KNAV
PARTNERS BEYOND BOUNDARIES

JULY 2023

2023
REPORT

"Drink" for Thought

Analyzing the Beverages Segment

Table of Contents

Executive Summary

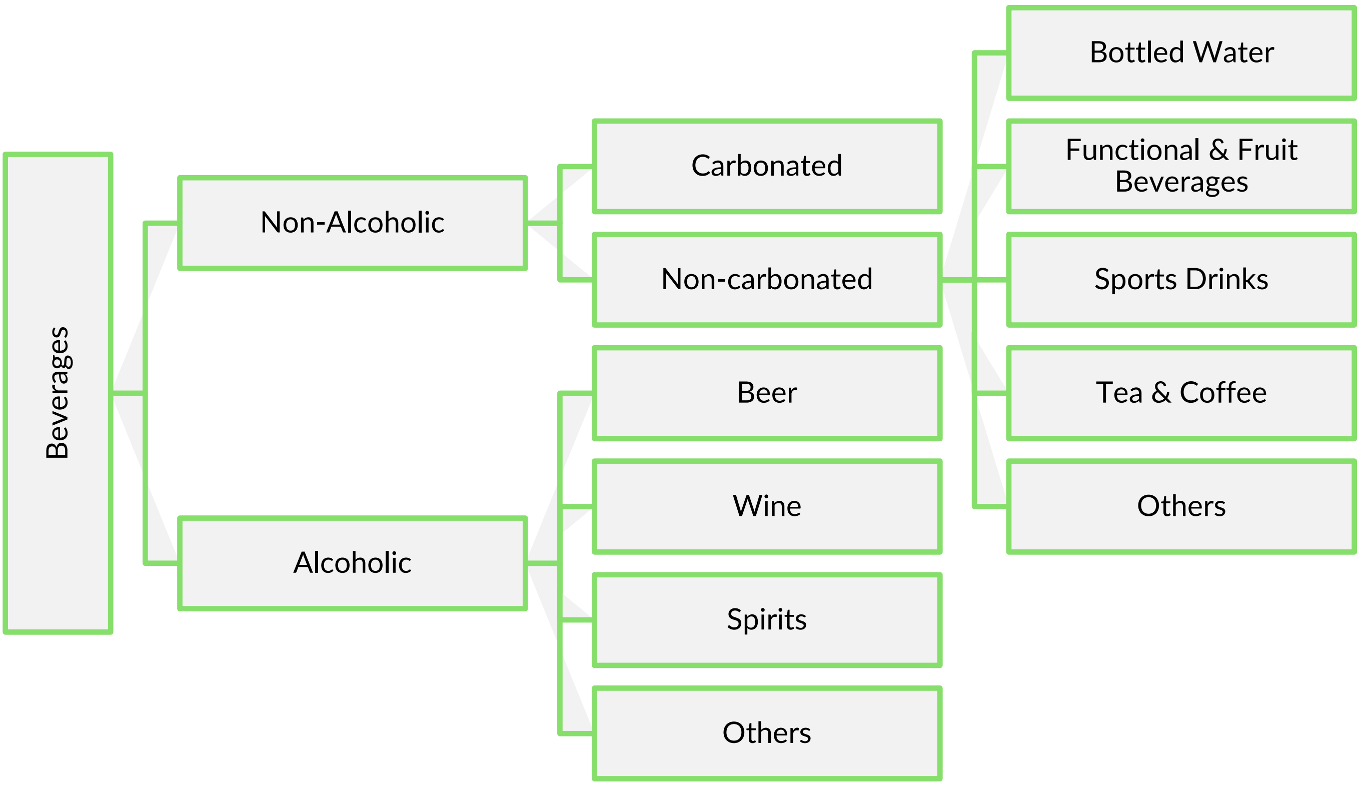
While carbonated soft drinks (CSDs), ready-to-drink teas (RTDs), energy drinks, and sports drinks account for more than 60% of the global market, carbonated beverages are the most popular choice in India, followed by bottled water, fruit beverages, and juices. The beverages space has seen seismic changes in the past few decades driven by the entry of major international beverage players in the Indian market, acceptance of newer product variants by the Indian consumer, and the evolution of the market to keep up with the consumer's demands.

However, per a recent report, a general shift in consumption patterns has been observed, indicating that CSDs are growing at a lower rate, while consumption of packaged water, sports drinks, and tea and coffee-based drinks is rising. While the market share of CSDs remains the highest, the highest socio-economic strata are moving away from the consumption of traditional CSDs.

According to a research firm, Mintel, while India is a smaller market for most packaged beverages, it is also overgrowing. Beverage products are gaining traction among Indian consumers mainly because of the convenience and hygiene offered to them. As one would have expected, consumption is higher among the younger consumers and gradually declined as the age increased. Therefore busy, on-the-move lifestyles will also positively impact on these categories as consumers look for easy solutions to satisfy their thirst and hunger

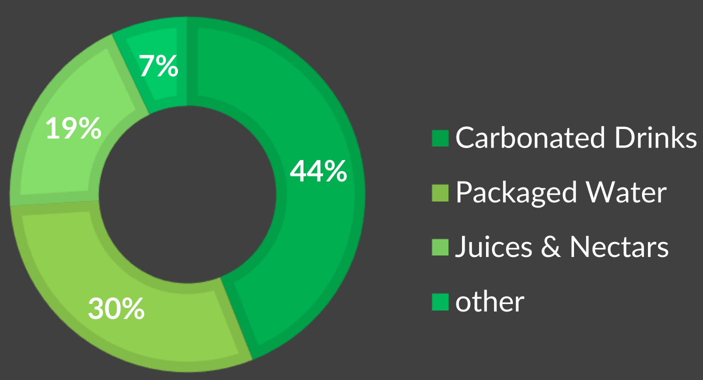
Market Composition

Market Composition



- Regarding alcoholic beverages, India is one of the fastest-growing markets globally, with a market of USD 49.6 billion in 2023, projected to grow by 6.53% per year till 2027. This growth is being pushed by newer categories introduced in the RTD (ready-to-drink) space, like Meads, Ciders, and Seltzers, making the transition from soft to alcoholic drinks smoother. India is predominantly a spirits market, which accounted for 59% of its consumption in volume, followed by beer, which made up 40% in 2021.

COMPOSITION OF NON-ALCOHOLIC BEVERAGE MARKET IN INDIA



- Revenue in the Non-Alcoholic Drinks market amounted to USD 16.74 billion in 2023 projected to grow annually at 5.17% till 2027.

  The market is roughly divided, as shown in the figure attached herewith, with carbonated drinks contributing almost 44% to the total market size, followed by bottled water and then juices.

Strategy & Positioning Lens

Understanding The Market Through Various Lenses

Strategy & Positioning Lens

Premiumization – The Key Theme

New entrants in the beverages space are focusing on conceptualizing products with "premium" as a dominant brand characteristic, having identified it as critical for maintaining sustainable growth in the long term. Whisky is expected to overtake vodka in global sales due to its association with the "premium single malt" positioning. Several Indian liquor brands have also jumped aboard this bandwagon by introducing Indian single malts and made multiple investments in this sub-sector. Further, Sula has also made a more significant shift in its product mix, focusing on premiumization. Revenue contribution from elite and premium Sula labels increased to ~71% in March 2022 from 68% two years ago.

From a consumer lens, they now have a more diverse product portfolio to try and experiment with, according to IWSR research, with a considerable interest in craft beer, hard seltzers, wine, and single malt.

Available Here, There, Everywhere

It is essential for brands today to have an omnichannel presence; it's no longer about choosing D2C or offline; it's about reaching the customers wherever they are. While beverage businesses are generally offline-first, the online channel is far more helpful in collecting customer data and allowing two-way communication with customers. This factor becomes crucial in designing the brand positioning strategy and strategizing new flavors and product launches. For instance, Cravova, a Mumbai-based beverage brand, is available across 25 cities in India, including Tier I-II cities, through the offline distribution channel and on most marketplaces. It has also tied up with 500+ standalone cafes and restaurants and their supply and productions to the Taj Gateway Hotel in Mumbai. It has also tied up with Swiggy-owned kitchens and dark kitchens to establish a strong online presence .

Innovative Product Communication

Given that consumers are now being bombarded with content across touchpoints, product communication needs to be condensed to those essential selling points that are paramount to consumers. Products with minimalistic designs that highlight natural ingredients and key health benefits will stand out to shoppers who feel that information fatigue makes product choices harder.
With the growing awareness of sustainability, the requirement for eco-friendly packaging is steadily rising. Case in point, Kagzi Bottles are India's first paper bottles, with patented packaging technology to replace single-use plastic.

Further, the convenience of carrying the products has been given an added preference. Vendors are experimenting with innovative packaging ideas to incorporate this utility into their product experience. For instance, bottled drinks have been replaced by drink mixes that come in powdered form. For instance, the brand '*Two Brothers*' launched a Thandai Mix, a beverage traditionally sold in liquid format only. The drink was converted into powdered form, making it durable and easy to carry. Another instance is Chaayos which started delivering tea in a box with a spout, which contained an insulated pouch to hold the tea, ensuring that the café experience and tea freshness are maintained for the customer.

Co-creating Experimental Drinks

The spirit of collaboration is rampant in the alco-bev industry as the demand for experimental drinks is rising. Brands are co-creating beverage lines on a revenue-sharing model, like the No Sleep Gin launched by Greater Than, which is India's first coffee-infused gin, and the brainchild of a collaboration between Nao Spirits and Sleepy Owl coffee, bringing together *"two of the world's most popular beverages."*

R&D To Battle Climate Change

In the coming years F&B companies will be looked upto drive innovations that help consumers deal with the harsh effects of the planet's volatile weather. Consumers are expected to seek products that help them withstand varying temperatures, from freezing winters to unbearable heat waves. Beverage houses would be expected to develop products that don't just offer a "feel good" experience to consumers braving the harsh weather but rather couple it with nutritional elements that provide sustenance and ease recovery. In the coming years, brands will promote products made with familiar energizing ingredients, such as caffeine, and plant-based ingredients like fruits, vegetables, and legumes. However, just claims would not be enough to attract consumer attention; tangible research will be needed to convince consumers that these natural and functional ingredients deliver on their cognitive health promises.

Cold Chain Storage Concerns

Cold-chain storage could be risky in some markets, including India, due to rising energy costs or conservative energy policies like rolling blackouts. Almost 92% of the Indian cold chain infrastructure is owned and operated by the private sector. The industry is hugely fragmented, with four states accounting for 60 percent of the country's cold storage - UP, Gujarat, West Bengal, and Punjab. Indian cold storage businesses pay approximately INR 100+ per cubic feet monthly as operating costs, mainly attributable to high fuel costs. It costs half of that in the West, as fuel costs constitute a mere 10% for them. While it is not cheap to build and maintain a cold storage facility, companies can target product safety by striking a trade-off between more shelf-stable formats and the use of harmless preservatives to battle this challenge.

Financial Lens

Financial Lens

The Online-offline Battle

While an omnichannel presence is key to establishing multiple contact points with the consumer and driving home marketing communication, the online channel generally eats up a good share of gross margins at a unit level. The listing margins, commission to marketplaces, shipping, and warehousing charges are sometimes as high as 40%, making it impractical for beverage brands to sell online. Further, buyers purchasing beverages in bulk quantities, the only feasible quantity size to sell online from a margin and cost maintenance perspective, form a very small component of the company's unique customer base. Therefore, for this small portion of the revenue pie, substantially disproportionate efforts must be undertaken for the online or direct-to-consumer channel to make financial sense for the brand.

Variety – A Boon & A Curse

Providing variety is essential to lure customers of all kinds to a brand. However, once the cost of manufacturing and maintaining inventory is factored in, sustaining margins with multiple SKUs becoming challenging, especially early on in a company's lifecycle. Ideally, brands should focus on earning their first INR 100 crores of topline with a limited set of SKUs – this shall help in smoothening the production planning and inventory management process internally while also allowing the company to champion cost structures for the limited product set before expanding to new categories.

(Negative) Way To Go

In normal circumstances, a negative working capital indicates financial liquidity distress for stakeholders. Paradoxically, FMCG giants like HUL are known to exist on negative working capital by riding on their strong supply chain management. Further, the negative cash conversion cycle hints at the managerial efficiency of the firm, wherein it can finance its daily operations from funds received from the customers instead of conventional short-term working capital loans. It has also been observed that companies with a negative working cycle tend to be associated with higher profitability and enhanced margins due to lower costs, savings on potential short-term interest, and early realization of cash leading to reduced bad debts. Therefore, retail and consumer-facing businesses like beverages, from an early stage itself, should endeavor to build a negative working capital cycle. While this may be difficult to build for young companies since they may not have the credibility or the bargaining equation required with vendors for this, companies could, however, evaluate sharing their inventory risk with super-stockists or work on a "Sale or Return" model, whereby they can receive an advance on their inventory. Trade payables of 60 days, inventory of 30 days and, trade receivables of 5 days will set many financial concerns rights for consumer brands.

Active Cost Reduction Is The Need Of The Hour

With edible raw materials prices increasing, food & beverage companies are lowering their gross margins. Gross margins, even for makers of Indian Made Foreign Liquor during the quarter ended September 2022, were lower compared to the same period a year ago due to the elevated cost of ingredients. Companies like Sula Vineyards took active measures to take charge of the situation by introducing cost-control measures. For instance, it started sourcing ~96% of its packaging material from India, which makes up a massive chunk of its operational cost. It bought bottles from vendors in the domestic market at INR 16 (USD 0.2) per bottle, saving 41% as opposed to imported bottles that used to cost INR 27 (USD 0.35) per bottle. These measures, coupled with the significant change in the overall revenue mix, helped Sula improve its gross margins to over 65% in the year ended March 2022 from ~48% two years ago.

Key Financial Metrics To Know

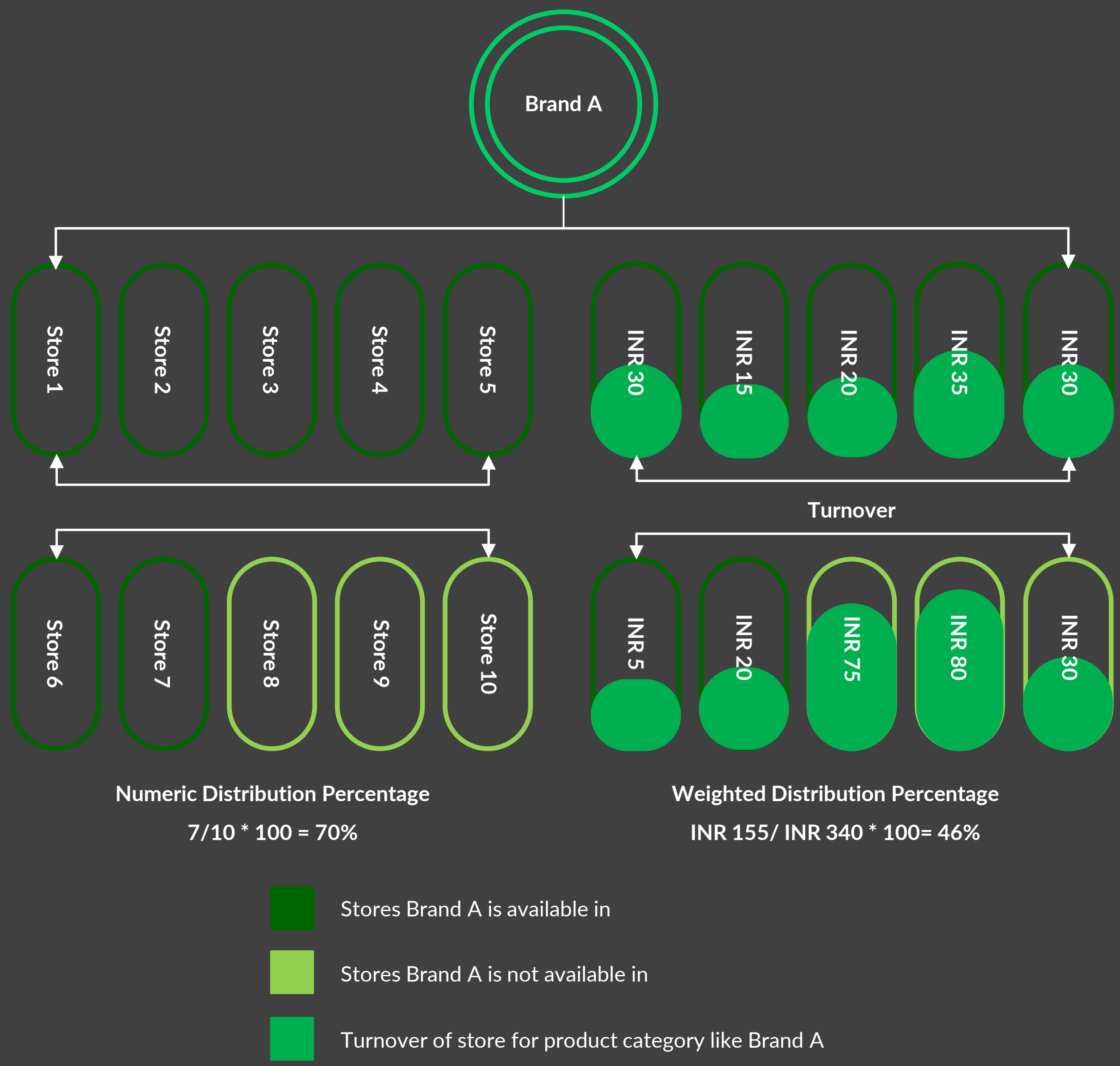
a. **Cycle time from cash to cash** – The cash-to-cash cycle includes the total time across the three stages of the cash conversion cycle: days of inventory outstanding (DIO), days sales outstanding (DSO), and days payable outstanding (DPO). This is a key metric to track to ensure that there is no cash shortage in the business at any point in the cycle.

b. **Inventory Turnover Days** – This metric measures the average days between production and sales. The longer it takes to sell a product, the greater the cost of sales will be in terms of holding inventory and vice versa. Analyzing the time it takes for goods to sell will provide information for procurement plans and aid in inventory control.

c. **Gross Margin Returns on Investments (GMROI)** – Gross margin return on investment is a metric used to evaluate the profitability of every rupee invested in inventory. Calculated as Gross Profit divided by Average inventory cost, GMROI must always be greater than 1 to indicate profitability. A good use case for this metric could be that of a slow-moving product, where GMROI can help determine whether this particular product is worth the investment.

d. **Numeric Distribution Percentage** – Numeric distribution refers to the percentage of stores selling a particular brand. It is calculated as the Number of stores distributing the brand's product divided by the Number of stores distributing this product category for the geography in focus. This metric enables organizations to track how much they have penetrated the offline retail channel in a particular geography.

e. **Weighted Distribution Percentage** – The weighted distribution percentage refers to the market turnover for a product category made by the stores distributing a brand's product. It can be calculated as follows:
Turnover of stores distributing a brand's product (from the product category) / Turnover of stores distributing this product category



To draw a complete analysis, it is necessary to compare this metric with the numeric distribution percentage; the goal is for the weighted distribution to be higher than the numeric distribution. While the numeric distribution percentage explains the penetration level in the channel, the weighted distribution percentage helps analyze the quality and efficiency of the throughput generated by chosen channel partners.

Consumption Lens

Consumption Lens

No Sugar, Please!

Considering the health concerns raised by consumers, consumption of carbonated beverages and soft drinks is expected to decline due to high sugar content, and preference shall be given to natural drinks & juices, with the beverages market value in India set to rise by USD 3,840 Million by 2026 due the growth spurt driven by these new-age health-conscious beverages. A space heavily dominated by Paperboat and Raw Pressery now has competition from younger brands like 24 Mantra, Good Juicery, and Fresh Pressery, to name a few. Another key element to remember here is that while consumers lean towards healthier beverages, this does not translate to them compromising on taste. This was a learning for Coca-Cola when it launched a healthier version of the drink in the form of "Diet Coke" and received critique for its different aftertaste, post which the company released "Coke Zero" – combining the best of health and taste.

The Non-Alcoholic Spirit

With young customers seeking better alcohol substitutes in the form of no and low alcohol by volume (abv) drinks, the trend toward conscious consumption is expected to intensify in 2023. While alcohol consumption is on the rise, the consumption of non-alcoholic beverages is trending at similar levels. Several alcohol companies have found a mid-way and are experimenting with "non-alcoholic" alcohol substitutes (like non-alcoholic beers, gin & tonic, rum & cola, etc.). Kati Patang & Svami are off late, garnering consumer interest for their non-alcoholic craft beverage offerings. According to Vineet Sharma, vice-president of marketing, South Asia, AB InBev, "Today, about 70% of India's consumers who previously abstained from alcohol now have a viable alternative. We are confident this market will grow exponentially. One of our global smart drinking goals on empowering consumers through choice is to ensure that no or lower alcohol beer products make up at least 20% of our global beer volume by 2025."

Alternate Caffeine

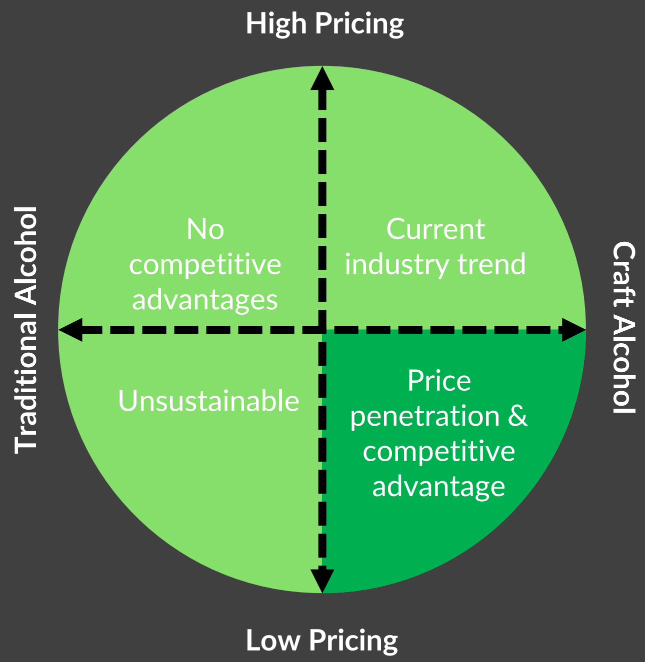
Alternate caffeine options have gained popularity in Tier 1 cities like Mumbai. With more and more consumers looking to reduce their sugar and caffeine intake, this space is likely to see a growing demand for healthier drink options like kombucha, matcha, and tea. Manufacturers have also begun to offer teas with herbal inclusions such as turmeric and ashwagandha, making it more convenient than ever for people to stay healthy. Companies like Infinitea Originals, offering consumers flavored teas, matcha, and RTD kombucha in flavors from across the globe, have already taken up this theme.

Favor The Local Flavor

Most beverages, like food items, are now being prepared using local and heritage-based ingredients, giving each drink a regional touch. The **rise of roots, fruits, and Indian spices** can be seen in beverages across segments. For instance, while Nao Spirits' Greater Than is a classic London dry gin, Hapusa, their contemporary gin offering, has a host of local ingredients such as Himalayan juniper berry, turmeric, raw mango, almond, and coriander seeds.

Experience The Beverage

People are no longer interested in off-the-rack alcoholic beverages. **Deep and rich flavors** are the key to a consumer's heart, with a strong preference for **experimental and local flavors**. Distillers in India are incorporating traditional botanicals such as neem, curry leaves, and lemongrass to create beverages with a distinct flavor profile meant for the Indian palette. Experience-driven businesses like **tap rooms and microbreweries** are becoming the go-to choice for consumers as traditional craft beverages like handcrafted beers, small-batch wines, and artisanal spirits are increasing in popularity in India.



For companies desirous of entering this space, a low-price-focused approach would be best suited for such new entrants, given the existing high price points established in this market by existing players. This approach might support the entrant in capturing a sizeable market share of a segment with high growth potential.

RTD & Premix Boom

Cocktail premixes and RTD, which gained popularity during the pandemic, have carved a niche in the evolving alco-bev market. As consumers focus on flavor, aroma, and quality, demand for convenient canned cocktails made with real spirits (vodka, tequila, or rum) is estimated to surge. Brands like Bab Louie & Co and Jimmy's Cocktail have experienced acceptability and success with their cocktail mixes in the Indian market. According to Jimmy's founder Ankur Bhatia, their brand, founded months before Covid-19 hit, has clocked INR 50 crore in revenue in the last three years and has seen a growth of 200% since the previous financial year.

New Guy On The Block – Seltzers!

Consumers are now moving away from bitter-tasting alcohol to more flavorful drinks that are gentler on the palate, with the fizz of seltzers helping soften the harshness of hard alcohol. The sheer range of flavors offered by brands like Raya, Pursue, and Wild Drum, combined with the use of different base spirits, make a strong case for the beverage over other popular fizzy alcohols such as beer and sparkling wine. As the market for hard seltzers grows in India, a ramp-up in innovation and experimentation from established brands and new entrants will likely be witnessed.

Nostalgic Choices

Simple cocktails and martinis around the globe are making their way back to the consumer's glass. Bartenders are expected to continue to create innovative beverages that combine nostalgia and escapism, whether rediscovered '90s hits or comfy dessert-inspired cocktails. They will also include visuals that are fit for social media. Brands will soon pick up on this growing trend and aim to produce RTD or premixes catering to the consumer's nostalgia.

References

1. https://www.financialexpress.com/industry/non-alcoholic-beverage-makers-on-a-high-as-demand-grows/2631060/
2. https://www.statista.com/outlook/cmo/alcoholic-drinks/india
3. https://the-ken.com/story/sula-vineyards-116m-ipo-is-fine-wine-for-its-shareholders-not-public-market-investors/?searchTerm=beverages
4. https://www.statista.com/outlook/cmo/non-alcoholic-drinks/india
5. https://restaurant.indianretailer.com/article/alco-bev-trends-that-will-soon-alter-the-beverage-industry.14256
6. https://the-ken.com/story/sula-vineyards-116m-ipo-is-fine-wine-for-its-shareholders-not-public-market-investors/?searchTerm=beverages
7. https://www.indianretailer.com/interview/retail-people/startup/how-omnichannel-brand-cravova-grew-500-pc-in-just-one-year.i2031
8. https://www.traveldine.com/matters-of-the-spirit-seven-big-alcobev-trends-we-can-expect-in-2022/
9. https://timesofindia.indiatimes.com/blogs/voices/cold-chain-logistics-current-challenges-in-india/
10. https://effulgence.rdias.ac.in/user/article_pdf/barticle_8_Vol14.pdf
11. https://www.thehindu.com/business/Economy/alcohol-industry-bemoans-high-taxation/article66266286.ece
12. https://www.linkedin.com/pulse/5-essential-kpis-fmcg-segment-wajid-ali-khan/
13. https://www.prnewswire.com/news-releases/usd-3-84-bn-growth-in-health-beverages-market-in-india-from-2021-to-2026offline-segment-to-be-significant-for-revenue-generation-17000-technavio-reports-301441661.html
14. https://www.financialexpress.com/industry/non-alcoholic-beverage-makers-on-a-high-as-demand-grows/2631060/

15. https://www.slurrp.com/article/raising-the-bar-2023-beverage-trends-from-india-and-the-world-1674205872596
16. https://restaurant.indianretailer.com/article/alco-bev-trends-that-will-soon-alter-the-beverage-industry.14256
17. https://timesofindia.indiatimes.com/blogs/voices/why-the-indian-alco-beverage-industry-is-recording-strong-growth/
18. https://www.slurrp.com/article/the-fizz-factor-hard-seltzers-rise-in-india-1672660398805
19. https://restaurant.indianretailer.com/article/cocktail-trends-to-watch-out-in-2023.14239
20. Mintel 2023 Food & Drinks Report

For queries, please contact

KNAV
PARTNERS BEYOND BOUNDARIES

KNAV has charted a course to be one of the world's leading accounting and consulting firms over the last two decades. We provide an expansive suite of public accounting services which includes accounting, assurance, taxation, international transfer pricing, global risk consulting, and business advisory services. With over 300+ professionals in 6 countries, our team combines local insights with global expertise to design powerful strategies and help our clients stay ahead of the curve. Our commitment to customer service, integrity, and innovation makes us the best choice for businesses of all sizes.

KNAV International Limited (KNAV) is a private not-for-profit company, incorporated in the State of Georgia, United States. It is owned by its members. Client services are delivered by KNAV International members, each of which is a locally owned and managed independent firm.

US | India | Singapore | UK | Netherlands | Canada

India Offices:

Mumbai
7th floor, Godrej BKC, Bandra Kurla Complex, Mumbai 400051

Bengaluru
306, 3rd Floor, Embassy Square, 148, Infantry Road, Bengaluru 560001

Other offices:

USA | Singapore | Canada | UK | Netherlands