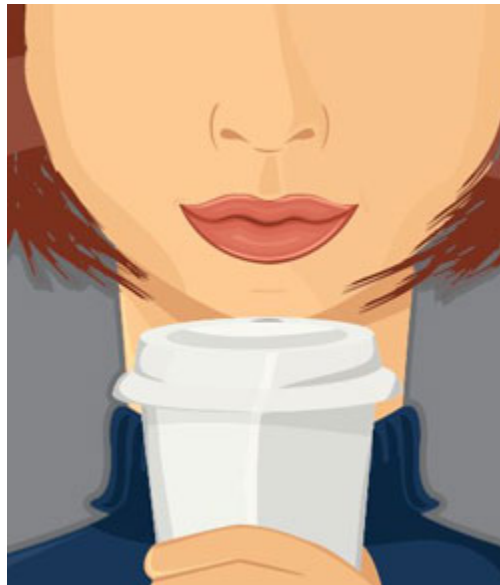


Coffee Category Close-Up: Buzz Kill

America's caffeine habit has made coffee a steady sales stream for convenience stores. In fact, consumers stop to buy coffee more than they fill their gas tanks, according to NACS data. But current market and consumer trends threaten the subcategory.

Coffee is an important part of the profitable hot dispensed beverages category, which adds around \$3,676 margin dollars per store per month, according to NACS State of the Industry data for 2010. Combined with cappuccino and specialty coffee - coffee accounts for the lion's share of the category's sales. Tea, hot chocolate and other dispensed beverages make up less than 3 percent. In 2009, coffee, cappuccino and specialty coffee sales per store neared \$80,000.

Overall, hot dispensed beverage sales have been declining slightly in recent years. In 2008, sales per store per month topped \$7,200; last year, sales didn't reach \$7,000. The recession may have put an end to the \$4 latte craze, but consumers still expect a premium brew at a reasonable price. At the same time, the price of coffee beans is going up, and members of Gen Y have found other — often less profitable — ways to get their caffeine fixes. To drive coffee sales, operators are getting creative.



Beans Break the Bank

The price of coffee is close to its historic high. Bad weather in key coffee producing nations, including Colombia and Brazil, has decreased harvests by 20 percent this year, and increasing demand in emerging markets means the supply is stretched even thinner. The weak dollar has also driven speculation in the coffee commodity market. As a result, the price of beans has more than doubled over the past 12 months.

"I don't see prices dropping this year," said coffee industry consultant Andrew Hetzel.

The good news, Hetzel says, is that the price of better quality, specialty coffee isn't rising at the same rate as standard commodity-grade coffees. Operators who haven't yet done so might consider switching to a better brew. And if customers are getting an improved cup of coffee, they won't be as bitter if operators have to pass on the higher cost.

"The underlying message is that coffee is a more valuable product than it has been in a long time," Hetzel said. "The days of the \$1 cup of coffee are long gone."

More than 10 percent of convenience store retailers raised coffee prices in 2010, and more than half said they will likely do so this year, according to the 2011 Convenience Retail Outlook Survey conducted by Balvor, a sales and marketing firm specializing in convenience retail.

Kids Get Their Kicks Elsewhere

Two-thirds of Americans drink coffee daily, but many of those drinkers are older consumers, according to market research firm Mintel. Only around a quarter of 18- to 24-year-olds drink coffee every day.

"As we lose [older consumers], the coffee market is going to lose its core clientele," said Bill Patterson, a senior market analyst with Mintel.

Whereas coffee is the go-to caffeine source for Baby Boomers, Gen Y consumers have grown accustomed to more options — from soda to ready-to-drink tea to energy drinks. Unfortunately for operators, those options aren't as profitable as coffee, with a gross margin contribution exceeding 50 percent.

Hot Dispensed Beverages Snapshot

	% of Foodservice Sales		Avg. Store Sales		GP Margin \$		Gross Margin %	
	2009	2010	2009	2010	2009	2010	2009	2010
Coffee	76.37%	76.85%	\$46,693	\$47,899	\$27,451	\$28,284	58.79%	59.05%
Hot Tea	0.98%	1.09%	\$599	\$679	\$332	\$383	55.33%	56.41%
Hot Chocolate	2.57%	2.02%	\$1,571	\$1,259	\$810	\$657	51.58%	52.16%
Cappuccino/Specialty Coffee	13.30%	13.35%	\$8,132	\$8,322	\$5,094	\$5,176	62.66%	62.21%
Refills, Hot Dispensed	6.15%	6.03%	\$3,760	\$3,758	\$2,532	\$2,532	67.33%	67.36%
Coffee Club Mugs	0.55%	0.61%	\$336	\$380	\$85	\$106	25.17%	27.79%
Other Hot Dispensed Beverages	0.08%	0.05%	\$49	\$31	\$20	\$14	40.07%	43.78%
Total	100.00%	100.00%	\$61,140	\$62,328	\$36,324	\$37,152	59.40%	59.61%

(Source: NACS State of the Industry Report of 2010 Data)

To attract younger coffee consumers, operators need to understand the new generation’s coffee culture. For starters, many drink coffee to calm down instead of get hyped up. Almost half of 18- to 24-year-olds say they like to relax with a cup of coffee. They also prefer sweeter drinks than their older counterparts and are more likely to get their coffee from cafés. Operators can satisfy younger consumers with coffeeshouse-inspired drinks and premium-quality brews.

“The 18- to 24-year-old gets turned off by big jugs of generic coffee sitting on the counter,” Patterson said. “Given choice between that and grabbing a Monster, I think they’re going to grab a Monster.”

Step-Up Service

Though some chains offer made-to-order coffee drinks, most convenience stores still rely on customers to serve themselves. A few, however, have stepped up customer service at the coffee station by employing coffee hosts or hostesses.

Though the job description is different from chain to chain, coffee host or hostess duties typically include ensuring there is enough coffee and that it’s fresh, keeping the coffee station clean, and making sure condiments, including sugar and cream, are stocked.

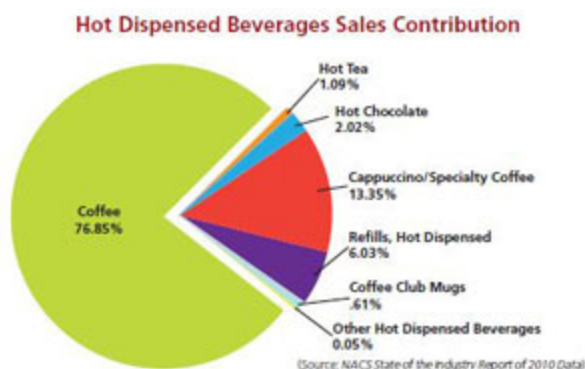
At Wawa, Lisa Wollan, head of consumer insights and brand strategy, says coffee hostesses are also an important part of many customers’ morning routines.

“They connect with customers,” Wollan said. “We have people coming in every morning, several times a day, and they literally greet them by name. They know about each other’s families, their work ... it’s a unique bond.”

The Pantry’s Kangaroo Express added coffee hosts as part of its coffee program upgrade in 2010, and Thorn-tons added the position to some markets starting this past February.

Variety Is Key

When it comes to coffee, consumers want options, as Casey’s General Stores found out. In the past, typical Casey’s stores offered only two types of coffee, regular and decaffeinated.



In 2010, however, the chain completed numerous coffee bar remodels that increased flavor profiles, added flavored creamers and expanded cappuccino choices.

“[W]e were not offering a wide enough selection to meet all of the customers’ demands,” Walljasper explained. “We believe this new program bridges that disconnect, which is why you are seeing such significant increases in this area.”

The changes drove double-digit same-store sales increases in the category, according to the company’s 2010 annual report. Stores that completed remodels saw coffee sales increase 30 to 40 percent. To date, 120 to 130 Casey’s stores have received the upgrades.

Promotions Pay Off

The Pantry-owned Kangaroo Express is another chain to improve its coffee offerings recently. The brand's Program Fresh foodservice initiative — rolled out in 130 stores in the Raleigh-Durham, North Carolina area in 2010 and continuing in other markets this year — is anchored by a re-launch of its proprietary Bean Street Coffee, including the addition of coffee hosts. Results of the re-launch have been positive, with coffee sales increasing in line with expectations, according to The Pantry's 2010 annual report.

Kangaroo Express stores also saw success from a novel coffee promotion run during the 2010-2011 college basketball season. "The Battle for Bean Street" leveraged the basketball rivalry among three schools in the brand's Raleigh-Durham market: the University of North Carolina, Duke University and North Carolina State University.

From November through March, Bean Street cups featured the three schools' logos, and customers were encouraged to choose the one representing their favorite team. The university represented by the most cups sold received a \$20,000 donation for a charity of its choice. The runners up received \$5,000 each for their chosen charities. The brand tapped students at the universities, former players, social media and a website to drive the promotion.

It was a resounding success. Almost 125,000 logo cups were sold and coffee sales increased by more than half over the previous year from January to March, according to the company. Store traffic and sales increased 8 percent compared with the previous year, and the promotion even received coverage in *The New York Times*.

Though coffee faces challenges, operators who understand the trends and can think outside of the box should see this segment's steady sales continue.

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