

Sara Lee Answers Clooney's Nespresso Query With Cheaper Coffee

By Tom Mulier

April 07, 2010, 4:22 AM EDT

April 7 (Bloomberg) -- "Nespresso, what else?" George Clooney asks in an ad for Nestle SA's espresso. Starting today, Sara Lee Corp. has an answer for French shoppers: cheaper coffee capsules you can buy in supermarkets.

Consumers who bought a Nespresso machine were previously committed to using Nestle's 16 "Grand Cru" and limited edition varieties sold only in its own boutiques and online. Sara Lee's L'OR capsules and a version from Ethical Coffee Co. may depress Nestle's fastest-growing major brand in Nespresso's biggest market, according to Nomura analyst David Hayes. Nespresso provided about a fifth of Nestle's sales growth excluding acquisitions and currencies last year, he estimates.

"Nespresso stands to lose some market share," said Richard Withagen, an analyst at SNS Securities in Amsterdam, who has a "reduce" rating on Nestle. "Nespresso sales are going to be under pressure."

Vevey, Switzerland-based Nestle first sold single-serve espresso for machines that don't need cleaning 24 years ago. Nestle cultivates the exclusive image of the coffee through boutiques that boast tasting salons in locations such as Paris's Champs-Elysees and via a magazine sent to the homes of some of its 7 million "Nespresso Club" members twice a year.

Hermetically Sealed

Nestle charges as much as 3.70 euros (\$4.95) in France for a 10-pack sleeve of the capsules, which are hermetically sealed in aluminum to protect against oxidation. L'OR capsules will cost about 2.99 euros for 10 and be sold in supermarkets including Carrefour SA, Auchan and LeClerc while Casino Guichard-Perrachon SA will start selling the Ethical Coffee version for about 2.60 euros next month.

The lower prices may attract consumers who want to cut spending in the economic slowdown, said Jean-Marie L'Home, an analyst at Paris-based brokerage Aurel-Leven SA.

The new competition to Nespresso is another stumbling block for Nestle, which analysts expect to miss its long-term so-called organic sales growth goal in 2010 for a second year. Withagen expects Nestle to post organic annual sales growth of 4.1 percent this year, trailing its long-term average goal of 5 percent to 6 percent.

Before today, Nestle shares had gained 37 percent in the past year, compared with a 57 percent advance in rival Unilever's Dutch-traded shares and a 68 percent jump at Sara Lee.

Slowing Down

While Nespresso is growing faster than any other major Nestle product, the rate has been slowing for three years. Sales rose 22 percent to 2.77 billion Swiss francs (\$2.59 billion) in 2009 and the unit said March 26 it expects "double-digit" sales growth in 2010.

Nespresso expects portioned coffee to expand its share to 25 percent of the European and North American coffee market by value in 2015 from 19 percent in 2009, spokesman Hans-Joachim Richter said. Sara Lee estimates the global market for espresso and single-serve coffee to triple to \$15 billion in the four years to 2012.

Sara Lee and Ethical Coffee are now taking the risk Nestle won't be able to obtain an injunction on patent infringement, said Jon Cox, an analyst at Kepler Capital Markets in Zurich. Ethical Coffee CEO Jean-Paul Gaillard, who used to head Nespresso at Nestle, said he found a fault in Nespresso patents about two years ago and has worked on a rival capsule since. Nespresso will evaluate its options if it finds that rivals infringe its patents, which requires an "in-depth analysis," Richter said.

Analysts are looking at France to see how Nestle will react. Nestle could start selling more limited-edition varieties or pull other products from retailers if they sell Nespresso rivals, Kepler's Cox said.

Higher Prices

The coffee maker raised Nespresso prices in France by about 6 percent last year, the first increase in four years, according to Richter. He declined to comment on future pricing, saying the company doesn't set prices in response to rivals.

"Nespresso is the most expensive coffee that you can buy per cup" for home use, said James Amoroso, a food industry consultant based in Walchwil, Switzerland. "If Nespresso consumers were price-sensitive, they wouldn't have bought the machines in the first place."

Nespresso has won customer loyalty by offering quality coffee in an easy-to-use machine, according to SNS Securities's Withagen. The company deems only about 1 percent of the world's coffee supply to meet its standards.

Senseo Rivals

The new java may not be all bad news for Nespresso. About a year after Sara Lee's Senseo coffee pods were introduced in 2001, the Downers Grove, Illinois-based food maker was staving off rivals making generic alternatives. Senseo's sales have advanced at least 10 percent every year since 2002 in France.

"When there is more competition on the market, the market becomes more alive," said Aurel-Leven's L'Home. He said some consumers who were reluctant to buy Nespresso machines might now consider buying one because of the new options.

France is unlikely to be the last stop for competitors. Sara Lee reckons the new coffee has the "the potential to be a global success," said Ernesto Duran, a spokesman, adding the company currently doesn't have agreements to sell the capsules in a second market.

Ethical Coffee aims to enter Germany and Switzerland, according to Gaillard. He has stopped seeking orders after retailers asked for 4 billion units, double the amount the company aims to produce next year.

--With assistance from Benedikt Kammel in Berlin. Editors: Celeste Perri, Chris Staiti

To contact reporters responsible for this story: Thomas Mulier at +41-22-317-9201 or tmulier@bloomberg.net.

To contact the editor responsible for this story: Celeste Perri at cperri@bloomberg.net.