The Natural and Organic Marketplace within Conventional Food, Drug and Mass Retailers

Key Trends for Success and Continued Growth

November 2008

SPINS®

Executive Overview

Global economic pressures can be felt within all aspects of the U.S. economy and the natural and organic products industry is not immune. However, there are number of underlying factors that will continue to drive the sales of the products and SPINS expects these products to outperform within the overall conventional food, drug and mass channel.

Over the past 52 weeks (10/4/08), the Natural Products Industry ("NPI") posted sales of $13.4 billion on growth of +12.2% within Conventional Food, Drug and Mass* retailers. The growth was largely driven by products in the Body Care (+28.5%), General Merchandise (+24.3%), Frozen (+12.8%), and Refrigerated (+14.7%) departments although all departments posted strong positive sales growth. As a testament to the continued growth potential of the NPI, three of the departments also increased sales rates over the previous year. Although slowing, growth rates within the recent 12 week data remained positive, at +8.0%.

Organic products, excluding private label and bulk/PLU, make up 23% of the NPI with sales of $3.8 billion over the past 52 weeks on growth of +13.5%. Although there is evidence of slowing within the segment, with the recent 12 week data up +6.8% over year ago, overall growth was strong across all of the departments, save packaged produce which has been strongly impacted by Private Label item launches by several key retailers. The top selling categories are concentrated on food and beverages, with milk, frozen entrees, soups, eggs and baby food posting some of the fastest growth rates within these top sellers. While the top sellers will continue to attract the majority of the sales, there are a number of extremely fast growing categories that will provide retailers and manufactures with additional expansion opportunities, especially in body care and pet products, to capture the innovation seeking consumer in the channel.

It is important to note that the organic segment of the NPI is not one large moving target, but an aggregation of distinct and disparate segments that have varying degrees of potential. Product and brand positioning provides one of the most salient segmentation options within the organic industry. SPINS considers five factors in coding natural & organic product positioning which include brand intention, consumer perception, company quality standards, channel distribution, and product category standards. When these factors are considered, it becomes clear that there are very definite consumer preferences in the conventional retail.

Within the conventional retail channel, the majority of the organic product sales are derived from Natural Standard brands (88%), followed by Conventional Natural, Specialty Natural, and Natural Perceived. Within the current 52 week period as well as over the more recent time periods, both the Natural Standard and the Natural Perceived posted the strongest growth rates, while those under the Conventional Natural segmentation posted zero to negative growth trends. These trends imply that the organic product shopper remains true to trusted organic brands and retailers should remain committed to this group of products to maintain the sales and growth of their organic initiatives.

In addition to the organic segment, there are a number of other opportunities that exist for consumer that shop just as much with the hearts as with their wallets. These include some of the “beyond organic” segments, such as fair-trade, raw foods and gluten-free. All of these posted extremely strong sales growth, remaining in the double digits; with fair-trade actually strengthening in recent periods. Opportunities abound in the expansion of these segments on shelf and within the depth and breadth of a manufactures product line.

As the sales of natural and organic products remain strong and growth continuing despite economic pressures, the underlying consumer dynamics provides further evidence of the continued strength of the segments. While core consumers, defined as heavy and committed shoppers, comprise 20% of the buyers and 80% of the sales of organic products, there remains significant opportunity for incremental growth from the transitional shopper. These shoppers tend to be the most vulnerable in the face of pricing pressures. SPINS proprietary research into these consumers within the NPI and organic segment indicate key categories where buyer rates and options for product expansion remain high. In fact, penetration rates for the majority of the organic categories have been on the rise over the past 52 weeks ending June 2008. Some of the categories with the highest percentages also posted some of the highest increases in new buyers, including packaged produce, refrigerated non-dairy, milk, and cookies and snack bars.

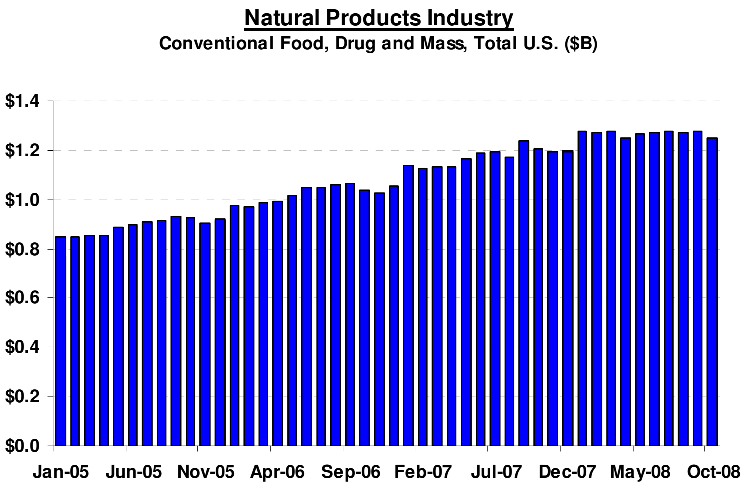
While the next few years will most certainly be a challenging time period, underlying factors indicate that the natural and organic product industry will remain an outperforming segment of the overall economy. SPINS research has shown a strong relationship between the authenticity of the products through trusted brands and retailers committed to the core consumer and their values. With a targeted approach that takes into account positioning, sustainability, health concerns and key categories, both retailers and manufacturers can capitalize and grow well into the future.

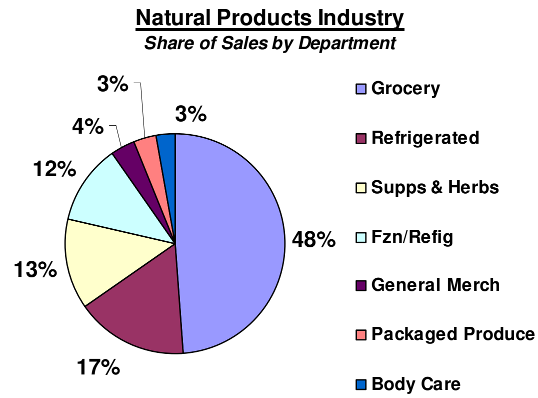
* Mass excludes Wal-Mart and Club Stores

Current State of the Natural Products Industry within Conventional Retailers

As the U.S. and international economies struggle in the wake of the global financial credit crisis, much attention has focused on how and where consumers will be spending their hard earned dollars. It is widely assumed that they will eat out less, travel less, cook at home more, and focus on pricing and value with greater detail. On face value, this does not present an opportunistic picture for the natural and organic industry, with their traditionally higher price points and associations with discretionary spending. However, there are other factors at play that will provide a significant counter balance in favor of natural and organic. These include the rise of pollution, global warming and lifestyle illnesses; increasing awareness of the environment and our bodies; a desire for a more natural, holistic approach to living; and seeking out of natural and environmentally friendly alternatives. In addition, the recent dramatic decline in the price of oil should also free up cash otherwise spent on transportation and heating. Given these competing forces, SPINS expects outperforming growth in the industry as compared to conventional products.

Over the past 52 weeks (10/4/08), the Natural Products Industry posted sales of $13.4 billion on growth of +12.2% within Conventional Food, Drug and Mass retailers. The growth was largely driven by products in the Body Care (+28.5%), General Merchandise (+24.3%), Frozen (+12.8%), and Refrigerated (+14.7%) departments. The remaining three departments, Grocery, Supplements/Herbs, and Packaged Produce, all grew over 6%, but slower than the overall natural industry. Despite the much discussed demise of the industry in the face of looming consumer spending concerns, three of the departments increased sales rates over the previous year, including General Merchandise, Refrigerated and Supplements/Herbs. Although slowing, growth rates within the recent 12 week data remained positive, at +8.0%.



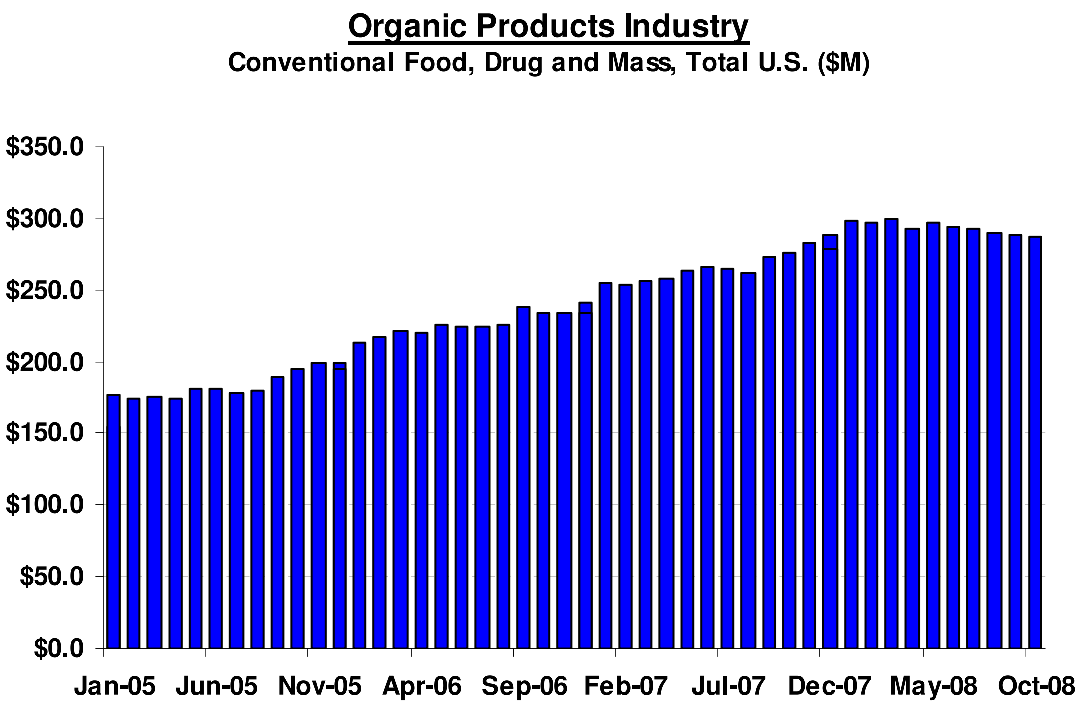


Source: SPINSscan Conventional, powered by Nielsen ScanTrack, period ending 10/4/08

Organic within the Context of the Natural Products Industry

Size and Growth of Organic in Conventional Food, Drug and Mass

As a subset of the Natural Products Industry, the organic marketplace is subject to many of the same drivers and concerns mentioned above. Over the past 52 weeks (10/4/08), the sales of organic products, excluding private label and bulk/PLU, reached $3.8 billion on growth of +13.5% while unit sales reached 1.3 billion on growth of +8.2%. These relative growth rates indicate that premium pricing continued to positively affect the success of the segment as consumers weigh health and environmental concerns against shrinking budgets. When we examine the department performance, all but one grew at or over the overall rate. Only Packaged Produce underperformed, posting growth of +6.1% over the previous 52 weeks.



Source: SPINSscan Conventional, powered by Nielsen ScanTrack, period ending 10/4/08

As evidenced by the trend chart, the organic industry is slowing, beginning in June 2008 and continuing through October. Historically, this seasonal shift is observed, but not to the current extent. Further evidence of the effects of the economic situation is witnessed in the slowing growth over the past 24, 12 and 4 weeks to +9.1%, +6.8% and +4.1%, respectively. The winter months have provided a bump in spending on organic in the past and we estimate that this trend will continue.

Dynamics Affecting Opportunities in the Organic Marketplace

Category Performance of Organic Products

Basic kitchen staples represent the top selling organic categories within the conventional food, drug and mass channels. Half of the categories are growing at double digit rates and include milk, frozen entrees, soups, eggs and baby food, representing just over 30% of the total organic sales. In addition, these top selling categories also represent the largest absolute growth categories, representing $260 million in growth dollars. Food and beverages dominate the top selling with organic skin care as the only non-food category to break into the Top 30 selling of the 60 available. Regulation of organic within the personal care industry has come under recent scrutiny with several lawsuits underway. To date, only those products with at least 95% organic ingredients may post the USDA seal. However, there is currently less regulation on the use of the term “organic” on the packaging, a situation that is ripe for change.

Top 10 Organic Categories

Conventional FDM	Current Dollars	Year Ago Dollars	Dollar % Chg	Share of Organic
Milk Half & Half & Cream	$607.5	$505.1	20.3%	16.0%
Packaged Fresh Produce	$540.5	$509.4	6.1%	14.3%
Refrigerated Non-Dairy Beverages	$302.5	$284.5	6.3%	8.0%
Yogurt & Kefir	$292.7	$272.2	7.5%	7.7%
Fz & Rf Entrees, Pizzas & Conven Foods	$206.3	$181.5	13.6%	5.4%
Cold Cereals	$148.2	$141.3	4.9%	3.9%
Soup	$122.7	$108.2	13.4%	3.2%
Bread & Baked Goods	$108.5	$101.0	7.5%	2.9%
Eggs	$104.7	$90.3	15.9%	2.8%
Baby Food	$104.6	$84.5	23.8%	2.8%

Source: SPINSscan Conventional, powered by Nielsen ScanTrack, 52 weeks ending 10/4/08

The mix of categories for those with the fastest growth rates is more varied, represented by personal care, general merchandise and food and beverages. These categories represent 5% of the organic sales and 14% of the growth dollars. In fact, 30 of the categories posted sales growth of over 20% and 15 at over 10% and only 6 categories down from year ago. While the top sellers will continue to attract the majority of the sales, the fast growing categories provide retailers and manufactures with additional expansion opportunities, especially in body care and pet products, to capture the innovation seeking consumer in the channel.

Top 10 Growing Organic Categories

Conventional FDM	Current Dollars	Year Ago Dollars	Dollar % Chg	Share of Organic
Cosmetics & Beauty Aids	$9.8	$0.6	1,480.4%	0.3%
Meal Replacements & Sup Powders	$0.4	$0.2	106.3%	0.0%
Pet Food & Pet Care	$16.0	$8.1	97.8%	0.4%
Refrigerated Sauces & Salsas & Dips	$15.8	$9.3	70.3%	0.4%
Shelf Stable Meats Poultry & Seafood	$0.4	$0.3	63.4%	0.0%
Baking Mixes Supplies & Flours	$21.7	$14.2	52.4%	0.6%
Hair Products	$13.6	$9.1	49.9%	0.4%
Seasonings	$26.9	$19.2	40.5%	0.7%
Refrig Juices & Functional Beverages	$38.5	$27.4	40.3%	1.0%
Skin Care	$29.5	$21.3	38.4%	0.8%

Source: SPINSscan Conventional, powered by Nielsen ScanTrack, 52 weeks ending 10/4/08

Brand Positioning Makes a Difference

SPINS considers five factors in coding natural & organic product positioning which include brand intention, consumer perception, company quality standards, channel distribution, and product category standards. Based on these factors, the natural and organic products database may be further segmented to understand the dynamics behind brands from a manufacturer and channel perspective. These segments are grouped as follows:

- ***Natural Standard:*** Brands/Products are marketed and approved for distribution and sale in Natural retailers because they meet the most strict and closely monitored standards set by these retailers and demanded by consumers that shop in these outlets. (example: Organic Valley, Seventh Generation)
- ***Natural Perceived:*** Brands/Products are often made specifically for the conventional (FDM) channels. These target the conventional shopper looking for an ‘entry point’ to make better Health and Wellness or environmental choices in their purchasing decisions. (example: Frito Lay’s Flat Earth, Kellogg’s Morning Star Farms)
- ***Specialty Natural:*** Brands/Products are marketed as artisan, premium quality, imported/regional or ethnic/cultural with quality standards similar to a Natural Standard brand. (example: Wolfgang Puck Organic)
- ***Conventional Natural:*** Brands/Products from traditional conventional banners that meet the criteria for natural positioned versions of their conventional counterparts. These have added value such as organic content, allergy free, fair trade, or environmental benefits such as recycled content. (example: Clorox Green Works, Oreo Organic)

When SPINS proprietary brand positioning segments are combined with the National Organic Program (NOP) levels, insight into the opportunities and success rates can be determined.

Within the conventional retail markets, the majority of the organic product sales are currently derived from Natural Standard brands (88%), followed by Conventional Natural, Specialty Natural, and Natural Perceived. Although organic penetration is 61% of the U.S. households, approximately 20% of all organic product buyers are driving over 80% of organic dollar volume. This implies an extremely committed group of consumers driving the majority of the sales and that these consumers are most familiar with the "Natural Standard" set of brands and potentially more cautious of those brands more tailored to the conventional market.

Growth rates of these segments also support these assumptions, with Natural Standard brands generating the majority of the dollar growth within organic. Those products more readily associated with the traditional natural products industry are also holding up better than those released by traditional conventional banners. The stronger growth of Natural Perceived is of particular note. This may be a result of a few factors, including consumer awareness, or lack of, the manufacturing company, greater marketing budgets and stronger relationships between conventional manufacturers and retailers as compared to the Natural Standards set.

Organic Products: $ % Chg vs Year Ago

Conventional FDM	Current 4 Weeks	Current 12 Weeks	Current 24 Weeks	Current 52 Weeks
Natural Standards - Organic	5.6%	8.5%	10.8%	14.6%
Natural Perceived - Organic	7.5%	12.8%	14.8%	22.4%
Specialty Natural - Organic	(5.6%)	(2.5%)	2.7%	12.8%
Conventional Natural - Organic	(9.7%)	(9.8%)	(8.8%)	0.0%

Source: SPINSscan Conventional, powered by Nielsen ScanTrack, 4-12-24-52 weeks ending 10/4/08

It is clear that the organic products shopper remains true to their trusted organic brands and retailers should remain committed to this group of products. This is particularly evident when the poor performance of the "Conventional Natural" set of organic products is reviewed. These products prominently display the conventional brand banner and are often organic alternatives to an existing conventional product. The core organic consumer is less inclined to purchase these items and the conventional consumer may not be readily swayed away from a trusted conventional product with a higher price premium.

"Beyond Organic" Drivers of Sales in Conventional Retailers

Health and environmentally minded consumers are also bringing their wallets to other segments of the natural and organic industry. Similar to the underlying drivers of organic, concerns over human welfare, allergic reactions and alternative dietary considerations are buoying the sales of these products.

Of the three shown here, fair-trade in particular has posted increasingly positive growth trends. Coffee products are by far the strongest driver of this trend, with over 50% of the tracked fair-trade sales. Fair-trade ready-to-drink products and chocolate candies are also posting growth rates of over 40%.

Although raw foods are not showing the same increasing strength, the growth rates for these products remain very attractive and indicate a continued willingness of consumers to maintain purchases that mean the most to them. Raw nuts, honey and alternative sweeteners, and refrigerated functional beverages, including kombucha, claim the most sales as well as the strongest growth rates for the raw foods segment. Some new entrants into the channel include chips, cheeses and cookies.

With ten times the sales of other two, gluten free continues to be a strong driver of growth. This is not surprising given that at least 1 in 133 people are estimated to have celiac disease while only 1 in 4700 is actually diagnosed. Strong sales should remain a stable source of growth for retailers and manufacturers alike in this under-supplied segment.

"Beyond Organic"	Dollars	$ % Chg vs Year Ago			
Conventional FDM	**52 Weeks Ending**	**4 Weeks Ending**	**12 Weeks Ending**	**24 Weeks Ending**	**52 Weeks Ending**
Fair-Trade Claim	$65.6	48.6%	42.5%	33.8%	32.1%
Raw Foods	$53.8	19.2%	25.5%	30.4%	35.5%
Labeled Gluten Free	$644.7	14.8%	15.0%	15.4%	16.9%

Source: SPINSscan Conventional, powered by Nielsen ScanTrack, 4-12-24-52 weeks ending 10/4/08

Although sales for fair-trade and raw foods are relatively small in the channel, the current growth rate trends should present strong incentives to conventional retailers to carry these products. Gluten-free, with its strong underlying drivers, will continue to grow well into the future.

Consumer Segmentation within Organic Products

In addition to understanding the retail sales dynamics of organic products, SPINS is also able to offer a unique view into the consumer of these sales through the marriage of our proprietary coding with Nielsen's Homescan Consumer Panel. The benefits of this combined service include the addition of over 200,000 UPC's that would otherwise be excluded from the study based on their unique distribution in the natural channel. SPINS is the only source for UPC based information within the natural supermarket channel, providing the most comprehensive view into the natural products industry. In addition, SPINS further segments the consumers within the natural and organic products industry into committed, heavy, transitional and trial buyer groups.

This segmentation is of particular importance when one considers the relative concentration of sales by the committed and heavy buyers of organic. Using the SPINS Consumer Panel results, we can determine which of the categories are more successful in attracting the transitional and trial buyers of organic. Targeting sales into these driving categories can guide both manufacturers and retailers to productive growth prospects.

For the transitional buyer set, organic options for produce, non-dairy and cold cereals are most likely to attract consumers. Some of the least likely include packaged meats, cheese, meat alternatives and refrigerated juices. This may be due to consumer perception of these products as being inherently natural and therefore not worth the added expense of organic premiums.

% of Segment Buying

Organic Categories	Transitional
PACKAGED FRESH PRODUCE (branded)	59.1
REFRIGERATED NON DAIRY BEVERAGES	21.2
COLD CEREALS	19.5
YOGURT KEFIR	16.2
SOUP	12.9
MILK HALF HALF CREAM	12.2
BREAD BAKED GOODS FROZEN NON FROZEN	11.2
CHIPS PRETZELS SNACKS	10.6
CONDIMENTS	10.3
COOKIES SNACK BARS	10.2

Source: SPINS Consumer Panel, powered by Nielsen Homescan, 52 weeks ending June 2008; Total U.S., all outlets
Penetration a measure of % of U.S. households buying at least once over the period

Trial buyers are much less likely to purchase organic products, regardless of the category. In fact, the only category where over 10% of the segment buys organic products is packaged produce. All others fall below this level, with most reporting under 5% of the segment buying.

Overall penetration rates across all of the buyer segments have been on the rise for many of the organic categories. When the year-end June 2008 rates are compared to the same period year ago, 37 of the categories attracted new buyers, 10 remained at year ago levels and 11 lost buyers. Organic milk, cookies and snack bars, condiments, and refrigerated non-dairy posted some of the highest increases in penetration rates.

Top 10 Organic Category Penetration Rates

Organic Categories	Current Period	Year Ago Period	Point Chg
PACKAGED FRESH PRODUCE (branded)	33.0	32.3	**0.7**
REFRIGERATED NON DAIRY BEV	10.3	9.2	**1.1**
COLD CEREALS	10.2	10.5	**(0.3)**
YOGURT KEFIR	9.1	9.2	**(0.1)**
SOUP	8.0	7.1	**0.9**
MILK HALF HALF CREAM	7.7	5.7	**2.0**
BREAD BAKED GOODS FROZEN NON FROZEN	6.9	6.9	**0.0**
SHELF STABLE FRUITS VEGETABLES	6.6	6.1	**0.5**
COOKIES SNACK BARS	6.2	4.5	**1.7**
CHIPS PRETZELS SNACKS	6.0	6.6	**(0.6)**

Source: SPINS Consumer Panel, powered by Nielsen Homescan, 52 weeks ending June 2008; Total U.S., all outlets
Penetration a measure of % of U.S. households buying at least once over the period

This information also shows that some of the most heavily penetrated categories are also the ones most shopped by the transitional organic consumer. As retailers work to increase customer traffic to these products, consumer familiarity with the products and a potential willingness to purchase a broader product offering should provide opportunities for incremental growth beyond the traditional “core” organic consumer.

Conclusion

Overall, the natural products industry, including the organic subset, continues to experience positive growth rates and strong sales. Authenticity and commitment to the core base of consumers which drive the majority of the sales will remain the key determiners of success in the marketplace. And, as this study has shown, those brands that are strongly associated with the roots of the industry perform the strongest. So, while NPI growth rates slow and are not expected to be in the historical double digits, the segment is expected to outperform the overall conventional product set.

The NPI consumer is no longer restricted to the natural supermarket channel, as conventional retailers have recognized and capitalized on the strong growth trends with expanded product assortment and increased alignment with the ideals of the industry. So while the natural and organic consumer, from committed to trial, has ample opportunities for purchase across a variety of channels, those manufacturers and retailers most authentic and truest to the industry are thriving.

While there are a number of negative economic factors that will challenge the industry for the next few years, positive drivers offer significant counter pressures. These positive drivers will continue and strengthen over time, offering significant fuel for continued growth which should begin to accelerate once the consumer and the economy regain their stability.

If you are interested in learning more about how SPINS can help you drive your sales during this transitional time period, please visit our website at www.spins.com or call us directly at 847-908-1200.

Appendix

Definition of Organic

SPINS follows the National Organic Program's definitions of organic products. For the purposes of this study, organic is defined as 70%-100% Organic Content.

Definition of Fair Trade

SPINS codes for fair-trade products based on label coding and recognizes the following two certification agencies, Transfair and Rainforest Alliance.

Definition of Raw Foods

SPINS coding process of food and beverages as a "Raw Food" includes those items with partial as well as 100% raw content. Brand positioning as a raw food is also taken into consideration.