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Why distilleries are banking on non-alcoholic beverages

By Gavin Daniels, Contributing Writer

The alcoholic beverage industry has a history of changing with trends. During prohibition, when alcohol was outlawed in the United States, Yuengling made ice cream and brewers Schlitz, Miller and Pabst made malt extract. Now, nearly a century later, brewers and distillers are getting sober again in response to evolving consumer preferences.

Diageo last year made its first investment in a non-alcoholic drinks company (after 250 years in the business of booze,) acquiring a minority stake in Britain's Seedlip. Submitted photo courtesy of Diageo North America

As is the case with most consumer products and services these days, it is all about the Millennials and how to maintain or grow their ever-changing "share of wallet."

Despite a trend towards leading healthier lifestyles, Millennials consume disproportionately more alcohol than their Baby Boomer and Generation X counterparts. According to Nielsen and the Wine Market Council, Millennials, representing one-quarter of legal drinkers, account for 35 percent, 32 percent and 42 percent of domestic beer, spirits and wine consumption, respectively. The key difference is this demographic is consuming lower quantities of value-oriented light beer and box wine in favor of craft beer, craft spirits and premium-to-super-premium wine. Similar to their food, Millennials spend more time than their parents evaluating the ingredients, nutrition facts, and source of origin of their beer, wine, spirits, coffee, tea, juice and kombucha.

While the leading global beverage companies have been addressing these better-for-you trends for the better part of two decades through acquisitions, several leading brewers and distillers seem to be taking a holistic approach to gaining a larger share of consumers' total beverage spend. The ultimate goal for these large players is top-line growth, an elusive metric of late. Categories of interest for these traditionally alcohol-only companies include premium sodas and mixers, energy drinks, cold-brew coffee and kombucha.

Similar to the largest packaged foods companies struggling to grow revenue with their established brands, several of the largest alcoholic beverage players are taking a two-pronged approach: acquisition and corporate-venture investing. They are hungry for faster-growth opportunities because global alcohol sales are declining. According to IWSR, which tracks alcoholic beverage industry data, global sales of alcoholic drinks dropped 1.3 percent in 2016, accelerating the 0.3 percent average downward trend in the previous five years.

Venture investing teams have been established within many large alcoholic beverage companies, such as Diageo, the world's largest distiller, hoping to find startup companies in rapidly growing subcategories. Diageo last year made its first investment in a non-alcoholic drinks company (after 250 years in the business of booze,) acquiring a minority stake in Britain's Seedlip. The company makes distilled non-alcoholics spirits and markets itself as, "Solving the dilemma of 'What to drink when you're not drinking.'" Similarly, Constellation Brands launched Constellation Ventures in 2015, seeking to make minority investments in complementary brands and technologies.

Seedlip is a great example of what alcohol companies want when investing in these smaller companies — a premium brand that makes craft beverages without artificial flavors. Large beverage firms want to make investments in or buy operations that have the potential to grow much faster than a traditional distiller or brewer.

In July, Anheuser-Busch InBev acquired San Francisco-based Hiball Energy, a maker of organic energy drinks, sparkling juices and waters. Hiball's organic, fair-trade drinks use ingredients such as guarana and ginseng and are sold at Whole Foods, CVS and Kroger. AB InBev wants to accelerate the company's growth and "bring their drinks to more customers in more places." AB InBev also is working with Starbucks to produce a bottled version of Teavana tea and has announced it plans to shift at least 20 percent of its global beer volume to low-alcohol and non-alcoholic beers by 2025.

Heineken too has expanded its non-alcoholic offerings after its no- and low-alcohol drinks enjoyed double-digit sales growth in Europe in the first half of this year.

While the details of the Hiball deal were not made public, there are other deals that underscore how hot this sector is — for example, Dr Pepper Snapple Group's $1.7 billion deal late last year to acquire Bai Brands. The storied soda maker paid four times projected 2017 annual revenue of $425 million for the maker of fruit-flavored, antioxidant-infused drinks that appeal to health-conscious consumers. In another deal where a seller was rewarded for high growth in a premium category, storied craft beer brand Ballast Point was acquired by Constellation in late 2015 for roughly 8.7 times projected 2015 revenue of $115 million.

That trend toward luxury, non-alcoholic drinks also is influencing the behavior of smaller, middle-market beverage producers. For instance, Copper & Kings American Brandy Co. has added a line of five high-end non-alcoholic beverages — Cola Superior, Ginger Beer, Cream Soda, Mandarin Mint and Tonic Water — to its product offerings.

Any investor wondering why a liquor company would want to add premium sodas to its product offerings only has to look at London's Fevertree Drinks Plc. The company makes premium sodas, ginger ales and lemonades, and its signature tonic water made from Congolese quinine that it markets as "3/4 of your cocktail" and sells for about $24 for eight small bottles. The company's mixers have become a staple of craft cocktail "mixologists" around the world. Growing revenue and profit margins at a feverish pace, Fevertree went public in 2014 and boasts an enterprise value of $3.7 billion today, nearly 21 times its last 12 months' revenue. By comparison, slow-growing behemoth Coca-Cola Co. trades at 5.7 times LTM revenue, AB InBev trades at 6.8 times, and Constellation Brands trades at 6.6 times.

In the coming years, producing spirits, beer and wine alone will make it hard for large beverage companies to sustain profits, given flagging global sales trends. As a result, we can expect a growing number of deals in the non-alcoholic beverage industry as alcoholic drinks companies evolve to thrive for the next hundred years.