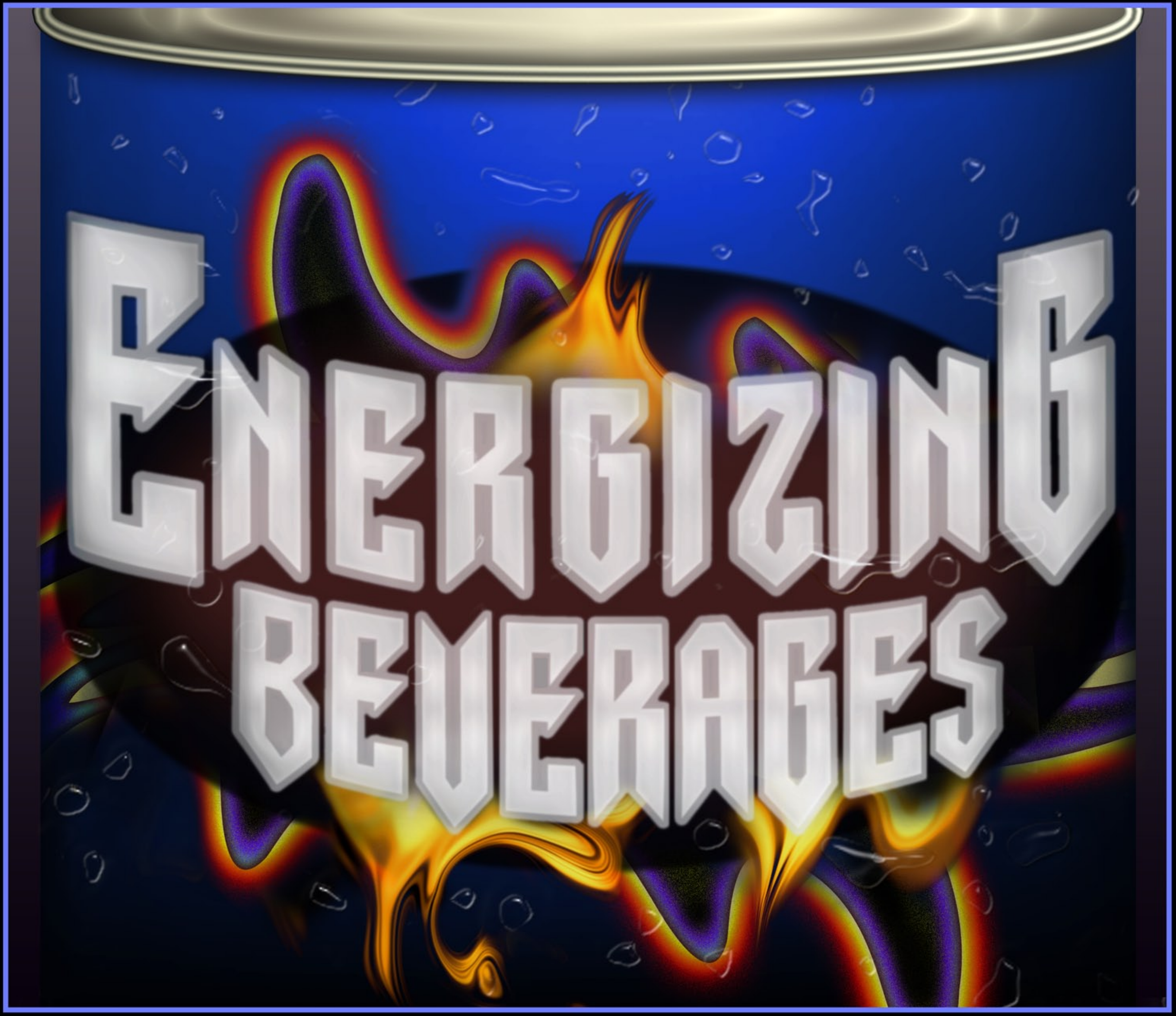

A plethora of new products is bringing energy to the beverage category

INSIDE ▶

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Off and Running

The popularity of energy drinks continues to skyrocket... and that's no (Red) Bull.

- By Bob Phillips

Of one thing there can be no doubt: Alternative/energy drinks represent a bull market. That the leader of the charge is the longtime No. 1 brand Red Bull, which launched the energy drink category in the United States, is fitting. And while Red Bull's position as the market leader remains unchallenged, many other brands are enjoying healthy sales in this age of prosperity for the alternative drink category.

According to ACNielsen data, the alternative/energy drinks market increased from $1.15 billion in the combined off-premise channels (food, drug, convenience, mass, excluding Wal-Mart data) for the 52-week period ending 4/17/04 to $1.79 billion for the 52 weeks ending 4/16/05. That represents an overall gain of 56 percent.

The convenience channel has been the primary driver of that growth. According to ACNielsen data, retail dollars are up 56.5 percent in the c-store channel over last year, while unit volume is up 49.3 percent.

The increase has been driven by several factors, including:

◗ An "on-the-go" American consumer looking for quick bursts of energy throughout the day;
◗ The adoption of energy drinks by "Generation Y" – the skateboard, dirt-bike, snowboard, X-Games set – as a drink they can call their own;
◗ The popular use of energy/alternative beverages as mixers for alcoholic drinks, both in nightclubs and at home parties.

Unlike sports drinks and isotonics, which are all about recovery from strenuous workouts, alternative/energy drinks are all about quick bursts of energy. While all alternative/energy drinks contain caffeine, most today also include a variety of exotic ingredients including glucose (i.e. sugar), taurine, inositol, guarana, ginseng and vitamins B6 and B12.

ALTERNATIVE/ENERGY DRINK SALES

TOTAL U.S. - FOOD, DRUG, CONVENIENCE, MASS (EXCLUDING WAL-MART)

	52 Weeks Ending 04/17/04	52 Weeks Ending 04/16/05
Carbonated	$1,096,569,371	$1,733,737,842
Non-Carbonated	$59,918,814	$60,656,873
TOTAL ALTERNATIVE/ENERGY DRINKS	$1,156,488,185	$1,794,394,715

▲ Source: ACNielsen

Retailers are pleased with the category because of its profit potential: Most leading brands retail for $1.99 per 8.8-ounce slimcan, and specially designed suction-cup racks that attach right to cold doors free up cold shelf space for other products. Several new products have been introduced in larger SKUs – primarily 16-ounce cans – but at the same profitable $1.99 price point.

"Energy drinks have had the highest average retail price (1.5 times the average for all packaged beverages), penny profit (1.8 times the average) and gross margin (40-plus percent)," says David Bishop, director of Barrington, Ill.-based Willard Bishop Consulting.

By far, most energy/alternative drinks are lightly carbonated, though some are non-carbonated. According to ACNielsen data, the carbonated segment accounted for 96.6 percent of all-channel category sales (food, drug, convenience, mass, excluding Wal-Mart data) for the 52-week period ending 4/23/05.

Last One In's a Rotten Egg

The fact that most major beverage companies – as well as a host of minor companies – have offerings in the category are a testament to the continuing potential that energy drinks have for future growth. As witnessed by the most recent NACS Show in Las Vegas, quite literally everybody and their brother is trying to jockey for some coveted position in cold vaults.

While market leader Red Bull may be a "smaller" company in terms of overall revenue, Pepsi has three brands in the category (Amp from Mountain Dew, SoBe Adrenaline Rush and SoBe No Fear), while Snapple (i.e., Cadbury Schweppes Beverages Americas) has its Elements line. Hansen's, the New Age company from California best known for its natural sodas and fruit beverages, is heavily vested in the category with several brands, including Hansen's Energy, Monster and Lost. Other New Age players include AriZona, Fuze and Jones Soda. Even brewing giant Anheuser-Busch has ventured into the category with 180. Not to be neglected, the hip-hop scene is well represented in the category with rappers Nelly (Pimp Juice) and Fat Joe (Stinger) fronting energy brands, and hip-hop impresario Russell Simmons (DefCon Records) behind the DefCon 3 brand.

With so many brands and so little space (even though many c-stores are now devoting entire doors to the energy category), how does one decide which brands make the planogram?

"Everybody has an energy drink to sell, so we look very hard at everything presented to us."

— Jon Bratta
am/pm

"Everybody has an energy drink to sell, so we look very hard at everything presented to us," explains Jon Bratta, national beverage lead for BP Plc.'s am/pm chain. "What is the marketing plan? How is it different? Is it a line extension of an existing successful brand? The successful companies are doing certain things that help insure their initial and continued success. We probably turn down 85 percent of what we see because many of these brands just have no plan."

One way that Red Bull was able to break through the clutter was with the innovative door rack that allowed its then-unique 8.8-ounce slimcan SKUs to be merchandised in the cold vault without encroaching on anyone else's existing territory.

"The tactic served its purpose, which was to create merchandising space where none had previously existed," explains Bishop. "Since then, energy drinks have found a more permanent location on the shelf, but the door holders are still used to highlight either certain price-promoted products and/or to build awareness and trial for new products in the door."

But not everyone is sold on the merchandising effectiveness of door racks.

▲ ***The first: Red Bull essentially invented the current alternative energy drink segment with its unique product and distinctive packaging.***

ENERGIZING GROWTH

ENERGY DRINK UNIT VOLUME AND DOLLAR VOLUME ARE GROWING SUBSTANTIALLY IN CONVENIENCE STORES

DOLLAR VOLUME	Dollar Volume 52 Weeks Ending 04/24/04	Dollar Volume 52 Weeks Ending 04/23/05	Percent Change vs. Year Ago 52 Weeks Ending 04/24/04	Percent Change vs. Year Ago 52 Weeks Ending 04/23/05
Carbonated	$473,266,348	$748,127,203	n/a	58.1%
Non-Carbonated	$20,435,053	$24,521,601	n/a	20.0%
Total Alternative Beverage	$493,701,401	$772,648,804	n/a	56.5%

UNIT VOLUME	Unit Volume 52 Weeks Ending 04/24/04	Unit Volume 52 Weeks Ending 04/23/05	Percent Change vs. Year Ago 52 Weeks Ending 04/24/04	Percent Change vs. Year Ago 52 Weeks Ending 04/23/05
Carbonated	228,919,261	346,155,157	n/a	51.2%
Non-Carbonated	12,513,793	14,364,087	n/a	14.8%
Total Alternative Beverage	241,433,054	360,519,244	n/a	49.3%

Source: ACNielsen

"We don't use cooler door racks," explains Bratta. "They block product, they tend not to get executed very well, and they breed competitive door racks." That, in turn, creates cold vault clutter.

"We allocate the proper space that the beverages deserve out of the existing space," says Bratta.

Perhaps the energy surrounding the category can best be illustrated by looking at Red Bull, which lost market share last year (from just over 50 percent to just below 50 percent), all the while increasing its own sales by over 40 percent. Perhaps with this in mind, Coca-Cola, which had very limited success in its initial foray into the category with KMX, has launched a new brand in 2005 – aptly named Full Throttle – in hopes of grabbing a larger slice of what should soon be a $2 billion pie.

An Immediate Success

According to ACNielsen figures provided by Coca-Cola North America, Full Throttle had achieved a 78 percent penetration rate among all convenience stores in the U.S. by June. Late this summer, the brand extended into the diet segment with Sugar Free Full Throttle, packaged in single-serve 16-ounce cans and four-packs, and launched primarily in the convenience channel.

"The Full Throttle brand has consistently driven growth in the energy drink category since its introduction, and Sugar Free Full Throttle will keep our momentum going," says Mary Herrera, director of marketing for sports & energy drinks for Coca-Cola North America. "Based on our results in test markets, we expect Sugar Free Full Throttle to increase consumption occasions among current energy drink users, and appeal to new consumers seeking the raw energy Full Throttle provides."

Generation Next

Perhaps the future of the category can be seen in a new product introduction from Pepsi's Mountain Dew franchise. MDX, which Pepsi first advertised during the World Series but launched nationally in November as an "energy soda," contains a veritable power pack of energy-inducing ingredients, including ginseng, guarana, taurine and D-Ribose (a five-carbon sugar).

"Mountain Dew helped create the energy category, and MDX is the next logical step in our evolution," explains Katie Lacey, vice president marketing, carbonated soft drinks for Pepsi-Cola North America. Citing the explosive growth of the energy drink category, Lacey defines the MDX target consumer as someone "who is looking for a boost of energy, but refuses to sacrifice taste and refreshment." ■

"Mountain Dew helped create the energy category."

—Katie Lacey Pepsi-Cola, N.A.

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*Beverage Marketing Industry Review — March 2005

Bottled water growth slows but remains extremely healthy in the c-store channel

A VERITABLE STREAM OF PROFITS

-By Bob Phillips

A decade after exploding onto the retail scene, bottled water remains not only strong, but a vital component in the ultimate profitability of convenience-store retailers. Although no longer in 'skyrocket mode,' bottled water sales remain quite strong for a maturing category.

According to Steve Seager, senior retail marketing manager for Greenwich, Conn.-based Nestle Waters North America (NWNA), bottled water is the No. 2 consumed beverage in the U.S. (behind carbonated soft drinks.) What's more, even with such long-term growth, the category's upside remains enormous.

"Currently Americans are drinking just over 23 gallons of bottled water per year," explains Seager. "Those per caps are expected to reach the developed European average of 32 gallons of bottled water per year by 2008," he says, adding that per caps in California, Massachusetts and Texas already exceed the European average.

NWNA, the leading company in the U.S. in terms of cumulative dollar and unit volume, markets many of the nation's strongest regional brands, including Poland Spring (Northeast), Arrowhead (West Coast), Zephyrhills (Southeast) and Deer Park (Mid-Atlantic). Indeed, according to Information Resources, Inc., four of the top 10 brands sold at c-stores are NWNA properties – even though each is sold regionally.

According to ACNielsen Convenience Track data, bottled water accounted for nearly $2 billion in sales for the 52-week period ending October 8, 2005. Furthermore, 32 percent of all bottled water purchased was done so at convenience outlets.

"We're expecting bottled water to grow between 15 percent and 20 percent this year," notes Ron Gillion, category manager at Texarkana, Tex.-based E-Z Mart Stores. "It will probably slow a little next year, but we're still projecting 10 to 15 percent growth in 2006."

Others in the industry concur with Gillion's projections.

"Our short-term forecast for 2006 is that water will continue to grow, but at a slower rate than in the recent past – most likely in the low double digits, 10 to 15 percent," notes David Bishop, director of Barrington, Ill.-based Willard Bishop Consulting.

Just as important as dollars for c-store retailers is the type of consumers bottled water attracts. While adult males continue to be the channel's target consumer, bottled water tends to bring in more diverse shoppers, resulting in greater overall sales.

"Bottled water is so important because it attracts younger consumers and women – both of whom we've worked very hard at getting into our stores," notes Gillion.

These consumers look for traditional bottled water, certainly, but also are interested in various extensions, such as flavored and nutrient-enhanced waters. That makes single-serve and sampling opportunities so vital to the continuing health of the bottled water category, and the convenience channel as the category's primary growth driver.

"C-stores represent a vital part of our business, because they offer trial to consumers," notes NWNA's Seager. "Furthermore, bottled water consumers are important to c-store retailers because of the wide demographic and the growing consumption per capita per year."

"From our perspective, much of the growth in bottled water will be driven by the extension of sports drinks and isotonics into the bottled water category, such as Gatorade has done with Propel," adds Bishop. In addition, Dasani and Aquafina have extended their lines to include flavors in an effort to further attract an ever-growing c-store consumer base.

Private Labels Deliver

Not surprisingly, chains of sufficient size have jumped on the private label bandwagon to offer consumers, in general, a lower-cost item while maintaining healthy margins on their end.

1	2	3	4	5	6	7	8	9	10
Aquafina	Private Label	Dasani	Poland Spring	Propel	Dannon	Arrowhead	Deer Park	Crystal Geyser	Ozarka
$411,510,500	$377,878,500	$339,454,300	$194,610,700	$177,940,100	$155,517,000	$140,480,700	$105,627,900	$84,441,140	$77,629,140

Total U.S. Dollar Sales – food, mass, drug, excluding Wal-Mart) 52 weeks ending 10/30/2005

Source: Information Resources Inc.

In terms of relative risk, getting into the private label segment of the bottled water category is a no-brainer, as consumers don't see a great degree of difference between high- and low-end brands.

Indeed, according to a recent research report by analysts at Morgan Stanley, just 20 percent of bottled-water consumers say they are loyal to a particular brand while 40 percent say they purchase whatever brand is cheapest [*CSP Daily News*, Dec. 16, 2005].

"Just 20 percent of bottled-water consumers say they are loyal to a particular brand."

— Morgan Stanley

"Much of this [growth in private label] is driven by a retailer perspective that doesn't perceive a lot of brand equity in many national branded waters," says Bishop. "Equally important, water, after energy drinks, delivers the highest retail gross margins of any beverage segment. And water will continue to show the largest amount of growth on an absolute basis. Combined, these factors create a strong opportunity that retailers have leveraged to accelerate profit growth while also producing differentiation in an otherwise commodity-driven segment."

Multiple Growth

While the growth of single-serve convenience-still bottled water (packaged in units 1-liter and less) is not surprising given the immediate consumption profile of the category, the growth of multi-packs in the c-store channel is somewhat unexpected. One might assume that multi-packs might be a better fit in the supermarket, club or mass channels. Then again, you know what happens when you assume something.

The term 'bulk' often refers to gallon jugs, most relevant to the supermarket channel. It can also refer to the 5-gallon cooler jugs relevant to home and office delivery. But to the c-store channel, bulk water refers to a new, increasingly important SKU: 24-pack cases, which drive volume, provide healthy margins and increase dollar rings without taking up cold vault space.

According to NWNA's Seager, while single-serve units will always be important to the c-store retailer's bottom line, promoting multi-pack sales wherever possible, from the cold door to the gas pump, represents an outstanding opportunity for incremental revenue.

"Display, display, display multi-packs of bottled water," he advises. "Make room for multi-packs in both cold and warm shelf as well as outside the store area."

According to Seager, it's important to display your high-margin brands and packs prominently and to price them competitively with other channels. You have the decided advantage of being a bottled water destination, where the consumer can pop in, make their purchase – either for immediate consumption or to take home – and be on their merry way.

"The multi-pack segment in c-store bottled water sales now represents 15 percent of the bottled water PET segment and has grown 28 percent year to date according to ACNielsen," says Seager. ■

HOLDING THE LINE?

After predicting bottled water would likely see a price increase led by Nestle Waters in early 2006, beverage analyst Bill Pecoriello of Morgan Stanley, says he now sees mixed signals on the pricing front.

"We thought there was a chance the industry would take prices up in [the first quarter of] 2006 due to higher cost resin and other cost pressures," Pecoriello wrote in a recently released report. "[But] Nestle indicated [on December 12] it hasn't received any indication that either Pepsi or Coke plans to follow its water price increase in early 2006." -- *Steve Holtz*

Diets, flavors are IN, Reshuffling the Deck full-calorie colas are OUT.

- By Bob Phillips

Carbonated soft drinks, the mothership of every convenience retailer's non-alcoholic beverage operation, have been undergoing a radical transformation in recent years. With more than half the adults in the U.S. overweight, and nearly 25 percent qualifying as obese, consumers have been turning away from high-calorie products. One of the major casualties in this mass exodus has been full-calorie CSDs, which have also come under siege from advocacy groups accusing soft drinks of creating a generation of overweight children.

The news isn't completely bleak, however. Just as full-calorie soft drinks have fallen out of favor, diet soft drinks have taken off. And while colas, the darlings of the baby boom generation in its formative years, have fallen off, flavored soft drinks, favored by today's younger generation as well as Hispanic consumers, are growing.

"While they continue to lose share to bottled water and energy drinks, CSDs still represent the largest share of the non-alcoholic beverage business, whether it's based on unit volume, dollar sales or gross profit dollars," says David Bishop, director of Barrington, Ill.-based Willard Bishop Consulting.

Overall, the performance of CSDs in the convenience channel remains strong – certainly when compared to grocery. According to ACNielsen Convenience Track data, carbonated soft drinks accounted for $9.8 billion in retail rings in the c-store channel for the 52 weeks ending October 8, 2005. That was up 7.7 percent over the previous 52-week period. Meanwhile, CSDs grew in supermarkets by only 1.3 percent during the most recent period.

Furthermore, convenience stores are a soft drink destination stop, as 41 percent of all off-premise CSD sales occur in convenience and gas outlets, according to ACNielsen.

"The C&G channel is a very important part of our business," explains Marty Eskenazi, vice president of the C&G channel for Cadbury Schweppes Americas Beverages (CSAB). "It's a great channel for consumers to try our products, with the single-serve format acting as a sampling vehicle for us."

Diets Lead the Way

In looking forward to long-term trends in the soft-drink category, the future is now for the diet segment. Over the past few years, both Coca-Cola and Pepsi have seen their diet brands grow at the expense of their flagship offerings. Indeed, Pepsi has repositioned Diet Pepsi as the flagship brand of the portfolio. And this new focus on diet products affected the company's flavored brands as well.

"Relaunching Diet Mountain Dew is a great opportunity for us to grow one of our strongest performing brands of the past few years," said Indra Nooyi, PepsiCo's president and Chief Fnancial Officer at Morgan Stanley's Global Consumer & Retail Conference in New York in early November. "Though Diet Dew has achieved nearly double-digit growth year to date, significant untapped growth opportunities remain."

Flavors Also Strong

While Coca-Cola hasn't gone quite as far – Coke Classic remains the company's flagship brand – it has shown a recent change of course. Take, for instance, the most recent news out of Atlanta – the launch of Diet Black Cherry Vanilla Coke and Black Cherry Vanilla Coke in January 2006.

The simultaneous launch of a diet and full-calorie brand is a North American first for Coca-Cola.

"Cherry-flavored beverages are experiencing significant growth, as are no-calorie soft drinks," explains Katie Bayne, senior vice president, Coca-Cola Trademark, Coca-Cola North America. "Our fusion of cola, black cherry, and vanilla flavors creates a taste that is complex and delicious."

The new flavors will replace Vanilla Coke and Diet Vanilla Coke which, according to the company, will go on "hiatus" at the end of 2005. ■

> **"While they continue to lose share to bottled water and energy drinks, CSDs still represent the largest share of the non-alcoholic beverage business**
>
> **—David Bishop**
> **Willard Bishop Consulting**

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