

A Case of the Vapors

Personal vaporizers becoming more than a wisp of the electronic segment

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Only a few years ago, the electronic-cigarette segment was barely a consideration in retailers' product sets. And now that it's one of the hottest sub-categories in the industry, some of its offshoots are also catching fire.

Last summer, RBC Capital Markets tobacco analyst Nik Modi noticed a distinct shift away from these cig-alike products and toward the larger, often more expensive personal vaporizer units (also known as tanks and eGo units) that allow consumers the luxury of customizing and filling their own flavored e-liquids.

Sure enough, a Google Trends search of "electronic cigarettes" and "vape shops" confirmed Modi's suspicions: While searches on electronic cigarettes are starting to decline, searches on vape shops are surging.

"You can see a significant cross around June of 2013, where the interest in vape shops actually outpaced the interest in electronic cigarettes," Modi said in a December 2013 Tobacco Update webinar hosted by CSP.

Beyond online searches, Modi reported that RBC's own research shows this segment is far more than

just a niche trend.

"Based on the consumer work we've done so far in this area, it's catching on like wildfire," he said.

Vaping-centric lounges and shops have been taking advantage of this growing opportunity; Modi estimates that 3,000 such establishments have popped up across the United States. But the convenience channel has been hesitant to embrace it.

"That will never sell in a c-store"; "It's too expensive"; "It's too complicated": These are just a few of the protests heard by Lou Maiellano, president of Sevierville, Tenn.-based TAZ Marketing & Consulting Group, when he brings up the vaporizer segment. The protests are similar to what Maiellano heard when electronic cigarettes first burst onto the scene.

"[A retailer who says this] is putting themselves in a box—the same box we experienced in 2008 with e-cigarettes," Maiellano says.

One of the biggest misconceptions about vaping products is the cost. As with electronic cigarettes, technology advancements have allowed the once-high price point of tank systems to drop significantly.

"Vapor kits used to sell for about \$100 to \$150," says Kevin Fija, CEO of Vapor Corp., Dania Beach, Fla. "Until recently, we were one of the only companies to



Liquid Gold: E-liquids boast a great value for consumers: A pack of cigarettes' worth of e-liquid retails for less than \$1. It also offers the option of mixing custom flavors and nicotine strengths.

bring them down to under \$50.”

While Vapor Corp. has been in the tank business with its Vapor X line for about two years, many of the e-cig companies that c-store operators already do business with are now developing vaporizer lines. 21st Century Smoke has Vapin Plus, and Crown 7 has the Gladiator. V2 CEO Andries Verleur hinted that his Miami-based company will also enter the vaping market.

“A significant number of electronic-cigarette companies and tobacco companies that are in the industry are seriously taking a look at this segment,” says Maiellano.

As co-founder of the New York-based Henley Vaporium—one of the many vapor lounges making millions off the segment’s popularity—Peter Denholtz is not at all surprised to see this trend becoming more mainstream.

“It’s going to become its own category, it really is,” he says.

But how big will that segment really be? Are these vaporizers the next evolution of the electronic industry, or merely a fleeting fad?

Tank Appeal

One reason behind the confidence Denholtz and others have is the number of perks vaping products offer consumers. Somewhat surprisingly, being more economical is one of the segment’s biggest benefits.

Yes, there’s an initial investment for the units themselves. But Maiellano doesn’t see this as a barrier, especially as the public becomes more educated about vaping.

“Consumers have already proven they’re willing to spend on this segment,” he says. “They already spend \$34.99 on a blu kit.”

And that initial price point is drop-

Vaping Lingo 101

Want to talk vape? Here are some terms you need to know:

Vaporizer: A device that vaporizes a substance (typically a liquid form of nicotine) for inhalation. Like electronic cigarettes, they usually include a battery and an atomizer; however, instead of a cartridge, a tank unit stores the liquid nicotine. *Also known as: hardware, personal vaporizer, tank, eGo unit, mod, vape pen.*

E-Liquid: Liquid used in vaporizers, usually containing propylene glycol and/or vegetable glycerin, nicotine and flavoring. *Also known as: software, juice, e-juice, smoke juice.*

Vaping/Vaper: The act of consuming/one who consumes nicotine vapor via an electronic cigarette or a larger vaporizer unit.

Vapor Lounge: A location aimed at attracting the vaping community that’s part retail, part education, part hangout. Patrons are encouraged to try (and purchase) vaporizers and e-liquids in trendy environments that also often offer coffee and free Wi-Fi. *Also known as: vape lounge, vapour lounge, vaporium.*

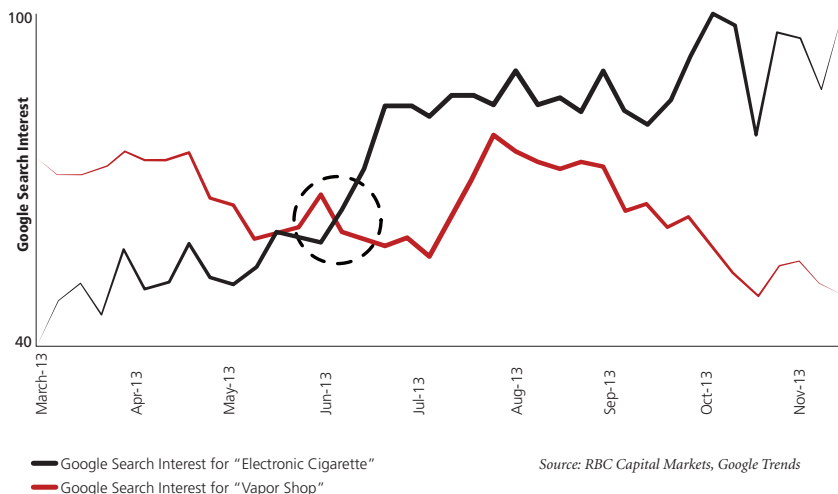
Vapor Shop: The all-retail counterpart of the vapor lounge, typically boasting more products, with less emphasis on hanging out. Many vaporizer manufacturers are offering retailers the option of turning part of their existing locations into a mini-vapor shop. *Also known as: vape shop.*



Familiar Faces: Many well-known electronic cigarette companies—including 21st Century Smoke, Vapor Corp. and V2—also offer vaporizer products at c-store-friendly prices.

Setting a Trend

A Google Trends search conducted by RBC Capital Markets showed interest in vape shops (with 100 being peak interest) is surging, and it surpassed interest in e-cigarettes.



ping: Vapor Corp. now has a tank kit that retails for just \$20.

"The consumer really gets their money back within the first month," Frija says, "because the e-liquids are that much less than the cartomizers."

As much as rechargeable electronic cigarettes offer a better value than disposable units, e-liquids go that much further. While price points vary depending on the amount of nicotine and quality of the juice, Frija estimates it costs about \$3 for a cartomizer replacement as opposed to \$1 to refill a tank. (Like cartomizers, a tank refill typically represents about two packs of cigarettes.) Denholtz' high-end liquids cost roughly \$2 per refill.

"Financially, it's so worth it," Denholtz says.

Besides savings, these e-liquids allow consumers the kind of customization more akin to the Coca-Cola Freestyle machine than RYO. Vapers can experiment not only with a wide variety of flavors, but also the levels of nicotine (which range from the levels found in Marlboro Reds to no nicotine at all).

This customization is such a huge part of the vaping scene that Denholtz has heard of enthusiasts who concoct their own "bathtub e-liquids." For those not as die-hard, vaping lounges such as Henley employ "vapologists" who help visitors mix up an e-liquid combination perfectly suited to their individual tastes.

But perhaps the biggest differentiation of the vaping segment is the quality of the vapor, thanks to larger batteries, on/off buttons and innovative designs.

"Consumers want a lot of vapor, and they get it out of this product," Modi said in December. "The draw on the actual vaporizer is much easier than the current branded e-cigarettes on the marketplace."

This improvement in quality represents true innovation, the kind consumers seek. "The difference with these eGo units isn't packaging or marketing; it's an advancement in technology," says Maiellano. "You've got a high-powered battery that's going to deliver much more vapor."

"Ultimately," adds Frija, "you get a better product, a better experience, and the cost is equal or less."

All of which leaves vaporizers perfectly poised to make the leap from niche to mainstream—at least in theory. "[Vaping] has all the consumer dynamics that are en vogue in today's day and age, especially the customization," Modi said. "The question now becomes: Will regulations come in and put a stop to it?"

Legislative Loopholes

As with electronic cigarettes, vaping products are currently unregulated. Nobody expects the legislative free-for-all to last much longer, but unlike electronic cigarettes, the question isn't how the U.S. Food and Drug Administration (FDA) will regulate vaporizers but if they can regulate vaporizers. This uncertainty stems from the fact that the tank units are sold independent of nicotine (e.g., e-liquids).

"I'm not sure what the government can do about it," said Modi. "The nicotine is sold separately from the vaporizer, so there's a lot of gray area. Does the FDA have purview or not?"

"It's hard for [the FDA] to regulate a product that doesn't contain anything," says Denholtz, echoing Modi's sentiments.

Muddying the waters is the fact that many e-liquids on the market do not contain much nicotine, and some none at all. If a product is free of both tobacco and nicotine, how can the FDA's Center for Tobacco Products (CTP) enforce tobacco-related regulations?

This exception could be crucial if the FDA were to enforce a flavor ban.

"With a vaporizer, you could have unflavored e-liquids with nicotine, but then you could add flavors that don't have nicotine in it," Frija says. "The FDA really doesn't have jurisdiction over nicotine-free flavoring; it's something consumers can do themselves."

Maiellano agrees: “If there’s no nicotine in the product, the FDA (theoretically) will have no control over it. I still think a lot of things are cloudy, but can they rule on an eGo unit?”

Taxation is another area in which vaporizers stand to benefit from the split of hardware and software, because the vaporizers themselves do not contain any nicotine. So while a state or federal tax on nicotine could be applied to the already low-cost e-liquids, the higher-priced tank units would be exempt from anything besides a sales tax.

“You’re really in a segment that alleviates that issue,” Frija says. “From the regulatory side, from the taxation side, the vaporizer trend is great all around for the consumer and the industry.”

C-Store Opportunities

With the law seemingly standing to benefit vaporizers, Maiellano believes now is the time for retailers to vape, even if they’re fully entrenched in the electronic-cigarette business.

“It’s absolutely something convenience stores should be looking at,” he says. “If you’re not doing it already, you’re behind the curve. There’s constant change within the industry, and I think people need to be careful about pigeonholing themselves to one product.”

Several high-profile chains that Maiellano works with as a consultant are preparing to go “all in” on vaping. One retailer is even bringing in the high-end Ploom line, which has found success by vaporizing not only e-liquids, but also

actual tobacco, waxes or herbs.

Even if a retailer is hesitant about such a robust rollout, e-liquids provide an easy—and potentially very profitable—option for dipping a toe in the proverbial vaping waters.

“If a retailer made the mistake of hesitating on electronic cigarettes, they should not make that same mistake again,” Frija says. “There’s no question that the majority of people who are smokers are going to switch to electronic cigarettes and vaporizers—and if you don’t have those products, they’re going to go somewhere else to find them.”

Which wouldn’t be a huge problem if vaporizer products appealed only to a small market of enthusiasts. However, with all the upsides and with more consumers willing to embrace nicotine-delivery systems that don’t look anything like combustible cigarettes, vaporizers are starting to prove their staying power.

“I still think electronic cigarettes are a long-term, viable product and will maintain a position in the market,” says Frija, who once predicted only 5% to 10% of e-cig consumers would upgrade to tank systems. “But I’d now say there’s a good chance some people may skip the electronic cigarettes altogether [and go straight from combustible to vaporizers].”

Still, considering the rate of innovation for both vaporizers and more traditional electronic cigarettes, it’s difficult to anticipate which products will fly off c-store shelves in 10 years’ time.

“The industry is constantly changing,” Maiellano says. “We don’t know what products will be obsolete tomorrow and we don’t know what new products will be introduced tomorrow.”

But for today, vaporizers represent a solid prospect. Why let vape shops reap all the benefits? ■



Lounging Around: The Henley Vaporium in New York’s SoHo neighborhood lets vaping enthusiasts and newbies experiment with new products and flavors.