

E-Cigarettes Expanding At Retail

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While FDA regulations remain to be seen, e-cigarette companies are self regulating, and technology continues to evolve.

By Erin Rigik, Associate Editor.

In a conference call yesterday with Bonnie Herzog, managing director of beverage and tobacco analyst at Wells Fargo securities, and Andries Verleur, co-founder at VMR Products, parent company of V2 Cigs, discussed trends and the future of the e-cigarette category, from the possibility of FDA regulations to the consumers trying the products.

Herzog predicted retailers will see more e-cigarette products and SKUs entering the market as the product technology continues to evolve. "I think things are going to get more crowded," she said.

Pricing has been coming down for electronic tobacco products, which have become much more affordable relative to traditional cigarettes. "I think that has encouraged some (consumer) switching or trial, so I expect that to help with volume growth," Herzog said. "My assumption is any new products that launch will feature attractive price points to woo customers and prices could come down a bit for that reason in the category as competition heats up."

As for which e-cigarette brands will come out on top, Herzog said there will likely be room for more than one winner, but those on top will be companies that have been successful in building a brand, and offering superior technology.

Retailer Adoption Already retailers are allocating more space to OTP, from smokeless and cigars to e-cigarettes. "The reason is retailers are getting better growth and better margins with these products," Herzog said. As the cigarette category margins continue to get squeezed, retailers are seeking areas of growth and margin expansion, which e-cigarettes are providing.

While much of the e-cigarette business was originally built online, it's now shifting toward brick and mortar stores. While online continues to be a very big piece, 2013 could be the first year where retail exceeds the overall sales of online e-cigarettes, Verleur noted.

Regulation Still, it remains to be seen how FDA will choose to regulate the e-cigarette category.

"E-cigs are going to have to have higher standards, and I think a lot of that is going to come from FDA regulation and higher product standards and safety. I think that will probably be dictated within the next year," Herzog said.

Major e-cigarette companies are already self regulating ahead of any regulatory action, from reducing flavor options to only those found in traditional cigarettes to restricting online sales.

Mitch Zeller, the director of the FDA's Center for Tobacco, has made comments that point to e-cigarette regulation as a priority, Herzog noted. "I think menthol is a bigger priority right now, but I'm hopeful that

in the next few months we can get some visibility on what the FDA is going to do, but my assumption is this e-cigarette industry will be regulated.”

Verleur agreed, and noted that contrary to popular belief, the larger e-cigarette corporations in the space are looking forward to regulation. “We feel it will lead to less players being in the e-cigarette industry,” he said, adding that regulation has been expected for some time, and could hit in the next six months. “There will be a public comment period, and I think after an initial regulation is suggested it would not be unlikely to expect 18 months of back and forth between all the stakeholders and government. I think the regulations we see in the end will be different from what is first released for discussion.”

Verleur noted that in his opinion, only about 10 e-cig companies exist in the U.S. right now that have the resources to self regulate properly. “The top 10 companies probably represent 70% of sales, but you have another 250 companies representing 30% of the marketplace, and they don’t have the resources or the global reach in their supply chains to facilitate the type of quality control standards we’d like to see,” he said. “We’ve been working very heavily through SFATA (the Smoke Free Alternatives Trade Association) to help educate these companies, and I know my company V2 Cigs has donated certain intellectual property to SFATA because we feel it’s in our best interest that even the smaller players begin to implement these things. You are essentially selling a product that’s both a technology product but also a consumable, and there is a very high degree responsibility you carry as a corporation in that space, and with the lack of regulation, especially with the smaller companies, it could taint the atmosphere for those companies that are investing in quality control.”

E-cigarette Users E-cigarettes attract a broad range of customers in various age groups, including current smokers who are either trying to quit regular cigarettes or looking to supplement their habit at times they cannot smoke traditional cigarettes.

“This is still such an early and young category that is evolving, but my assumption is it’s going to be a lot of the current smokers that are trying these products,” said Herzog.

The range of products on the market are diverse as well, from electronic cigarette modifications (*MODs*), which tend to be larger scale devices, and the smaller microcig form factor, which are similar in size to a cigarette. “The mass consumer does not want to carry around a baseball bat sized e-cigarette around their neck. As the technology get better you’ll find the microcig form factor devices will get better in their ability to simulate the traditional smoking experience, and those brands that have been able to pack more realism into a smaller form factor, I think, will get the most traction, especially at retail. I’m not saying the *MODs* will go away, but most people want something more like a cigarette,” Verleur said.

V2 Cig currently is conducting a test with Hess stores throughout the state of Florida with a three-tier display featuring disposables, rechargeables and cartomizers (disposable cartridges with atomizers built in). In about 60% of the stores, the company exceeded its disposable sales with rechargeables.

“If you look at the growth rate of rechargeables and cartomizers at retailers, as opposed to the growth rate of disposables, you’ll find that although rechargeables and cartomizers represent a much smaller piece, the growth rate is about three-times better than disposables,” Verleur said. He predicted that as the price point drops on rechargeables and becomes more in line with the price of disposables, more customers will gravitate toward rechargeables. “It’s going to become a big piece at retail,” he said.

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