Consumer Pulse Survey

A DRINK TO HEALTH | JULY 2023

A Drink to Health

For a market led by a few massive, multi-brand corporations, the U.S. non-alcoholic beverage sector is remarkably dynamic. Consumption of carbonated soft drinks and other sugar-sweetened beverages has been in steady decline since the mid-1990s[1], replaced by increased consumption of a wide range of healthier beverage alternatives and bottled water. To capitalize on this shift, a proliferation of new beverage types, flavors, brands, and packaging pops up on grocers' shelves each year, often produced by upstart companies with a mission to innovate and disrupt. The space in consumers' shopping carts once commanded by flagship brands from large global companies is now being filled with products featuring unique ingredients, serving new occasions, utilizing alternative channel distribution, and prioritizing more sustainable packaging. While the market extends into new categories and smaller, more agile companies commandeer market share from major corporations, the drinks attaining consumer adoption begin a virtuous cycle that includes increased distribution, larger marketing budgets, and attractive financials—positioning them for further organic growth and, potentially, eventual acquisition by a financial sponsor or a strategic house of brands. The key to success is, as always, understanding consumer behavior with respect to how their beverage consumption is evolving.

As part of the ongoing Lazard / CH Consulting Advisors Consumer Pulse Survey series, we surveyed consumers about their beverage choices with an eye to uncovering emerging trends that are impacting both current and future markets. We surveyed a demographically proportionate audience of more than 1,000 Americans on how they purchase and consume non-alcoholic beverages, how those habits have changed in the last year, and what they look for when choosing a new product. Our research focused on purchase and consumption of packaged water[2], flavored water, 100% fruit and vegetable juice, and the growing category of natural healthy beverages[3] (NHBs).

Overall, each of these beverage categories remains strong, with portions of the population both purchasing and consuming frequently. However, digging into the specific consumer behavior around each beverage category yields insights into market stability, growth potential, and how investors and brands may be able to capitalize on the opportunity presented by the different product groups. For example, it may be intuitive that categories like packaged water and juice have the broadest penetration[4] (Exhibit 1), but the fact that far more consumers of NHBs make purchases multiple times per month indicates a more engaged, and, as we shall see, younger customer base (Exhibit 2).

Exhibit 1 – Of categories assessed, NHBs have least penetrated the general population ...

Percent of people who have consumed in the last 12 months

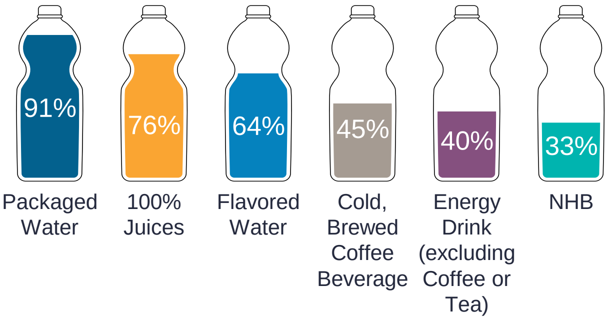
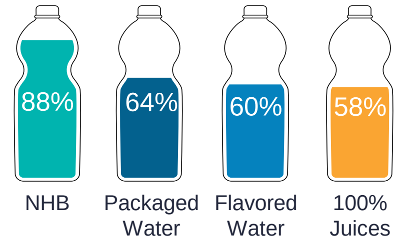


Exhibit 2 – ...but among people who drink a packaged beverage, NHBs are purchased far more frequently than any other analyzed beverage category

Percent of people who have consumed in the last 12 months and purchase that type of beverage at least 2-3 times per month



Young and "Less Young" Beverage Customers

The beverage buying habits of Millennial and Generation Z consumers (those born after 1981) differ starkly from older consumers in purchase frequency, beverage package size, and new product trial. Unsurprisingly, younger consumers experiment more than their older counterparts in the emerging NHB category. However, our research also shows that a higher proportion of younger consumers are frequent purchasers of all types of packaged beverages. While the stereotypical image of a young adult may be of a budget-constrained and eco-conscious consumer, we find that this cohort is highly engaged with the beverage category (Exhibit 3). In fact, not only are younger consumers buying more beverages, their consumption of packaged drinks is increasing faster than members of Generation X and older (Exhibit 4).

Exhibit 3 – Gen Z and Millennial consumers purchase more packaged beverages than older consumers, belying the assertion that younger consumers purchase less due to budget and environmental concerns

Frequent purchase (2-3x per month), by beverage type and generation

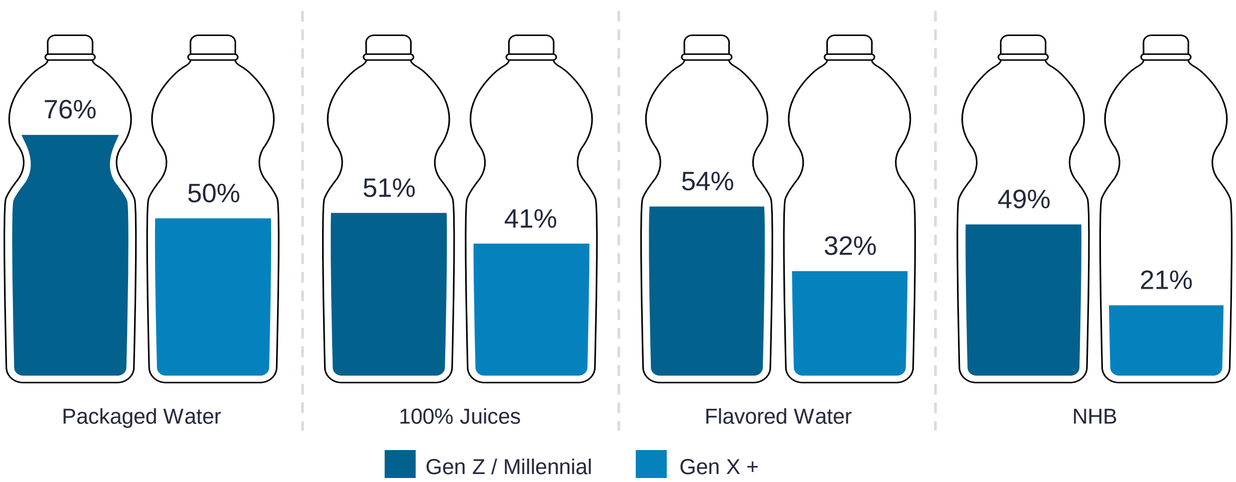
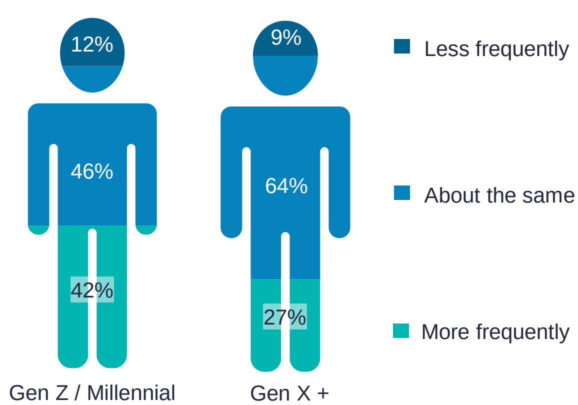


Exhibit 4 – Younger consumers' rate of purchase is increasing faster than older consumers

Percent of people saying purchase rate of beverage is changing, by generation



Younger consumers are far more likely to purchase individually packaged, single-serving drinks across beverage types. Whether due to a proclivity for experimentation, differentiated marketing or distribution channels aimed at younger consumers, product packaging and pricing, or smaller households, these smaller package sizes translate into more frequent purchases, which, in turn, allow these consumers to explore new brands, flavors, and functional benefits more often (Exhibit 5). Though brand loyalty remains high across generations and beverage types, this willingness to try other options opens the door for new products and provides manufacturers and retail merchants an impetus to continuously introduce variety into their offerings to satisfy customers' interests (Exhibit 6).

Exhibit 5 – Frequency of use and purchase, by generation

Percent of people saying purchase rate of beverage is changing, by generation

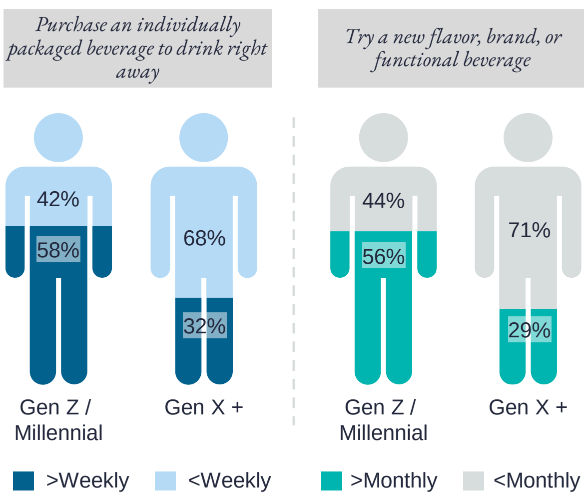
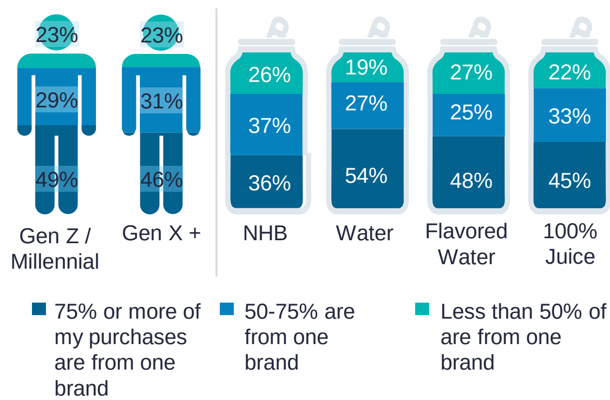


Exhibit 6 – Brand is important across generations and product categories

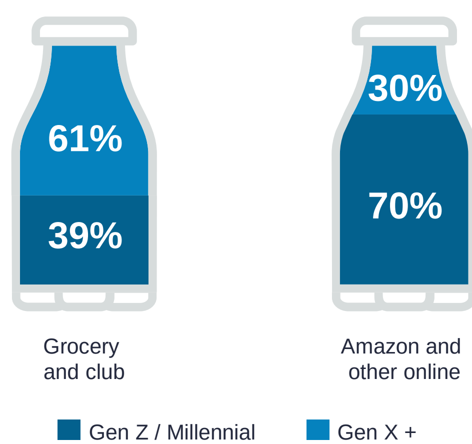
"Of the beverages in each category that you purchase, what percentage is from the same brand?"



Beverage purchasing largely remains in traditional grocery, club, and mass channels for all generations of consumers. However, as more and more commerce across all consumer categories converts to online ordering, beverages are following suit. Just as Millennials and Gen Z are the most prominent cohort leading online purchasing in general—with some estimates stating over 60% of their total purchases are made over the internet—these generations continue to be the most prominent cohort for online beverage transactions as well (Exhibit 7).

Exhibit 7 – Younger consumers are 70% of the market for purchasing beverages through online channels

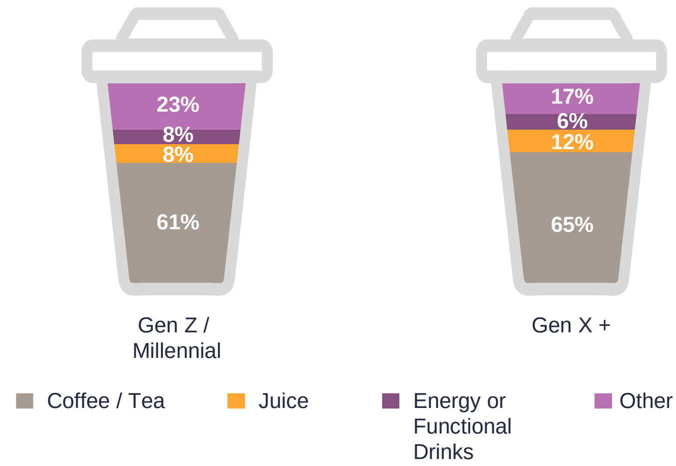
"Where do you most frequently purchase your beverages?" Percent of people choosing channel, by generation



One thing that younger and older consumers continue to have in common is their reliance on coffee and tea for their morning pick-me-up.[5] Despite the wide range of alternative beverages available to consumers to start their day, traditional beverages still hold the lion's share of the market (Exhibit 8).

Exhibit 8 – Morning pick-me-up

Primary drink of choice for occasion

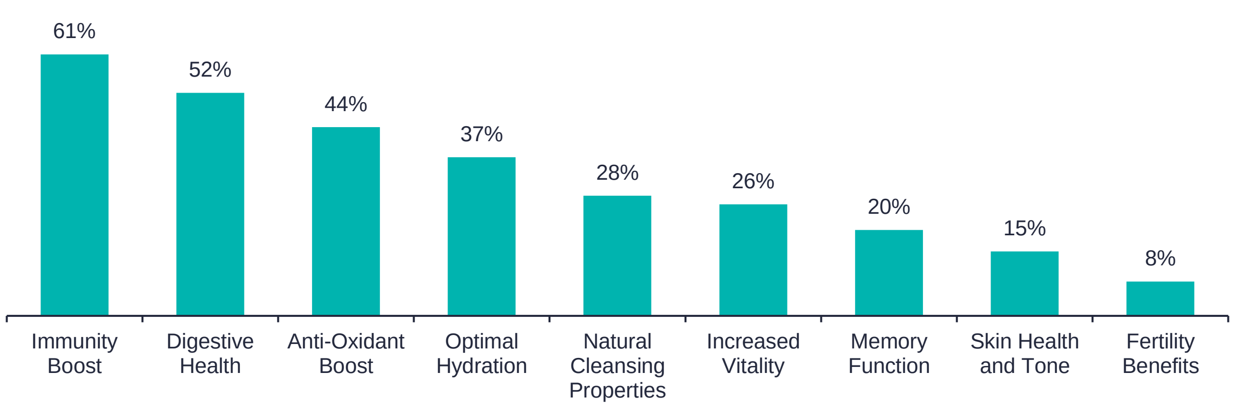


Natural Healthy Beverages

The category of natural healthy beverages (NHBs) has emerged as a true contender over the past decade, competing against existing functional or energy drinks with a promise of fewer ingredients but additional functional benefits provided naturopathically thanks to superfoods, pre- and pro-biotics, and infused botanicals. The International Food Information Council (IFIC), a nonprofit educational organization promoting science-based information on nutrition, lists wellness drinks as its number one food trend for 2023, writing: "Wellness will continue to be top-of-mind for many consumers, but it will increasingly come in liquid form, driven in large part by consumers looking for added benefits."[6] The second trend cited by the IFIC is a focus on digestive health, with beverages viewed as a delivery system for pro-biotics and pre-biotics. According to our survey, digestive health is the second most common benefit sought by consumers, behind only immunity support (Exhibit 9).

Exhibit 9 – NHB: Most important health benefits

Percent of people selecting benefit as one of their top three reasons for purchase



With product or brand names that include terms like “remedy,” “tonic,” and “adaptogenic,” NHB companies may also be targeting consumer needs that would otherwise be met by herbal supplements in pill or capsule form. Of NHB consumers whose frequency of consumption is increasing, 60% say those drinks are replacing supplements. It is not surprising that NHB consumers pursue healthy dietary and lifestyle choices, and, because they are often viewed as a health product first and refreshing beverage second, many consumers are willing to accept flavors that they find less appealing (Exhibits 10-11).

Exhibit 10 – Purchase Rationale

Reasons for NHB purchase among frequent purchasers

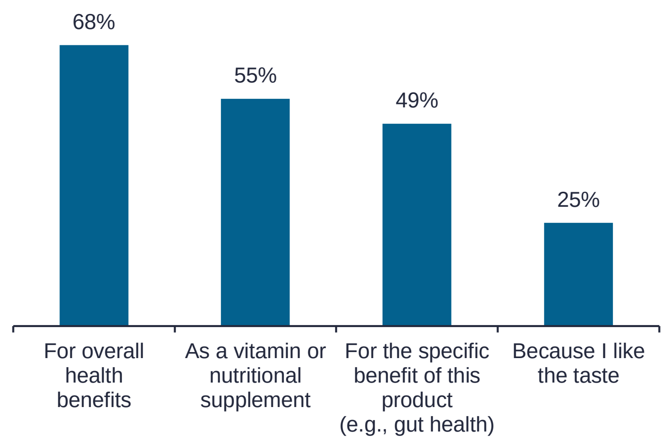
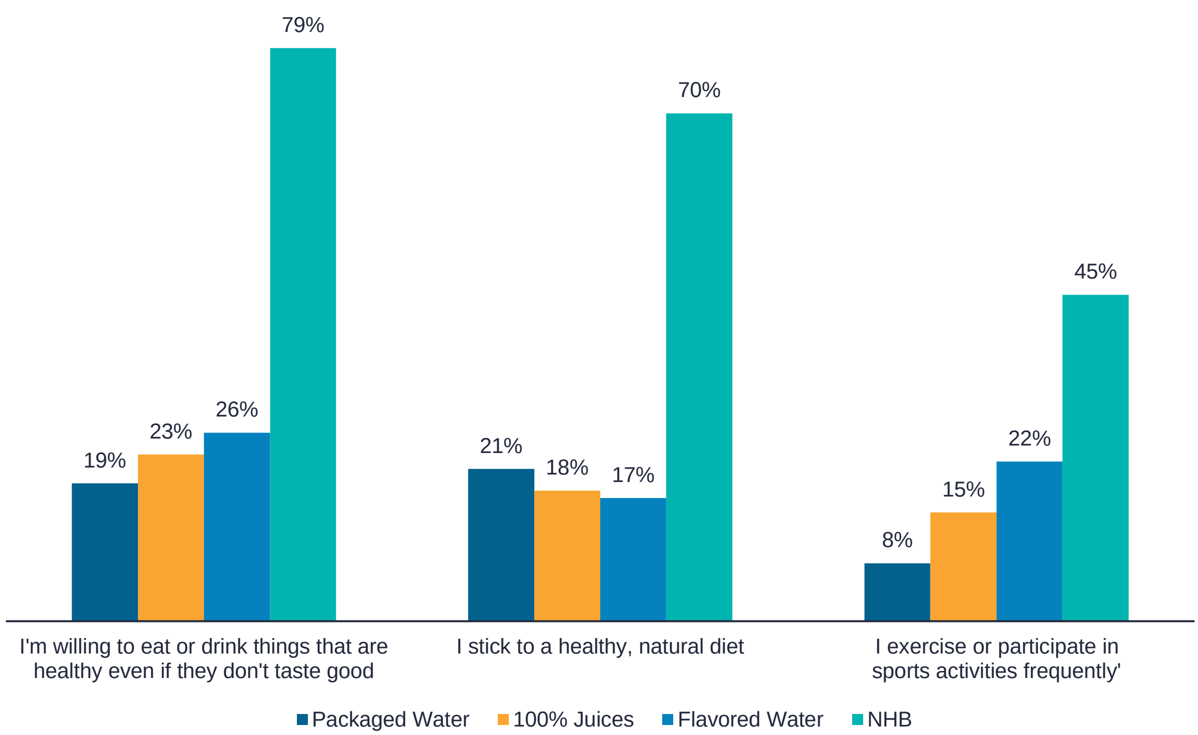


Exhibit 11 - Drinkers of NHBs are psychographically different from other beverage drinkers in that they are much more health conscious and willing to forego taste for health

Percent of frequent purchasers agreeing with the following statement (selecting top two boxes on a 1-7 agree / disagree scale)

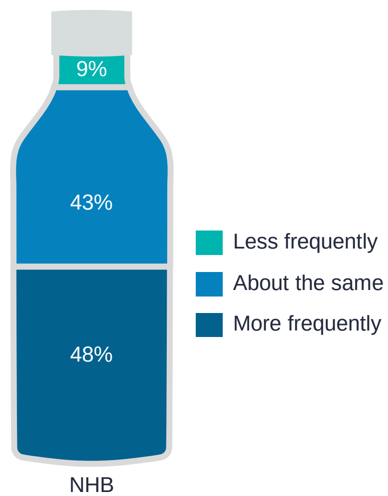


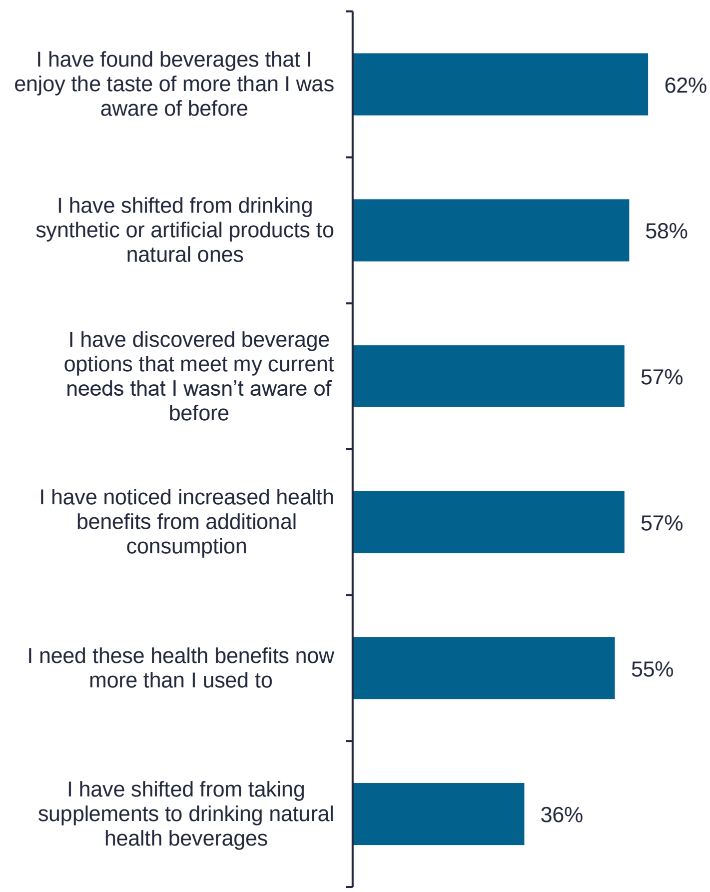
Although NHBs are the least penetrated of these beverage categories, the consumers who have discovered these drinks and have made them part of their diet apparently feel and appreciate the benefits offered by these drinks. Not only are they purchased more frequently, but purchases by existing customers are increasing more rapidly than the frequency of other beverage categories. This trend is most noticeable among younger consumers, who constitute over 50% of frequent NHB consumers despite only being about 30% of the adult U.S. population.

One reason for the continued increase in usage and penetration is that newer generations of NHBs are being engineered to taste better. The natural evolution of any new technology or product category is to focus first on functionality to capture early adopters, and then to improve iteratively on hedonics to broaden the category's appeal. Consider the journey that diet sodas took from the mid-1970s through the introduction of drinks that were marketed on the promise that the consumer would no longer have to compromise on taste. The NHB category is now in a similar phase of development, when taste will be a significant distinguishing factor. Nearly half of the current NHB consumers say they have increased their consumption in the past year, citing improved taste, choosing to drink natural health aides as opposed to synthetic beverages, as well as becoming aware of more options, which further encourages trial and consumption (Exhibit 12).

Exhibit 12 – Purchasing Trends

Purchases of NHB (now vs 12 months ago)



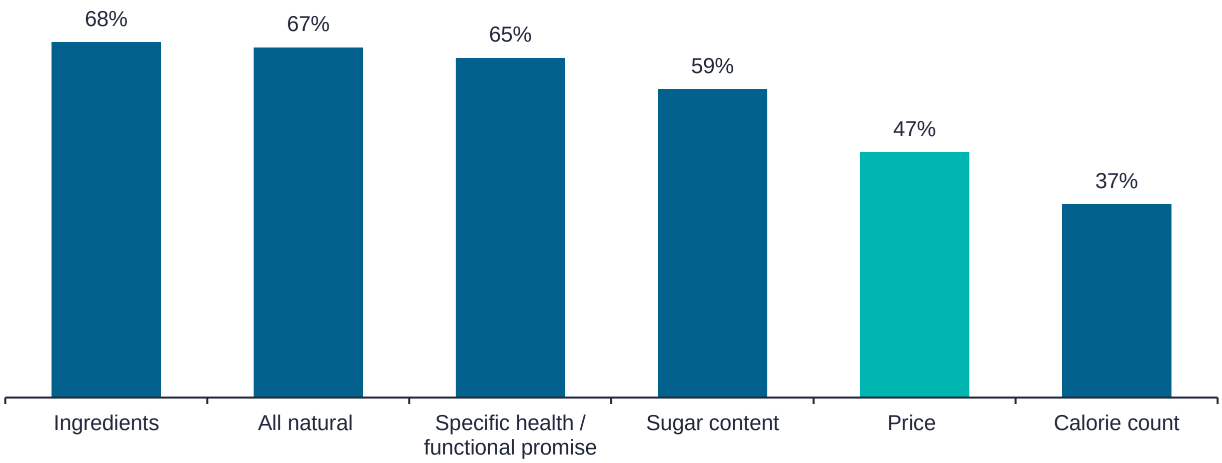


Reasons for NHB purchase increase (Top 2 Boxes, 1-7 scale)

When selecting and purchasing natural healthy beverages, consumers are consistently less concerned about the price than they are about the quality and effectiveness of the product. This relatively low level of price elasticity can inform manufacturers' decisions not only about investing in the quality of their ingredients, but also with regard to marketing decisions, packaging, and sales channels (Exhibit 13).

Exhibit 13 – Price is less important than many product characteristics for NHB consumers

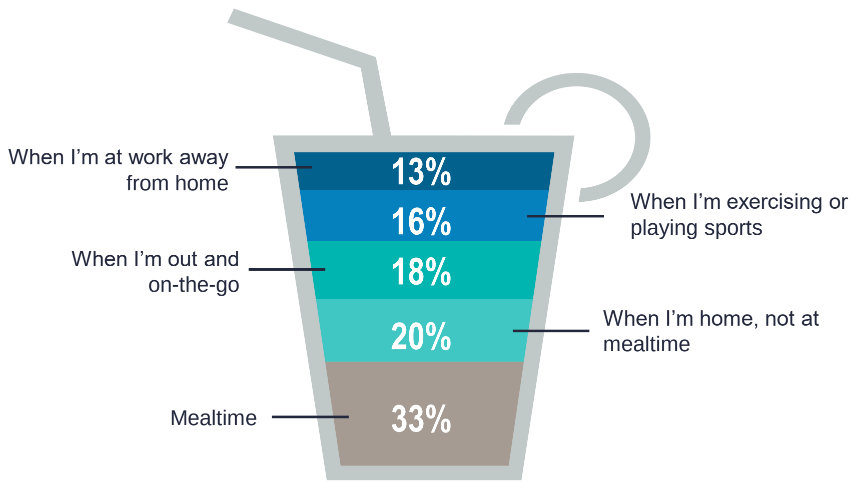
Important NHB characteristics
(Percent selecting top two boxes on a 1-7 scale)



Consumption of natural healthy beverages happens throughout the day – they have become "anytime" drinks. When considering these products for their health benefits, the important issue for consumers is not when they drink them, but that they drink them at all. Consequently, the growth of natural heathy beverages can cut into the market share of all other drink categories at all drink occasions (Exhibit 14).

Exhibit 14 – Usage Occasions

"Which of these describe when you generally drink NHB?"

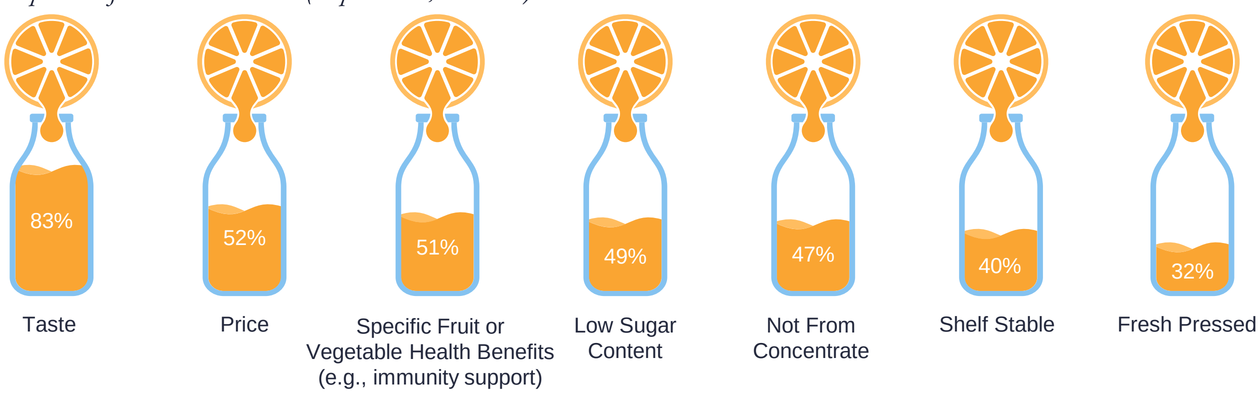


Juice

Juice consumption in the U.S. has seen minimal growth in recent years, with flat volume and low single-digit dollar sales increases. Much of that growth has come from introductions of lower calorie/lower sugar options to address consumers' health concerns. Today's juice drinkers are distinguished from natural healthy beverage drinkers by their relative prioritization of taste, with a secondary focus on price (Exhibit 15). With the number one reason consumers are increasing purchases of natural healthy beverages being improvement in taste, the traditional juice market may come under increased market share pressure from these drinks. The market may evolve to be divided primarily on price, with beverages touting health benefits able to extract a premium from those consumers who are using those drinks as a replacement for supplements. If newer, premium processing methods like fresh pressed juice fail to dominate the mainstream juice market, traditional juice companies may seek to continue reinforcing the health benefits of their products to capture more of that pricing leverage.

Exhibit 15 – Characteristics

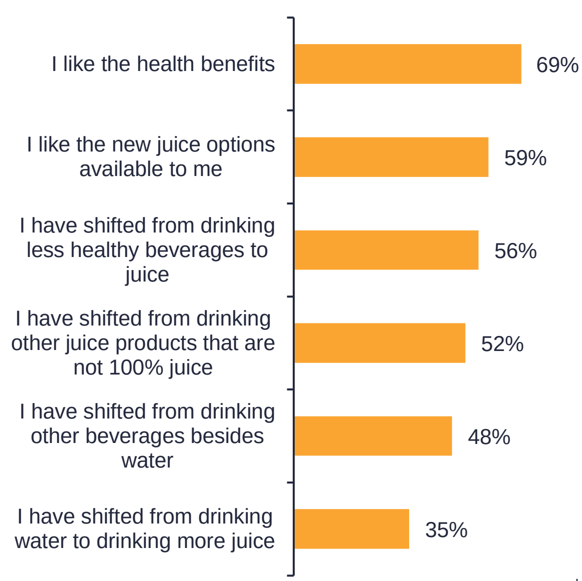
Important juice characteristics (Top 2 Boxes, 1-7 scale)



Further blurring the line between natural healthy beverages and traditional juice, the top reason juice drinkers provide for their continued consumption is the *perception* of the overall health benefit provided (Exhibit 16). That is to say, juice drinkers are either unaware of the (typically high) sugar content of their juice beverage or are simply ignoring that characteristic likely for the reason that it provides a "better-for-them" alternative. However, when consumers were asked why they don't purchase juice more frequently, survey respondents cited expense and sugar as the two most common reasons.

Exhibit 16 – Purchasing Trends

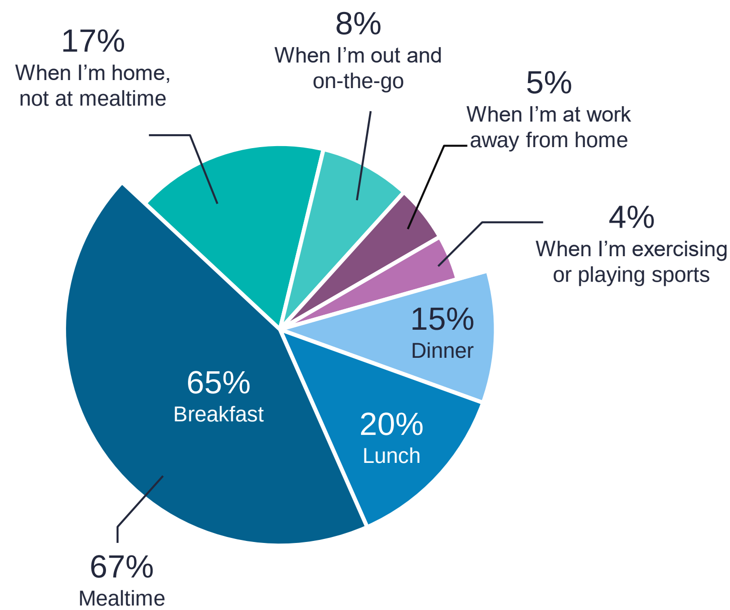
Reasons for juice purchase increase (Top 2 Boxes, 1-7 scale)



As for consumption, juice has long been a staple at the American breakfast table. This remains true and shows yet another front in the market share battle between traditional juices and the newer categories with explicit benefits. Today, nearly 60% of people say that they most commonly drink juice during breakfast or lunch. This strong association of juice with mealtime likely indicates staying power for juice, but also implies limited growth upside in the category in the near term. However, as consumers add fruit- or vegetable-based beverages to their diet during other times of the day, it becomes clear that they are searching for drinks that offer something extra to those occasions.

Exhibit 17 – Usage Occasions

"Which of these describe when you generally drink juice?"

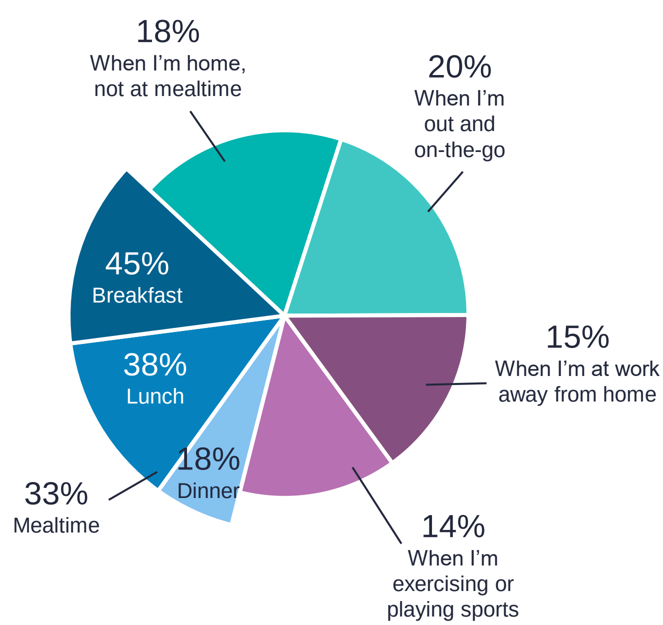


Water

The market for packaged water may be far less dynamic than that of natural healthy beverages, but differences between brands and products continue to drive consumer behavior. Since 2017, Americans have consumed more packaged water than any other packaged beverage, totaling nearly 50 gallons per capita in 2021, with over 90% of survey respondents sharing that they purchase packaged water, at least occasionally.[7]

Exhibit 18 – Usage Occasions

"Which of these describe when you generally drink packaged water?"



While convenience has been cited historically as a top reason for choosing bottled water, our survey results demonstrate that consumers drink only slightly more packaged water outside of the home than they do at home, where tap or filtered water is readily available (Exhibit 13). Rather, it appears that people strongly prefer packaged water due to the taste, whether due to mineral content, processing, added flavoring, or effective marketing (Exhibit 19).

Consumption of packaged water, both flavored and unflavored, continues to rise. According to the International Bottled Water Association, American consumption of packaged water rose 4.7% in 2021.[8] Our survey shows that roughly 1/3 of people are purchasing more packaged water than a year ago, largely because they are focusing on hydration and drinking more water in general (Exhibit 20).

Exhibit 19 – Characteristics

Important water characteristics (Top 2 Boxes, 1-7 scale)

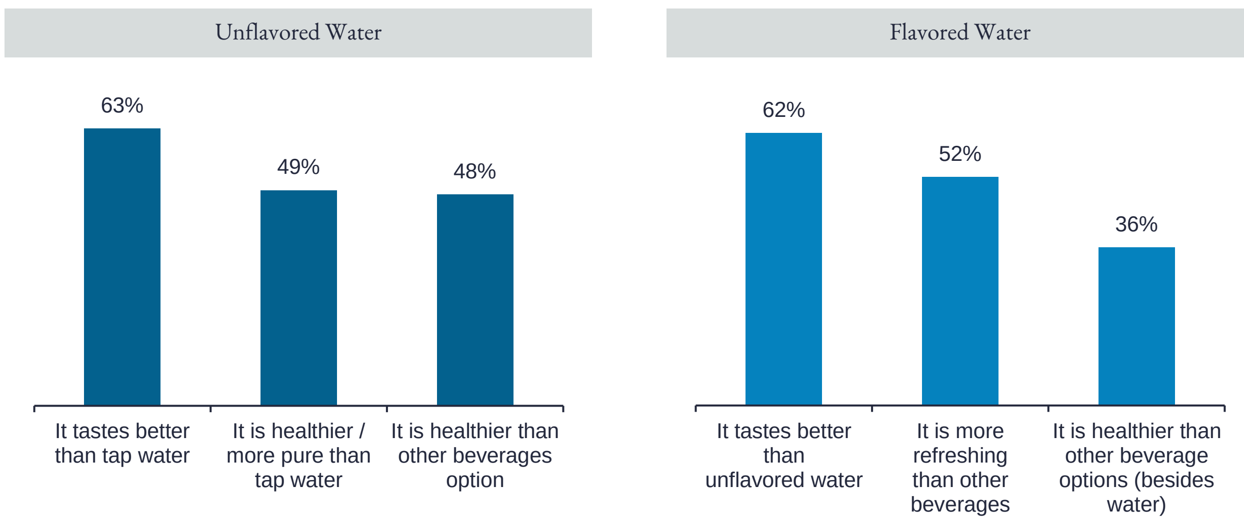
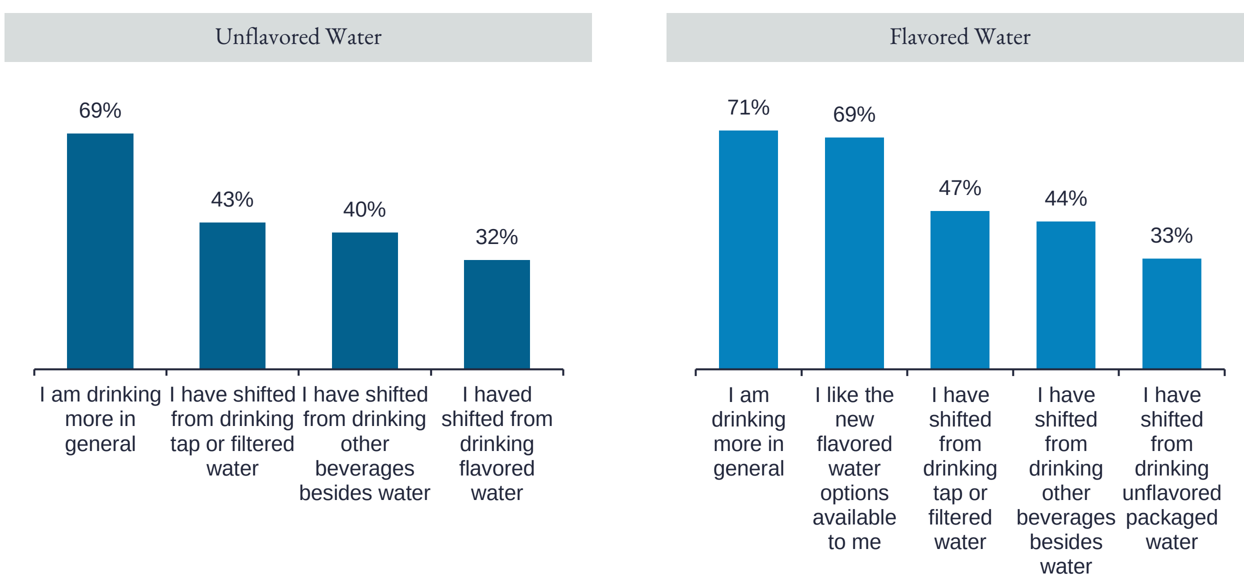


Exhibit 20 – Purchasing Trends

Reasons for water purchase increase (Top 2 Boxes, 1-7 scale)

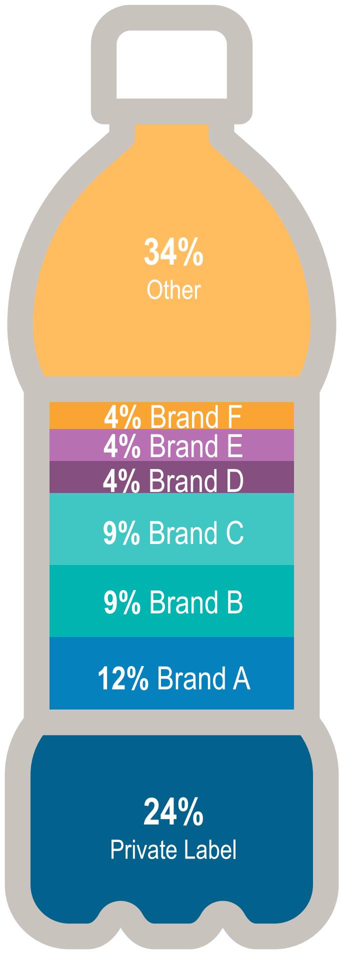


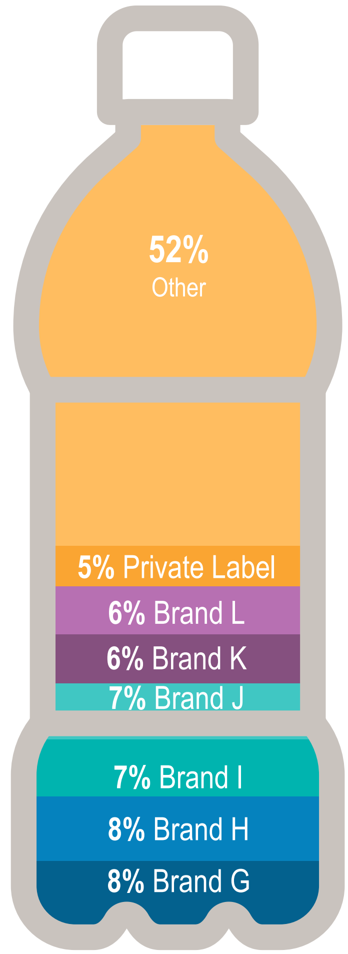
Unflavored packaged water companies have long sought to differentiate their products through branding, packaging, or taste. For a product that has largely been commoditized, it is not surprising that the list of brands preferred by consumers across the country comprises a long, thin tail, with a plurality of consumers favoring their grocer's private label. While flavored water brands are able to produce drinks that are more distinct from each other, the list of brands favored by consumers is also very diverse with no brand commanding even 10% of our survey's market (Exhibit 21).

Exhibit 21 – Consumers' Preferred Water Brands

Percent of people selecting brand, anonymized

Unflavored Water	Flavored Water





How to Grow the Beverage Category

For companies and investors looking for growth in the beverage market, certain trends emerge from this survey.

Look to Gen Z & Millennials

As is the case with many categories, the opportunity appears to lie with Generation Z and Millennials. Not only are they more frequent purchasers across all beverage categories today, but a higher percentage of them are increasing their consumption rates across beverage types. These younger generations, while fairly brand loyal, are also much more likely to experiment with new products, creating an innovation requirement for incumbents large and small and an ever-present opening for new players. Companies that have a core competency in innovation—be they flavor and ingredients houses or beverage businesses—tend to be more attractive to investors for their ability to build their brands within categories or sub-category niches. Such companies can outpace slower-moving large corporations, maintaining a high level of newness in their SKU assortment and pruning slow-moving product lines.

An All-Day Affair

The range of usage occasions exemplified by NHBs is an asset to manufacturers which can perhaps be leveraged by crafting more specialized yet health-beneficial products. Whereas most NHBs today are juice-based, other categories like coffee, tea, sodas, energy drinks, or even water, are also appearing on the market fortified with ingredients that offer health benefits, further increasing NHB penetration.

A Conduit to Wellness

Another likely place for companies and investors to focus is in expanding the market for NHBs, especially those that can effectively market health benefits related to digestion and immunity, beyond the 33% of consumers who our survey indicates drink them today. This category appears to be the next frontier of beverage consumption, as we can see through the increasing trial, penetration, and purchase frequency relayed by our survey results. In many ways, beverages can be a more enjoyable health conduit to the consumer than traditional vitamins and supplements. Where there is consumer demand for the health benefits of a supplement with a product that provides refreshment, the supply of natural healthy beverages should follow.

Err on the Side of Caution

As is the case within the vitamins, minerals, and supplements industry, beverages with health and nutrition claims are under increased scrutiny by the FDA and other regulatory authorities. In this highly fluid regulatory landscape, companies must be cautious to not overstate or mislead consumers about the benefits or effects of the product. Recently, those companies that have not heeded such caution have endured deleterious effects on their business.

Taste Reigns Supreme

Across product categories—generally speaking—the technologies and products that have successfully climbed the adoption curve moved beyond early consumers who were willing to look past some detracting characteristics (like lackluster taste or high cost) for the ultimate benefit of the product. Such products achieve mass acceptance when those rougher edges have been smoothed down allowing the less passionate consumers to reap the benefits without the downside experienced with earlier iterations. A company that creates the best-tasting, “best-for-you” beverage line—perhaps on par with juices that are widely enjoyed today—could most likely reach those customers who are unwilling to try the current offerings in the category.

Taste remains a driver to consumers’ water purchase decisions, especially when comparing packaged water to tap water. Packaged water brands taste slightly different from each other due to mineral content, carbonation level, source, or flavor essence, but taste is rarely emphasized as a differentiator by companies, despite its importance to consumers. Instead, today’s water brands distinguish themselves from each other and commoditized private label options on a wide range of traits (e.g. exotic place of origin, packaging, price, and flavor varieties). If a water brand can win the “Pepsi Challenge” taste test, it should be able to go to market on that basis with a sustainable differentiator that has not yet been developed in the market.

Opportunities for Investment and Acquisition

In addition to using M&A to expand across subcategories, some companies may want to explore using an inorganic growth strategy to expand vertically. For example, acquisition of ingredients manufacturers may enable companies to further develop their healthy beverage business, staying at the forefront of trends and ensuring access to in-demand emerging components. Alternatively, a focus on manufacturing, co-packing, and distribution capabilities may unlock direct-to-consumer channels that are growing in importance, especially with younger consumers. Successful inorganic growth efforts center on careful evaluation of target companies’ assets and ensuring that their brands have earned the right to compete. Solid channel support from distributors and buyers combined with high levels of consumer engagement are likely essential elements to successful acquisitions. Companies that construct a platform of brands or products with these traits may quench their thirst for growth.

Our research can be tailored to provide insight into your company’s unique situation. We would be delighted to explore how consumer sentiment could affect your business and the potential implications for financing, valuation, transactions, strategy, and priorities.

About Lazard

Lazard, one of the world's preeminent financial advisory and asset management firms, operates from 43 cities across 26 countries in North and South America, Europe, Asia and Australia. Celebrating its 175th year, the firm provides advice on mergers and acquisitions, capital markets and other strategic matters, restructuring and capital solutions, and asset management services to corporations, partnerships, institutions, governments and individuals. For more information on Lazard, please visit www.lazard.com. Follow Lazard at @Lazard.

Lazard's Consumer, Food & Retail Team

Lazard has financial advisory specialists throughout the world with experience and relationships in the consumer, food, agriculture, restaurant/ multi-unit franchise, and e-commerce/ retail industries. These bankers have played key advisory roles in some of the most important, complex, and industry-defining transactions. Our transactions are award-winning, strategic, and often, cross-border. We have built our reputation advising firms like yours.

We welcome the opportunity to share our views on consumer, food and retail M&A trends, your specific business attributes, and potential strategic alternatives in this dynamic market place. We are available to connect at your convenience.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About CH Consulting Advisors

CH Consulting Advisors is a boutique strategy consulting firm focused on the consumer and retail industry. We advise leading private equity, consumer, and retail companies in corporate and portfolio growth strategy and buy-side and sell-side diligence. CH Consulting Advisors brings deep analytics, extensive industry experience, and flexible approach to working with executive teams, boards, and investment teams. Our senior leaders are deeply involved with every effort.

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Consumer Goods & Retail

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Growth Strategy Expertise

Planning and prioritization process has helped dozens of middle market and global companies ignite growth

Senior Involvement

Our leaders are involved in driving the thinking and delivering seasoned practical insights leveraging 80 years of industry experience

Flexible and Expandable

Customized assessment approach for targeted or expansive scopes that leads to shareholder, board, executive and investor confidence

Notes

1. https://www.businessinsider.com/americans-are-drinking-less-soda-2016-3
2. Packaged water includes bottles, cans, and boxes of still or carbonated water.
3. Natural healthy beverages (NHBs) include natural health shots, cleansing drinks, kombucha, antioxidant-rich fruit drinks, natural energy drinks (including canned ready-to-drink coffee or tea), gut health, and pro- or pre-biotics
4. Penetration is defined as the percent of people consuming within the last twelve months.
5. “Morning Pick-Me-Up” is independent of breakfast, implying both time and purpose. Breakfast throughout this survey refers to a morning meal.
6. https://foodinsight.org/food-trends-for-2023/
7. https://bottledwater.org/nr/increased-consumer-demand-for-bottled-water-as-a-healthy-alternative-to-other-packaged-drinks
8. https://bottledwater.org/nr/increased-consumer-demand-for-bottled-water-as-a-healthy-alternative-to-other-packaged-drinks/

Consumer Pulse Survey Methodology

A typical Lazard and CH Consulting Advisors Consumer Pulse Survey is designed to capture a snapshot of the current consumer sentiment in the United States related to a certain topic within the consumer industry. Such a survey is designed and implemented to minimize total survey error.

Lazard and CH Consulting Advisors contracted a third-party market research company to conduct the survey online in the United States to a sample of U.S. adults ages 18 and older. Panel members are recruited by the third-party market research company, and survey questionnaires are taken via self-administered online surveys.

Our survey audience is balanced to be representative of the United States Census on gender, age, income, and ethnicity. We screen out panel respondents not residing in the United States or under the age of 18. This survey, *A Drink to Health*, included 1,007 qualified respondents: 312 who were born in 1981 or later that we have identified as Gen Z / Millennials and 695 born before 1981 who we have identified as Gen X or older.

Lazard and CH Consulting Advisors develop the survey questionnaire by leveraging our industry expertise, monitoring what is taking place in the market, and focusing on what we believe may be relevant to entrepreneurs, financial sponsors, and corporations.

Lazard and CH Consulting Advisors retain the questionnaire with all the questions from this survey with the exact question wording and response options as presented to respondents, as well as the results from the survey. This published Consumer Pulse Survey does not represent all of our ultimate findings. Instead, the responses can potentially be reviewed to provide insight into your company's unique or specific concerns. We would be delighted to explore how consumer sentiment could affect your business and the potential implications for financing, valuation, transactions, strategy, and priorities.

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