

Coke Invests in Tea Company, Expects Steeper Growth

By BETSY MCKAY

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With its purchase of a 40% stake in tiny Honest Tea Inc., Coca-Cola Co. is banking on making tea a much more popular drink for Americans than it is today.

But while U.S. consumption of tea is growing, there are big challenges to making it as popular as coffee. Coffee has been a breakfast staple for decades, and corner coffeehouses have become regular gathering places for everyone from entrepreneurs looking for Wi-Fi access to teens meeting their friends over a \$4 Frappuccino.

Americans drank 16.3 gallons per person of hot and bottled coffee in 2006, dwarfing their 7.1 gallons per person of hot brewed and cold bottled tea, according to Beverage Digest, an industry publication and data service. And while total U.S. coffee consumption has declined since 1985 amid growing competition from soda and other drinks, the explosion of the coffeehouse concept led by Starbucks Corp. has transformed a once-cheap drink into a premium beverage. The percentage of 18-to-24-year-olds who consume coffee daily rose to 37% last year from 16% in 2003, according to the National Coffee Association of U.S.A. Inc.

Coffee can be whipped up into a specialty drink that is hard to make at home, while tea, made with leaves and boiling water, is harder to build a retail environment around, acknowledges Seth Goldman, president and "TeaEO" of Honest Tea, a fast-growing maker of premium and organic bottled teas. "There's a whole culture associated with Starbucks that's hard to replicate with tea," he says.

Still, Coke, Mr. Goldman and other beverage makers have high hopes for tea in the U.S. A growing number of consumers are seeking drinks that they perceive to be healthier than soda, and marketers tout the antioxidants in teas. Specialty black, white and green teas have appeared on shelves in the U.S. market, jazzing up a category once dominated by the plain old tea bag or iced-tea powder. "We see so much opportunity out there," Mr. Goldman says of his reasons for seeking the investment from Coke.

Ready-to-drink bottled-tea volume -- a measure of sales -- rose 24% in the first nine months of 2007, while Coca-Cola Classic volume declined 5.6%. But tea sales still remain tiny compared with those of soda: Americans drank 50.9 gallons of soft drinks per person in 2006, compared with the 7.1 gallons of tea.

Honest Tea, founded in 1998 by two entrepreneurs seeking to offer teas that were natural and less sugary than other commercial beverages, has been able to get its teas and juices into a few mainstream outlets. But the Bethesda, Md., company's lack of clout and financial resources have limited its distribution mostly to natural-foods retailers such as Whole Foods Market Inc.

Coke, which is paying about \$43 million for the 40% stake in Honest Tea, plans to expand distribution of the company's drinks into grocery stores, restaurants and other outlets. Coke will have the right to purchase the remainder of the company, currently valued at about \$110 million, after three years.

A \$12 million equity infusion last year from a group of investors, including organic-food producer Stonyfield Farm, owned by Danone SA, and Inventages Venture Capital Investment Inc., a private-equity firm whose limited investment partners include Nestlé SA, helped Honest Tea fund some recent expansion.

Taking on Honest Tea won't help Coke narrow PepsiCo Inc.'s lead in the tea wars much. Honest Tea sold 2.7 million 192-ounce cases last year, with \$23 million in sales. Top-selling Lipton, which PepsiCo markets in a joint venture with Unilever, had sales of 213 million 192-ounce cases in 2006, the last year for which figures were available.

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