

THE SMOKE LIFTS

Are they a trend or mainstay?
Questions remain for
e-cigs and vaping

BY LARA R. JACKSON
AND MITCH MORRISON

They're becoming more mainstream—you see them at mall kiosks, perhaps the local coffee shop, maybe even on college campuses. The presence of electronic cigarettes (aka e-cigs or cig-alikes) and vapor cigarettes has exploded.

Yet their momentum has hit a speed bump of late. Traditional smokers are not converting at the speed of puff, and Wells Fargo tobacco analyst Bonne Herzog reported late in 2014 that e-cigarette sales had “decelerated” to a still-solid 25.6% in the period ending in mid-November. >>



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There is little doubt that the battery-powered devices are undergoing a period of introspection, that public enthusiasm has waned a bit. Some blame the lack of instructive and constructive federal regulation, which would allow these devices to be marketed as modified-risk products, a safer alternative to cigarette and cigar smoking. Others say the expected crossover of cigarette smoker to e-cig has not materialized as expected, that the populations are different.

In an exclusive CSP webinar, RBC Capital Markets tobacco analyst Nik Modi delivered a report of mixed blessings: one that spoke of the struggles of e-cigs but the expansion of a vaping lexicon of open systems, mods, tanks and e-liquids.

So who are e-cigarette and vapor smokers? According to some in the media, it's a motley crew of millennials but also unsupervised teenagers and even preteens. In fact, many e-cigarette and vapor companies have age restrictions on their websites and support age verification.

"Roughly 98% of our consumers are adult smokers," says Miguel Martin, president of Logic Technologies, Pompano Beach, Fla. "[Logic] supports a conservative marketing approach and market to adult smokers."

Modi says the demographic difference is dramatic between those smoking traditional combustibles and new-generation devices. Traditional smokers, he says, typically consist of lower-income individuals who are working class and in underdeveloped communities. By contrast, those vaping are generally younger, a "rebellious generation": millennials.

And even within the broader world of vaping are noticeable differences among consumers. "The e-cigarette user is much different than the vapor user, which in turn is different than the traditional smoker," says John Wiesehan III, president of sales for Charlotte, N.C.-based Mystic. "We [Mistic] found there is more of a cross-pollination between the e-cigarette user and the traditional smoker, where the user will smoke e-cigarettes 50% of the time and smoke traditional cigarettes the other 50%."

Trying to find its niche in this turbulent market, Mystic recently rolled out Mystic

Bridge, a product that combines tank and e-cig technology.

Retail Embrace?

A January report by Herzog of Wells Fargo suggests a confluence of optimism and caution. While she says it's possible that consumption of vaping and non-combustibles may surpass cigarettes in the next decade, she acknowledges the increased uncertainty in the marketplace, which she blames on several factors: lack of regulation or leadership from the FDA, mixed-media reports on the health claims of vaping and a lack of consensus within the vaping community itself.

"We have become more concerned that lack of FDA regulations has caused a 'paralysis' in the industry as retailers and wholesalers are afraid to get stuck holding product they cannot sell or return," she wrote.

Likewise, Modi of RBC Capital—though careful to cite improved overall vaping sales in c-stores—believes many challenges stand in the way of being able to consider vaping the energy drink of the next decade.

Among the challenges he points out:

- > Regulatory uncertainty (lack of FDA leadership has invited a bevy of restrictions across local and state government).
- > Lack of appeal or invite to "non-techies."
- > Too many SKU and too many flavors.
- > Risk that the business is becoming more of a commodity.

Modi says vaporizers may lack appeal to traditional smokers who usually are older. Also, the vapor experience is not geared toward the average pack-a-day smoker.

The hope is that science will bear out vaping's virtues, that many will turn to cig-alikes and vaping devices because they contain less nicotine. Consumers actually have a choice of the amount of nicotine in vapor cigarettes.

According to the Centers for Disease Control and Prevention, about 443,000 U.S. deaths are attributed to cigarette smoking each year. Knowing the dangers of cigarette smoking, some traditional smokers and the younger generation have turned to e-cigarettes and vapor as an alternative.

Remaining hopeful, Wiesehan says, "We have found that more traditional tobacco smokers have transitioned to vapor exclusively based on our focus-group research. This is primarily due to a better satisfaction with vapor, more in line with a traditional cigarette, with the throat hit experience and more 'vape' that is created with a vapor unit."

Clearing the Smoke

On the c-store side, the world of vaping remains largely experimental—more than a fad but not yet a certainty.

An exclusive CSP-Technomic consumer report [CSP—Jan. '15, p. 38] shows that cigarettes, cigars and moist smokeless continue to generate significantly more rings than e-cigs or vaping but that the younger population of shoppers are still testing the waters on these devices.

Both data and anecdotes bear out this hesitation. According to Modi, e-cigarettes haven't had a significant effect on cigarette volumes in c-stores. In the third quarter of 2014, the volumes adjusted for elasticity were down 1.9%, with a two-year average of -3.0% and a three-year average of -3.1%.

But while c-stores' interest in e-cigs seems



to be waning, many retailers have found their sales in open systems, or vapor, growing. According to Modi, 46% of retailers surveyed said sales of open systems were on the rise.

“Currently, [e-cigarettes] and vapor comprise about 1% of our sales, with traditional sales totaling 39%,” says Steve Monaco, director of category management for Rockport, Mass.-based Tedeschi Food Shops.

Frank White, director of retail operations for Wheeling, W. Va.-based Tri-State Petroleum, also reports modest vaping sales. “The [e-cigarette] and [vapor] category comprised 0.41% of [our] overall merchandise sales for sites ending in 2014. ...The volume is up 8% from the prior year, which had an increase of share of category of 0.2%. We have limited vapor presence but it was new for us in 2014.”

With this still nascent segment undergoing growing pains—yet showing so much potential—Modi questions whether manufacturers will continue to make the necessary investments, and also take the risks.

Don Burke, senior vice president of Management Science Associates, Pittsburgh, has similar concerns. “Even though the vapor/liquid category is growing and is a great opportunity for c-stores, the amount of choices may be a deterrent for c-stores,” he says. “C-stores may be hesitant to expand the vape category due to the amount of SKUs, too many categories or the lack of counter/display space.”

Yet companies may have an advantage in gaining new customers. In 2014, the FDA announced a more lenient attitude toward the marketing and advertising of e-cigarettes and vapor. It agreed to allow these companies to advertise and market their products via methods that cigarette companies cannot use, such as newspaper, TV and radio ads, and sponsoring events. However, e-cigarettes and vapor can be sold only to those 21 and older.

Advocates are working aggressively to slow down a spate of local and state restrictions to give vaping a chance to flourish as a less-risky alternative to cigarettes and to see if, indeed, these devices are as they claim: a far better option.

“E-vapor consumers are increasingly seeking disassociation from combustible cigarettes,” says Vito Maurici, senior vice president of Scottsdale, Ariz.-based NJOY. “Many of our consumers have

worked very hard to move on from smoking and no longer want to be associated with the negative stigma of smoking. As our consumers make the switch from combustible cigarettes, we want to provide them with products that satisfy their needs and differentiate them from their old identity of a cigarette smoker.”

Because there is not enough scientific research concerning possible health risks and benefits, consumers many times find themselves in the dark when considering e-cigarettes and vapor. Education about these products is of concern. When marketing these products, manufacturers should also educate their consumers.

“The biggest challenge for these manufacturers and what is needed to provide as much consumer education as possible,” says Monaco of Tedeschi. “There is still quite a bit of doubt and skepticism on the part of consumers regarding e-cigarette and vaping attributes.”

“Right now the e-cigarette market is all about price and technology; only NJOY and Blu have made a big push for a brand iden-

tity,” says White. “The big tobacco players [Altria with MarkTen and R.J. Reynolds with Vuse] entered with items that have no brand identity and have pushed the quality of their technology as a point of differentiation, and created trial through massive couponing.

“To grow this category, manufacturers will need to create those unique brand identities to attract consumers to that experience.”

Wiesehan of Mystic remains optimistic. “I believe the industry hasn’t taken off to its fullest potential yet,” he says, “and the manufacturers and retailers are positioning ourselves for the growth we need to experience.”

Something New in 2015

A third choice in combustible-cigarettes alternative may be the next trend in 2015: heat-not-burn tobacco. These are noncombustible tobacco products in the form of vaporizers that heat the tobacco, but it doesn’t combust. According to many in the industry, this is the closest form of alternative smoking to an actual cigarette.

“Perhaps more closer to the smoking regime, heat-not-burn may get more dialogue in 2015,” comments Modi.

Some believe or, at least hope, that vaping will continue to gain popularity while e-cigarettes enjoy a rebound with the national rollouts of Vuse and MarkTen.

“In e-cigarettes, I feel there will eventually be a standard for the technology,” White says. “It is hard to measure performance because inventory units are not equalized like cigarettes. This makes it hard to designate space appropriately, and some companies are taking advantage of this by offering lucrative shelf payments, which is not best for our consumer.”

As with any newer industry, caution and disruption are common. On a whole, there seems to be room for growth for both e-cigarettes and vapor. “Retailers are more guarded because of the e-cigarette ‘bubble.’ They’re just taking a more cautious approach,” says Martin of Logic.

Burke of MSA remains cautiously optimistic: “The satisfaction of e-cigarettes and vapor is just not there yet. ... But with improved technology, there is a greater potential that e-cigarettes and vapor will overtake cigarettes.”

