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Water Is the New Soda -- and That's a Problem for Coke and Pepsi

By Motley Fool, August 31, 2015, 08:00:07 PM EDT

Despite the best efforts of **The Coca Cola Co.** and **Pepsico** , soda sales continue to decline in the U.S. What was the beverage of choice for all occasions has become the bogeyman in light of the nation's obesity crisis as parents and governments relegate the fizzy drink to the back of the fridge.

Soda consumption has declined every year for the past 10 years; since 2000, it's fallen by 25% per capita from 53.2 gallons to 39.9 last year. In its stead, bottled water has come into vogue as the drink of choice for health-conscious Americans. Sales rose 7% last year, and **Nestle** , the parent company of Poland Spring, became the No. 3 beverage seller in the U.S., surpassing the Dr Pepper Snapple Group. The research firm Beverage Marketing now projects that bottled water will outsell soda by 2017. Though Coke and Pepsi have made efforts to diversify beyond their core colas in order to find new growth opportunities, the rise of bottled water presents a distinct challenge for several reasons. Let's take a closer look.

A fragmented industry

While Coke and Pepsi own about two-thirds of the market in sodas, when it comes to bottled water, the two most powerful beverage companies control just around 20%. Coke counts among its portfolio Dasani and Glaceau SmartWater while Pepsi owns Aquafina.

Coca-Cola's water portfolio. Source: Coca-Cola.

The two companies have expanded their portfolios in recent years to carry natural juices such as Odwalla (Coke) and Naked (Pepsi), teas, and other healthier beverages. Coca-Cola, in particular, has made attempts to expand beyond its core carbonated beverages. Unlike other soft drinks, however, bottled water is an extremely fragmented market, and the widespread availability of the product -- along with the similarity among purveyors -- makes it difficult for a product to distinguish itself. After all, water is essentially a commodity, and there isn't an opportunity to differentiate it through taste or other characteristics as there is with soda. Competitors range from **Wal-Mart** 's Great Value brand to the high-end Fiji label, which is owned by Roll Global.

Even if Coke and Pepsi wanted to acquire their way to dominance, it would be much more difficult than it has been in other industries.

Profits are slippery

While the fragmentation of the industry presents one significant challenge to Coke and Pepsi, the low margins in water are yet another hurdle for the two beverage giants. Profits on bottled water are significantly lower than on soda, so even if they could establish a strong position in water they would still rather sell you soda. The wholesale price for gallon of soda is now $4.05 compared to just $1.23 for water. Despite volume sales of bottled water now approaching that of soda, dollar sales of H2O are only half that compared to its fizzy sugar-water substitute.

While Coke and Pepsi will continue to dominate the beverage business for the foreseeable future thanks to their marketing muscle, distribution network, and brand portfolios, the rise of water presents some interesting opportunities in other corners of the industry.

National Beverage has seen sales of its sparkling water brand La Croix triple since to 2009 to $175 million , delivering growth at a time when Coke and Pepsi have struggled to make a dent in the sparkling water segment. **SodaStream International** , meanwhile, is still licking its wounds from overestimating demand for its soda products, but as it regroups as a sparkling water brand, the company may find renewed success in that growing market.

National Beverage and SodaStream are still small fish in a big pond, but what is clear is that Coke and Pepsi are losing traction in the beverage wars. As bottled water's share continues to grow, those companies will be further challenged to increase sales and find new markets.

The article Water Is the New Soda -- and That's a Problem for Coke and Pepsi originally appeared on Fool.com.

Jeremy Bowman owns shares of SodaStream. The Motley Fool owns and recommends PepsiCo. It owns shares of SodaStream and has the following options on Coca-Cola: long January 2016 $37 calls, short January 2016 $43 calls, and short January 2016 $37 puts. The Motley Fool recommends Coca-Cola. Try any of our Foolish newsletter services free for 30 days . We Fools may not all hold the same opinions, but we all believe that considering a diverse range of insights makes us better investors. The Motley Fool has a disclosure policy .

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