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Fizzling sales: Soda producers will face declining soft drink consumption

IBISWorld Industry Report 31211aCA
Soda Production in Canada

March 2015

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Industry at a Glance

Soda Production in 2015

Key Statistics Snapshot

Revenue	Annual Growth 10-15	Annual Growth 15-20
$2.6bn	0.0%	-0.5%
Profit	**Exports**	**Businesses**
$335.7m	$103.3m	140

Market Share

The Coca-Cola Company
32.5%

PepsiCo
17.4%

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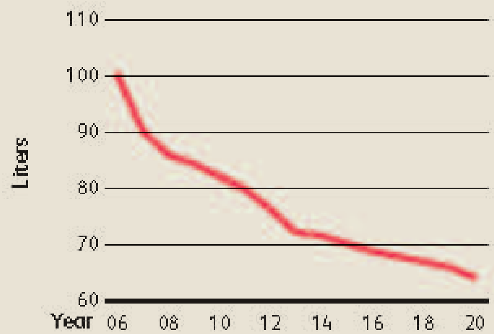
Revenue vs. employment growth

Per capita soft drink consumption



SOURCE: IBISWORLD

Key External Drivers

- Per capita soft drink consumption
- Per capita disposable income
- Canadian-dollar effective exchange rate index
- World price of sugar
- Leisure time

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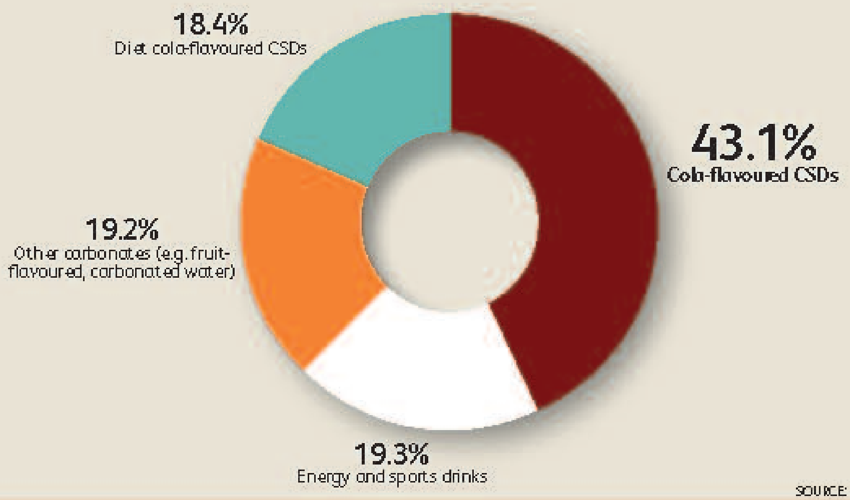
Products and services segmentation (2015)



SOURCE: IBISWORLD

Industry Structure

Life Cycle Stage	Decline	Regulation Level	Medium
Revenue Volatility	Medium	Technology Change	Medium
Capital Intensity	Medium	Barriers to Entry	High
Industry Assistance	Medium	Industry Globalization	Medium
Concentration Level	Medium	Competition Level	High

FOR ADDITIONAL STATISTICS AND TIME SERIES SEE THE APPENDIX ON PAGE 31

Industry Performance

Executive Summary | Key External Drivers | Current Performance
Industry Outlook | Life Cycle Stage

Executive Summary

The Soda Production industry produces carbonated soft drinks (CSDs) as well as energy drinks and sports drinks. Over the past five years, industry operators have faced declining domestic and international demand for regular and diet soda, mainly driven by growing health concerns among Canadians. In addition to increasing health consciousness instigated by the media's coverage on the health consequences of drinking soda, lower disposable income has caused some consumers to trade down to generic soda brands. Consequently, industry leaders The Coca-Cola Company and PepsiCo acquired independent bottling companies in 2010 to strengthen their market position and boost earnings and revenue. Producers have also invested in developing or acquiring new noncarbonated drink brands to meet evolving demand for beverages. Overall, IBISWorld anticipates industry revenue to remain stagnant over the five years to 2015; revenue is expected to decline 0.5% in 2015, totaling $2.6 billion.

Though soda sales have declined, operators have benefited from demand for energy drinks and sports drinks

Despite the poor performance of companies' soft drink business lines, declining industry revenue has been somewhat offset by growing demand for energy drinks and sports drinks; these products are still in the growth stage of their life cycles, enabling producers to capitalize on the expanding adoption of functional beverages. While these product segments have grown rapidly over the past five years, consumption was curbed by new regulations and media coverage of the health consequences associated with drinking caffeinated and sweetened beverages, like energy drinks.

In upcoming years, industry operators are anticipated to face declining sales of soft drinks. Soda producers will have to contend with intensifying competition from producers in the Juice Production industry (IBISWorld report 31211cCA) as consumers demand healthier beverages. Furthermore, an increasing number of individuals will likely substitute regular and diet CSDs for carbonated and still-bottled water and ready-to-drink tea, which provides caffeine and refreshment like soda. As demand continues to decline, a number of smaller operators are expected to exit the industry. Also, while sales of energy and sports drinks are anticipated to improve, growth will be slower than in the previous five-year period, causing industry revenue to decline at estimated annualized 0.5% to $2.5 billion over the five years to 2020.

Key External Drivers

Per capita soft drink consumption

Industry revenue depends on the level of demand for both regular and diet carbonated soft drinks. Due to growing health concerns, many consumers have begun to limit their consumption of sugary beverages, curbing industry revenue growth. Per capita soft drink consumption is anticipated to decrease in 2015, posing a threat to the industry.

Per capita disposable income

While soft drinks represent a relatively inexpensive treat for consumers, changes in price and income can influence the level of demand for industry goods. As discretionary income rises, consumers are more likely to trade up to branded soft drinks and purchase a variety of packaged beverages, helping lift industry revenue. In 2015, per capita disposable

Industry Performance

Key External Drivers continued

income is projected to rise, presenting an opportunity for the industry.

Canadian-dollar effective exchange rate index

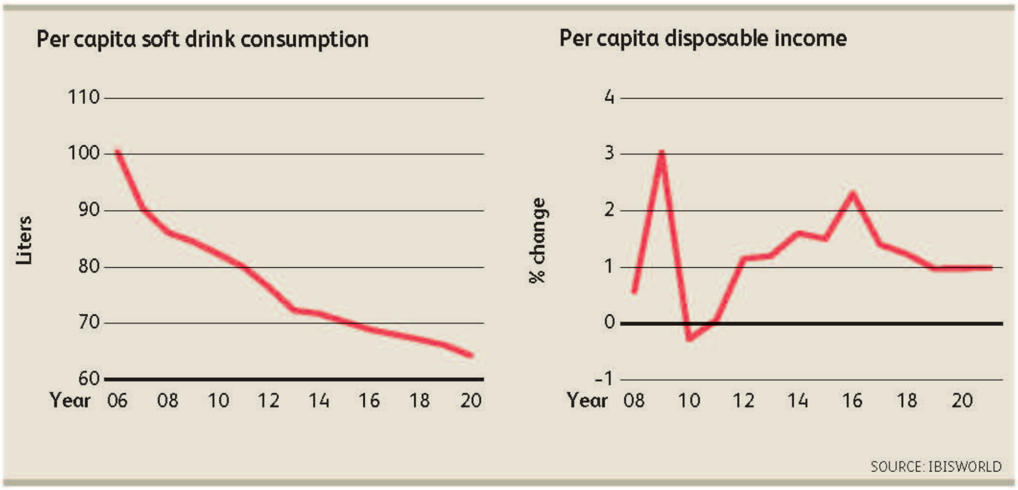
Although producers of finished beverages engage in minimal international trade due to the high cost associated with shipping bottled beverages across long distances, this industry imports and exports its goods. As the Canadian dollar strengthens against the currencies of its major trading partners, imported beverages become more affordable in the domestic market, increasing competition for producers. In 2015, the Canadian-dollar effective exchange rate index is expected to decline.

World price of sugar

Sugar and high-fructose corn syrup are used to sweeten carbonated soft drinks, energy drink and sports drinks. Therefore, a rise in the price of these inputs causes producers to raise the prices they charge downstream customers, or absorb these costs to the detriment of earnings. The world price of sugar is expected to slightly decline in 2015.

Leisure time

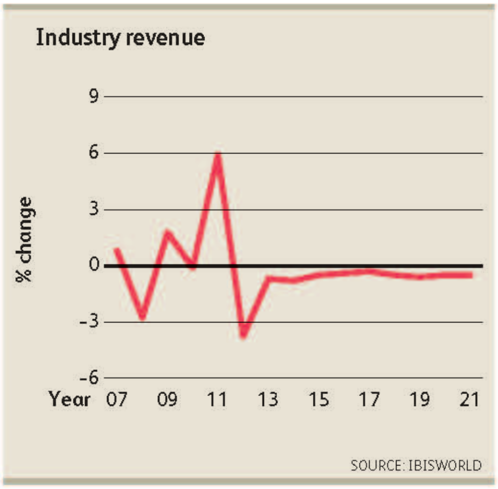
One of the primary benefits of drinking caffeinated drinks is their energizing quality. As consumers become busier and have less leisure time, people are more likely to rely on energizing beverages, such as soda and energy drinks. Leisure time is anticipated to slightly diminish in 2015.



Industry Performance

Current Performance

Operators in the Soda Production industry have faced numerous challenges in recent years. Increasing media coverage of the health consequences of drinking sugary beverages and new government regulations that restrict the sale of soft drinks in public spaces placed downward pressure on demand for soda. Additionally, lower disposable income caused many consumers to trade down to private-label beverages, which further curbed industry revenue growth. To combat declining sales volumes of carbonated soft drinks, the leading soda producers introduced a variety of brand extensions. Furthermore, the two leading industry companies, The Coca-Cola Company (TCCC) and PepsiCo, purchased independent bottling companies to strengthen their market position. Despite these efforts to boost industry-related revenue, sales of soft drinks continued to decline due to health concerns in the latter-half of this five-year period. Despite acquisitions made by TCCC and Pepsico in 2010, industry revenue is anticipated to remain stagnant in the five years to 2015. In addition, industry operators have suffered from lower profitability during the period. The average profit margin is expected to fall from 13.6% in 2010 to 13.0% in 2015. Lower sales volumes, costs associated with acquisitions and higher operating costs have all contributed to slightly lower margins for producers.



Health-conscious era

A number of factors have driven consumers to become more health-conscious in recent years. First and foremost, the media has educated consumers about the consequences of drinking large volumes of sugary beverages, including the risk of getting diabetes and suffering from a high body-mass index. In addition to greater media coverage, the government has implemented various regulations to help curb soda consumption. For instance, the Ontario government banned the sale of soda in elementary schools in 2010. In addition to schools, the city of Toronto banned the sale of both soda and energy drinks in public areas, such as community centres and arenas. Partly driven by these initiatives, per capita soft drink consumption is estimated to contract an annualized 3.1% during this period, with industry revenue declining each year following 2011.

Coupled with growing health consciousness, slow growth in disposable income in 2011 and subdued growth in following years caused some consumers to opt for more affordable beverages like tap and bottled water. Lower discretionary income also caused many shoppers to trade down to generic soft drink brands, purchase multi-serve containers and buy discounted products, which further curbed industry growth. Also, the Canadian dollars' appreciation during part of the past five years made domestically produced beverages more expensive overseas. While the value of the dollar has fallen, its value has remained relatively high throughout the

Industry Performance

Health-conscious era continued

period. In turn, exports are estimated decline at an annualized rate of 1.5% to $103.3 million in the five years to 2015. Consequently, industry revenue is forecast to decline 0.5% in 2015. On top of lower demand from consumers abroad, domestic operators were also faced with higher competition from foreign producers. Foreign imports are estimated to rise at an average annual rate of 3.9% to $374.4 million during this period.

Industry concentration

Faced with falling sales volumes of carbonated soft drinks, many of the leading soda producers have introduced a variety of new products and brand extensions to offset lower sales of their flagship brands. For example, Dr Pepper Snapple Group (DPS) launched its Dr Pepper Ten product in 2011 to appeal to consumers who prefer the taste of corn syrup-sweetened soda but still want reduced calories. Similarly, the leading energy drink producer, Red Bull, launched its Total Zero brand extension in 2012 to expand its consumer reach and appeal to drinkers who prefer not to consume calories in liquid form. TCCC and PepsiCo also introduced new midcalorie sodas in 2014 in response to falling diet soda sales.

Despite the launch of new brand extensions, leading participants in this industry have continued to see their sales volumes erode. Consequently, TCCC and PepsiCo both acquired independent bottling companies in 2010 to expand their share of the market, causing industry revenue to increase 5.9% in 2011. As the leading operators acquired smaller competitors, the number of establishments per enterprise is expected to rise slightly during this period.

Growing segments

Although energy drinks and sports drinks are estimated to constitute less than one-fifth of industry revenue in 2015, growth of these product segments has helped offset the effect of declining soft drink sales. Although consumers have become more health-conscious in recent years, energy and sports drink consumption has increased due to the relatively nascent characteristic of these products. Moreover, leading energy drink producers, such as Red Bull and Monster, have obtained a significant following among young adults through branding and celebrity or athlete endorsements. Nevertheless, Health Canada transitioned energy drinks from being considered as natural health products to food in 2013. As a result of this transition, Health Canada now restricts the level of caffeine in energy drinks, requires clearer labelling and prohibits the sale of premixed alcoholic beverages with caffeinated energy drinks. While new regulations may pose an inconvenience to beverage producers, they have not curbed demand for energy drinks. As a result of growing demand for functional beverages, a number of new companies have entered the market; therefore, the number of industry enterprises is estimated to grow an annualized 0.7% to 140 in the five years to 2015. As a result, employment is also expected to increase at an average annual rate of 0.02% to 5,829 workers over the five-year period.

Though soda sales have declined, energy and sports drink consumption has increased

Industry Performance

Industry Outlook

Operators in the Soda Production industry are expected to face a challenging environment in the next five-year period. Per capita soft drink consumption is anticipated to continue on its downward trajectory as many drinkers try to curb consumption or eliminate soda from their diets altogether. Competitors in the Juice Production industry (IBISWorld report 31211c) are expected to innovate and introduce healthier alternatives to soft drinks, placing downward pressure on demand for industry goods. In response to growing competition, soda producers are expected to introduce a variety of new brand extensions made with healthier sweeteners and ingredients. While energy and sports drink consumption is forecast to grow in the upcoming years, the growth of these product segments will decelerate compared with the previous five-year period as the market for these goods becomes saturated. Consequently, growth of functional beverages will not be enough to offset the decline of soda, which is expected to cause industry revenue to decline an estimated 0.5% to $2.5 billion in the five years to 2020, including a contraction of 0.4% in 2016.

Changing consumer preferences

Health concerns are anticipated to drive consumers to seek more healthful, purifying beverages in upcoming years. Health Canada's recommendations for healthy drinking and eating habits as well as the media's coverage on soda and its effect on health will continue to place downward pressure on soda consumption. Instead, more consumers will turn to tap, still and carbonated bottled water as well as alternative packaged beverages produced by operators in the Juice Production industry. Due to the perceived health benefits provided by tea, many drinkers are expected to replace soda with ready-to-drink (RTD) tea. In addition to being a more healthful and more nutritious option, caffeinated RTD tea provides energy, which is one of the primary drivers of soft drink consumption.

Rising health consciousness and increasing competition from alternative beverages is expected to further the decline of per capita soft drink consumption. The amount of soda consumed in Canada will decline at an annualized 1.8% during the five-year period. Coupled with a depreciating dollar, lower demand for soft drinks is expected to drive imports to decline at an average annual rate of 2.0% to $338.1 million. As soda consumption also declines in the United States, the industry's leading export market, the industry will also face lower demand for its products abroad. Consequently, exports are projected to fall 1.2% per year on average to $97.2 million during this period. Faced with a shrinking market for soft drinks, a number of smaller producers are expected to exit the industry, causing enterprises to fall an annualized 0.1% to 139 in the five years to 2020. As companies exit the industry, industry employment is expected to follow suit, declining 0.7% per year on average to 5,633 workers.

Growth of functional beverages will not be enough to offset the decline of soda

Industry Performance

Favourable trends

Despite falling soda sales, energy drinks and sports drinks are anticipated to become more popular over the next five years, helping decelerate the industry's downward spiral. However, these products are expected to grow at a slower rate than during the previous five years as the market for energy and sports drinks becomes more saturated. Due to the popularity of energy drinks among younger individuals, provincial governments have tried to limit consumption by passing various regulations. As new legislation gets passed at the provincial level, including a ban on selling energy drinks to people younger than 19 in Nova Scotia, these efforts could further limit growth of these functional beverages.

In addition to growth of energy and sports drinks, the industry is anticipated to benefit from slightly higher profitability in the next five years. A number of factors, including the exit of unprofitable businesses, will drive profit growth. IBISWorld estimates margins will increase to 13.4% in 2020, up from 13.0% in 2015. Namely, as the leading operators continue to strengthen their market position by acquiring brands from competitors and specialty manufacturers, they will benefit from lower per unit costs of production, driven by economies of scale. In addition, as global commodity markets steady, the cost of key inputs, such as corn syrup and plastic, are anticipated to minimally grow or decline, helping lift the industry's earnings.

The cost of key inputs, such as corn syrup and plastic, are anticipated to minimally grow or decline

Industry Performance

Life Cycle Stage

IVA is expected to underperform GDP

There are clearly segmented product groups

Per capita soft drink consumption is anticipated to decline

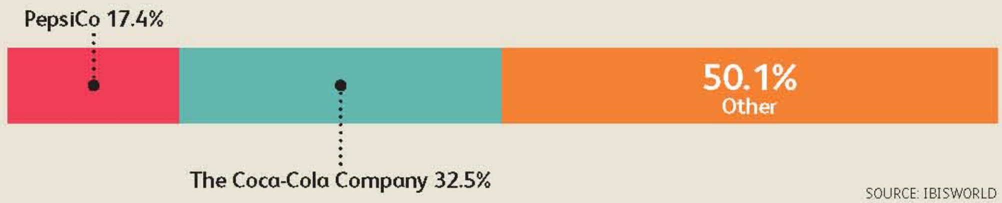
SOURCE: WWW.IBISWORLD.COM

Major Companies

The Coca-Cola Company | PepsiCo | Other Companies

Major players

(Market share)



SOURCE: IBISWORLD

Player Performance

The Coca-Cola Company
Market share: 32.5 %

Industry Brand Names
Coca-Cola
Diet Coke
Sprite
Barq's

The Coca-Cola Company (TCCC) is the leading global soda producer with more than 500 nonalcoholic brands in its product portfolio. Founded in the United States in 1886, the company has expanded its operations to more than 200 countries. Its business is divided into seven operating segments, including Eurasia and Africa, Europe, Latin America, North America, Pacific, bottling investment and corporate. Overall, the company's seven operating segments generated a combined $50.0 billion in revenue in 2014.

The company operates in Canada through its North America operating segment. TCCC produces a range of products in seven production facilities across Canada. Some of the company's leading beverage brands are Coca-Cola, Diet Coke, Nestea, Powerade and Minute Maid, among others. Despite its portfolio of popular brands, TCCC has experienced volume declines across its sparkling product line. Consequently, in 2010, the company acquired the former North American business of Coca-Cola Enterprises Inc., one of the company's leading bottlers and distributors. This acquisition substantially boosted the company's performance, causing its industry-relevant revenue to more than double in 2011.

In recent years, Coca-Cola has reacted to shifting consumer demand for healthier beverage options by releasing new versions of its flagship Coca-Cola product. In 2014, Coca-Cola launched Coke Life, a stevia-sweetened variety of carbonated drink that the company has marketed as a more natural alternative to its diet soda brand. Diet sodas, which are estimated to represent a significant portion of Coke's carbonated beverage

The Coca-Cola Company (Canada industry-specific segment) – financial performance*

Year	Revenue ($ million)	(% change)	Operating profit ($ million)	(% change)
2010	361.4	57.0	49.0	3.6
2011	781.2	116.2	88.1	79.8
2012	820.4	5.0	98.3	11.6
2013	843.0	2.8	95.0	-3.4
2014	885.9	5.1	101.0	6.3
2015	839.9	-5.2	98.0	-3.0

*Estimates

SOURCE: ANNUAL REPORT AND IBISWORLD

Major Companies

Player Performance continued

sales, have fallen sharply out of favor in Canada in recent years. Nevertheless, Coke Life is still considered a niche product and is unlikely to significantly affect company revenue or profit in the coming years. Instead, Coca-Cola is likely to attempt to stem its revenue decline by focusing on expanding its noncarbonated beverage brands.

Financial performance

TCCC has strengthened its position within the Soda Production industry in Canada over the past five years. Namely, the acquisition of Coca-Cola Enterprises contributed to significant revenue growth during the outset of the period. However, volume sales of its sparkling brands have continued to decline to the detriment of the company's long-term performance. Falling sales of the company's core brands are expected to result in a decline in revenue of 5.2% in 2015. Nevertheless, TCCC's sales increased overall during the five-year period at an average annual rate of 18.4%, due in large part to the company's acquisition strategy in 2010.

Player Performance

PepsiCo
Market share: 17.4%
Industry Brand Names
Pepsi

PepsiCo is a global food and beverage company with headquarters in New York, NY. Founded in 1898, the company has grown to become one of the leading carbonated soft drink producers in the world. Along with its soda brands, such as Pepsi, Mountain Dew and 7-Up, PepsiCo manufactures beverages including Gatorade, Tropicana and Aquafina. The company's business is divided into six segments: Frito-Lay North America; Quaker Foods North America; Latin American food and snack; PepsiCo Americas Beverages (PAB); Europe; and Asia, Middle East and Africa. PepsiCo operates in the Soda Production industry through PAB. Globally, the company earned $66.7 billion in 2014.

The company produces a variety of sparkling and still beverages through PAB, including concentrates, fountain syrups and finished beverages. Furthermore, finished beverages are anticipated to constitute a majority of this business segment's revenue. However, due to growing health concerns among consumers, sales of carbonated soft drinks have fizzled in recent years, causing the company to focus more on its snacks and still beverages business lines. As with The Coca-Cola Company, PepsiCo purchased independent bottling and distributing

PepsiCo Inc. (Canada industry-specific segment) – financial performance*

Year	Revenue ($ million)	(% change)	Operating profit ($ million)	(% change)
2010	444.4	143.1	60.5	54.1
2011	465.7	4.8	25.1	-58.5
2012	460.4	-1.1	63.2	151.8
2013	460.6	0.0	64.6	2.2
2014	484.4	5.2	70.4	9.0
2015	449.4	-7.2	63.3	-10.1

*Estimates

SOURCE: ANNUAL REPORT AND IBISWORLD

Major Companies

Player Performance continued

companies in 2010, significantly boosting the company's income and revenue from carbonated beverage sales. The company also followed Coca-Cola's in introducing a new stevia-based midcalorie soda in 2014 called Pepsi True. Beyond different ingredients, this new product is also available in a smaller 7.5 fluid ounce can as well as standard 12 ounce cans.

Financial performance

PepsiCo's industry-relevant revenue in Canada is expected to grow an annualized 0.2% to $449.4 million in the five years to 2015, driven by the acquisition of independent bottlers in 2010. While acquisitions enabled the company to more than double its revenue generated from the sale of carbonated beverages, industry-relevant revenue declined in the latter-half of this five-year period due to declining consumption of soda. While the company's energy drink and sports drink brands, AMP and Gatorade, respectively, have performed well, growth of these brands has not offset the decline of the company's soda brands. As a result, IBISWorld expects PepsiCo to suffer a decline in sales of 7.2% in 2015 despite efforts to boost sales with new product launches.

Other Companies

Cott Corp.

Estimated market share: 4.6 %

The Cott Corp. is one of the leading global producers of private-label beverages. The company produces generic brands of carbonated soft drinks, juice and drinks, flavoured bottled water, energy drinks, sports drinks and ready-to-drink (RTD) tea for retailers, brand owners and distributors. Cott was founded in 1955 and is headquartered in Pointe-Claire, QC. Outside of Canada, the company operates in the United States, Mexico and the United Kingdom, employing about 4,000 workers globally. Consequently, the company's business is divided into three operating segments: North America (which includes Canada and the United States), the United Kingdom and all other. In 2014, Cott's three segments earned a combined $2.1 billion in revenue, representing a slight increase over the previous year.

Carbonated soft drinks and concentrates accounted for over half of the company's case volume but only about 32.3% of revenue in 2014. Furthermore, revenue generated in Canada only accounts for about 20.0% of the company's total revenue. In addition to declining demand for carbonated soft drinks, the company has faced pricing pressures; because Cott produces generic beverages, it does not have the ability to charge a premium for its goods. Overall, IBISWorld anticipates the company's industry-relevant revenue in Canada to total $118.4 million in 2015, representing a double-digit decline from the prior year.

Dr Pepper Snapple Group

Estimated market share: 3.7 %

The Dr Pepper Snapple Group (DPS) is one of the leading manufacturers and distributors of nonalcoholic beverages in North America. Based in Plano, TX, the company produces its beverages across the United States, Mexico and Canada. In 2014, Canada generated about 4.0% of the company's total revenue. In addition to carbonated soft drinks, DPS produces a range of beverages including RTD tea, fruit drinks and bottled water. Some of the company's leading brand names are Dr Pepper, Snapple, Motts and Schweppes. Overall, the company generated global revenue of $6.1 billion in 2015, representing slight growth from 2014.

Major Companies

Other Companies continued

As with its major competitors, DPS suffered from declining volume sales of its carbonated soft drinks. Furthermore, health and wellness concerns have caused consumers to shun certain sugary beverages. DPS is currently testing stevia-based versions of Dr Pepper, 7-Up and Canada Dry in three markets following the failure of its 10-calorie TEN line to gain traction. In 2014, sales volumes of Dr Pepper, 7-Up and Sunkist declined, whereas volume sales of Canada Dry increased helping to offset declining sales. Overall, company revenue is expected to decrease 2.6% in 2015 to $96.8 million.