



Gourmet Sodas Quench Health-And-Wellness Thirst

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With health and wellness worries curbing consumption of Coke and Pepsi, sales of another kind of carbonated soft drink, so-called gourmet sodas, have accelerated.

The trend has grown to the point where gourmet soda companies, mostly small and privately held, could become acquisition targets for Coca-Cola Co. (KO), PepsiCo Inc. (PEP) or other large public companies.

At the heart of the worry is high fructose corn syrup, an ingredient in Coke and Pepsi, but absent in gourmet sodas, such as **Izze** of Boulder, Colo., Grown-up Soda, or GuS, of New York, Fizzy Lizzy of New York and Steaz of Newtown, Pa.

"Corn syrup is a real hot button now," said Steve Hersh, founder and president of GuS. "That's really helping us," with parents keeping their kids away from it and schools banning sodas containing it from cafeterias and vending machines.

Gourmet sodas are carbonated - and have plenty of calories, though generally fewer than their giant counterparts - but they are perceived as healthier because they get their sweet taste from natural juices and cane sugar.

"It's the refreshment of carbonation without the baggage," said Todd Woloson, founder and president of **Izze** Beverage Co.

Gourmet sodas also are perceived as more exclusive, which in a way they are, because they are considerably higher priced. They sell in the \$1.25 to \$1.75 range for 12 ounces, compared with 75 cents to 90 cents for a Coke.

That plays into the "trading-up" trend that is sweeping beverages and other products - for example, higher-priced craft beers, wines and mixed drinks gaining sales at the expense of traditional beers.

Although GuS, like most other gourmet soda companies, doesn't disclose specific figures, "sales have more than doubled each year" since its 2003 startup, Hersh said. **Izze's** Woloson said, "We've had triple-digit growth since we started" in 2002.

That said, while these companies are growing rapidly, they are a tiny part of the overall market. Their combined sales are estimated to be less than \$400 million a year.

For example, **Izze** sales "are well north of \$20 million" a year, Woloson said, but compared to Coke and Pepsi aren't "even a rounding error for a division of a division."

Though "the revenue potential may be limited," analyst Mark Swartzberg at Stifel Nicolaus said, "the margins are very good and these products are growing."

Meanwhile, one or more of the gourmets soon could be ripe for takeover, especially if there's a breakout brand.

"That's an objective," said John Bello, an **Izze** board member and founder of SoBe, a non-carbonated brand that he sold to PepsiCo for \$370 million in 2001. **Izze** "will become a takeover target for a major soft drink

company," he predicts.

"Regardless of whether it's **Izze**, it's going to happen," Woloson said, There has been a "quality-based breakout in every category except carbonated soft drinks," he said, such as Boston Beer Co.'s (SAM) Sam Adams in beer, Starbucks Corp. (SBUX) in coffee, and Bacardi International Ltd.'s (BCD.YY) Grey Goose vodka in spirits.

Coca-Cola and PepsiCo declined to comment on the possibility of acquisitions, but Coke spokesman Scott Williamson said, "We clearly understand that the beverage landscape continues to broaden."

Swartzberg and analyst Lauren Torres at HSBC Securities both note that Coca-Cola and PepsiCo have tended to acquire, rather than develop, niche products.

"You'd hope they'd be a little more proactive than reactive," Torres said.

But Dan Varroney, president and chief executive of the Association for Corporate Growth, a trade group for mergers and acquisitions, says purchases are the smart way for big beverage companies to proceed.

"It's less expensive to buy than it would be to develop new products and new brands," Varroney said. "Acquiring these brands will grow the top line and give shareholders a quicker return."

Gourmet soda companies have their own worries, including higher sugar prices. Hersh says GuS' sugar costs "are up about 40% in the last three months." In addition, Torres notes, the gourmet sodas' price premium "could be a touchy subject" in schools.

But they also have opportunities, such as major retailers and expansion into Europe, where schools also are banning drinks containing high fructose sugar syrup.

Both **Izze** and GuS are testing the U.K. "We're going to do more," Woloson said, though "it's expensive to ship liquid packed in (**Izze**'s) glass bottles."

HSBC has had Coca-Cola and PepsiCo as clients. Stifel Nicolaus has had Coca-Cola as a client. The analysts don't own shares.

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