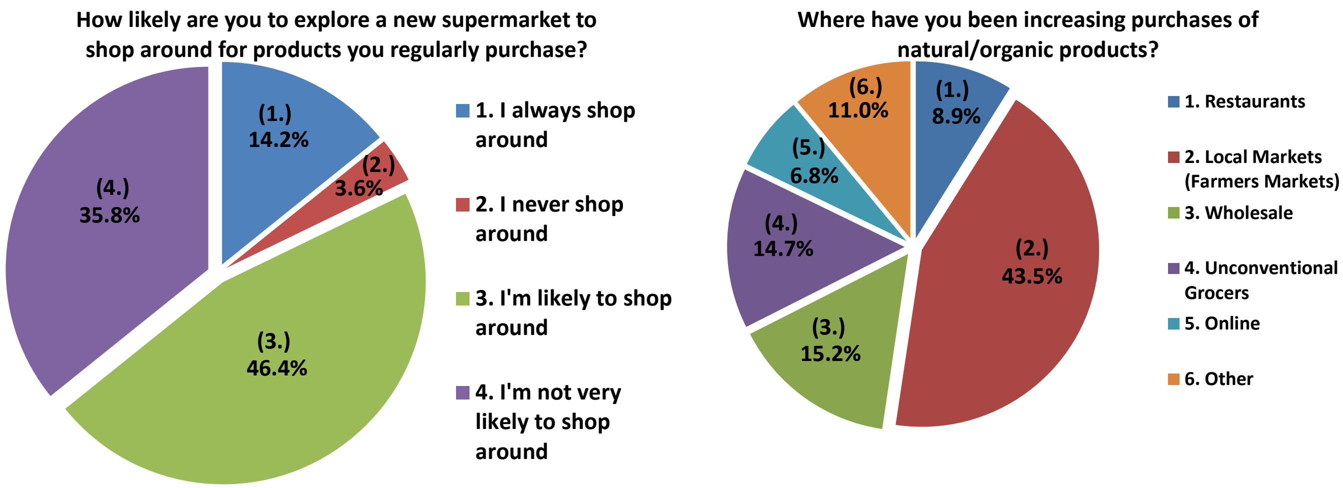


Source: Wedbush Securities, Inc.

2. **Consumers appear to be changing retail shopping habits, buying more natural/organic through alternative channels.** Nearly half of our respondents that indicated they have increased purchasing patterns of organic and other specialty foods away from their typical shopping supermarket noted local markets (farmers, etc.) as the number one channel they've increased purchases. Local Markets were the major share winner, followed by unconventional (~15%), wholesalers such as Costco (~15%), restaurants (~9%), online (~7%), and other (~11%). Approximately 60% of respondents noted always or likely shopping around as new supermarkets or other avenues open up, versus ~36% who indicated they are not very likely to do so.

   Wedbush Take: As shown above, availability and quality are key factors to purchase patterns. This is accented by consumers also willing to try new stores (which they have done so meaningfully as of late) and purchase through non-traditional channels such as local farmers markets at a much higher rate than we'd expect. In other words, availability appears to be increasing, and consumers seem to be willing to shop around.

Figure 5: Consumers More Likely To Shop Around (left), Local Markets Picking Up the Lion's Share (Right)



Source: Wedbush Securities, Inc.

3. **Consumers less concerned regarding store qualities/attributes when shopping for natural/organic, weight price and quality more heavily.** Although price did not rank quite as highly as we expected, consumers, regardless of channel, ranked quality and selection the highest when asked to rank Price, Selection, Quality, Availability, and Store Specifics on a scale of 1-5 when shopping for items. WFM and SFM shoppers both ranked quality slightly higher than price, but interestingly ranked store specific attributes as modestly less impactful. Meanwhile, despite prominence of price, consumers that changed their natural/organic purchasing patterns over the last 12 months cited perceived health benefits (~35%) and availability (~20%) at roughly 3x more frequently than price (~13%).

   Wedbush Take: On the one hand, we were surprised consumers shopping at WFM and SFM did not rank store attributes higher, similar to seeing a higher focus on quality compared price that was shown. Furthermore, we believe many questions in our survey showed some contradictions in shopping patterns, essentially showing consumers do give prominence to price, but seem to be changing habits over the last twelve months mainly on factors such as availability, *not* pricing or promotions.

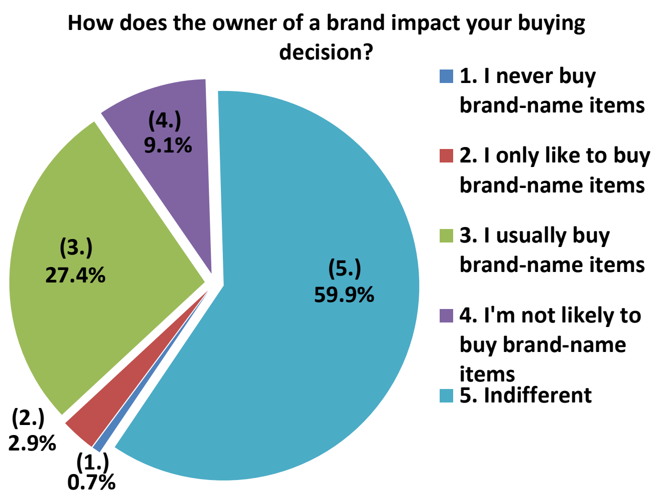
Figure 6: Health Benefits Main Cause of Changing Consumption Patterns (left), Rank Attributes Most Important to Least Important (1 = Most Important, 5 = Least Important) (right)

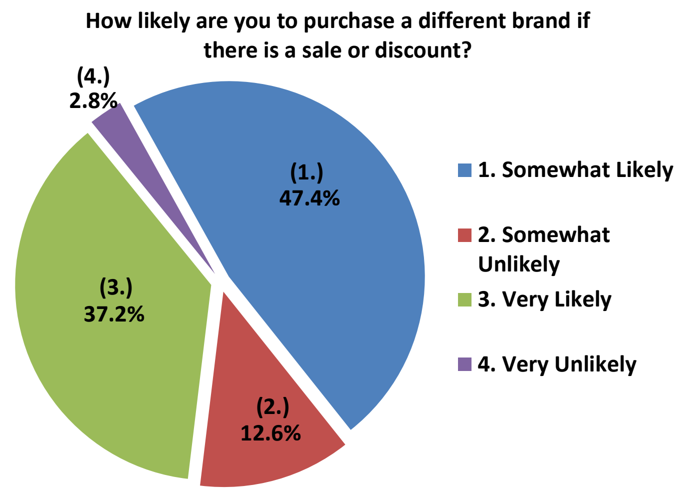
Source: Wedbush Securities, Inc.

4. **Consumers appear brand agnostic and more willing to experience new products.** Overall, 83% of consumers are more influenced by price than by brand. Further, when asked how much the owner of the brand impacts their buying decision, 60% said they are indifferent compared to only ~30% that either usually or exclusively buy name-brand products.

   Wedbush Take: These data points, coupled with the increasing presence of natural/organic private label SKUs and offerings from major CPG players like General Mills and Kellogg, add weight to some of the long-term structural risks facing specialty foods manufacturers like HAIN. While we don't view this as a threat in the near-term, we believe that over the long-term, organic manufacturers will be forced to compete directly with additional private label offerings and major CPG peers as consumers continue to gravitate towards lower-priced equivalents.

Figure 7: Most Consumers are Indifferent to Brand (left), and Willing to Try New Products If on Sale (right)





Source: Wedbush Securities, Inc.

Covered Companies Mentioned in This Report (Priced as of 8/31/2015)

Company	Ticker	Rating	Price Target	Price
Whole Foods Market	WFM	NEUTRAL	$40	$32.76
Sprouts Farmers Market	SFM	NEUTRAL	$33	$20.37
The WhiteWave Food Co.	WWAV	OUTPERFORM	$56	$46.14
The Hain Celestial Group	HAIN	OUTPERFORM	$72	$60.85

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Disclosure information regarding historical ratings and price targets is available at http://www.wedbush.com/ResearchDisclosure/DisclosureQ215.pdf

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Wedbush Equity Research Disclosures as of August 31, 2015

Company	Disclosure
Whole Foods Market	1
The WhiteWave Foods Company	1
The Hain Celestial Group	1
Sprouts Farmers Market	1

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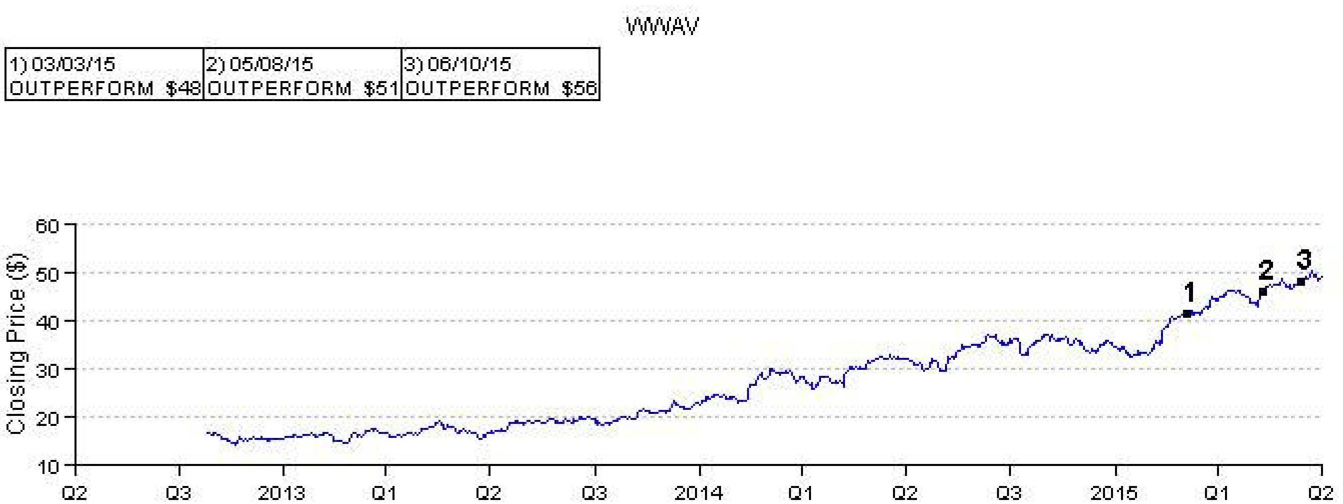

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