The Evolving Non-Alcoholic Beverage Landscape

A First Beverage Group Perspective

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Synopsis:

• The non-alcoholic beverage space is projected to grow from roughly $160 billion in 2008 to almost $190 billion by 2020, driven by growth in smaller, emerging “better-for-you” brands
  • Approximately $35 billion of market share in play for small brands
• Beverage retailing continues to evolve:
  • Demand for healthier, fresh alternatives driving expansion to the perimeter of the store
  • E-commerce has become a viable channel and increasing area of focus
• Key growth trends driving the industry include:
  • Health and Wellness
  • Rise of the Smart Consumer
  • Influence of the Millennial Consumer
• Growth categories to watch:
  • Super-Premium Juice
  • Premium Hydration
  • Probiotics/Kombucha
  • Craft Soda
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Industry Overview

The non-alcoholic beverage segment is highly competitive and dynamic segment. Innovation and the increasing focus by the consumer on health and wellness have driven growth and an evolving competitive landscape. Non-alcoholic beverages encompass a wide range of liquid refreshment beverage categories, including carbonated soft drinks (CSDs), energy drinks, juices, bottled and enhanced water, RTD coffee and tea, probiotics, and sports drinks. Many of these sub-categories have enjoyed growth driven both by consumers' increasing demand for healthier, functional beverages, and companies' abilities to deliver compelling products with unique flavors and innovative packaging. This paper highlights some of these emerging segments which we believe will continue to outpace category growth and provide an opportunity for scalability in many categories currently perceived to be niche enthusiast segments.

As the chart below demonstrates, with almost $71 billion in sales, CSDs remain the largest single category within non-alcoholic beverages. Bottled water and juices come in a distant second and third (respectively) in market size. However, as CSDs continue to fall out of favor, the other segments have a tremendous opportunity to gain market share.

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As outlined in the chart below, between 2003 and 2013, per capita consumption of CSDs decreased by 23% (from 836 pcc to 644 pcc), while bottled water saw a 105% increase in per capita consumption. CSDs’ decline is expected to continue, with a projected 5-year CAGR of -3.1%, while other “better-for-you” non-alcoholic beverage segments are expected to continue gaining share.

![US Beverage Per Capita Consumption 2003-2018e](chart)

**Beverage Retail Landscape**

The retail landscape for beverages has also continued to evolve. Categories which have traditionally appealed to the niche health and wellness oriented consumer are finding their way into conventional channels as retailers seek to replace declining CSD and shelf stable juice with higher margin, healthier alternatives. According to Denise Morrison, President and CEO of Campbell Soup Co., the industry is “seeing a stunning transformation in consumers’ food preferences and in their expectation of food manufacturers and retailers. Across generations and cultures, heightened concerns about the impact of diet on health and well-being is fueling the growth of fresh, packaged fresh and organic foods- trends that are driving the expansion of the perimeters of retail stores and adversely affecting center-store categories.”

E-commerce and online grocers are also playing an increasingly important role in the beverage industry. Historically, beverage brands tended to rely on third-party e-commerce providers rather than invest in building a dedicated e-commerce channel, given prohibitive shipping costs and the perception that beverages are often convenience-based, single-serve purchases. Today, many brands have started to embrace an e-commerce strategy as a more direct way to communicate with millennials and their core consumers, who are often pantry loading, particularly with products that have become part of a healthier lifestyle. Two recent notable e-commerce launches have been from Bai Brands, which in January 2015 announced plans to build out its e-commerce business beyond its already successful Amazon presence and hint water, which launched its own platform in 2014 after realizing it was unable to gather data or directly communicate to its core consumers through third party sites.

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Brick-and-mortar retailing is also evolving to address today’s consumer demands. As recently stated by Chris Reed, CEO of Reed’s, “Generally, you still have to prove yourself in natural foods, but not necessarily, we’re seeing big retailers like Target and Kroger coming in and wanting to bring in very early innovations.” Target’s “Made to Matter – Handpicked by Target” campaign is one example of how mainstream retailers are adapting their marketing and merchandising platforms to cater to today’s consumer. This new campaign was launched in collaboration with 17 leading natural and organic brands, who will now have a large scale platform to introduce new products. Collectively, these brands will unveil over 120 new and limited-edition products. Included in the program are beverage brands such as Horizon Organic and Vita Coco. While not part of the Made to Matter campaign, Suja also recently worked with Target to launch an exclusive “Suja 1-Day Renewal Fresh Start” line which offers to help consumers “jump start healthy eating habits by pairing Organic, Non-GMO & Cold-Pressured juices with whole food.”

In conventional grocery chains, the produce section continues to evolve with healthier beverages playing a leading role. As noted by Sherry Frey, health and wellness expert for Nielsen, “The one area of the store where we are just seeing phenomenal growth is the produce department.” Nielsen estimates the value jump for all produce section beverages – which includes smoothies, fresh juices and teas as well as water – was nearly 13 percent in 2014.

As the beverage industry and mainstream conventional and mass retailers embrace the transition to healthier, better for you products, we believe there is a tremendous opportunity for emerging beverage brands to gain share. Small brands which, at $60 billion in value in 2008, made up roughly 1/3 of the non-alcoholic beverage market, are expected to grow into half of the segment, representing a $95 billion market by 2020.


Categories include water, CSD, concentrates, juices, RTD coffee, RTD tea, sports and energy drinks.

~$35 Billion in Play for Small Brands

$60B

$95B

$0

$50

$100

$150

$200


Small Brands

Big Brands

Coca-Cola

pepsi

kraft foods

DR PEPPER

SNAPPLE

Nestle

~$35 Billion in Play for Small Brands
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In this paper, we outline key trends which we believe will continue to drive growth in the non-alcoholic beverage segment. We will also highlight four segments – Super-Premium Juices, Premium Hydration, Probiotics/Kombuchas and Craft Sodas - that we believe are well-positioned to capture a meaningful share of the $35 billion market opportunity in play for emerging brands.

Key Growth Trends in the Overall Category:

We believe that there are three important factors that will continue to drive growth in the non-alcoholic beverage category. An increased focus on "Health and Wellness" has already shaped general consumption habits across food and beverage categories and this focus will continue to have a significant impact on non-alcoholic beverage trends.

Also profoundly impacting the business of beverages is the rise of the "Smart Consumer" - the informed buyer who demands increased transparency, simplicity in ingredients, and truth in labeling. Brands that meet the demands of these consumers while also providing a great tasting yet functional product have a tremendous opportunity to take share and gain consumer loyalty.

And finally “Millennial Consumers”, who, as the single largest consumption generation to come of age in the US, will deeply affect growth trends in all segments of the industry. Millennials are the most socially and digitally connected generation in history and their consumption patterns, which demand better-for-you, authentic, hand-crafted, and local products, will continue to drive a significant shift not only in consumption patterns, but also in the way brands market themselves to this increasingly important consumer group.

Health and Wellness:

Health and wellness awareness is a trend which has significantly impacted the food and beverage industry in recent years. Not only does the increased focus on health and wellness cause consumers to make replacement choices (replacing "bad-for-you" beverages with "good-for-you/healthy" choices), but it also creates new purchasing occasions through preventative/functional products and meal replacements.

In the decade leading up to 2013, US per capita consumption, based on “consumer need states” of CSDs and traditional fruit juices (referred to as “Refreshment” in the chart below) decreased 2.3% annually. Alternatively, per capita consumption in the Hydration category grew at an annual rate of 2.9% during the same decade. In particular, plant-based products like coconut water along with alternative beverages such as kombucha and tea-based drinks are experiencing tremendous growth. In addition, several new emerging categories are gaining traction including plant-based waters such as maple, aloe and cactus water.
The Rise of the “Smart Consumer”

Consumers are more informed than ever before. The rise of today’s “Smart Consumer” has been driven by the increased awareness of the negative health effects related to artificial, highly-processed ingredients, as well as the increased importance placed on simplicity and transparency of ingredients as well as product origin. Plentiful and readily accessible data empowers consumers to conduct some form of research before making purchasing decisions. According to Pew Research, 81% of internet users say that the internet keeps them better informed about products and services to buy.

Multiple studies have shown that consumers - especially younger, Millennial consumers - are looking at ingredients lists when making food and beverage purchasing decisions. A key distinction between today’s “Smart Consumer” and the previous generation of “Informed Consumers” is that while the “Informed Consumer” looked to the nutrition label primarily for calorie and fat content, the “Smart Consumer” looks to the nutrition label for ingredient information, focusing instead on how the product is made and the simplicity of the ingredient profile. The NPD Group, a global information provider, showed in its latest research that “57% of Americans are concerned about the health risks associated with GMOs compared with 46% a decade ago.”

As Campbell’s Soup Co. CEO Ms. Morrison notes, “Consumers are demanding greater transparency. They want to know where and how their food is grown and produced, where food companies stand on issues that are important to them.” The “Smart Consumer” has been instrumental in driving the push for products without artificial sweeteners and high fructose corn syrup, products low in sugar, and non-GMO products. Brands that can deliver this simple, yet functional ingredient profile, such as enhanced and functional waters, are well-positioned to attract and gain the loyalty of the “Smart Consumer.”

The Millennial Generation

The replacement of Baby Boomers by Millennials amongst the working ranks marks the largest consumer demographic shift in US history. Representing close to 80 million people and accounting for roughly 25% of the US population, this generation, born between 1982 and 2001, has markedly differing consumption habits and demands from preceding generations. These differences will have a profound...
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impact on all industries, beverages included, as Millennial spending is projected to reach $1.4 trillion by 2020, and represent 30% of all retail purchases.

Millennials have already demonstrated their inclination towards purchasing healthy products and authenticity is also a key driver behind the purchasing decisions of Millennials. Much more so than previous generations, Millennials align their own identity with the products they consume. As such, they actively seek products and brands with an authentic story that aligns with how they view the narrative of their own lives. “Local” and “craft” have become synonymous with Millennial consumption habits as Millennials seek to be more connected to the products they buy than previous generations. Roughly half of Millennials claim to prefer buying local, even if it comes at additional cost. Two of the most successful categories catering to this trend are craft beer and craft soda. Millennials love the journey of discovering, researching, finding, enjoying, and then sharing their discovery of a new product.

As the most connected generation to come of age in the U.S., Millennials’ purchasing decisions are heavily influenced by social media, including recommendations from friends and high-profile bloggers. As the chart below shows, more than 80% of Millennials actively engage in social networking. It is imperative that brands recognize this important marketing tool to enhance their credibility with the Millennial consumer.

![% of Internet Users who use Social Networking](chart)

Such interconnectivity has made Millennials a group which thrives on sharing information and influencing peers through word-of-mouth. Beyond simple social media campaigns, brands are increasingly seeking out the services of small, progressive agencies to launch their social media and grass-roots marketing campaigns. One such agency, Brand Adoption, whose tagline is “social media with legs,” seeks to spread peer-to-peer awareness about its client brands’ through its “UREP” network (short for “university representative”). Their strategy is to harness social media alongside their UREP network in order to move brands “from consideration into trial, then purchase and ultimately into advocacy.” Market research has shown that Millennials feel that peer-to-peer recommendations are the most trusted resource when evaluating a brand.

This cycle of peer-to-peer recommendations fuels organic growth as well, as brands that offer a high quality, functional, and delicious product with an authentic story have the ability to engage consumers, many of whom can subsequently serve as “social ambassadors” for the brand.

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**Growth Categories to Watch:**

Highlighted below are a few of the key segments and companies we believe are poised to benefit from the trends in health and wellness and the shifts in consumer profiles, which together are driving tremendous growth in the non-alcoholic beverage industry:

**Super-Premium Juices**

- Super-Premium Juices have exploded into mainstream awareness over the last several years, initially fueled by interest in Juice Cleanses as a detoxifying and weight loss regimen. Super-Premium Juice has expanded beyond cleanses and broadly refers to fresh-packed juices, most notably created using cold-pressing and high pressure processing (HPP) technology. These methods essentially redefine freshness, health, and flavor for the entire juice category.

- Today, the super-premium juice category generates approximately $2 billion in revenue, and continues to grow at double-digit rates. According to Beverage Marketing, the super-premium fruit and vegetable juice segment grew 58% in the period from 2004 to 2011.

- HPP enables products to be treated in their final packaging, replacing the traditional method of sanitation-by-heat with sanitation-through-pressure. Heat treatment, while effective in killing molds and bacteria, adversely affects the taste of the final product. HPP, on the other hand, damages the cellular structures of the same bacteria and molds, but without altering taste, texture, or flavor, and while retaining more of the nutrients that are otherwise damaged during heat treatment.

- A major challenge in this space is rooted in manufacturing and logistics, because while HPP increases the shelf life of the juices up to 28 days, the product is still perishable and requires refrigeration. Initially the development of the industry was shaped by companies investing in manufacturing capacity and building their brand locally, keeping their distribution footprint tight and manageable. Going forward, a critical issue will be in successfully implementing a supply chain that can manage production and distribution to support national expansion. As Suja CEO Jeff Church recently stated, “You need to be really well funded...we’ve invested nearly $50 million into Suja in two and a half years because we do everything in house...the big chains like dealing with someone that can work with them on a national scale and deliver a consistent product, and Suja is well-equipped to do this thanks to the investment in its supply chain and manufacturing footprint.”

- While there are several innovative brands to watch in the category, we believe those brands that have developed an authentic brand position while successfully managing capacity and logistics and extending to lower price point products and more conventional offerings will be the companies that have the ability to gain significant share. Highlighted below are three Super-Premium juice brands we believe are well-positioned to achieve true scale in the industry:

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**Suja**

- San Diego, CA-based producer of cold-pressed, organic, juice.
- The company has a three-tier pricing architecture: *Suja Classic* ($7.99/16oz.); *Suja Elements* ($4.99/12oz.) - exclusive to Whole Foods; and *Suja Essentials* ($3.99/12 oz.)
- **Founded:** 2011
- **CEO:** Jeff Church
- **Investors:** Boulder Brands, Alliance Consumer Growth
- **Estimated Revenue:** $70M-$80M projected for 2015, an increase from $45M in 2014.

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**Pressed Juicery**

- Pressed Juicery is one of California’s leading cold-pressed juice chains which has differentiated itself through its clean, modern design and branding and innovative flavor profiles.
- Expanded to over 30 locations throughout Southern and Northern California.
- **Founded:** 2010
- **CEO:** Hayden Slater
- **Investors:** Finn Capital Partners
- **Estimated Revenue:** $20M-$30M

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**RIPE**

- New Haven, CT-based FreshBev is a unique HPP juice company that both markets its own brands and also co-packs for other leading HPP brands.
- FreshBev’s *RIPE Bar Juice* is an innovator in the cocktail mixer category. In 2014, the company launched *RIPE Craft Juice*, a line of premium HPP cranberry juices in partnership with Ocean Spray.
- **Founded:** 2008
- **CEO:** Michel Boissy
- **Estimated Revenue:** N/A
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Growth Categories to Watch:

Premium Hydration

• The premium hydration segment has gained increasing popularity as health and wellness-oriented consumers seek out beverages which provide increased hydration. Broadly speaking, beverages in the premium hydration segment offer specific functional benefits and include flavored and functional beverages, which can be enhanced with vitamins, ionized to increase alkalinity, or supplemented with specific ingredients (coconut water, coffee fruit). FoodBev estimates that the global flavored and functional water market will reach $36 billion by 2019.¹⁰

• High-alkaline water has been one of the fastest-growing segments in the premium hydration category and is created when base molecules in water (low pH ions) are removed, creating two effects. First, because the bitter tasting low pH ions are removed, the process creates a cleaner tasting product. Second, it alters the pH of the end product, creating an ionized, higher pH product. A pH level of 7 is considered to be neutral, with a reading above that level meriting a high pH rating. The success of high-alkaline water is based on the functionality that ionizing water molecules creates smaller clusters of molecules, which can then be absorbed into the body more quickly and efficiently, leading to increased hydration.

• The success of coconut water demonstrates the increased consumer focus on the functional benefits of plant-based products. Coconut water has been among the fastest growing segments within the non-alcoholic segment in recent years with strong growth in both the natural and conventional channels. SPINS/IRI data for the food, natural and specialty/gourmet channels for the 52-weeks to November 2014 showed annual growth of +15.9%.⁴ With continued product innovation and expansion into mass and conventional channels, we expect growth in the coconut water segment to continue to be robust. Beverage Daily estimates that while coconut water has reached mainstream awareness in about 40% of the population in large metropolitan cities, the segment has only penetrated about 5% of the Midwest.

• Today’s enhanced and functional waters are far superior to previous iterations, which were often high in calories and sugar. Fast-growing brands within this category focus on natural, functional ingredients at low or zero calorie counts. We believe enhanced water’s ability to garner multiple drinking occasions with limited calories will continue to drive the growth of this segment. Highlighted below are three brands we believe are well-positioned to gain share in the premium hydration category:

Bothell, WA-based premium high-alkaline enhanced water company, pioneered the enhanced water segment by developing a proprietary process that enables Essentia to deliver enhanced hydration via a 9.5 pH water to the consumer.

- **Founded:** 1998
- **CEO:** Ken Uptain
- **Investors:** Castanea Partners, First Beverage Ventures
- **Estimated Revenue:** ~$20M, with sales up 60% in 2014¹¹

Fair Trade Certified, organic coconut water launched by Palo Alto-based Maverick Brands.

- **Coco Libre** organic coconut water remains the core line, available in Original and Pineapple flavors.
- **Coco Libre Protein** comes in Chocolate, Vanilla, and Almond flavors.

- **Founded:** 2010
- **CEO:** Candace Crawford
- **Investors:** Undisclosed
- **Estimated Revenue:** $20M

Hamilton, NJ-based company making a naturally sweetened five-calorie beverage with antioxidants and caffeine. Bai 5 is derived from coffeefruit, enhanced with white tea extract, and sweetened with stevia and monkfruit. Bai Bubbles, a sparkling drink, launched in October 2014.

- **Founded:** 2009
- **Investors:** Strand Equity Partners
- **CEO:** Ben Weiss
- **Estimated Revenue:** $50M, with 300% growth in both 2013 and 2014

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**Probiotics/Kombucha**
- Probiotics broadly refers to the positive microorganisms in the human body that aid in digestion and general gut health. What was once a niche health food category has now crossed over into mainstream consumption as consumers increasingly seek probiotic benefits in categories beyond yogurt. According to research firm MarketsandMarkets, the larger digestive health ingredients market in the US is projected to reach $495 billion by 2015, from roughly $266 million in 2010.8
- Kombucha, a sub-segment of the probiotic category, is a centuries-old Eastern beverage. In its most basic form, it is made from the fermentation of beneficial bacteria and yeast in tea, and the drink has enjoyed a surge in consumer adoption in recent years due to kombucha’s unique ability to offer probiotic benefits in a naturally carbonated tea beverage. Increasing awareness of the benefits of probiotics and the tremendous appeal of kombucha can be seen in the growth of kombucha sales in the US, from $49 million in 2011 to $90 million in 2013.4 SPINS data shows that in the 52-week period to February 2014, kombucha scans totaled $122.7 million9.
- However, there continues to be concerns about Kombucha’s ability to achieve mass consumer adoption given the often vinegary taste profile and the heightened concerns about alcohol levels from continued in-bottle fermentation. As recently stated by Bill Moses, CEO of KeVita, “It is the white elephant in the room and people don’t want to address it.”21
- Another category to embrace probiotics is enhanced juices and single serve supplements/shots. Juice-based probiotics provide another alternative to dairy-based yogurt and with a sweeter taste profile which more often appeals to children and younger consumers - providing a way for mothers to offer a more healthful alternative to kids at home. Outlined below are three companies in the probiotic/kombucha segments that we believe are well-positioned to capture an increasing share of the growing probiotics market:

  - Oxnard, CA-based KeVita offers a full line of probiotics in sparkling juice, kombucha and tonic formats. KeVita’s products are handcrafted in its own facility in California and offer a proprietary culture with four strains of probiotics.
  - KeVita announced a distribution partnership with PepsiCo in 2014.
  - **Founded:** 2009
  - **CEO:** Bill Moses
  - **Investors:** KarpReilly, SPK Capital
  - **Estimated Revenue:** $25M, a 100% growth rate in 201325

  - Los Angeles, CA-based Health-Ade has created an extremely loyal and passionate consumer following based on its unique, vintage glass bottles and approachable recipes with seasonal ingredients made in small batches.
  - Health-Ade is available in six year-round flavors and four seasonals offerings which generally retail for $4 per 16-oz. bottle.
  - **Founded:** 2012
  - **CEO:** Daina Trout
  - **Investors:** First Beverage Ventures
  - **Estimated Revenue:** N/A

  - NextFoods, based in Boulder, CO is the maker of GoodBelly, the leading probiotic juice brand in the US. GoodBelly juices are available in seven flavors and offer the exclusive LP299V strain of probiotics.
  - GoodBelly also offers a line of three 80 ml shots, including *PlusShot*, which offers a stronger dose of probiotics, *StraightShot*, a no sugar added, lower calorie option, and *SuperShot*, which contains the strongest dose of probiotics.
  - **Founded:** 2006
  - **CEO:** Alan Murray
  - **Investors:** Maveron, Emil Capital Partners
  - **Estimated Revenue:** $25M

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Growth Categories to Watch:
Craft Soda

Craft soda has gained popularity even while general carbonated soda consumption has decreased by over 20% in the decade to 2013. Craft soda, which, according to Beverage Digest, is “largely defined as being manufactured in smaller batches with more natural ingredients” currently owns approximately 1% of the 9 billion-case US soda market. Craft soda is differentiated from traditional soda given its focus towards natural, local, and artisan ingredients and is frequently used as not only a healthier refreshment alternative often with lower calories, but also as a mixer for cocktails.

Many craft soda participants believe the craft soda trend will mirror what has happened with craft beer, which has been the bright spot in an otherwise challenged beer market with annual growth rates of up to 15%+ / year. Today craft beer accounts for 14% of beer dollar sales (and 9% of beer volume) in the United States.

While some experts have questioned the true scalability of the category given it is still “sugar water”, we believe the that the innovation in flavor and unique, healthful ingredients (lavender, ginger, cucumber) that many craft brands are introducing will continue to attract consumers seeking a more acceptable indulgence (like dark chocolate and wine).

Proof of craft soda’s increasing relevance is evidenced by soda mega-brands now quietly entering the segment. Pepsi-Cola announced its debut of Caleb’s Kola, which is named after the original proprietor of the Pepsi cola formula and carries the slogan “Honor in Craft.” Unlike Pepsi, Caleb’s is made with only sparkling water, cane sugar (rather than high fructose corn syrup) and kola nut extract. Caleb’s comes in a glass bottle and the label distinctly lacks any Pepsi-Cola company markings. Whether or not a mega-brand can compete in this segment with a “craft” offering is to be determined, but Pepsi’s entry into the craft soda segment speaks to the increasing awareness of the importance of this segment.

Highlighted below are three craft soda brands which we believe have the ability to scale and capture an increasing share of the overall soda market:

**Dry Soda Co.**
- Seattle, WA-based Dry Soda was created specifically to appeal to a palate seeking less-sweet, all-natural sodas. Its 10 modern, adult twists on soda flavors contain only four ingredients and have up to 33% less sugar than traditional sodas and far fewer calories.
- DRY Soda also allows customers to taste their different flavors in their upscale tasting room at their Seattle headquarters.
- **Founded:** 2005
- **CEO:** Sharelle Klaus
- **Investors:** N/A
- **Estimated Revenue:** N/A

**Sipp Dranken**
- Chester Springs, PA-based Sipp markets organic, hand-crafted craft sodas offering a distinctly upscale, adult feel. Available in four flavors: Ginger Blossom, Lemon Flower, Mojo Berry, and Summer Pear.
- Sipp differs from other craft sodas in that every Sipp soda is caffeine free. This gives Sipp a unique positioning not only as a craft soda, but also as a natural sparkling juice.
- **Founded:** 2009
- **CEO:** Beth Wilson-Parentice
- **Investors:** Emil Capital Partners
- **Estimated Revenue:** N/A

**Q Drinks**
- Brooklyn, NY-based Q Drinks was originally founded as “Q Tonic,” but has since expanded to include eight unique flavors, including ginger beer, kola and grapefruit sodas.
- The company markets its products primarily as cocktail mixers with a focus on sourcing the highest quality ingredients from around the world.
- **Founded:** 2006
- **CEO:** Jordan Silbert
- **Investors:** N/A
- **Estimated Revenue:** N/A

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With tremendous growth in emerging brands and increased focus on expanding into health and wellness by large strategics, we have seen a notable increase in M&A and financing activity. Highlighted below are some of the notable M&A transactions and financings:

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# The Evolving Non-Alcoholic Beverage Landscape


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