INTELLIGENCE REPORT
FUNCTIONAL DRINKS

JULY
2022

INTRODUCTION

Functional Drinks is one of the oldest categories within the current drinks industry. It is also one of the broadest, with a list of sub-categories that continues to grow.

It's a dynamic space to be in, with new technology and changing health and lifestyle trends providing new opportunities. Despite a wealth of innovation in Functional Drinks, however, we are entering a crucial point where the scales could tip either way between continued growth or a risk of stalling.

In this report we will:

- Unpick what it means to be a Functional Drinks brand
- Outline what we see as the key challenges and opportunities the category currently faces
- Identify the factors that we believe will define its future.

We have complemented our own research with insights from interviews with key figures within the drinks industry – Freya Twigden, founder of Fix8 Kombucha, and Vaughan Yates, founder of The Virgin Mary Bar – and from the panel in our recent webinar on the subject.

But before we get to that, and at the risk of sounding like the introduction to a school essay, **we need to start with a definition...**

WHAT ARE FUNCTIONAL DRINKS?

One of the earliest definitions of functional consumable goods was introduced by the Japanese government in the mid-1980s:

> *"Foods which are expected to have certain health benefits, and have been licensed to bear a label claiming that a person using them for specified health use may expect to obtain the health use through the consumption thereof"*
>
> Definition of functional foods by the
> **JAPANESE MINISTRY OF HEALTH - 1984**

When applied specifically to the drinks market, and taking the average of the many variations now in circulation, we believe a 21st century definition might read:

Non-alcoholic drinks that contain active ingredients that provide an added benefit, be that nutrition, health, energy, gut or mood.

But is this enough and does it really reflect the true nature of the category?

HOW HAS THE CATEGORY EVOLVED?

To better understand today's Functional Drinks landscape, we need to look at its history.

The first significant step was taken by brands like Red Bull in the 1980s, providing an alternative to coffee and differentiating itself from drinks giants like Pepsi and Coca Cola by leaning in to energy boosting properties.

By the 2000s, energy drinks was a saturated market, with brands competing to offer USPs as the strongest or most convenient in shot format.

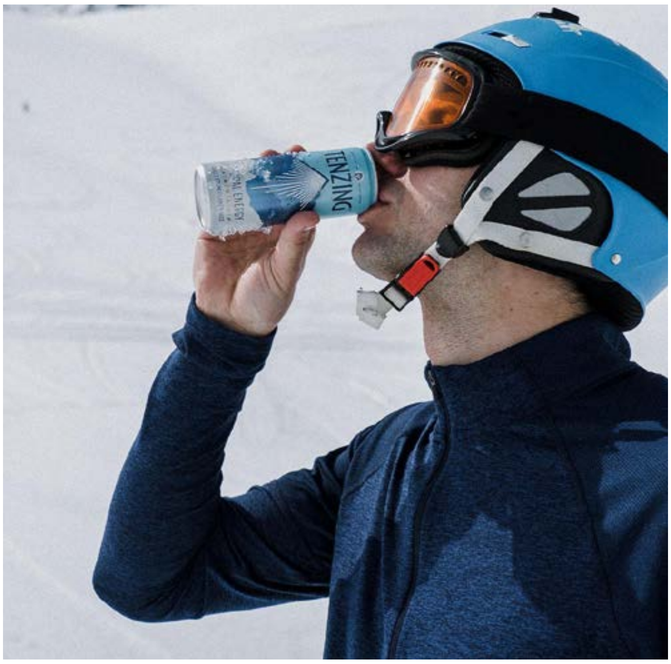

Image Credit: Tenzing via Instagram

Driven by concerns around health impacts, a push-back against the potency trend brought about a new phase. Brands began exploring energy drinks with lower sugar, fewer calories and more natural ingredients to provide healthier alternatives.

With 'wellness' a dominant lifestyle value through the 2010s, there was further acceleration and a more holistic focus on body and gut health – teas, kombuchas, kefirs, smart waters, various drinks with added vitamins, minerals and collagen... the list goes on.

Until recently, this was the broad picture of the category.

At this level, the Functional Drinks category fits comfortably into the definition we suggested above

Underpinned by a new awareness of the unhealthy traps of modern lifestyles, Functional Drinks offer a convenient way for affluent, health-conscious consumers to achieve balance by supplementing diets, improving gut health and managing stress. Individuals can integrate brands into their self-care via Off Trade, At Home and Out of Home consumption.

This segment of the business remains one of the biggest opportunities for success, but innovation within the category in recent years has created wider opportunities in two key emerging areas in particular: CBD/Alcohol-Adjacent Drinks and Nootropic & Adaptogen Drinks.

"We are creatures of ceremony, we crave ritual and interaction with other humans. In the west that's meshed into involving alcohol – but it doesn't have to be."

ZOEY HENDERSON
Founder of Fungtn

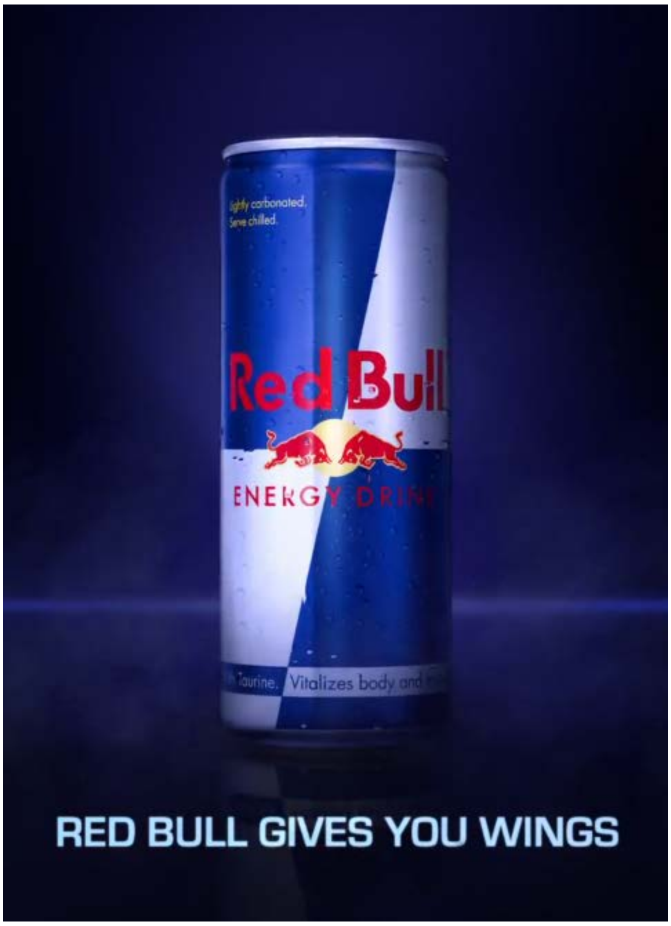

Image Credit: HomeBoyz Radio for Redbull, via Twitter

Section 2: Recent Expansion

CBD/ALCOHOL-ADJACENT DRINKS

Functional drinks have been breaking new ground.

The trend away from alcohol – and the vacuum this has left – has encouraged the growth of non-alcoholic functional drinks geared towards capitalising on new sociable moments.

Since the arrival of Seedlip in 2015, non-alcoholic brands have been trying to step into this gap. While early brands straddled a grey area within functional drinks – are non-alcoholic products functional if they've just taken something away, not put in an ingredient? – innovation from newer brands like Fungtn and Three Spirit have taken it one step further, by adding benefits as well as removing alcohol, thereby staking out their place in the category, forming their own non-alcoholic or alcohol-adjacent space.

They now stand alongside CBD beverages, providing a more active alternative to alcohol with compounds that promise beneficial impacts on the brain and nervous system.

> *"It was always 'without' – alcohol free or non-alc – removing something. With functional, we've gone from 'without' to 'with' and that's where you see this surge from consumers: 'Now I can actually have an added benefit'"*
>
> **HEIDI DILLON**
> MD North America at Distill Ventures

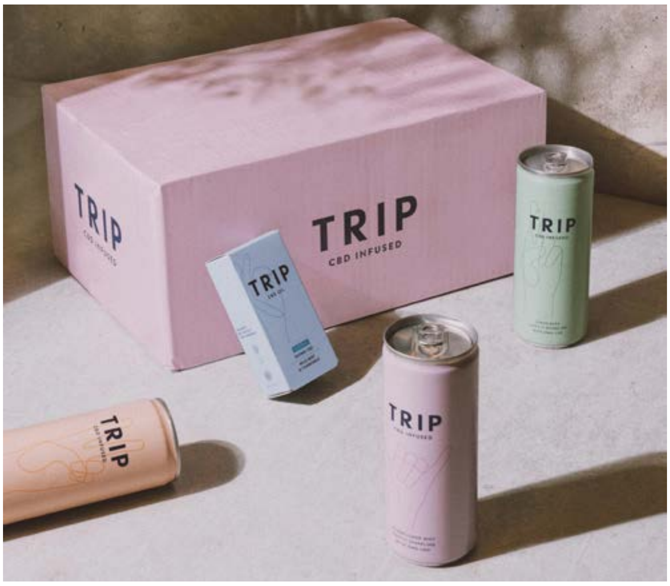

Image Credit: drinktrip.com

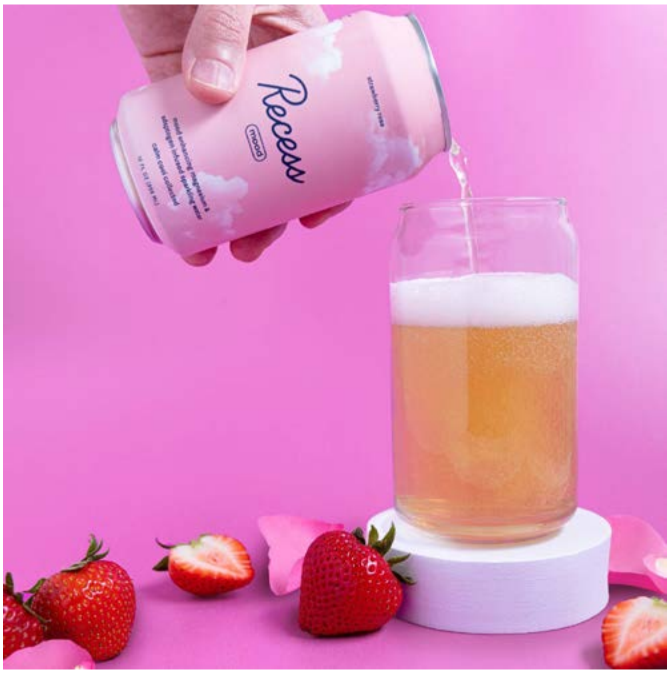

Image Credit: Recess via Instagram

> *"People were used to seeing these ingredients in the health and wellness sector – smoothies, juice, coffee – a daytime occasion. But more people are keen on having them in cocktails – the mindshift has gone to evening"*
>
> **ZOEY HENDERSON**
> Founder of Fungtn

Following the growth pattern of the CBD category, these new functional alcohol alternatives seem poised for a rapid expansion

When we released our report Lifting the Haze in January 2020, our predictions were for further innovation and interest from big players in the industry that would result in rapid growth. And our predictions have held true, though with added stimulus through the arrival of the Covid-19 pandemic that drove CBD sales.

A report from Alphagreen.io in May 2020 showed a spike in sales of CBD products over the first four months of the year. And the growth didn't stop there. The UK CBD market value is predicted to hit £1 billion by 2025. This is a picture mirrored globally, with projections estimating a global CBD market value of £80 billion by 2026, according to Global Market Insights Inc.

Recent Expansion

WHAT DROVE THIS GROWTH?

Covid brought about a new level of focus on our health and wellbeing, not just to support our immunity and find alternatives to alcohol, but also as a tool to support our mental health in the face of global lockdown.

> *"As soon as the pandemic started, our immunity became the focus of everything… consumers are always looking for ways to make switches and be healthier"*
>
> **FREYA TWIGDEN**
> Founder of Fix8 Kombucha

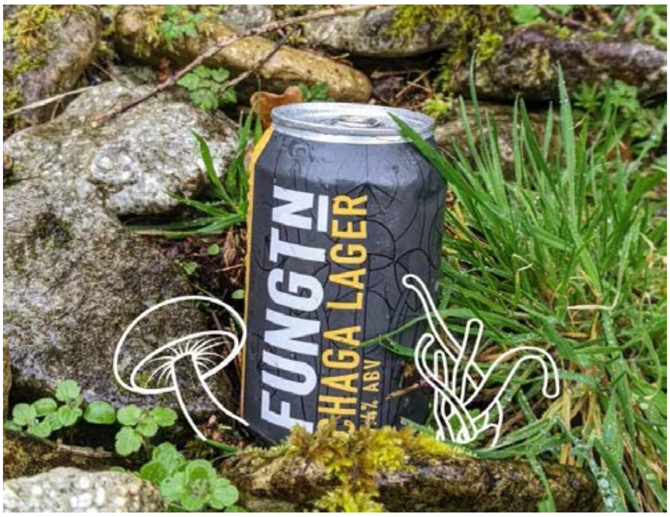

Image Credit: Fungtn via Instagram

Brands that can boast such benefits have a strong window to become part of consumers' lifestyles.

We have also seen the category moving into a more active and sociable space, no longer confined to the Off Trade and At Home: CBD and non-alcoholic drinks are now a growing section in On Trade menus, too.

But this does not mean success is guaranteed

> *"While consumers want to be healthier, they will always default to low calorie, cheap, tasty liquids and that's where the innovation needs to be"*
>
> **FREYA TWIGDEN**
> Founder of Fix8 Kombucha

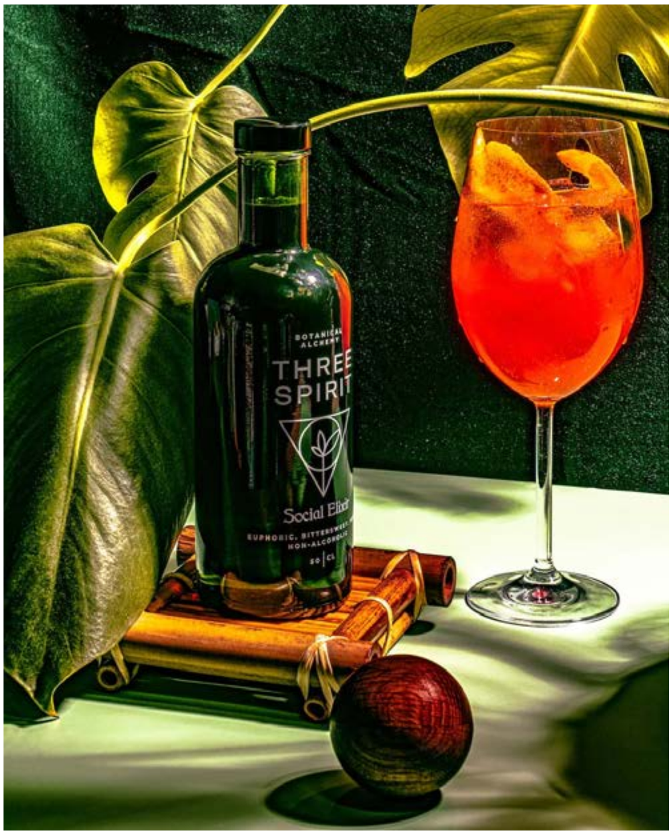

Image Credit: threespiritdrinks.com

> *"Are consumers willing to pay? Are folks going to show up at the bar? From an On Premise perspective, there's no question. And retailers are making space on the shelf – consumers are searching for the best products"*
>
> **HEIDI DILLON**
> MD North America at Distill Ventures

These categories are becoming more saturated; CBD has become a closed market in the UK, creating a temporary monopoly for approved brands; and the pandemic has put a strain on global economies. The cost of living is rising, reducing the opportunistic, exploratory purchasing patterns of consumers. All this means brands need to ensure they are delivering quality, appeal, approachability and benefit, all while avoiding a prohibitive price tag.

> *"ABV should not be the only carrier of value in this world"*
>
> **LAURA WILLOUGHBY**
> Co-Founder of Club Soda

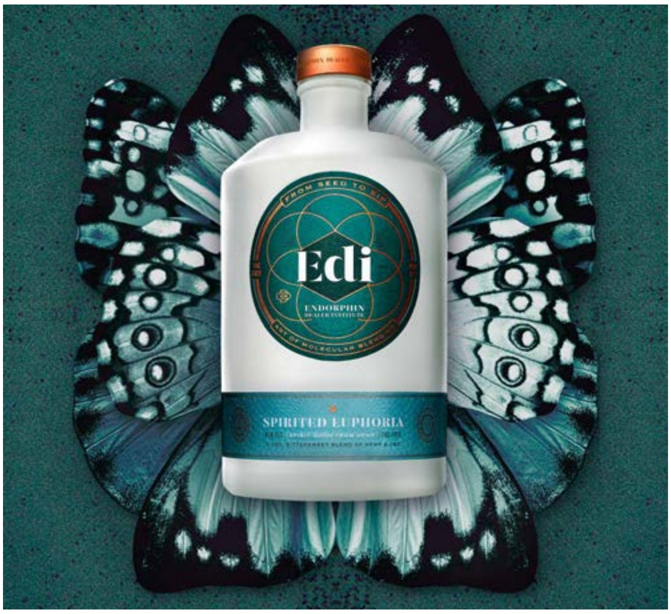

Image Credit: Edi via Instagram

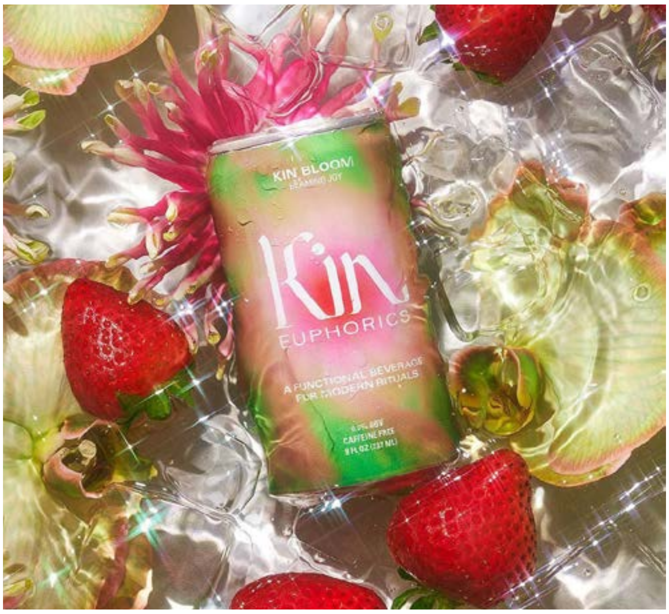

Image Credit: Kin Euphorics via Instagram

NOOTROPIC & ADAPTOGEN DRINKS

The latest trend to catch our eye is the growth of drinks using nootropics, adaptogens and other non-alcoholic stimulants like GABA – cognitive health drinks with active ingredients that influence brain and nervous system function for benefits to mood, focus, sleep, relaxation or sociability.

The opportunities for these brands are similar to those outlined for CBD and alcohol-adjacent: to capitalise on alcohol-alternative demand, with a more active effect on the brain and perceived slight mischievous appeal.

And with a less crowded product group, the right brands have the opportunity thrive.

But what they lack is clarity, category permanence and consumer understanding, leaving us at a tipping point where we could see these products rise or fall.

Image Credit: Sentia via Instagram

An issue of classification.

We see the solution as a mix of brand education, classification and legality.

Brands in this space define themselves in a range of ways including *active botanical spirits, euphorics, GABA spirits, endorphin spirits or an "alcohol-free buzz"*. But ultimately, they all fall under the classification of 'food supplements':

> *"any food the purpose of which is to supplement the normal diet, and which is a concentrated source of a vitamin or mineral or other substance with a nutritional or physiological effect, alone or in combination and is sold in dose form"*

This creates a barrier to entry for consumers who want to understand what they are drinking and what it will do.

It also creates an operational minefield for new brands, as they attempt to work with regulatory bodies like the FSA or FDA and navigate processes like Novel Foods Registration, to be able to sell their products. With the added complexity that the legal barriers vary between different countries, and a general lack of guidance from such boards on the application process, or even who is responsible for gaining approval (brand vs raw ingredient supplier).

> *"Within our bar, 70% of customers choose cocktails from the 'Mood-Boosting' section of the menu, compared to just 30% who opt for drinks from the non-alcoholic section"*
>
> **VAUGHAN YATES**
> Founder of The Virgin Mary Bar

The challenge to create clarity.

The preferred solution is often function-forward marketing, trumpeting the effect that products will achieve. This can be a powerful tool even in the On Trade, bridging the gap for consumers to understand what they're looking for and which products will work for them. But it must be done in the right way.

For example, the *"endorphin spirit"* brand Edi (Endorphin Dealer Institute) advertises that its products trigger "feelings of pleasure, without the downsides of alcohol"

Non-alcoholic brands may have the benefit of being able to use language like this, but brands like Edi exist in a grey area. While the category is new and relatively undefined, they can test is new and relatively undefined, they can test these boundaries, but as legal definitions and regulations begin to be established, this could be challenged.

> *"There's lots of studies, but very few effects are on a list of approved health claims. So we have to be careful what we say. Brands need to educate on their websites, blogs and social media – to talk about the benefits of the ingredients rather than directly about their brands"*
>
> **ZOEY HENDERSON**
> Founder of Fungtn

There is also a polarising impact to leading with function. Placebo can help to elevate the impact of the product itself, but it leaves room for consumers to be disappointed if it doesn't work the way they believe it will.

And as with CBD, legal restrictions vary between regions and countries, making it difficult to build a global brand presence and voice to overcome consumers' confusion.

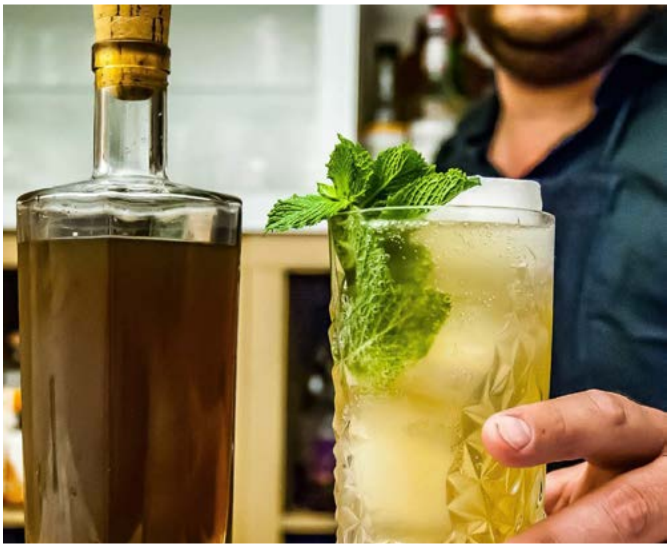

Image Credit: Johann Trasch via Unsplash.com

> *"Education is the biggest thing that we do – educating people on this new type of drinking"*
>
> **VAUGHAN YATES**
> Founder of The Virgin Mary Bar

SO WHAT IS THE SOLUTION?

Aside from pushing for more widespread acceptance of these products and establishment of proper categories with regulatory groups (a longer-term goal), we believe the key is a strong push by new brands and progressive venues for simple and clear communication.

Using friendly, approachable language that consumers can engage with, they need to communicate exactly what they are, the comparable benefits and how to make Functional Drinks part of a better lifestyle.

The benefits of this approach are already more obvious in the North American market where the category is more established and regulations around what brands can say is looser.
Good, clear communication has paved the way for a far greater expansion of the category.

> *"Even if your product is going to connect across the spectrum, you have to start somewhere. If it's for an adult beverage occasion – with sophistication, with food – then let's be that. Or it just ends up blurred for the consumer"*
>
> **HEIDI DILLON**
> MD North America at Distill Ventures

Section 3: The Current Playing Field

CATEGORY FRAMEWORK

Functional Drinks has become a rich and varied space, each area with its own opportunities and challenges. And we expect further diversification as brands seek to broaden their appeal by catering to more needs, blurring the boundaries between benefits.

With the arrival of products like hard kombucha (kombucha with a higher alcohol content) and probiotic beer in recent years, there's even the emerging question of whether alcoholic brands could have a role to play – but that's perhaps one for its own report.

For us, Functional Drinks are becoming increasingly defined by consumer need and the moments that prompt their consumption rather than by rigidly defined categories – a spectrum of products differentiated by the needs and benefits they cater to, from health to elevation.

> *"People go out as a treat. The idea that you can add benefits and a boost adds more reward, which people are looking for during an Out of Home occasion"*
>
> **LAURA WILLOUGHBY**
> Co-Founder of Club Soda

NEED

HEALTH ← → **ELEVATION**

Nutrition & Gut	Energy Drinks	CBD	Alcohol adjacent	Stimulants & Nootropics
Huel (Human + Fuel) Drinks designed to be nutritionally complete meals	**Red Bull** An energy drink to vitalise your body and mind	**OTO** Helping people discover the power of CBD through products that fit their daily lives	**Martini Vibrante and Floreale** Non-alcoholic vermouths to bring taste without compromise when moderating alcohol	**Sentia** Non-alcoholic drinks that provide the social benefits of alcohol using GABA, the amino acid associated with the positive effects of alcohol
NGX Nutri-Genetix Personalised nutrition drinks tailored to your DNA using technological advances in home testing	**Brite** Nootropic drinks that replace coffee for energy and boost productivity	**Prima Powder Blend Sticks** Powder sachets that combine CBD and active ingredients to suit your occasion	**Fungtn** Non-alcoholic beer brewed with functional adaptogen mushrooms to boost mind and body	**Kin Euphorics** Transforming the social ritual of drinking into a thoughtful act
FIX8 Craft kombucha with all the flavour and benefits of traditional fermentation in a category flooded with tame fizzy pop	**G Fuel** Creating the healthiest, most effective energy drinks for gamers	**Recess** CBD drinks that canned a feeling, helping to bring calm in a stressful world	**Three Spirit** Celebrating what goes into non-alcoholic drinks, rather than what you take out	**Edi** Non-alcoholic drinks to deliver functional effects and create the future of socialising

MOMENT

AT HOME ← → **AT HOME AND ON-TRADE**

With this overview of the category laid out, it is hard not to see it as an exciting and vibrant market. Despite the challenges that exist, there are several trends that demonstrate the current potential across key channels.

ON TRADE

In the last few years, we have seen non-alcoholic bars launching across the world: from Brewdog's Non-Alcoholic Beer Bar in London to the "0% Non-Alcohol Experience" bar in Tokyo; from The Virgin Mary Bar in Dublin, the city's first "wellbeing bar for mindful drinkers", to Glasgow's first all-CBD cocktail bar Tabac opened in 2020.

Even leading cocktail venues have been integrating more quality alcohol alternatives, with names like Mr Fogg's House of Botanicals and The Coral Room getting on board.

These venues have created elevated, educational and personalised in-venue experiences to guide exploration of these intriguing new ways to drink. In turn, they have shown that this enhanced social experience can drive the engagement and repeat purchase innate to the traditional alcoholic bar experience – leading by example, pathfinding for others to follow.

Brewdog - Off-Trade Fridge. Image Credit: brewdog.com

> *"We add drops of concentrated extracts to the drinks to boost the experience for people. Then we really do see a more amplified reaction"*
>
> **VAUGHAN YATES**
> Founder of The Virgin Mary Bar

Jen Batchelor & Bella Hadid. Founders at Kin's

OFF TRADE

Despite Covid's influence on temporarily reducing retailers' appetite for functional beverages, Whole Foods recently named 'Functional Fizz' and 'Buzz-Less Spirits' for the sober-curious as two of their top 10 predicted food trends for 2022. Health-conscious trends are here to stay and are an essential opportunity for brands to become staples.

NEW LEADERSHIP

This innovative new territory has attracted a greater diversity of brand creators, with backgrounds as varied as fashion (Kin), Formula E racing (Edi), science (Sentia) and even alpaca farming (Miraflora). Where Functional Drinks was once a playground primarily for multinationals or industry professionals, we have seen the arrival of a more nimble phase.

ANTICIPATING KEY TRENDS

From a UK perspective, the best indicator of what the future holds is North America, always a step ahead and dominating the global market at 39.5%, the largest share in 2020. We are now beginning to see some of its latest trends spill over, with the arrival of innovations like hard kombucha and cognitive health drinks set to see continued growth.

Australia may also provide an idea of where the UK Functional Drinks market is headed. Driven by strongly health-aware consumers, it has led the way in advancements in sports and energy drinks, with a high demand for more natural energy drinks, plant-based offerings and complete health solutions like the one-stop exercise beverage, BODIE'z Protein Water. We expect to see many of its innovations making their way to Europe.

Section 4: Case Studies

The flip side of this wave of innovation is the risk of drowning in the surge of a category constantly looking to do more.

We believe that clear education around benefit, alongside strong community engagement and lifestyle alignment, will be key ingredients for functional brands to succeed. To provide some inspiration, we have examined key case studies within each of our five categories to highlight brands that excel.

NUTRITION & GUT | FIX8 KOMBUCHA

Kombucha is one of the most competitive areas of Functional Drinks, but Fix8 has managed to stand out through quality and communication.

Its craft kombuchas are brewed traditionally for optimum flavour and gut benefits while delivering tantalising flavours like Strawberry Tulsi and Citrus Saffron.

It pulls away from the crowd by suggesting easy sophistication, with fun but premium branding and clear brand communication that advocates a wellness lifestyle.

All this is underpinned by its strong online presence that effectively communicates these benefits with an approachable start-up personality, delivered by founder Freya Twigden through social media and its website blog, *Fermentalism.* Freya regularly shares insights into the experiences of Fix8 team members and the wider family, key milestones for the brand, learnings about business, and honest advice about her explorations of gut health which help to demystify the role and importance of gut support.

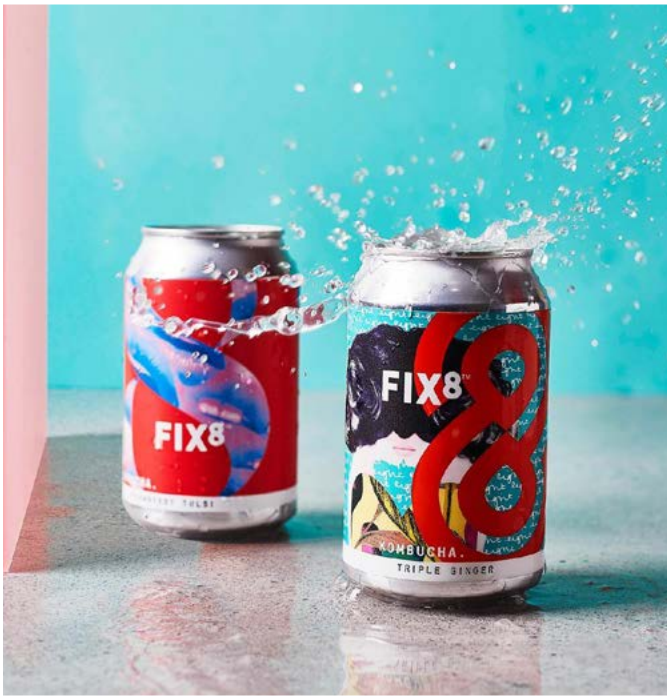

Image Credit: Fix8 via Instagram

Key Learnings

Fix8 brilliantly balances feeling like an approachable, well-crafted brand, backed up with well delivered education that speaks to consumers on a level that is digestible and informative and acknowledges their needs. This helps Fix8 to form a strong community and clearly communicate their value over the many other choices.

ENERGY DRINKS | G FUEL

Energy drinks can feel like one of the less innovative arms of the Functional Drinks category, but they present one of the strongest opportunities to integrate with a community.

Few brands have done this better than G Fuel, part of the new generation of energy drinks that have cut back on the sugar and built in vitamins, minerals and antioxidants to provide a healthier option.

The strength of the G Fuel brand is its strong community focus on gamers through e-sports. Every level of the brand from the ground up, from packaging to flavour naming, has been developed with its audience in mind. The brand has then amplified this by sponsoring key e-sports tournaments, content creators and gamer organisations to spread the word and place its products as a key ingredient for success within a highly competitive community.

G Fuel has integrated all these collaborators to form a community around the brand, promoting partners' content and profiles within the website and even creating custom flavours and shakes with high profile members for fans to buy.

Key Learnings

G Fuel's strength is in building a brand that feels like the product of a community that celebrates its people.

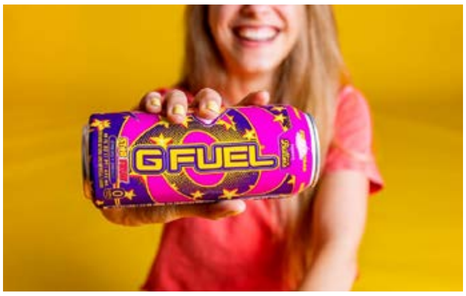

Image Credit: G Fuel via Instagram

CBD | *RECESS*

Aligning to a feeling or mood is common practice for CBD brands, promoting the mind- and body-balancing effects for which CBD is reputed to drive a moment or mood.

For us, perhaps the brand that most excels at this is Recess. Its ready-made drinks and mix-for-yourself powders are positioned to help people feel "calm, cool and collected", having "canned a feeling" for people to enjoy.

What sets Recess apart is its attention to detail, layering and consistency of messaging, building a sense of calm into every element from its colour scheme to its fonts and even its website layout.

The brand carries this perfectly into social media, playfully advocating for a lower stress life and promoting the value that taking a pause can have on your wellbeing – a theme embodied through activations like its *Recess IRL* pop-up in 2019, an oasis where New York creatives could come to unwind. The branded space featured drinks fridges, a mini Zen garden and free themed talks on mental wellbeing.

Key Learnings

Recess has taken the opportunity to focus on mood and moment a step further by weaving it into the fabric of the brand wherever it shows up for consumers. The result is an almost instantaneous understanding of, and connection with, the brand and its functional benefits, creating an alluring hook for customers

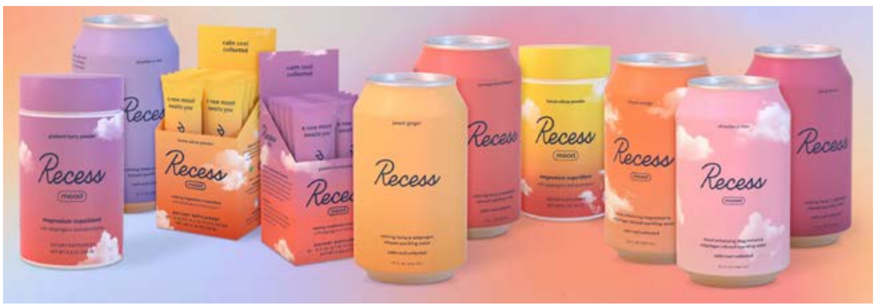

Image Credit: Recess via Website

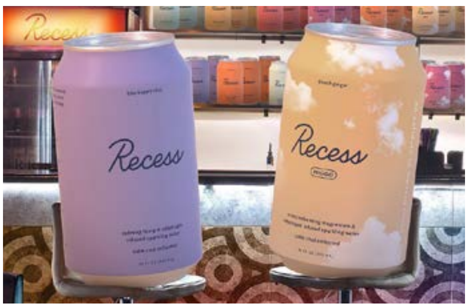

Image Credit: Recess via Instagram

ALCOHOL-ADJACENT | THREE SPIRIT

The common barriers that non-alcoholic spirit brands face when engaging with consumers are justification of price point, quality, benefit and depth of flavour. Three Spirit embraces these challenges and uses them to its advantage.

Each of its core products leads with its functional benefit – Livener, Social Elixir or Nightcap – as a simple proposition. The brand then leans heavily on the quality ingredients it uses, their role in flavour and adaptogen properties, and the way the ingredients are crafted together by "a blend of plant scientists, world-class bartenders, hedonists, herbalists and artists".

Every facet of the brand, from its messaging to its packaging, tackles the barriers, repeatedly providing evidence that its products deliver on quality and benefit. Three Spirit also carries this attitude through into its physical events, with activations like a Dry January mixing masterclass in partnership with the team at Lyaness bar in London further solidifying quality associations.

Key Learnings

By understanding the limitations of the category and addressing key concerns, a core element of its communication, Three Spirit has created a brand that feels premium, intriguing and crafted.

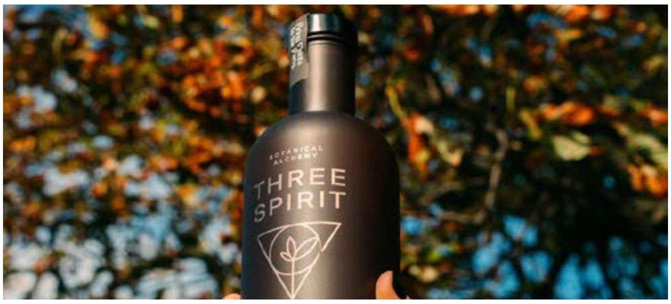

Image Credit: Three Spirit via Instagram

Image Credit: Kin Euphorics via Instagram

STIMULANTS & NOOTROPICS | KIN EUPHORICS

Though nootropic and adaptogen drinks are still finding their place in the market, one of the brands that has stood out for most for us so far is Kin Euphorics.

The brand adopts a vivid, energetic, new age feeling brand world, promoting a new era of drinking as a social ritual. The vibrant, haptic and almost psychedelic imagery and video content it shares teases the euphoric, stimulated functional benefit its products promise.

Kin's strong and distinctive identity helps it stand out and also drives a sense of mysterious appeal – anticipation for what the drinks will do that generates an escapist appeal.

In social media and online, this comes together with a playful, yet premium, wellness lifestyle, pushing its integrated role in a better way of life alongside other wellness rituals like meditation and digital detoxing. Kin even sells a 2-Week Reboot bundle on its website, reinforcing the lifestyle connection.

But it's not just on online. Kin's lifestyle appeal is boosted in person by co-founders, Jen Batchelor and Bella Hadid, who use their connections in luxury and fashion to host events and launch parties, like recent ones for New York fashion week, that attract some of the world's top trend leaders.

Key Learnings

Kin has managed to break away from the crowd in the emerging nootropics drinks space by creating a mysterious, alluring brand and a strong lifestyle alignment, piquing consumer interest and helping to lower the category's barrier of confusion. This sense of excitement gives the brand more energy than some of its competitors, though it remains to be seen whether this style of messaging will endure as the category matures.

Section 5: Woderworks Take-Outs & Conclusions

We are in the middle of a transformational period for Functional Drinks. There are issues, but even so, there has never been a more exciting time to be part of the category. What do we expect to see in the next few years?

OUR 8 KEY LEARNINGS FOR BRANDS

01

The Growth Continues

Recent forecasting has projected that the global functional beverages market is set to almost double in value between 2020 and 2030. We expect to see consumer appetite for new and exciting brands continuing to drive a blossoming of new brands and a growing role for Functional Drinks at social occasions.

02

A Focus on Education

To cultivate the essential ingredients of familiarity and understanding, we hope to see brands prioritising education to establish the identity of this new category. Messaging will need to reach not only consumers but also retail buyers to help them appreciate the opportunity, ensure effective communication in store, and encourage listing, despite the many commercial hurdles smaller functional drinks brands often face, that stem from a lack of preservatives, limited marketing budgets etc.

03

Regulation Barriers

While consumer education is vital, continued pushes with regulatory administrations to establish defined categories for new functional drinks, register new ingredients and lift the current closed market state on CBD, will all be essential steps to permit further growth.

04

Continued On-Trade Expansion

Driven by expanded appetite and better consumer familiarity from brand education, we expect to see an increased role in the On Trade in both Lo and No sites and leading cocktail bars, following the pioneering venues that have led the way and expanding beyond existing non-alcoholic offerings.

05
Following Example

Following success in overseas markets, we expect to see the UK adopt various trends including hard kombucha, more advanced sports drinks (Australia) and exploration of nootropic and adaptogen drinks (US).

06
Further Blurring of the Boundaries

The world of Functional Drinks has become an intricate place and we expect to see more brands looking to offer more functions to their products.

07
Leadership of Entrepreneurs

Among newer brands, there is significant opportunity to connect with consumers who increasingly expect transparency, a personality they can engage with directly and a community to be part of online.

08
Embracing the New Power of DTC

Direct-to-Consumer sale was an navoidable reality for brands during the pandemic. Although it is often less profitable, particularly for smaller brands, we expect to see continued activity for the value of its data capture, using data to better map, understand and communicate with communities.

*We hope you have enjoyed this report –
maybe you even savoured a functional tipple as you read?*

*If the topic has sparked your creativity as much as it did ours,
please don't hesitate to reach out.*

wonderworks