

The Golden Bubble?

INTRODUCTION

In late 2006, Daniel Birnbaum, the chief executive officer of Nike Israel, received a phone call that would revolutionize an industry. Yuval Cohen, a Harvard friend managing a technology private equity fund, was considering buying SodaStream and wanted his professional opinion¹. “I got the phone call,” said Birnbaum, “and I did a double take. SodaClub? I literally almost fell off my chair. ‘Are you crazy?’ I asked him, ‘I thought you invested in technology companies.’ I remembered the company from my childhood and I was surprised it even still existed.” Three weeks later, Birnbaum got another phone call. This time it was a job offer; he was being given the reigns of the company². Despite his own better judgment, Birnbaum became infatuated with the business. He felt it was an opportunity to do something significant and important.

Four years later, after being bought for \$6 million dollars, SodaStream (SodaClub) was worth \$1.15 billion. By 2011, it was the world’s largest manufacturer, distributor, and marketer of Home Carbonation Systems. It had over 5 million active customers, sold its products in over 55,000 retail stores across 43 countries, including over 13,000 in the U.S. Although they have had amazing success, SodaStream still has less than 1% of the carbonated beverage market and investors are keeping a close eye on how well the company can penetrate the US market³. What led to this success and how will the company fare in new waters?

COMPANY HISTORY

SodaStream was founded in 1903 by Guy Gilbey. The revolutionary system added carbonation to water via a pressurized carbon dioxide cylinder. The product was more expensive than the average consumer could justify paying and was therefore targeted to the upper-class royalty including the Queen and her family, the Royal Navy, and the Royal Yacht Britannia. The SodaStream machine was mainly used by

royalty until 1955, when distribution of the SodaStream Popular Outfit began. This product was the first home carbonation system that made sparkling drinks at home. Consumers were also able to enjoy a selection of 14 flavored syrup concentrates for turning their homemade carbonated water into flavored soda. SodaStream successfully made the transition from offering an expensive and exclusive apparatus to providing a convenient consumer product that could be enjoyed by everyone.

A few entrepreneurs realized the potential of success to offer this product in the UK. Together with East Anglia TV, Scottish American Investments, and Banquer Belges, the entrepreneurs purchased the rights for producing the home-carbonation machine in the UK. The launch was focused on penetrating the soft-drink market and producing the product for the mass-market in attempt to become a commodity for every household. The new distribution efforts proved successful and popularity in the UK peaked in the 70's and 80's. By 1989 the company's total turnover amounted to 15.1 million pounds, 12.2 million of which were derived from UK sales. Syrup sales alone amounted to 6.6 million pounds.

Peter Wiseburgh had been the main distributor of SodaStream in Israel since 1978, however due to complications and disputes, his relationship with SodaStream was ended in 1989. In 1991, Soda-Club, a direct competitor of SodaStream, was founded by Peter Wiseburgh. Efforts for global expansion began and distribution was launched in South Africa, Switzerland, Austria, Germany, and the Netherlands. Soda-club invested \$.5 million in an injection blow-molding machine to produce its high pressure carbonating bottles. A few years later, in 1996, an old military factory outside of Jerusalem was purchased to house local production of its products. In the meantime, SodaStream was suffering financial difficulty due to poor marketing and overall inefficient operational strategy.

The opportunity arose and in 1998 Soda-Club purchased SodaStream for \$26 million, which created the world's largest Home Carbonation System supplier. Seven injection-molding machines were operated which produced 1 million Soda-Club machines and a unique process for bottle production was implemented which produced 5 million bottles per year. Expansion efforts continued and Soda-Club expanded distribution to the US and Belgium and took over operations in South Africa, New Zealand, and Germany. Soda-Club continuously tried to grow, however due to various reasons including poor company management and ineffective marketing, the company was suffering from financial difficulty.

THE FIZZY SITUATION

In 2007, when Fortissimo Capital Fund acquired controlling interest in the Soda-Club Group, the

company was on the verge of bankruptcy. In some departments, employees were already throwing goodbye parties. The market value of the company was in decline; Soda-Club had purchased SodaStream for \$26 million dollars in 1998 and now the whole company was being sold for only \$6 million. The company was operating under heavy losses. After Birnbaum took over the company still lost \$2.2 million dollars in 2007.

Birnbaum described the company as “rusty, dusty, [and] not very exciting.” The product was considered to be an outdated device and the company was quietly accepting its end. People associated the soda-making machines with something from their childhood at their grandparent’s house and not something to be taken seriously today. Further exasperating the issue was the fact that SodaStream was considered to be a cheap alternative for what people could buy in the store. At the time SodaStream didn’t even have a marketing department. The lawyer who gave the marketing presentation to Fortissimo couldn’t even answer basic questions about the company. It was clear SodaStream was a failing company and that there was no plan for turning it around.

Despite all of these negative aspects, Birnbaum had exciting new ideas about how to revitalize the dying company. Taking advantage of current world trends he developed a new vision through which SodaStream would bubble to the top of the carbonated beverage market. With the right marketing campaign and a new design, SodaStream could become an integral part of peoples’ lives.

THE TURNAROUND

SodaStream would need to earn their spot on the counter. In order to succeed, they needed their product to look great and be used regularly. Among other things, such as hiring new talent from the technology industry and restructuring the business, the company hired famous designers to create eye-catching models and hired famous ad agencies to promote their new image (Figure 1). The new machines ranged from basic iterations with manual controls to expensive premium models with LCD screens and buttons for different levels of carbonation. Their new ads would focus on differentiating SodaStream based on five main benefits to their customers: environmentally friendly product, convenience, cost effectiveness, promotion of health and wellness, and creative fun use⁴.

Environmentally Friendly

Disposable plastic bottles are harmful to the environment and only a small percentage of plastic bottles are recycled (20% US). SodaStream products reduce the number of plastic bottles and cans used by their

customers (Figure 2). In addition, the pollution caused by the manufacturing and transportation of plastic bottles is significant. SodaStream's bottles are made with environmentally friendly materials that can be reused for over two years (with warranty) and are easy to recycle. Their products do not use electricity either (except for the LCD screen model), therefore reducing their environmental impact.

Convenience

SodaStream eliminates all the hassles that come with buying bottles from the market. Consumers don't have to lug around big packs of sodas, store them at home, or dispose of the empty bottles. Bottled beverages are bulky and difficult for consumers to transport and store, especially for those without private vehicles or large kitchens. The fact that most of their products do not require electricity enables them to be easily transported and used anywhere, even on recreational vehicles and boats.

Cost Effectiveness

There are large cost savings for a consumer who carbonates soft drinks at home as opposed to purchasing bottled or canned carbonated water or soft drinks. In the United States, the estimated cost to a SodaStream consumer can be as little as \$0.23 per liter of sparkling water and \$0.65 per liter for carbonated soft drinks, each of which is significantly lower than most bottled or canned sparkling water or carbonated soft drinks. Based on price studies by IRI in 2011, SodaStream provides savings of up to 70% for sparkling water and up to 30% for carbonated soft drinks. On average the cost of the machine will be recovered within a period of one year according to SodaStream. In addition, not only can SodaStream's new bottles keep beverages carbonated longer, but you can also carbonate drinks again, which means less waste due to soda going flat.

Health and Wellness

SodaStream products present consumers with a healthier alternative to traditional carbonated soft drinks. Their flavors contain two-thirds less sugar, carbohydrates and calories than the leading soft drink brands, and one-third less caffeine than popular carbonated soft drinks. They don't use high-fructose corn syrup in their flavors, instead substituting Stevia and Splenda. Consumers are given the choice of adding a variety of flavors to carbonated water, many of which are sugar-free, low sodium, low calorie, naturally sweetened or vitamin-enhanced.

Fun and Easy Use

Consumers can customize beverages in fun and creative ways. With SodaStream's home beverage carbonation system, the consumer has full control over the level of carbonation. There are more than 100

different flavors, including new all-natural versions (including cola, root beer and ginger ale) and diet versions, which can also be mixed to meet consumer preference. Each member of the family can consume a different flavor or blend flavors together to create new flavors. The soda makers are quick and easy to use, do not require cleaning and provide instant enjoyment by enabling all members of the family to make their own sparkling water or soda within seconds.

Rebranding the company was an instrumental part of turning the company around. The most successful aspect of their campaign has been the environmental benefits. The outspoken CEO of the company has made this a moral fight about the highly visible waste plastic bottles create. The century old technology had finally become relevant to consumers looking for ways to reduce their carbon footprint. Positioning themselves as a healthier alternative to soda also came at a fortuitous time when concerns about diabetes and obesity are at an all time high.

THE BUBBLE

SodaStream machines and solid marketing strategies proved to be the right flavor for success. The company went from hemorrhaging over a million dollars in 2007 to making \$.75 million profit in 2008, \$10 million in 2009, and \$12.9 million in 2010. Within three years of being taken over by Fortissimo, they were ready for an IPO. The company was valued at \$367 million when it went public on November 3rd. The new design and marketing campaign had successfully revived the stale company; turning an old technology into a "new" one that appealed to environmentally sensitive consumers.

SodaStream is a very strong company and it has earned its place as the “at-home pop leader”. From carbonation machines, to the CO₂ cylinders, to flavor syrups, they sell the entire experience. As more machines are sold into the market the demand for their higher margin products, e.g. CO₂ and syrups, increase. SodaStream offers over one hundred different flavored syrups and has earned a significant profit on not only the sale of the machines, but on the syrups as well. SodaStream boasts a five-year average revenue growth rate of 28% (Figure 3), and gross profit margin has remained stable in the 53-55% range.

SodaStream also has several weaknesses. Their CO₂ canisters are a hassle to consumers who either have to find a local dealer or mail them in to be refilled. In addition, buying extra canisters are expensive at about \$30 each, which causes customers to think twice before purchasing. The machine mainly appeals to soda enthusiasts and the syrups don't have the same appeal as the major brands. More than 52% of SodaStream's sales come from within the EU, causing concerns about the company's diversification.

Investors became worried that the SodaStream bubble would burst eventually. Was the company's success a fad? Would it dry up overnight? Up until this point, the company had done very well in other markets, but whether they could repeat this success in the soda-guzzling US market was the question weighing on everyone's minds. Without expansion there is not much room for growth in their current saturated markets.

EXPANSION INTO US MARKET

SodaStream was rapidly expanding into more countries with large markets, and their next logical move was to stream into the untapped US market. The carbonated beverage industry in the US is \$264 billion, and if they are able to capture a few percentage points of the market by selling the idea of making soda at home, the opportunity would be game changing. Further success could be obtained by adopting the big brands which Americans are loyal to. SodaStream has already partnered with Country Time Lemonade and Kraft, and it is likely that other small to mid-size beverage companies like Pepper-Snapple might offer a few of their sodas for the SodaStream, making the product even more attractive (Figure 4). Lastly, the manufacturing of new product lines serves as a prime time to tap into the US market. In addition to the countertop machine, they are designing an under-the-sink dispenser, a filtered soda maker, as well as an on the go single serve soda maker to appeal to all demographics.

SodaStream has already made a small splash in the US market. Leveraging the publicity generated by their large IPO and record growth, the company created buzz about their products. They made deals with major chains including: Bed Bath and Beyond, Best Buy, Costco, Kohl's, Macy's, Sears, Target, and most recently with Wal-Mart. With their new elegant designs, sophisticated market campaign, and endorsement by celebrities, such as Susan Sarandon and Tori Spelling, they marketed themselves as a premium product rather than a cheap solution for soda consumption⁴. Based on the success they have had so far, the company continues to invest heavily in advertising; they hired an award winning marketing company to produce an ad and recently (12/4/2010) spent \$4 million for a 30-second Super Bowl commercial⁵.

SodaStream has no major direct competition so far, mostly due to the fact that they have many patents on their products, but there are several hurdles for them to overcome. Substitutes (Coke and Pepsi primarily) will be reluctant to compete with SodaStream because it would cannibalize their own larger profit margins, but they have attacked them through legal means. For example, the companies threatened to sue SodaStream for their bottle display in Australia and recently lobbied Clearcast, the approval body for UK

broadcast TV advertising to ban the bubble company's latest commercial featuring exploding bottles⁶. New entrants in the US syrup market could interfere with their razor-blade model cutting them off from their higher margin syrup profits.

LOOKING FORWARD

In addition to the steps they took so far, there are some options we think could be useful in their attempt to further succeed in penetrating the U.S. market. Firstly, SodaStream could license out the machine manufacturing rights to other companies to establish a low end market. By doing so, they would both expand the market for complements, increasing the demand for their high margin syrups and CO2 tanks, and at the same time differentiate SodaStream as a high end product. This would also help prevent companies from entering the market and under pricing them. They could also partner with existing bottle manufacturers such as Camelback or Nalgene, to produce bottles that would be compatible with the SodaStream machine. This would help them capture more market share by giving people who use these types of bottles an easy transition to using SodaStream products. Finally, they could partner up with schools and other public facilities under the guise of promoting health and environmental issues. In doing so, they could subsidize or give away bottles to kids and install SodaStream carbonating and syrup vending machines. Together, all of these efforts could ensure SodaStream rises to the top of the carbonated beverage market without bursting the bubble.

Figure 1

New Soda Maker Innovation



Revolution™
Designed by Tamooz

- One-touch automatic carbonation
- Electric-powered, LED display
- Snap-and-Lock mechanism

Source™
Designed by Yves Behar

- Elegant design
- LED display
- Snap-and-Lock mechanism

AquaBar
Designed by Stefano Giovannoni

- Single-Serve
- Carbonated, also Hot / Cold / Ambient
- Double-Filtration

sodastream™

Figure 2

Since January 2009,
SodaStream has saved the world from **2,574,697,960** bottles

340.000.000.000 Bottles
and cans are not recycled every year

- 1 bottle takes **450** years to decompose
- 1 bottle needs **5** times its volume in water to manufacture

LEARN MORE >

BELIEVE >



sodastream
Help free the world from bottles

Figure 3

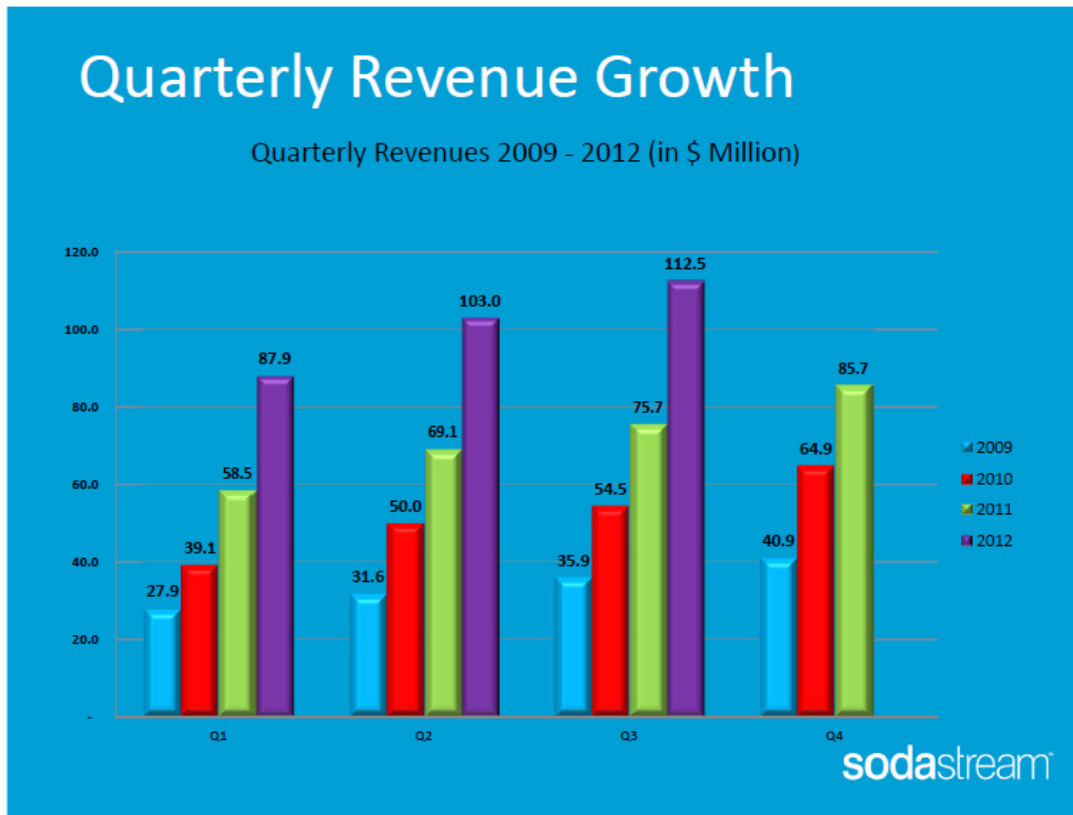


Figure 4



All information without footnote is derived from www.SodaStream.com

- ¹ "SodaStream's Moneymaking Battle Cry: Get Rid Of Plastic Bottles". Forbes. (2012).
<http://www.forbes.com/sites/calebmelby/2012/07/19/sodastreams-moneymaking-battle-cry-get-rid-of-plastic-bottles/>
- ² Video interview (in Hebrew) (2012). <http://www.mako.co.il/news-channel2/Friday-Newscast/Article-61775f8b5865031004.htm>
- ³ SodaStream Corporate Website (2012). <http://www.sodastream.com/>
- ⁴ SodaStream Investor Relations (2012) <http://sodastream.investorroom.com/>
- ⁵ "SodaStream to Represent Israel at Super Bowl XLVII". The Jerusalem Post. (2012)
<http://www.jpost.com/Business/BusinessNews/Article.aspx?id=294708>
- ⁶ "New Cola War?" SodaStream Refuses To Comply With Coca-Cola Cease-And-Desist Letter". Forbes. (2012)
<http://www.forbes.com/sites/calebmelby/2012/06/18/new-cola-war-sodastream-refuses-to-comply-with-coca-cola-cease-and-desist-letter/>