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STRATEGIC INFORMATION FOR THE NUTRITION INDUSTRY

The Transformation of Corporate America

Health & wellness M&A moves beyond tuck-ins by global strategics to realignment at mid-caps

It finally happened. On September 8th, after months of speculation over whether or not **Annie's** would be "taken out" by one of the large, diversified food companies, **General Mills** announced the acquisition of Annie's for a whopping $820 million. Annie's is a very expensive acquisition for General Mills at more than 3.8x revenues, but it highlights the robustness of the current M&A market and clearly shows that if you want to acquire the top companies and brands within the natural & organic industry, the price tags can reach very lofty levels.

Annie's has been the darling of organic for some time, and after a short stint as a public company—Annie's completed an initial public offering in 2012—it will soon become the key organic brand in General Mills' healthy foods platform, **Small Planet Foods**. This transaction is a highly visible one, one that at first glance might appear transformational in nature given its size, scale and significance within the industry, however, given the gargantuan size of the parent, Annie's $204 million in annual revenues represents only 1% of General Mills' more than $17 billion in total revenues.

In this case, and in many others like it, the size differential of this transaction masks an important trend that is becoming more prevalent across the U.S and is gaining momentum—the complete transformation of corporate America toward "healthier" businesses and healthier alternatives.

Fully transformational

Transformation can be immediate, substantial and even alarming—as it was one morning for Gregor Samsa, Kafka's protagonist in "The Metamorphosis"—or it can be more gradual, iterative and happen over time, so that it deflects significant attention or alarm. This latter type of more gradual transformation has been happening across corporate America in the health, wellness and nutrition spaces for a number of years, so what's changed of late? The pace now is rapidly accelerating and the participants are no longer only the large consumer packaged goods and food companies, but also companies of all sizes and industries, many of which are making sizeable, bold moves to affect significant business transformation or reposition their companies. Yes, the healthy transformation of corporate America is now fully under way.

Where did this transformation trend first start? Significant credit should go to the grass roots "green" movement that began decades ago with a mere few organizations advocating for better standards in health, wellness and nutrition. But the trend didn't really surface in a big way or become clearly visible in corporate America until the 2000s, when the large, global consumer packaged goods companies began to scoop up the pioneers of the industry—including some of the industry's most notable companies, like the four horsemen of **Ben & Jerry's** (acquired by **Unilever** for $326 million in 2000), **Tom's of Maine** (acquired by **Colgate Palmolive** for $100 million in 2006), **Seventh Generation** (remains independent) and **Burt's Bees** (acquired by **Clorox** for $925 million in 2007).

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NUTRITION, HEALTH & WELLNESS INDUSTRY TRANSACTIONS

	2014	2013	2012	2011	2010	2009
Retail & Distribution	5	10	9	9	10	2
Supplements	10	11	17	19	15	7
Ingredients	9	30	26	31	27	11
Contract Manufacturing	6	9	5	4	8	3
OTC & Personal Care	6	4	9	12	8	5
Organic, Natural, Functional Food	12	69	62	77	65	40
Others	23	26	31	29	8	5
Total M&A	**71**	**159**	**159**	**181**	**141**	**73**
Financings	**96**	**93**	**101**	**63**	**62**	**60**
Total Transactions	**167**	**252**	**260**	**244**	**203**	**133**
Average Size of Financing	**25.9**	**9.1**	**8.7**	**9.7**	**7.9**	**11.7**

Source: Nutrition Capital Network Dealflow Database 2014

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Letter from nbj

When a small company is sold, it's not always a sell-out. As this issue went to press, megacorporation **General Mills** bought organic icon **Annie's** for $820 million, another acquisition in an accelerating trend.

It's the same old story, almost. A company selling for $820 million on a 37% premium over closing stock price would be a headline in any industry, but an organic food company pushing $1 billion would have been a much bigger story 20 years ago.

Last year, **Happy Family** sold for an undisclosed price reportedly in the "hundreds of millions of dollars" to **Danone**, which had already acquired Gary Hirshberg's **Stonyfield Farm**, a pioneering force in organic. In 2012, **Bolthouse Farms** got picked up by **Campbell's** for $1.55 billion.

Annie's is just the latest chapter, immediately echoed by another story we've seen before—consumers worried the values that made Annie's an icon of the organic movement will be diluted. As one commenter on the Annie's **Facebook** page wrote: "We supported Annie's precisely because it WAS a small company that I felt could be trusted. It feels like you sold out and almost like a bait and switch move to make."

That may be the story we don't need to tell any more. Hirshberg stayed directly involved in Stonyfield and it stayed organic. When Seth Goldman sold his **Honest Tea** to **Coca-Cola**, bloggers immediately called it "Dis-Honest Tea," but Goldman points to how the company expanded the fair trade program. Big corporations don't buy the smaller organics to gut what made those companies thrive. Authenticity drives the premium. Big CPG knows that.

With these acquisitions comes scale and with scale comes, we hope, a drop in price. Undoubtedly, many millions of parents would buy Annie's mac and cheese but reach for **Kraft** because of the price. If the price does come down with a bigger footprint in mass, millions of kids will eat healthier, less-processed foods. The accessibility challenge—making it more possible for more people to buy more healthy food—will be difficult to solve without the scale big CPG brings to bear.

General Mills didn't buy Annie's to kill it and sell more Hamburger Helper and, if change happens best when it comes from within, Annie's could lead the corporate mothership by example and the occasional "let's try it this way!" nudge. Between accessibility and shifting the business model from the inside, acquisition of smaller organics might be something consumers could cheer and not fear.

Maybe it's not a "sell out" any more.

Maybe the correct term is "sell up."

Rick Polito
Senior Editor, NBJ
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COVER STORY CONTINUED

Indeed, a number of other transactions of significance were also completed over the same time period, such as **Danone**'s acquisition of **Stonyfield Farm**, **L'Oreal**'s $1.3 billion acquisition of **The Body Shop**, **Dean Foods**' acquisition of **Horizon Organic**, and **Coca-Cola**'s $181 million acquisition of **Odwalla**. But most all of these transactions were tuck-ins for multi-billion-dollar conglomerates, product/channel/geography extensions, or small acquisitions (relative to the acquirors) of companies and brands that offered healthier alternatives. It wasn't until 2007, when Clorox announced the acquisition of Burt's Bees for $925 million—a transaction that turned everyone's heads—that we first saw a company make a bold and decisive move that was more transformational in nature. Let's note that, given the size differential between the two companies, this transaction was a significant strategy and brand transformation, not a financial one.

In the case of Clorox, the company acquired Burt's Bees and then used Burt's Bees strong market positioning and brand image within the health, wellness and nutrition space to help transform its own business and public image in a significant way. Recall that, at the time of the acquisition, Clorox was best known for its more traditional brands such as **Clorox Bleach**, **Armor-All**, **Kingsford** and **STP Auto Care**. The acquisition of Burt's Bees enabled the company to migrate itself from a perceived purveyor of chemicals and toxins, to a company with a serious, if not legitimate, focus on natural, organic and sustainable products. It then supplemented this acquisition with the launch of **GreenWorks**, a successful line of naturally-derived cleaning products, and has since benefitted from an enhanced and much stronger brand image.

This transaction, one could argue, was the jumping off point for the acceleration of the healthy transformation of corporate America, a movement that has since evolved to include a much broader set of companies across a broader set of industries and has established itself as a more significant and long-term trend.

The most telling sign of the broader adoption of healthy corporate transformations is the rate at which mid-capitalization public companies—a simple guideline here is public companies with market capitalizations of under $3 billion—are now aggressively using M&A to affect significant change, often substantially re-positioning their companies. This tier of companies has been very active in the past 12-18 months, aggressively using corporate cash balances and easy access to

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What Does Transformation Look Like?

Post has made healthy acquisitions of approximately 34% of its entire revenue base, which has significantly transformed its business. General Mills has made key acquisitions, but its entire healthy platform—including Annie's—accounts for only 3% of total company revenues.

	Current Market Capitalization	Total LTM Revenue	Healthy Acquisitions	Total Healthy Acquisition Revenue (Estimated)	% Healthy Acquired Revenue to LTM Revenue
Post Holdings, Inc.	$1,580 billion	$1,659 billion	Attune Foods Premier Nutrition Dymatize Power Bar/Musashi	$564 million	34%
GENERAL MILLS	$32,830 billion	$17,909 billion	Cascadian Farm Muir Glen LARABAR Food Shoud Taste Good Annie's	$534 million	3%

Notes: Market capitalizations as of September 9, 2014; LTM period ending June 30, 2014 for Post, May 31, 2014 for General Mills.
Sources: CapitalIQ, Google Finance, company press releases, Aspect Consumer Partners estimates.

debt to gobble up some of the top performing natural, organic and healthy brands. The food and beverage industry has seen the most robust activity and it's in this industry where the "healthy" transformation trend is most visible across a broad array of categories, including ready-to-drink, functional and healthy beverages, protein, healthy snacks, supplements, ingredients and many other categories.

Post transforms

Did you know that **Post** was founded by C.W. Post in 1895? Given an almost 120-year heritage in cereals and other consumer packaged goods, you could argue that it's taken Post longer than most any company to transition to a healthier product offering. However, it probably makes more sense to look at the company's recent past, given that it only became an independent public company since its spin-off from **Ralcorp** in February of 2012. Since that time, the company has embarked on a high-velocity acquisition strategy focused on healthy and active lifestyles that has significantly transformed the company into a key new player in what it calls "active nutrition," including such categories as body building, endurance, lifestyle and sports nutrition. Post has spent well over $1 billion on acquisitions with over $560 million in "healthy" revenues, more than a third of its total for the last twelve-month period ending June 30, 2014.

It should be noted, however, that Post's first two acquisitions after completing its spin-off were not at all transformational. In January 2013, the company acquired **Attune Foods**, a natural & organic cereals company, for an undisclosed amount, and in June 2013 it acquired the branded and private-label cereal, granola and snacks business of **Hearthside Food Solutions** for $158 million. These two acquisitions appeared to be more of the same—acquisitions of much smaller companies that added additional products in line with the company's core focus areas.

And then everything changed. In August 2013, Post announced the acquisition of **Premier Nutrition** for approximately $180 million, marking an initial and significant departure from its more traditional focus on breakfast cereals and other packaged goods primarily sold in the center of the grocery store. This was an eye-opener for many as the long-time cereal maker went deep into nutritional beverages and supplements, acquiring in one fell swoop both a leading brand in protein beverages and foods, Premier Nutrition, and a leading brand in functional beverages, **Joint Juice**.

But the company didn't stop there. In September 2013, Post announced the $370 million acquisition of **Dakota Pasta Growers**, a manufacturer of a full line of pastas, including whole grain and organic alternatives. And while this cannot be categorized as moving the company forward toward a healthier offering, within less than three months, in early December 2013, it announced two additional acquisitions: **Golden Boy**, a maker of private label peanut and other nut butters, as well as snacks and dried fruits, for $300 million; and **Dymatize**, a leading manufacturer and marketer of premium protein powders, bars and nutritional supplements, for $380 million. Dymatize in particular represented another significant step in the right direction by adding almost $200 million in annual revenues.

The most recent milestone in Post's continued transformation came early this year, when in February 2014 it announced the acquisition of the **Power Bar** and **Musashi** brands, as well as related assets, from **Nestlé** for an estimated $150 million, bringing almost $200 million in new revenues to the company and firmly establishing Post as a significant competitor within the nutrition and supplements industry. This last acquisition gave the company the size and scale needed to become a leading competitor within the industry and enabled it to establish an Active Nutrition Group, with estimated annual revenues of approximately $560 million. Post is likely to make additional acquisitions to continue to further

evolve. And while Post management will certainly be mired in integration for the foreseeable future, the company should be studied for its valiant effort at using M&A as a strategic tool to affect significant business transformation. Perhaps others will take Post's lead.

All shapes & sizes

A number of other mid-tier companies, both public and private, have been active in pursuing strategic M&A within the broader nutrition industry that has significantly impacted their organizations. And while these companies have perhaps not experienced as much transformation in as little time as Post, they have certainly affected significant business transformation and repositioned their companies into leaders within their respective industries. The benefit of these changes—increased size, scale, profitability, growth—can be substantial, and for the publicly traded companies can even translate into higher stock price valuations.

Boulder Brands is a prime example. Since launching in 2006 as a special-purpose acquisition corporation, better known as a SPAC, the company has made a string of acquisitions in a broad range of healthy categories (and a key name change) that has repositioned the company into a leader in the industry. The company's progress to date has been remarkable and its acquisitions include: **EVOL Foods**, **Glutino** and **Udi's Healthy Foods**. In particular, the acquisition of Udi's in 2012 solidified the company's leadership in the gluten-free category and significantly enhanced the company's growth profile. This single acquisition was the catalyst that propelled the company to new heights—it's now a high-growth industry leader benefitting from enhanced visibility and a premium valuation in its stock price. Since the acquisition of Udi's at the end of May 2012, the company's stock price has increased over 125%, as compared to an approximately 62% increase in the NASDAQ.

Omega Protein is another company that has made significant progress in repositioning its company—in this case from primarily an animal and plant nutrition focused company to that of a human nutrition focused company. Until just this past month, it had completed three acquisitions, including **CYVEX Nutrition**, **InCon Processing** and **Wisconsin Specialty Protein** which includes the **tera's whey** brand. This enabled the company to enhance its processing capabilities and to expand into nutraceuticals and dairy protein. A week before press time, the company announced its acquisition of **Bioriginal Food & Science**, a leading supplier of plant and marine based specialty oils and essential fatty acids to the food and nutraceutical industries, further expanding the company's position in human nutrition by adding close to $100 million in revenues. The company is now expected to derive close to 40% of total annual revenues from human nutrition. Omega Protein has also seen its stock price climb, having increased approximately 89% since the acquisition of Wisconsin Specialty in February of last year.

Another company that has used M&A to change the profile of its business is **KeHE Distributors**, which over the past five years has acquired both **Tree of Life** (approximately $1.2 billion in revenues) and **Nature's Best** (estimated at close to $500 million in annual revenues) to become the clear #2 leading distributor of natural & organic foods and other products, second only to **UNFI**.

Other companies have made sizeable healthy acquisitions, but it has yet to be seen if these transactions are part of a more significant move toward a healthier business focus. Such companies include the likes of **Hormel Foods**, which recently made a bold acquisition in the high-growth sports nutrition category by acquiring **CytoSport**, makers of **Muscle Milk**, for $450 million. This transaction is significant in that it departed from the company's core food focus, but it's hardly transformational given that it added only $370 million in revenues to the over $9 billion company total.

Another company that has made a significant move into healthier alternatives—in this case healthy snacks—is **B&G Foods**, which acquired the **Pirate's Booty** brand in June 2013 for $195 million, and then followed that up in October 2013 with the $57 million acquisition of **Rickland Orchards**, a maker of better-for-you granola bars and bites sold primarily in the club channel. Together these acquisitions added close to $140 million in annual sales, which is significant for a company that reported $725 million in total 2013 sales.

Additional activity includes companies such as **Treehouse Foods**, which acquired in June of this year **Flagstone Foods**, a top provider of trail mixes and dried fruits, for $860 million, and **Helen of Troy**, which also in June announced the acquisition of the market leader in premium doctor-branded vitamins, minerals and supplements, **Healthy Directions**, for approximately $195 million, a very different acquisition for the housewares and personal care company that could signal more on the horizon.

Snyder's-Lance has also been active, and in May 2014, following up on the September 2013 acquisition of the **Pretzel Crisps** brand for $340 million, announced in one fell swoop both the divestiture of its private-label business and the acquisition of **Baptista's Bakery**. These transactions netted the company over $100 million in cash to use for additional acquisitions. What is interesting here is that in its investor presentation announcing these transactions and 2014 first quarter results, Snyder's-Lance highlighted its own definition of better-for-you as products perceived healthier by consumers that have distinctive nutritional claims, and noted that these types of products would remain a focus for the company. Post-transaction, better-for-you would represent approximately 25% of total company revenues.

Outside of this trend of business transformation, traditional M&A continues at a very robust pace. In the past two months, **J.M. Smucker** announced the acquisition of **Sahale Snacks**, a manufacturer and marketer of premium branded nut and fruit snacks, for an undisclosed amount from **Palladium Equity Partners**, and **Peet's Coffee & Tea** announced the acquisition, in partnership with **Next World Group**, of **Mighty Leaf Tea**. Private-equity firms have also been active across a number of categories, with the **Invus Group** completing a growth equity recapitalization of the organic skin care and make-up company **Juice Beauty**, **BRS** completing an investment in the rock-climbing shoe company **Evolv**, and **Alliance Consumer** investing in **People Dedicated to Quality**, or PDQ, a fast casual restaurant chain that focuses on fresh, hand-battered chicken tenders and other items.

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What Can Tech Teach Food & Beverage?

Silicon Valley money is coming into food & the effects are not yet clear

Last week, **Apple** moved to reboot the wrist watch, a technology that's been around since the 1860s. That's the kind of market creation/disruption Silicon Valley is famous for. Food is a different matter entirely.

In the last year, Silicon Valley investors are getting enormous press for pouring money into food with an ambitious mission to change what we eat, how we get it and how it's grown and prepared. A tech bauble like the iWatch could present more sweeping change than is immediately apparent, but shifting the $1 trillion food industry is far more than asking people to look to their wrist for a weather report. Humans have been going to the market to buy food since Babylonian times. Plant-based protein needs a bigger place on the global plate but meat has been on the menu since man's ancestors first wrapped their opposable thumbs around a rock.

And yet, the food system is as ripe for disruption as the wristwatch, say investors like VC legend Ali Partovi. Says Partovi: "What Silicon Valley brings more than anything is the mentality of: 'What if we started over? What if we threw out some of our assumptions? What would it look like if we were designing this thing from scratch?'" Partovi has money in egg-substitute startup **Hampton Creek** and boasts an entrepreneur and early investment résumé that includes **Zappos, LinkExchange, Facebook** and **Dropbox**.

Partovi, named as Hampton Creek's chief strategy officer earlier this month, calls the food system "broken." It's ripe for change—or disaster if that change doesn't come. "It's a broken system. It's not efficient in terms of the use of resources. We're not getting the food that is best for us to eat, and we are not getting it cost effectively," Partovi explains.

Mission & infrastructure

Many of the big tech investors would appear motivated more by a save-the-world mission than profit. Partovi has had big shares in deals totaling over $1 billion. Hampton Creek's most famous investor, Bill Gates, isn't exactly hurting for cash either. The Microsoft billionaire also put money behind **Beyond Meat's** plant-based protein, a meat substitute that comes closer than any product yet to matching meat for taste and texture. One of Partovi's projects is **Farmland LP**, a company buying farmland and transforming it to organic, sustainable practices. It's not exactly technology but it's a technological approach, he says, using science-based practices to rotate crops and maximize soil nutrients and food production. "It's technical in the application to farming."

Indeed, it may be what the customer does not see—changes far from the shelves and freezer space—that will mark the biggest impact tech money and tech thinking could bring to food, says natural & organic industry veteran Brad Barnhorn, who sold his **Fantasia Fresh Juice** company for a reported $15 million in 2000 and has been watching staggering numbers tally in and on the fringes of the edible sector. "There's been $3.9 billion invested in food tech so far this year," he says. Little of that is going to land on the dinner plate, he notes, but food tech may change how products make it from field to shopping cart. "There are so many dimensions of it that ultimately have nothing to do with food. They are not about this lettuce or that mayonnaise," Barnhorn says. "It's not the Beyond Meats and Hampton Creeks only."

Barnhorn says technology related to distribution, delivery and demand modeling are prime targets. "There's a lot of infrastructure investment around the food space," he notes, but he is not entirely confident in the direct-to-consumer models developing in businesses like grocery delivery companies **InstaCart** and **Good Eggs**. Less ambitious startups delivering organic meals or ingredient kits for consumers to cook their own meals are getting astounding funding. Barnhorn is not sure the models work, but he can see how tech VCs would be attracted to something that uses tech tactics. "I think VCs tend to be attracted to where you can take something from X category and put it in Y category," Barnhorn says. That can't work for every company in the space. "I will be shocked to see in five years how many of those still exist."

Forget Webvan!

Everybody who looks at online-driven grocery delivery can't ignore the specter of **Webvan**, a company that went through $800 million in funding and shares Web 1.0 Hall of Shame space with the **Pets.com** sock puppet, but backers are quick to point out that society is far more connected in 2014 than it was in 2001, the year Webvan went bust. Mobile imposed a new paradigm, they maintain. "I really believe that the underlying technology has changed a lot since then," says Brendan Dickinson at **Canaan Partners**, a New York-based venture capital firm.

Nobody is building the huge warehouses that Webvan built. InstaCart has its delivery shoppers picking up ice cream and milk at existing grocery stores. **Whole Foods Market** announced a partnership with InstaCart just last week. Consumers expect things to happen immediately and mobile apps optimizing the most efficient routes make "right now" more possible. "You have a fundamental shift in the consumer mindset," Dickinson observes. Still, he says, investors have to realize that the space is tightly targeted to dense urban areas and populations keen to technology. "At the end of the day we are not going to have 100 different billion-dollar companies in these spaces. You are definitely going to have some winners and some big losers," Dickinson says. "It will sort itself out. Not everybody is going to make it."

Partovi sees meal delivery as another place where tech thinking can move past conventional assumptions to create a new market. He has money in **SpoonRocket**, a company delivering prepared meals with organic ingredients. The convenience factor is the key, he says. Doubters "discount

how important convenience is." Drivers will have warm and ready-to-eat meals in their cars and can get them to consumers in minutes. People want to eat healthy, Partovi believes. They just want it easy. "A lot of people who eat at **McDonalds** are not doing that because it's the cheap option. It's because of the convenience option."

If those models play out, the benefits roll down the supply chain. Whenever money comes into natural & organic, whether it's **Wal-Mart's Wild Oats** or SpoonRocket, the result is more acreage with less pesticide and healthier food consumers can bring home. That's some of the indirect benefit Barnhorn can see. Companies will rise and fall, but a bigger market means more choices. "More choice is always better than less choice for a consumer," Barnhorn says. Silicon Valley money, however it plays out, creates choice. "I don't think there are any negatives to consumers."

Another payoff from the delivery models could be consumer intelligence. What customers keep or check off their lists is information CPGs would jump at and delivery companies could sell it. "They are looking at other ways to monetize beyond a classic food business," says Barnhorn. A company like **NatureBox** delivering a box of natural food products every month is not so different from having sample stations in every natural grocer in the country. "You are looking at ways that you can get information that can be used for food companies to mitigate risk without ever touching a retail shelf," Barnhorn says.

Who needs a product?

That doesn't mean that information creates opportunity, or innovation. For all the talk of Silicon Valley moving into food, few edible and drinkable products fall in the target zone. Hampton Creek, Beyond Meat and **Nu-Tek Salt** are notable names in every "Tech VC Making Big Bets on Food" magazine article, but that list of standouts is short.

Most food and beverage entrepreneurs face the financing challenges they always have. Adam Louras has seen it from both sides. He worked at **Transom Capital Group** and **Bain & Company** and is now raising capital for his **Koa Organic Beverages**, a drink he calls the first "zero-calorie juice." Louras calls the "Silicon Valley shakes up food" headlines "a hype train." "I wish it was real," he says. "We are looking for money right now, and it was just as difficult as it was when I had the idea on a napkin."

The problem, Louras explains, is that the Silicon Valley VC model simply doesn't play well in food and beverage. VC accustomed to tech has built what he calls a "small box" out of growth-curve expectations that include billion-dollar exits. "The problem is a lot of food and beverage stuff does not fit that box," Louras says. "You can't really take that and apply it to food and say everything should line up the same way because it just doesn't." The delivery services are getting

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THE NEW NUTRITION INVESTOR

Marc Andreessen
Soylent
Instacart
uBiome

Steve Case
Revolution Foods
Sweetgreen
Gaiam

Bill Gates
Hampton Creek
Beyond Meat
Nu-Tek Salt

Ali Partovi
Hampton Creek
Farmland LP
Bright Farms

"For food product entrepreneurs, what Silicon Valley is investing in right now changes almost nothing." —Austin Kiessig, Greenteaspoon

the funding because it's within the tech VC comfort zone, he says. Apps and online ordering systems are familiar, but they are not food. "Products will be the very end of this whole thing, unless there is somebody who can create a business model where the products and delivery are intertwined."

Austin Kiessig sees the same phenomenon occurring. Kiessig, a San Francisco blogger at **ediblestartups.com** who has written pieces like "What 'Big Ideas' In Food Get Funded in Silicon Valley?" is currently hunting capital for **Good Gut Daily**, a prebiotic drink with offices in Palo Alto, the heart of Silicon Valley. It's not easy, if early conversations with VC firms are any indication. "We are almost too small with too little prospect of a hockey stick growth curve for them to even pay attention to us," Kiessig says. "That is true of 99.8% of food or supplements, or any physical product businesses. For food product entrepreneurs, what Silicon Valley is investing in right now changes almost nothing."

The benefits for food may come through the new distribution channels, the Instacarts and Good Eggs, he says, describing something not so different from Louras's "intertwined" prediction. "You could see some artisanal cheese finding customers through Good Eggs," Kiessig says. "But it's indirect."

Those distribution channels, however, almost assuredly do not have the business potential to match the huge investments, both Louras and Kiessig maintain. Most Americans don't live in the dense urban environments that might support delivery, and most Americans are happy to go to the market. They are not sitting at their desks coding 16 hours a day in a San Jose cube farm, and they don't need somebody to shop for them, or make a drink like **Soylent** they can slurp to get all their nutrition. "There are a lot of companies in Silicon valley built on the problems of Silicon Valley," Kiessig says.

The problem for food, he says, might come when the delivery companies discover their target markets are too crowded and they crash out à la Webvan. That could "discredit food." "I think that's very unfortunate, because there are a lot of food investments that should be financed and may not yield a billion-dollar payout in five years but will be a money-making business that will sell product to customers."

As Kiessig sees it, the reason the few companies like Hampton Creek and Beyond Meat get big attention is because they are tackling big problems—that offer big payouts. Replacing meat and eggs is huge. The current meat production infrastructure is "built on an unstable backbone," he says. It is destined to fail and there is opportunity in failure. "Instead of that being a bet on prices coming down because of technology, it's a bet on price going up on the alternative."

Big problems

Big problems with big solutions, however, are not abundant. Scott Smith is not convinced better-for-you-*and*-the planet is a simple sale. Predicting the future isn't easy, but it's his job as a futurist at **Changeist.com**. Eating is a mix of ritual, culture and taste that doesn't always sit well with plans and market models, something he wrote about in a piece for **Quartz** titled "There's nothing new about Silicon Valley's food hacking." Consumers may not want their food "disrupted," and meal choices are not quantifiable in the **Netflix/Amazon** mold. "Analyzing our food as a chemical program and reformulating it to sort of give us more nutrition and sustainable food sources is again kind of taking this algorithm filter on the world and applying it to something that's a lot more complex than choosing a book or a movie," he says. Consumers who aren't changing their eating habits to save themselves may not be ready to change those habits to save the earth. "The same thing could be said about self-driving cars," Smith says. "Yes you could build them. You could solve some problems. But there is a whole lot of culture around mobility and transportation that is not being addressed." Consumer tastes and acceptance changes slowly, he points out. "Something like soy milk took decades to get into the mainstream."

Meat substitutes exist at a whole new level. "It's going to be quite difficult to move the population away from traditional proteins and I don't see anything major generationally that's going to change that in the near term," Smith says. Even something as simple as grocery delivery runs into deeply ingrained culture around food. "These are millennia-old behaviors," he says, "I have done a lot of primary research on grocery shopping. Yes there are inconveniences. Yes there are cost inefficiencies. At the same time, there are other secondary issues that are solved by those

GOOGLE HITS

Company	# of search results
Hampton Creek	349,000
Instacart	307,000
Beyond Meat	172,000
Nu-Tek Salt	135,000
Soylent	87,200

Source: Google, as of September 11, 2014

behaviors." Going to the market is a kind of ritual—"There is more in it than negotiating the price of a tomato"—just as people who could get their meals delivered see eating at the same restaurant as an outing, an event. The growing locavore movement is a testament to culture over commerce. Hyper efficient supply chains and lab-grown meat have little place in a farmers' market.

Some would even question the better-for-the-world ethic behind the food tech innovations. Writing from New Zealand, environment-focused wealth manager Rufo Quintavalle worries that efficiency, food tech innovation and the startup model might not benefit farmers, and farms are where sustainability has to start. "One of the things that seems to distinguish a 'startup' from previous generations of new companies is that start-ups tend to employ fewer people ... Job destruction in the rural economy seems particularly damaging to me since it reduces the resilience of small communities and increases urban migration which brings with it a myriad of social and environmental problems. And farming and food processing are big rural employers."

The money may not go where it's most needed either, Quintavalle writes. "There are parts of the food value chain that could do with a big injection of cash in order to make them more sustainable - irrigation, cold storage, regional processing plants. But these are long term infrastructure type investments which offer slow and steady returns and are hence unattractive to the VC firms."

Will it work?

Beyond that, the alleged disruption in food may not be the revolution many expect it to be. "A tech approach which focuses on new forms of processed food and selling farmers new kinds of inputs is essentially just tweaking the status quo," Quintavalle writes. The status quo, however, may look different from Silicon Valley. The tunnel vision and self-obsession of the Bay Area is famous. What works in San Francisco may not work everywhere. Phil Sanderson works in San Francisco, a managing director at **IDG Ventures.** He subscribes to two CSAs. He owns a "cowshare" to get raw milk, and he knows he lives in the "microcosm of Northern California." IDG is watching food but he's not investing in it, yet. "I think there could be a misstep in believing that the mentality you find in Northern California is everywhere," he says. "Because it's not." Sanderson's family ran a regional dairy operation, **Honey Brook Farms**, in Upstate New York. Silicon Valley investors may also discover that the efficiencies are harder to tease out than they thought, he says.

If the alleged revolution fizzles, would Silicon Valley's flickering attention span remain focused on food? As Kiessig says, a few major nose dives in the crowded delivery sector could put a chill across food.

Louras worries that high profile bets that end in high profile failure bring a new raft of headlines about Silicon Valley money moving ***out*** of food, and the stage is set for just such an event. "It is worrisome because there are very few at bat," Louras says. "They could either make it or break it in one shot. If they are looked upon as the poster child for food investment and they bomb, everybody is going to look elsewhere until you get a couple of big wins."

Kiessig sees a struggle in the Bay Area between "techno optimists" and the "cynical realities" of existing challenges that are resistant to innovation. "There are a lot of these cynical realties in food," Kiessig says. "Can you drop a techno-optimist concept on every single one of them and solve the problem? Absolutely not."

In the end, he says VC and food may never have the relationship predicted in the national press. The Good Gut Daily project has been "self-financed and boot-strapped." Kiessig can show clinical results for digestive support but he can't always get investors to look at those results. It's food. It's not a gadget. It's not an app. "It's not in their bailiwick," he says.

Still, food has big challenges and the ideas that may save the food ecosystem could very well come from outside the entrenched institutions and established supply chains. Partovi isn't looking at disrupting food as much as saving it. The interest in Silicon Valley is no fad, he says. The goals are both long term and urgent.

"I would say that the conventional agricultural system is short term, in that it's not sustainable. People are making money with practices that are someday going to hit the wall, and we are investing in alternatives that have a more long-term future." Silicon Valley has the money to build the new models and take the big risks. "Trying them," he says, "is really the only way to find out."

—RICK POLITO

"It's a broken system. It's not efficient in terms of the use of resources. We're not getting the food that is best for us to eat, and we are not getting it cost effectively." —Ali Partovi

M&A Moves Down the Supply Chain

Q&A

with William Hood, Houlihan Lokey

William Hood is Managing Director of **Houlihan Lokey**'s Consumer, Food and Retail Group. Hood has landed smack in the middle of such notable deals as **Jamieson Lab**'s sale to **CCMP Capital**, **Santa Cruz Nutritionals**' sale to **RoundTable**, **Avid Health**'s sale to **Church & Dwight**, **Healthy Directions** sale to **Helen of Troy**, and **Schiff Nutrition**'s sale to **Reckitt Benckiser**. **NBJ** spoke with Hood from his offices in New York City.

nbj: How healthy is the supplement market right now?
William Hood: A little bit of historical context would be helpful here. If you rewind the clock five years, the dietary supplement category was viewed as much less attractive than it is today. It was considered a commodity driven, me-too category—how inexpensively can you sell 500mg of vitamin C compared to your competitor? There were more questions around the science and efficacy of the category. The credibility of the category, in the eyes of the large global strategic players, has increased fairly dramatically since that time. The fundamentals are incredibly strong. Science is improving every day. Retailers are allocating more and more shelf space, and finally, you're seeing the emergence of real brands.

If you put all of that together, the strategic universe has really woken up to the fact that this is a large category in the US—$33 billion dollars and growing 5-7% a year. You'd be challenged to name many consumer product categories that large and growing that fast. All of this has resulted in what I would describe as a feeding frenzy for good supplement brands and companies in the US. The best evidence of this is the fact that many of the large consumer packaged goods companies, who were not in the category five years ago, have landed there now—specifically, **Reckitt Benckiser** with its acquisition of **Schiff**, **Church & Dwight** with its acquisition of **Avid Health**, and more recently, **Helen of Troy** with its acquisition of **Healthy Directions**. The other obvious transaction of note is **P&G**'s acquisition of **New Chapter**. There you have four of the largest CPGs entering the category in meaningful ways.

nbj: What does the M&A landscape look like now?
Hood: M&A activity has been very robust. As we move into more recent history, one of the interesting dynamics is the lack of independent VMS brand still available for sale or investment. Most of the brands have been acquired. **Airborne** was acquired, **Emergen-C** was acquired, the Avid brands—**Vitafusion** and **L'il Critters**—have been acquired, New Chapter has been acquired. There is a real dearth of independent brands over $50 million in revenue. Brand M&A has consequently slowed, but we've seen the action shift to other areas of the VMS category, specifically the supply chain.

In the last 12 months, we've seen the sale of Santa Cruz Nutritionals to RoundTable Healthcare Partners. We just saw the sale of **Cornerstone** to **HIG** and their **Integrity Nutraceuticals** business. We also saw the sale of **NutriForce** to **Vitamin Shoppe**, and you will see additional activity in the co-manufacturing arena over the next six to 12 months.

nbj: Has the recent bad press for supplements had an effect?
Hood: We are active in a number of nutrition-related transactions right now. There is a lot of interest from strategic and financial players and we have seen very little—if any—impact on the part of both strategics and financials from some of the recent negative news. Players that are in the category are looking for ways to build market share. They recognize the attractive growth and margin profiles and want to do more in the category. There are also a number of players who, despite their best efforts, still have not been able to access the category with a successful transaction. These are consumer health players and big pharma companies who have consumer healthcare divisions. These are CPG players, and these are selectively food & beverage players as well.

We're obviously very close to the category. From an M&A context, we haven't had one situation where the first-half category slowdown in sales impacted a transaction. I can also say that many of the independent companies that we work with are still in high-growth mode. They're outpacing the category so dramatically that a slowdown is not having a big impact on interest in their specific business.

If you take some of the sports nutrition businesses right now, the growing successful brands, they're growing 10-20% a year. Obviously, broad line VMS is significantly more mature than sports nutrition. What you're seeing with sports nutrition currently is a broadening of the demographic. Sports nutrition grew up in the gym with 18-26-year-old bodybuilders, predominantly male. Now you're seeing very successful brands, like **Vega**, targeting the 25-35-year-old woman with a whey protein alternative in the form of plants and finding success, even at premium pricing.

nbj: Is sports nutrition attracting the most investor interest?
Hood: I would say branded active nutrition is No. 1 right now. No. 2 would be the manufacturing base and co-manufacturers. No. 3? Alternative channels of distribution. All of that to say, if an attractive brand or portfolio of brands in classic VMS—like an Emergen-C or Airborne—were to come up, there would be a feeding frenzy for that. But there just aren't any independents available, so it would mean that one of the larger players would need to look to divest.

> "There is a real dearth of independent brands over $50 million in revenue. Brand M&A has consequently slowed, but we've seen the action shift to other areas of the VMS category, specifically the supply chain."

A perfect example of that is the ongoing rumor of P&G looking to divest some smaller brands. If they were to decide to divest one or two of their VMS brands, they would have a tremendous amount of interest in those.

nbj: What about alternate delivery formats. Still of interest?
Hood: Both of the major effervescent transactions have already occurred with Emergen-C, an effervescent powder, sold to **Pfizer**, and Airborne, an effervescent tablet business initially sold to Schiff and ultimately part of Reckitt Benckiser's portfolio. Of the major iconic effervescent brands, those transactions are done. There are a number of smaller players that are doing some interesting things with effervescents, but those are still small brands that are not yet large enough to be on the radar of the large strategic players. Many of them, at this point, are considered me-too products.

You are seeing some interesting things going on in the market. **Bayer** just launched their **Berocca** effervescent product in the US. It's predominantly vitamin B, and I think that brand and product should do very well. On the gummy side, there are really only two scale manufacturers of gummies in the US. One is Avid, acquired by Church & Dwight for $650 million, and the other would be Santa Cruz Nutritionals, now owned by a financial sponsor who will, at some point in a number of years' time, look to exit that business for their return. The gummy category, as a whole, has shown no signs of slowing down. It continues to grow very rapidly across brands and acquiring a co-manufacturer is a great way to leverage all of those marketing budgets. You're supplying gummies to all of the players. Other than those two, there really are no scale manufacturers of gummies in the US.

NBTY is rumored to be making some gummies, but that's their own gummies. Where you may see some additional gummy activity is with some of the new brands, like **SmartyPants**. Smarty Pants is too early for an acquisition, but I like their positioning and if they continue to grow, that might be an interesting opportunity for somebody down the road.

On the effervescent and gummy side, I think you've seen a lot of the action that's going to take place and the question is—is there room on the shelf for incremental innovative delivery forms, whether it be a chew, a lozenge, drops or a shot? Personally, I'm skeptical that you will see any new form have the success of effervescents or gummies. That's a personal view and consumer preferences change every day, but it's hard to see a new form take significant share from those two in the near future. I do think tablets will continue to decline as the gummy trend continues and people find additional things to do with effervescents.

nbj: What do you make of this trend toward organic, non-GMO, whole-food supplements?
Hood: The challenge with that segment is that it's still predominantly stuck in the Health Food Store (HFS) channel. New Chapter, despite rumors that P&G was going to take it to mass, still hasn't gone to mass and fundamentally, the HFS channel is less well-known by the large strategic universe. None of the large CPG players, other than P&G now, play in that channel. They don't have a sales force there, they don't understand the educational nature of the sale in that channel, and so, they prefer businesses that have sales and marketing fundamentals that are consistent with their own.

Specifically, they like national mass-market brands with, call it north of 60-70% aided awareness distributed through the Food, Drug, Mass and Club channels. That's what the consumer health marketers do best at Big Pharma, that's what the CPG marketers do better than anyone, and that's what the food & beverage companies do best. More food & beverages companies do play now on the HFS side and sell through **Whole Foods**, but a business that is predominantly HFS channel today will likely have less interest than a national mass-market brand from the global strategic universe, simply for sake of comfort. The HFS channel is highly SKU intensive, and classic marketers really prefer to market a limited number of SKUs under a brand umbrella. You see lots of sub-brands in HFS, and really it's the product that's driving the sale as opposed to one major umbrella brand that's driving the sale.

nbj: How about another early trend—personalized medicine?
Hood: Large strategics are starting to think about it, but not to the point where we've seen any meaningful M&A activity. The companies operating here are still immature at this point—there are lots of startups working on it, as you know. I find it very exciting for the category, but I don't think it will have a tremendously detrimental impact on the multi, let's say. I think there will be a role for personalized supplements as well as a standardized multi regimen.

—MARC BRUSH

Trouble On Wall Street

Missed expectations hammer two of the industry's bellwether stocks

Investors aren't as bullish on public retailers in the nutrition and natural products market as they were in 2013. **GNC** (GNC), which finished last year with a stock price above $60, is now a sub-$40 stock. In February 2014, **Whole Foods Market** (WFM) saw comp store sales decelerate for the first time in nearly a decade. GNC and WFM act as bellwethers for their respective categories (dietary supplements and natural & organic foods)—as they go, so go their spaces.

Competition for WFM

Competition is the name of the game this year for natural retailers, and few felt it as strongly as Whole Foods Market, the world's largest. "Natural retailers are underperforming this year because of competitive pressure," says Scott Van Winkle, Managing Director of Equity Research at **Canaccord**.

Andy Wolf of **BB&T Capital Markets** sees increased competition across the board: "You've got **Trader Joe's, Sprouts, Mariano's** in Chicago. **Kroger** and **Safeway** are growing same-store sales for natural & organic products. Warehouse and club stores are selling more natural & organic."

This trend is, of course, a barometer for success in the overall natural products industry, which continues to experience stellar sales growth. The Great Recession is solidly lodged in the rearview mirror and consumers continue to trade up to natural & organic at retail. But for Whole Foods, this high-impact growth has created something of an identity crisis, and investors have begun to turn off. In May 2014, share prices dropped a precipitous 35% after quarterly earnings revealed that earnings per share were far below projections. Comp store sales growth fell to 5% for the year, well below the 7% to 9% it had enjoyed for several years previous.

Natural channel

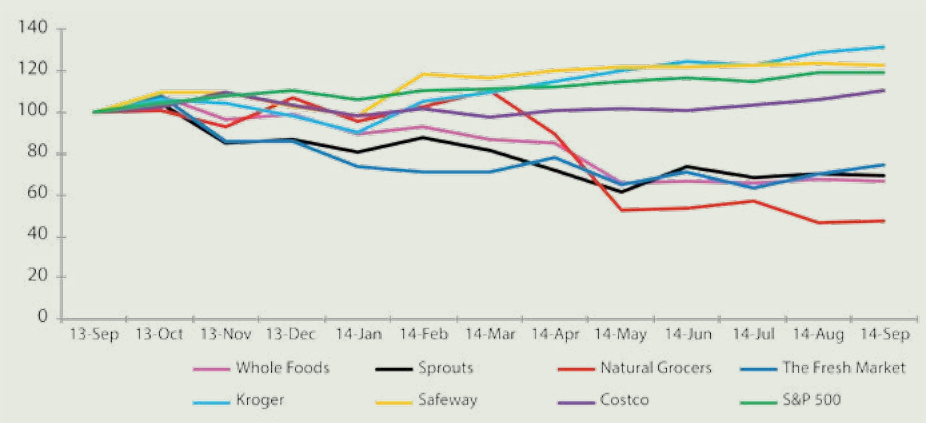
The natural retail space has gotten much more cramped as supernaturals grow their footprints and enter public finance. While Whole Foods is still committed to opening over 1,000 stores in the U.S. (a number it augmented to 1200 recently), it faces stiff headwinds from aggressively expanding public retailers such as Sprouts (SFM), **Natural Grocers by Vitamin Cottage** (NGVC), and **The Fresh Market** (TFM).

Where WFM wins on size, these latter three retailers are winning share on identity and value proposition. Sprouts has nabbed the value-oriented natural shopper with its major point of focus—cheap produce. (Over half of Sprouts' revenue comes from fresh produce.) Natural Grocers and Fresh Market utilize smaller store formats to position themselves as convenient, neighborhood grocers in suburban settings. Whole Foods, on the other hand, has to appeal to every natural products shopper.

Here are a few more noteworthy details on these retailers:

- Sprouts came out of Q2 2014 with 20% year-over-year growth and same-store sales up nearly 10%. The company, based in the southwest United States, opened its first stores in the Atlanta metro area.
- Natural Grocers, which traded above $40 this spring, is now a sub-$20 stock. Though it can boast nearly 50 quarters of positive comp store sales growth, it's Q3 2014 comp performance fell to just 2%.
- Fresh Market just received an upgrade from BB&T Capital Markets. According to Wolf, despite poor performances in new store openings in urban Texas and California, the company's renewed focus on core markets makes it a strong buy.

STOCK PRICE INDEX OF MAJOR GROCERY CHAINS, SEPTEMBER 2013 TO SEPTEMBER 2014



Source: Yahoo Finance

Mass tightens too

Kroger, Safeway and **Costco** are a few of the most visible mass market competitors for Whole Foods. While incremental purchases of natural & organic products won't make a material impact on these grocery giants' bottom lines, their combined weight has begun to impact WFM's.

"The growth for natural & organic has been a little better in mass market," says Wolf, with an emphasis on "little." Grocers are simply adding natural & organic products alongside their conventional counterparts in order to nab the purchase a consumer would otherwise make on their Whole Foods trip. These incremental sales are a drop in the bucket in the scheme of mass grocers' financials. Nevertheless, here are a few highlights of these companies' 2014 performances to date:

> "The retail players gaining share—Walmart and online in particular—are more price focused, while some retailers that had backed away from deep-discount promotions, such as Walgreens, are coming back to it." —Jack Neff, Ad Age

- Kroger (KR), whose stock price has steadily climbed to above $50 in 2014 from a low of $35, has been on an expansion spree of late. The company announced in September a plan to hire 20,000 new supermarket associates in order to better serve its stated customer focus.
- Safeway (SWY), meanwhile, is gearing up for a buyout by **AB Acquisition LLC**, an affiliate of **Albertsons**—a deal announced in March and expected to close by the end of 2014. In the meantime, its stock has held steady at just below $35.
- Costco (COST) continues to experience comp store sales growth, both domestically and internationally. The company's stock has traded over $100 since the beginning of 2013.

The competition among supernaturals experienced in 2014 is similar in scope to that from 2006, says Van Winkle, when **Walmart** attempted its first foray into the organic market and Safeway began in earnest to ramp up its O Organics private label line. WFM's comps went negative as competition heated up, and the company responded by focusing on value, in an attempt to shed itself of its "Whole Paycheck" reputation.

Value is not so valuable a strategy for Whole Foods, however, with the ascendance of more value-focused supernaturals, such as Sprouts. On the specialty and gourmet front, there's Trader Joe's on the rise. On small-store formats, there's Natural Grocers and Earth Fare.

The year of the manufacturer

While the year is shaping up as nothing special for the history books in public natural retailers, it's really the curse of prior-year overperformance that makes the comparables less attractive. According to Wolf, we're in an extended period of dramatic competition in natural retail, which tends to be a turnoff for investors. "It's when competition peaks that investors want to get back in," he says.

For natural & organic food manufacturers, distributors and suppliers, however, these are the salad days. **Boulder Brands** and **Hain** have enjoyed banner years. **WhiteWave** completed its $600 million acquisition of **Earthbound Farms** (the largest organic produce company in the U.S.) in January of this year. **General Mills** acquired **Annie's** in September. Non-GMO soybean processor **SunOpta** (supplier to Hain, Boulder Brands and Whole Foods) crossed $1 billion in revenue and boasts one of the best performing stocks in the natural & organic space. **UNFI**, which tends to go as WFM goes, has actually outperformed its largest customer thanks to its high-growth mass market distribution business. Those who stand to gain most during this period of increased competition are young, innovative food brands. As retailers race to stand out from one another, new, high-value and differentiated products will be in large demand.

Also on the horizon for food manufacturers could be a concerted push into the food service industry. According to Van Winkle, Boulder Brands plans to announce a major partnership to sell gluten-free items through restaurants later this year. Hain, with its gluten-free offerings, could find a similar opportunity. For the retailers, expect promotional fury, cutthroat value pricing, and possible acquisitions as we move through this period of competition.

Multis, omegas & GNC

GNC experienced a much more significant shake-up than Whole Foods in 2014, with its share price dropping below $40 from a high of $60 earlier this year. Earnings per share took a two-cent dive from Wall Street consensus estimates following the company's release of second-quarter earnings. Comp store sales also shrank to 4% in Q2, compared to nearly 7% in the previous year's quarter.

On August 5, former **Vitamin Shoppe** (VSI) president & COO Michael Archbold took the reins of GNC, replacing nine-year veteran Joe Fortunato as CEO. Fortunato appears to have suffered quick reprisal from just two quarters of underperformance. "I look forward to working closely with the team across GNC and the Board to further strengthen the company's market position and deliver improved financial performance," says Archbold in a GNC release. Archbold has 25 years' experience in the retail world, with executive tenures at Vitamin Shoppe, **Talbot's**, **Saks Fifth Avenue** and **AutoZone**.

But most would argue that GNC's performance hiccups are beyond the control of management. "In 2014, the broader market for supplements has softened, creating a pause in the growth cycle for what has been a very resilient sector in the past," Fortunato said on the company's Q2 2014 earnings call. He called out negative media, inclement weather, and a difficult new member pricing initiative as hindrances to the company's 2014 performance.

"The culprit is multivitamins and omegas," says Van Winkle. When negative studies surrounding these two supplement mega-categories hit media outlets last summer, retailers and manufacturers couldn't

CONTINUED ON PAGE 14

act fast enough to stem the tide of consumers who chose to nix these products from their supplement regimens. There's also the specter of DMAA, rogue ingredients in the sports nutrition category, and the potential reputational damage to GNC as such a major proponent of the preworkout category so often home to these products.

The year 2013 was otherwise strong financially for supplement sellers. IPOs and stock value appreciation accelerated through the first half and this acceleration kept retailers and manufacturers buoyant through the initial media wildfire. But a consistent lack of good news regarding omega and multivitamin science brought a sluggish start to 2014. **NBJ** continues to forecast a sales slowdown for 2014, with annual growth down from 7.5% to approximately 5%, assuming some rebound in the second half of the year.

Analysts had previously concerned themselves with finding out how GNC planned to contend with **Amazon** selling supplements for cheaper than GNC could compete with. Now the question is whether the supplement industry as a whole can dig itself out of a spiral of bad press.

Competitors in channel

Anxiety surrounding GNC's future performance has some analysts chomping at the bit. Gary Balter of **Credit Suisse** released a report in August suggesting that GNC purchase Vitamin Shoppe. The merger makes sense from a logistical standpoint—a former VSI exec is now CEO of GNC, the companies have overlapping footprints that could easily be integrated, and the combo of websites would bolster an online play that would better rival Amazon's ascendance.

But it also has the tenor of general Wall Street braying. Vitamin Shoppe has faced similar challenges as GNC this year, but has not suffered any precipitous declines in stock price. In Q2 2014, the company posted weakness in its margins, with gross profit down 120 basis points. Higher consumer spending on low-margin items, growing e-commerce sales, and the effects of integrating the company's latest acquisition, **Nutri-Force**, all contributed to the dip in profits.

Unlike natural & organic food retail, competitive pressures have remained fairly consistent this year, VSI executives said during their Q2 2014 earnings call. All in all, the company has maintained strong results through softness in the overall supplements market.

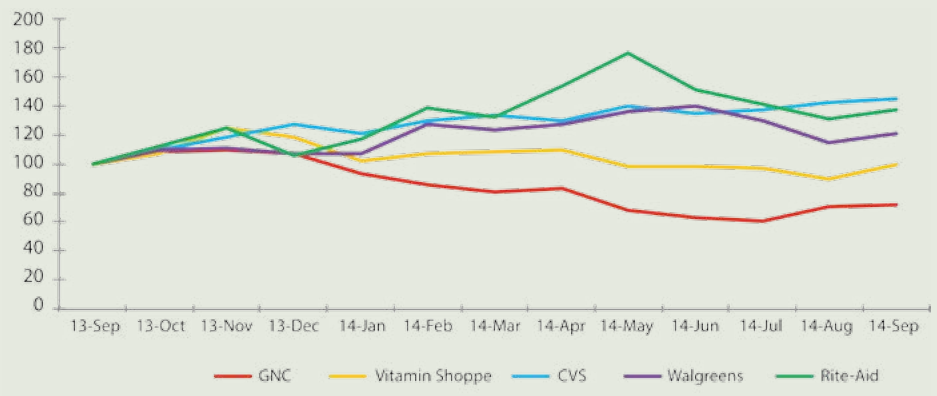
Competitors out of channel

C-stores, pharmacies and big box have responded to supplement softness with aggressive discounting and promotions, especially through e-commerce. According to Jack Neff of **Ad Age**: "The retail players gaining share—Walmart and online in particular—are more price focused, while some retailers that had backed away from deep-discount promotions, such as **Walgreens**, are coming back to it."

Otherwise these retailers remain fairly insulated from weakness in the market and are free to pursue new marketing and branding techniques to take ownership of the health market—whatever that may mean**. CVS** has nixed cigarettes from its product line-up in order to rebrand as **CVS Health**. Walgreens has decided to reincorporate in the United States rather than follow the lead of several companies clambering to the tax haven of Ireland. **Rite Aid** acquired health coaching provider **Health Dialog Services** in April. All three companies are hiring health coaches, guides and nurse practitioners to walk their floors and assist consumers.

This last trend, of course, has been a hallmark of natural retailers and pharmacies for years, while attendants at GNC, Vitamin Shoppe, **Vitamin World**, **Max Muscle**, and others receive training on new products and science on a regular basis. But where these companies win in specialization and breadth of product offering, they're beginning to lose on price and general consumer excitement.

STOCK PRICE INDEX OF VITAMIN & PHARMACY CHAINS, SEPTEMBER 2013 TO SEPTEMBER 2014



Source: Yahoo Finance

A new omega-3?

According to Van Winkle, what the supplement industry's really missing right now is a new breakout category, on the scale of gluten-free or non-GMO in the food market. Probiotics sales have been strong this year, as well as smaller categories such as sleep aids, mood enhancers, inflammation supplements, and, of course, protein. But the supplement industry desperately needs a new omega-3, a new billion-dollar-plus market to build some consumer excitement. Protein has supply constraints. Inflammation and brain health are risky from a regulatory perspective. Probiotics face problems of potency, consumer confusion, and scientific inconsistency. That said, supplements are a historically resilient product category—and GNC is a historically resilient company.

—CONNOR LINK

Dealflow at NCN

With fewer big deals on the table, financing of early stage companies picks up

by Grant Ferrier, Nutrition Capital Network

September 2014 brought the news of **General Mills**' acquisition of **Annie**'s in an $800 million deal, but the pace of M&A in natural & organic foods has slowed, largely because of a relative lack of dealflow of companies of sufficient scale to attract the interest of strategic buyers. A transaction database maintained by **Nutrition Capital Network** (NCN) indicates that M&A in the natural & organic foods segment has declined marginally in recent years, but has tumbled noticeably through the midway point of 2014. (It is worth noting that dealmaking is a bit of a seasonal phenomenon—mostly due to tax-year issues—and it tends to increase in the second half.) Balancing the decline in food deals was a notable increase in M&A in supplement companies as **Healthy Directions**, **Jamieson Labs** and **Atrium Innovations** were all acquired in large deals, as were **PowerBar** and **Muscle Milk** in sports nutrition.

In all segments of what we call the nutrition and health & wellness industry, however, activity in financing of early-stage companies has increased to the point where the 96 companies financed in the first six months of 2014 already exceeds the 2013 total. About half of these 2014 transactions were in the Enabling Technology segment with a breadth of Internet companies, apps and e-commerce companies raising usually between $1 million and $10 million.

Also notable thus far in 2014 is the big jump in the average financing from around $9 million in 2011, 2012 and 2013, to $26 million in 2014. Two investments were largely responsible: Greek yogurt brand **Chobani** secured a $750 million investment from **TPG Capital**, a private-equity investment firm; and wearable tech-space leader **Jawbone**, maker of the Up wristband, closed a $250 million investment led by **Rizvi Traverse Management**. In addition, a number of e-commerce health & wellness companies raised big bucks, such as: **MindBody** ($50 million), **Blue Apron** ($50 million), **Birchbox** ($60 million), **HelloFresh** ($50 million) and **Instacart** ($44 million).

No doubt investor interest in things digital is not sector-specific, but the crossroads of IT and health & wellness (investors generally don't use the term nutrition) is fertile ground for those with growing companies and ambitious business plans. So where is the dealflow today in our industry?

NCN's measure of deal flow is in applications and referrals of companies looking to present their business plans for consideration at one of four annual investor meetings. The six-year and 2014 snapshot in the table below provides more detail. Supplements and ingredients roll up together to 25-30% of companies looking to raise capital. Natural & organic foods represents a growing plurality, with functional food & beverage collectively accounting for more than 10% of industry deal flow.

In finished products, the trend of investors looking for larger and larger companies has been going on for some time, and has led to the pipeline of available deals of sufficient scale for them drying up. There are certainly fish in the sea for acquisitions and larger investment, but the larger financial players and strategic acquirers realize they have to pay more attention to stocking the waters, or to working with smaller and smaller deals. A typical private-equity investor may only invest in a firm with a minimum of $3 million in EBITDA, which they define as proof of concept, while a typical startup feels they have reached proof of concept when they have sold $20,000 worth of product.

This divide still yawns in the nutrition and health & wellness industry, but as investors and entrepreneurs increasingly interact—NCN, Natural Products Expo or other industry events—the gap between investors and entrepreneurs is thankfully narrowing. There is no shortage of professionally-managed investment capital aimed at health & wellness, but it is not always in risk-tolerant hands to invest in the innovative companies that are most likely to make a difference in future markets. Our industry and our entrepreneurs and growing companies need that capital to become a bigger part of the solution, not part of the problem.

DEALFLOW BY SEGMENT

	# of Deals, 07/2007-06/2014	% of Total	# of Deals, 2014 YTD	% of Total
Functional Beverages	140	8%	9	4%
Functional Foods	79	4%	5	2%
Ingredients	279	15%	31	14%
Media	20	1%	1	0%
Medical Foods	10	1%	0	0%
Natural & Organic Foods	654	35%	106	48%
Natural Personal Care & Household	171	9%	14	6%
Retail & Service	96	5%	1	0%
Supplements	251	13%	23	10%
Technology	109	6%	16	7%
Other	56	3%	14	6%
TOTAL	**1,865**	**100%**	**220**	**100%**

Source: Nutrition Capital Network Dealflow Database 2014

Grant Ferrier
CEO, NCN
nutritioncapital.com

Kickstarting Food

Crowdfunding offers a new option for natural & organic but pitch & tone are key

The product development cliché in natural & organic food has always been a farmers' market launch out of the back of a hatchback. A few hundred taster spoon responses later, the product might be ready for the local coop and from there, bootstrap financing and shoe-leather marketing takes the product into chains via a lucky encounter at **Expo West**.

Now there's a new step. **Kickstarter** has become the world's biggest market research and seed-funding test kitchen. At press time, 2,853 food projects had successfully raised $42.5 million on Kickstarter. Of course, 5,737 food projects had raised zero dollars too in Kickstarter's all-or-nothing model.

The difference between a successful campaign and an unsuccessful campaign is not always easy to discern. When a low-income farmers' market misses its all-or-nothing $2,000 goal by $1,999 while a hungry guy in Ohio can bring in $55,000 to make a potato salad, it can be downright infuriating.

Still, with all the talk of Silicon Valley tech money coming into food, many culinary entrepreneurs are saying the money remains tight for actual products and they're calling Kickstarter the best thing tech ever did for food startups.

Let's take a look at successful food projects, paired with projects in the same category that failed or barely hit their mark, to offer some small insight into the new market for financing food startups.

On trend

Success story: **Six Foods**

Six Foods is turning insects into snack food with its Chirp Chips and more than doubled its $30,000 ask to close with $70,559 in May of this year.

What worked: Six Foods timed the buzz perfectly. A **United Nations** report on edible insects and a **New Yorker** piece gave the movement momentum, and Six Foods lassoed its crickets with a different format—chips, instead of the bars that have inexplicably become the go-to bug snack. Smart modern packaging with strong graphics explaining the sustainability story

KICKSTARTER STATS

Category	Launched Projects	Total Dollars	Successful Dollars	Unsuccessful Dollars	Live Dollars	Live Projects	Success Rate
All	#####	$ 1 B	$ 1 B	$ 155 M	$ 21 M	#####	41.35%
Games	12,180	$ 270.14 M	$238.57 M	$ 28.15 M	$ 3.42 M	572	34.69%
Film & Video	39,463	$ 236.45 M	$ 197.32 M	$ 37.00 M	$ 2.13 M	955	39.68%
Design	9,813	$ 201.60 M	$ 177.36 M	$ 20.97 M	$ 3.27 M	522	36.62%
Technology	7,306	$ 193.89 M	$ 166.76 M	$ 21.84 M	$ 5.29 M	819	28.5%
Music	32,585	$ 122.76 M	$ 111.14 M	$ 10.28 M	$ 1.39 M	798	54.19%
Publishing	19,546	$ 55.95 M	$ 46.37 M	$ 8.47 M	$ 1.11 M	760	31.23%
Food	9,611	$ 52.63 M	$ 42.75 M	$ 8.27 M	$ 1.61 M	813	32.7%
Art	14,039	$ 41.76 M	$ 35.94 M	$ 5.19 M	$ 633.04 K	537	46.16%
Fashion	7,811	$ 40.84 M	$ 34.79 M	$ 5.23 M	$ 816.00 K	429	27.57%
Comics	4,589	$ 31.25 M	$ 28.41 M	$ 2.35 M	$ 483.27 K	163	49.91%
Theater	6,855	$ 27.53 M	$ 24.15 M	$ 3.09 M	$ 291.51 K	163	63.33%
Photography	5,600	$ 15.35 M	$ 12.72 M	$ 2.34 M	$ 287.79 K	263	32.9%
Dance	2,177	$ 7.38 M	$ 6.84 M	$ 483.68 K	$ 63,340	67	68.82%
Journalism	1,500	$ 4.59 M	$ 3.95 M	$ 573.6 K	$ 64,428	127	30.52%
Crafts	2,210	$ 3.62 M	$ 2.95 M	$ 599.56 K	$ 122.34 K	271	31.87%

Source.Kickstarter, updated September 10, 2014

doubtlessly helped, as did a lively video with the three young founders offering a compelling quirky story.

Missed opportunity: **Don Bugito**

A variety of bugs prepared in "pre-Hispanic and contemporary Mexican cuisine" had the novelty but not the pitch, missing its $40,000 goal by $30,928.

What didn't work: The goal was smaller here—building a food cart—but the target was smaller too. Intact insects are finding acceptance in foodie circles, but even hardcore foodies might flinch at the squirming "worms taco" that greets visitors to the Kickstarter page. The video was too long, pushing 4 minutes, and boring to the point of preachy.

Gearheads

Success story: **SCiO Scanner**

The **Consumer Physics** hand-held molecular scanner capable of measuring the content of any food in seconds is the only food project that has topped $1 million, and it topped it in a big way, reaching $2.7 million when the campaign ended in June.

What worked: Face it. This is revolutionary. It makes a **Star Trek** Tricorder look like a rotary dial phone. That kind of excitement got Consumer Physics write-ups everywhere from **Forbes** to **Gizmodo**. The video keeps that excitement at pitch by not making this a "it's good for you" device to track nutrition, but a scientific instrument. It'd be easy to see why the "Partner With Us" reward for a $10,000 pledge would seem reasonable to more than a few companies.

Missed opportunity: **ComboKeeper**

What didn't work: Anybody who has kept a compost bucket on the counter would see the appeal in the CompoKeeper—a foot-pedal-operated compost can that keeps the smell in and the flies out—but the campaign raised less than half of its $100,000 goal.

What didn't work: The CompoKeeper was the right idea for the right people but there weren't enough of those people to make it work. The father and daughter team behind CompoKeeper live in Boulder, where curbside pickup makes composting practical for people who don't keep a worm farm in the backyard. In Boulder, a $70 compost bucket makes sense, but the vast majority of towns don't offer curbside compost. However clever a design, it's hard to rise above limited demand. The video with the father-daughter team is sweet but unexciting.

Setting the bar

Success Story: **Kuli Kuli**

What worked: **Kuli Kuli** used authenticity and a cause to move their campaign $3,000 beyond its $50,000 goal. Though an **IndieGoGo** project rather than Kickstarter, Kuli Kuli faced the same challenges any Kickstarter project would face. They also faced a very crowded bar market. Shelf space is limited and buyers likely roll their eyes at scores of me-too pitches. Kuli Kuli stands out with a cause—moringa, a plant that grows on little water in arid environments—and the company commits a share of proceeds to educate African farmers and encourage moringa cultivation. Co-founder Lisa Curtis' story of discovering the benefits of moringa as a **Peace Corps** volunteer in Niger rings with authenticity and is told simply in a simple video.

Missed opportunity: **Fat Bars**

This fat and protein product "based on the latest nutritional science" garnered just $40 of its $16,000 goal.

What didn't work: However many recent headlines declare that fat is not the health risk previously believed, it's still not a great word to put in the name of your product, but that's only the beginning of this product's campaign problems. Lacking a video, graphics or even a slogan, the copy is dry and the carbs vs. fat debate is less than compelling when used to promote a particular product. The would-be founder has a personal story of obesity issues in his family that might have made sense to tell but from the looks of it, but he barely got off the couch to complete this campaign.

The meat of it

Success Story: **Three Jerks Jerky**

What worked: Three Jerks used a very basic campaign to more than double their $20,000 goal and hit $45,663. It could have been the funny name, good timing with the Paleo movement, or the taste. We'd say all of the above trending toward taste. That's an amazing feat to pull off online. "The Original Filet Mignon Beef Jerky" tagline grabs interest but the food porn photos of the actual jerky probably had many of the donors salivating and then clicking "pledge." The video is too long and amateur, but with many "lesseterians" cutting back on meat without eliminating it, they want their meat to be a high-end indulgence. Indulgence was the theme here and it worked.

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Missed opportunity: **Sweet Meat Organic Beef Jerky**

What didn't work: This one missed it's $12,000 goal by more than $5,000. The campaign hits bullet points for organic, grass fed, non-GMO, gluten-free, and "50% less sodium" before it gets to taste. It was also their second Kickstarter campaign (the first topped a $900 goal at $2,623) which emphasizes the wisdom of going to the well only once.

The heat of it

Success story: **SOSU Barrel-Aged Sriracha**

What worked: Pitching the hippest hot sauce of the century worked with a campaign that blast past a $20,000 goal and hit $104,146 in March. Sriracha is not the hottest hot sauce by taste, but it may be the only hot sauce in history to approach cult status. That helped Lisa Murphy get mentions in online sites like **Chow.com** and publications around her San Francisco base where the cult might be most fervent. Beyond the right idea at the right time, SOSU had a strong video heavier on testimonials than story, and pledge rewards that include styled for-the-cult T-shirts and a Shriachapocalypse Kit that fit well with the crazed fans of the precious red liquid.

Missed opportunity: **BOSS Hot Sauce**

What didn't work: **BOSS** barely got off the ground, garnering just $386 of an obviously overly ambitious $22,500 goal in February. Sauce maker Vinny Santoro likely turned off many potential donors with a video that was the equivalent of a selfie, but even with the low-production quality, the lack of energy was shocking—"It's not really my goal to make hot sauce but that's what happened." The pledge rewards also lacked effort with each level resulting in more bottles of hot sauce and more BOSS stickers. A "second go round" five months later met the same fate.

Against the grain

Success story: **WEDO Banana Flour**

What worked: In the exploding gluten-free market, it'd be easy to expect a business like **WEDO** to face a lot of competition for donor dollars, but they managed to shoot past their $30,000 goal by nearly $6,000. The gluten-free movement is not known for a sense of humor, but WEDO founder Dave Wintzer had us laughing 10 seconds into his video and kept the tone clever all the way to the $5,000 "BEST KICKSTARTER SKI & DINNER DATE EVER" donor reward. It must have worked for the 685 backers too. All the nutritional and what-it-is information is clear, and placing the playful packaging on a shelf amid the other stodgy gluten-free products helps WEDO pop.

Missed opportunity: **Gluten free fair food**

What didn't work: This is a concept in search of a market, and the Kickstarter campaign ended $30,000 short of its $50,000 goal. Clearly would-be founder and celiac sufferer Nolan Russell has passion for the idea—a food cart for county fairs offering gluten-free versions of funnel cakes, cheese curds and other upper Midwest favorites people with celiac might crave but can't eat. And clearly, friends and family shared some of that passion because the $20,000 in pledges came from just four backers. That passion would likely never be shared by grease-hungry throngs at the county fair. A farmers' market? Maybe. But not the midway. Even then, gluten-free consumers are far more diet conscious than the funnel cake crowd. Whatever the appeal, the pitch never equaled the passion and the goal was hopelessly high. Nobody is going to raise $50,000 on a less-than-appetizing photo of unidentified fried objects, three paragraphs of dry text and a single reward—a recipe? Really?

Back on the farm

Success story: **Primal Pastures**

What worked: This campaign to expand a sustainable livestock farm in Temecula, Ca. went well past its $40,000 goal to hit $57,810. The "Let's Build a Farm Together!" theme feels like a perfect pitch to environmentally conscious carnivores who want to feel like part of positive change. We also enjoyed the pledge reward of 50 chickens on the farm with "10 to 20 dozen eggs a week" and "periodic videos and photos from your very own flock."

Missed opportunity: **Sunburst Farms**

What didn't work: North Carolina's Sunburst Trout Farms wanted to build an indoor "agritourism and learning facility" in a nearby town but barely topped 10% of their $16,000 goal. Sunburst Trout Farms is an already established outfit and building what sounds like a way to sell more trout hardly inspires donors. There are already many questions about the environmental impacts of aquaculture and though the video mentions that compost from the fish processing goes to local farms, doubts only grow deeper when the rewards package reveals that Sunburst aimed to charge $10 for tours of the facility.

Bottom line

In food, idea and execution mean everything. Kickstarter hasn't changed that. The right idea at the right time is likely to get the best traction, just as it does offline. An entrepreneur could conceivably leapfrog the taste test in the crowdfunding round, but the successful projects we've seen come with a story closer to the hatchback-farmers' market cliché than a secret lab. Passion and authenticity are still required and that combination usually results in a quality product. What comes with the opportunity, however, is the demand for a skillset the passion doesn't always provide—presenting well online, and making social marketing work. In short, all the skills that have become make-or-break for any startup.

—RICK POLITO

In Praise of the Moonshot

Why aren't we getting more innovation from large consumer companies?

by Ryan Caldbeck, CircleUp

Consumers are hungry for innovation. Disruptive innovation. That means more than simply labeling an old product "All Natural." Making a product natural or organic is often a very good thing, but it's not disruptive innovation.

Here's a story. In 2010, passing through the Denver airport, I stopped to eat. Four years later, I'm still telling people about **Itza Wrap! Itza Bowl!** In the ensuing four years, I've been through a lot of airports and eaten at a lot of restaurants, and I still remember that experience. It was that good. It's not that the food was amazing. It was that good because it fulfills what many business travelers want: quick, healthy food. And that is exceptionally rare.

How is it possible that we still can't get healthy food at 80% of the airports in this country? Because, in a market dominated by large players—either those that own the retailers or rent the space—there is little innovation at the top.

This is just one example of large companies failing to provide the innovation that consumers are crying out for. Where is the portable protein that is actually good for you? Where are more gluten-free options? What about a skincare product that has a value proposition other than "the best ingredients?" How is it possible there is not a dish soap that is actually effective but also edible? Is that really crazy? Was **Uber**'s goal of on-demand transportation less radical? My wife and I recently had a baby, and we are not the first to wonder aloud: "Why is there nothing on the market to calm a crying baby?" Nothing.

In my role as the founder and CEO of **CircleUp**, an equity crowdfunding platform, I recently spoke with a Fortune 500 company that was doing a huge initiative to spur innovation internally. A company representative said: "We are looking to create innovation internally and would love your help in spurring that innovation. But we really only want to make bets on products or brands that we think will be billion-dollar ideas at the outset."

I asked: "How many have you seen like that in the past five years?"

The answer: "None."

Consumer demand is clearly there. **Booz & Company** analyzed the food and beverage industry and found that small players with sales of less than $1 billion are outperforming larger competitors in 18 of the top 25 categories, including the largest ones, such as bakery, dairy, snacks and ready meals.

Smaller, younger, more creative businesses are seeing opportunities among consumers and moving quickly to meet the need. Comparing large companies' brand creation and that of companies with less than $2 billion in revenue, **Gamechanger** found that those small companies have created six times more new brands since 2000.

This is why large consumer and retail companies are so acquisitive. They are acquiring innovation. Just look at **Coca-Cola**, which has acquired brands such as **Glaceau** (**vitaminwater**), **Fuze**, and specialty drinks **Odwalla**, **Honest Tea**, **Innocent**, and **Zico**.

The value of consumer-retail deals in 2013 actually exceeded the value of technology M&A. In consumer and retail, there were 126 deals last year with a total value of $107 billion and 129 deals worth $81 billion in 2012, according to data on publicly disclosed transactions in **PriceWaterhouseCooper**'s US Retail & Consumer M&A Insights for 2013. This compares to $55 billion for software and internet M&A combined.

Strategics—the major public consumer or retail companies—have a track record of expanding their product portfolio through acquisitions. That's a great way to acquire innovation, just as we see happening in the tech world. But we need more from large consumer companies. We need them to acquire innovation from both external and internal sources.

Here is why that innovation isn't happening internally. Large incumbents are often blind to disruptive innovation—as **Harvard** professor (and CircleUp investor) Clay Christensen explains, innovation that transforms a market by introducing simplicity, convenience, accessibility, and affordability where complication and high cost are the status quo. Large consumer packaged goods companies looked at **Chobani** and didn't see the demand. Look what happened there. Chobani created the Greek yogurt category in America in 2005, and by 2011 Greek yogurt was 20% of all U.S. yogurt sales.

Similarly, incumbents shrugged off **5 Hour Energy** drink. Why, they asked, would that product grow when **Red Bull** had the market dominated? If we were to apply one of Christensen's theories, it's because it does the job well enough, and it's easier and cheaper to use. Comparing 5 Hour Energy to Red Bull, you'd see Red Bull was more expensive when 5 Hour was released, it came in a larger container, and it didn't fit in your pocket. On the other hand, 5 Hour did Job One—it provided energy—and it was easier to use and less expensive. So it won over consumers and expanded the market.

It's clear that the innovation teams at large companies are challenged from above to spend their time only on massive ideas that have a clear path to becoming billion dollar brands. In consumer and retail there is very rarely a culture that promotes the types of moonshots that a company like **Google** will take. Think about how crazy self-driving cars sounded 10 years ago. If that's possible, is it really crazy to think that we could invent a product to put a baby to sleep in a healthy way? Or soap you can eat?

Ryan Caldbeck
CEO, CircleUp
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Health Is A Right, Not A Privilege

Q&A

with Maddy D'Amato, Love Grown Foods

The **Love Grown Foods** line of oats and cereals experienced the kind of unprecedented skyrocket growth in mass that many companies would kill for … but did that growth come at a price? **NBJ** spoke with "Chief Love Officer" Maddy D'Amato about the practicalities of making healthy foods accessible to more people.

nbj: You bypassed natural specialty retailers to go straight into mass market. How did that happen?
Maddy D'Amato: We started the company in my hometown of Aspen, Colorado after graduating from the **University of Denver** and we got into two local coffee shops. Then in the summer of 2009, we got into a local **City Market**, a supermarket chain owned by **Kroger**. And six months later, we got into 80 **King Soopers** and City Markets in Denver. We had the opportunity then to present to Kroger corporate, and they pioneered us and put us in 1,300 stores in January of 2011. So we went from one store to 1,300 stores in a year and a half.

That was the best thing we could have asked for in the sense that it put us on the map, but it also put us in a retailer that really speaks to our goal and mission in being in parts of the country where you don't find natural food stores, where you don't have access to healthy foods as much as you do in large cities. It almost wasn't even a strategy, if you will. It was being in the right place at the right time. Kroger has really been a leader in saying—'We're a one-stop-shop. You can find organic, natural, better-for-you items, in addition to everything else we offer in our stores.' They're bridging that gap between natural and conventional.

nbj: Was not seeking organic certification part of that?
D'Amato: We consciously did not go organic, knowing that if we had, our price point would be $1 to $2 more across the board. It's not that we don't value organic, and it's not that we don't' think organic foods are good or important—they are and we recognize that. I think the biggest excuse as to why people don't eat healthy is that they can't afford it. So, you have to decide what route you're going to go, and we went the route in making healthier foods more available to more people with the goal that, if more people can demand healthy organic foods, that price will be driven down and eventually we can offer organic foods in our product offering.

nbj: Was there any negative reaction?
D'Amato: Yes, there will always be consumers who are only buying organic. They don't purchase our products because they are not organic, and at the end of the day, we salute those people. They are also helping make a change. But there are also people who are so grateful that they found our products, and that they can afford to buy them, and that their family has changed how they eat breakfast in the morning.

nbj: Where do you want to go next?
D'Amato: We want to continue to bridge that gap. I don't want to overlook the natural channel by any means. It's an amazing channel to do business in—that's our target consumer, hands-down—but we're also continuing to build on how to reach more people. That's been our ultimate goal—to make health less of a privilege and more of a right.

nbj: People are talking a lot about defining 'natural.' How do you see that happening?
D'Amato: It's going to have to start with some of the largest companies out there. If change can start with **Walmart**, everything else will follow. If we can get some big retailers doing huge business to set those standards—and, of course, the large companies like **Kraft** to abide by them—that trickle-down process will happen. Right now, it's those small companies trying to overcome those challenges, but I think that for the real change to take place, it has to come from the top.

nbj: Do you worry that natural & specialty retailers create a cultural divide around food?
D'Amato: We see some of the larger retailers wanting to offer these smaller specialty/natural items, and then the push-back from the natural specialty retailers saying they don't want to carry what the large retailers carry. We face that challenge every day. How do we keep every one of our customers happy, while sticking to our ultimate goal to not make this a difference between the haves and the have-nots? For small retailers to be unique, they want to have exclusives, but at the same time they need to understand that we're all in this together. Big companies, small companies, big retailers, small retailers—that's what's going to change the way we eat as a country. We have to work together in creating access and affordability for natural foods.

nbj: Target and Walmart's organic brands would seem to create more accessibility. What could go wrong?
D'Amato: It really comes down to the supply chain, the farmers at

the start of that process, and recognizing that it all has to be sustainable. There has to be sustainability in it on all ends, not just the raw material, but the business people too in their business practices. That can't happen overnight for every single product. We simply don't have the infrastructure as a country to do that.

nbj: So some values might get lost in translation?
D'Amato: Not only that, but some of the small farmers potentially get pushed out. These huge companies that used to be conventional can switch to organic and drive down the price—which is good at the consumer level because it makes organic more accessible—but then what does that do to the smaller, independently owned farms? It's a balance of figuring out how we can work together and figuring out how we can promote the long-term solution as an industry.

nbj: Kids are part of your mission. What's it going to take to get the next generation on the right track with nutrition?
D'Amato: It starts with education and access. And that's not just the kids' education, but also how do you educate their parents? How do we educate our society as a whole? But it can't just be talk. If you know why you should eat healthier, but you don't have a grocery store that sells healthy food, or it doesn't have a price tag that you can afford, how do you then expect people to switch their behavior? It's really a multi-pronged approach that we have to take. After you visit them at school, they go home at night and tell their parents what they learned about whole grains and why you should be able to pronounce every ingredient in your food, and they get excited to go to the grocery store and read the labels on the back of the bags. That's going to help trigger the revolution that has to happen.

nbj: The message is out there. How do we get it heard?
D'Amato: So much of it is making the connection between the fact that healthy food can also taste great. If you can show kids that something that's so delicious, that's so simple and not overly processed with tons of ingredients, that can also taste really good, that's when you get them to change how they eat. A lot of these schools and programs are getting kids to connect with the concept that your food comes from the earth and this is what it looks like, this is how it's made, how it grows. You can pick a tomato off the vine and eat it and taste how delicious it is. Bringing that awareness to the forefront of conversation is really important.

nbj: What's changed in the way the healthy food message gets told?
D'Amato: We have an opportunity to use social media and connect with people in a different way than we ever have before. At the same time, that means unhealthy food has the same opportunity. We are the small fish. We're up against huge fish. We are seeing kids, sick kids who will face illness for the rest of their lives because of how overweight they are before they're even 10. So, we walk into classrooms and we educate kids on the importance of happy lifestyles and eating. For kids in 5th grade and older, we start the presentation by showing them a video of open heart surgery. We talk about a diet high in saturated fats and how the foods you put into your body impact you, not just today, not just this week, but over the course of your life.

nbj: Do you worry about scare tactics? How do you go from fear back to the "making it cool" part?
D'Amato: We need to spin it such that kids are seeing the people they look up to leading a lifestyle that they admire and want to emulate. Everybody from pro athletes to pop stars. How do we get those people to make the shift? It's so hard when you have these athletes who are endorsed by huge fast food companies. That's where the money comes directly into play. You're not going to have a small natural food company able to sponsor star athletes when they're going up against the largest fast food companies in the world.

–RICK POLITO

NATURAL & ORGANIC DRY BREAKFAST FOODS SALES & GROWTH, 2004-2017E

Source: NBJ estimates ($mil., consumer sales)

The Internet's Third Wave

Q&A

with Steve Case, Revolution

As co-founder and CEO of **America Online**, Steve Case is widely credited for bringing the internet into mass consiousness throughout the 1980s and '90s. Case remains active in the entrepreneurial world as the founding chair of the **White House**'s **Startup America Partnership**, now part of **UP Global**. Case is also chairman and CEO of **Revolution**, a Washington, DC investment firm with several recent moves into natural products and nutrition, including **Sweetgreen** and **Revolution Foods**.

nbj: What attracted you to Sweetgreen? Is food service the next wave of innovation in healthier food choices?
Steve Case: Our mission at Revolution is to partner with entrepreneurs that have a unique blend of vision and execution to build high-growth, high-impact companies. Sweetgreen co-founders Nic Jammet, Jonathan Newman, and Nate Ru have done that in the fast casual sector. They have emerged as a leader in satisfying the growing demand for fast healthy options. We believe that Sweetgreen has the potential for significant scale, not just as a regional player, but as a national brand. Beyond their great concept and successful business model, what impressed me about Sweetgreen was the team, culture, and the value placed on building and maintaining community. The company's trajectory is proof that innovative, high-growth companies aren't limited to the traditional tech and internet sector.

nbj: Same question for Revolution Foods … what attracted you? What does success look like for that particular investment?
Case: We've known about Revolution Foods for many years and have been keeping an eye on their growth as they look to revolutionize a space that desperately needs disrupting—creating better access to healthy, convenient food options for kids in schools. The company's founders, Kirstin Groos Richmond and Kristen Saenz, have built a strong foundation in transforming school lunches—today they serve more than a million fresh meals each week, in 1,000 schools in 26 cities throughout the U.S. We hope that our involvement and investment will enable the company to significantly scale their school lunch program to more schools in more cities.

In addition, we also see great potential in the company's recently introduced grab-and-go Meal Kits available in grocery stores, helping to bring healthier options to families at home. And one more aspect of the Revolution Foods business we like—it creates jobs. School meals are prepared daily in seven culinary centers around the country, which creates over 1,000 jobs in urban communities with an emphasis on providing jobs to inner city workers.

nbj: How did you come to the 'food reform' movement? Is this a longstanding interest, or a new passion?
Case: From the time we created Revolution in 2005, we've stated our belief that the high-growth companies that create jobs and drive creative change won't and can't just be technology and Internet companies. As a result, we're investing in companies in a variety of sectors that are leveraging a new approach to transform a market—in this case the $16 billion a year school lunch industry, and the rapidly growing fast casual industry—and building iconic brands in the process. I've long been interested in opportunities that bring innovation to healthy living, and we're bullish on the transformative potential of Sweetgreen and Revolution Foods.

nbj: How do you explain all of the energy in food and creating healthier solutions there for consumers?
Case: Healthcare is a big challenge in our country—it represents a big opportunity, as the health care industry accounts for one-sixth of our economy. There are many facets to solving our healthcare challenges, but food is a big part. After all, our health starts at the end of our forks. At the same time, the growth of on-demand services, better logistics and increasing consumer awareness of what goes into our food presents a huge opportunity for new players.

nbj: Whose brains do you admire in the discussion around food? Who influences your thinking here?
Case: We've had the opportunity to meet a wide range of people in the food world, ranging from chefs such as José Andrés and Sam Kass, to founders such as Nic Jammet, Jonathan Newman, and Nate Ru at Sweetgreen and Kirstin Groos Richmond and Kristen Saenz at Revolution Foods, to current and former CEOs of major food companies, to a wide range of investors and entrepreneurs looking to disrupt the status quo and usher in a better way.

nbj: Are you pursuing additional investment opportunities in food? How do you evaluate a food company?

> "From the time we created Revolution in 2005, we've stated our belief that the high-growth companies that create jobs and drive creative change won't and can't just be technology and Internet companies."

Case: We're looking across a range of different sectors, where we see an opportunity for disrupting a significant market. In the case of Sweetgreen, we saw an organization that was operating not like a regional player with an eye to opening a few more restaurants, but rather as a startup with high-growth potential in a significant market. With Revolution Foods, we saw a company implementing an innovative new model to disrupt what had long been a market that was in great need of change. We are talking to other companies and likely will make additional investments down the road.

nbj: Why is tech getting so interested in food?
Case: I believe this has something to do with what I see as the third wave of the Internet revolution. The first wave was all about building the infrastructure, and getting people online. The second wave was building Internet products and services on top of these platforms. The coming third wave is about integrating the Internet in more aspects of our lives. And food is about as important to our everyday living as anything you could imagine. So it's not surprising that entrepreneurs are now focused on food.

nbj: What did you learn from AOL that applies to this escalating debate around food and nutrition?
Case: At AOL, we recognized the crucial role of people, partnerships and perseverance. For any of these companies to build iconic brands and truly disrupt these nascent industries, they have to build strong teams and surround themselves with the right people. On partnerships, we like to reference an African proverb: 'If you want to go fast, go alone. If you want to go far, go together.' Sweetgreen and Revolution Foods have both focused on establishing strategic partnerships that can accelerate their growth and impact. And perseverance will be critical—revolutionizing an industry isn't easy and won't happen overnight. Companies in the food and nutrition space will have to have a lot of perseverance and persistence to stay in the game. Revolution Foods was started eight years ago, Sweetgreen six years ago, and both are only now really hitting their stride. We've learned that revolutions often happen in evolutionary ways, and we bring that long-term perspective to the entrepreneurs we back.

—MARC BRUSH

TOTAL NUTRITION INDUSTRY SALES & GROWTH, 2000-2020E

Source: NBJ estimates ($mil., consumer sales)

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