

Case 29 Keurig Coffee*

On November 3, 2008, Michelle Stacey was appointed president of Keurig, Inc., a wholly owned subsidiary of Green Mountain Coffee Roasters, following the resignation of Nicholas Lazaris. Stacey joined Keurig with more than 20 years of experience as a senior executive in marketing and global business management with the Gillette Company and then as the vice president and general manager of Global Professional Oral Care with Procter & Gamble. Speaking of Stacey's appointment, Lawrence J. Blanford, Green Mountain Coffee Roasters (GMCR) president and CEO, said, "I am extremely pleased that Michelle will be joining the team at Keurig and GMCR. Michelle has an impressive track record of success in organizational leadership, strategic planning, global marketing and supply chain management at major Fortune 500 companies and leading consumer brands. Her depth of experience with and understanding of, consumer package goods and technology-oriented products with a razor/razorblade business model are perfectly suited to our strong platform for growth at GMCR and Keurig."¹ Michelle Stacey faced several potential challenges at Keurig including transitioning Keurig from a technology-driven to a marketing-driven company, maintaining the entrepreneurial and innovative culture at Keurig, Inc., expanding the distribution network for Keurig, and dealing with potential elasticity-of-demand concerns given the retail prices of Keurig's at-home products and decreased consumer spending.

Coffee Consumption in the United States

The U.S. annual per capita consumption of coffee was estimated to be 424 servings, which included in-home and out-of-home roast and ground, instant, and ready-to-drink (bottled/canned) coffee.² The total coffee market in 2008 was estimated to be 1.8 billion pounds, or \$19.3 billion.³ Although coffee consumption had remained relatively flat over the past few years, a consumer survey by the National Coffee Association revealed that the percentage of people drinking gourmet coffee on a daily basis increased from 14 percent in 2007 to 17 percent in early 2008.⁴

While specialty coffee was only about 17 percent of total domestic coffee consumption by volume, the sector had grown to over half the value of the U.S. coffee industry.⁵ The specialty coffee market was estimated to be worth \$11 billion annually.⁶ Specialty coffee consumption had increased over 48 percent in the United States from 2001 to 2006.⁷

*This case was prepared by graduate student Keith F. Moody and Professor Alan B. Eisner of Pace University as a basis for class discussion rather than to illustrate either effective or ineffective handling of an administrative situation. Material has been drawn from published sources. Copyright © 2009 Keith F. Moody and Alan B. Eisner.

"Pod" Brewing Market

While the entire category of coffee-maker sales posted a 3 percent drop in 2008 as compared to 2007, sales of single-serve (pod) units increased 50 percent. Although machines that make single-cup brews accounted for just 6 percent of the 90 million brewers in U.S. homes, the trend was gaining momentum as consumers were trading old-school coffee pots for machines that made gourmet coffee at home. Approximately 18.5 million coffee brewers were sold each year in the United States, and Keurig's goal was to convert half of the 90 million American homes with coffee brewers to Keurig brand pod brewers.⁸ As recently as 2007, research by the NPD Group indicated that the single-serve proposition wasn't compelling enough for consumers to replace their existing coffee makers with pod machines. NPD's research indicated that a significant proportion of purchasers were unsatisfied and cited unreliable machines as a problem as well as the coffee itself. The pods available, consumers complained, were pricey, often hard to find, and limited in terms of flavor and blends. In its survey, the NPD Group found that some consumers were dissatisfied with the performance of pod machines, with 17 percent of machines returned, thrown out, or given away. John Block, director of the NPD Group, said, "Manufacturers and retailers have a great opportunity to improve their position in the marketplace by listening to consumer feedback, and integrating all three attributes that customers want most into their product offering: a reliable pod machine, easy-to-find refills and a variety of coffee flavors."⁹ According to NPD, Keurig was the leading single-cup brewing system in the at-home market, with 82 percent of the market in terms of dollar sales and 81 percent in terms of unit share as of December 31, 2008 (see Exhibit 1).

A MultiChannel Strategy for the Away-From-Home Market

Keurig initially focused on the away-from-home (AFH) commercial segment of office users. Increasing demand and brand awareness enabled Keurig to pursue a multi-channel strategy, providing widespread exposure through consumer trial. Starbucks and other specialty coffee purveyors had laid the groundwork for launching into the AFH office coffee service (OCS) market by educating consumers about gourmet coffee and moving coffee beyond the commodity category. Starbucks may be responsible for a paradigm shift regarding the price elasticity of coffee. The price elasticity impacting consumer purchases of Robusta coffee by the can shifted with the proliferation of fresh-ground Arabica beans served in a coffeehouse, often for \$2 or more per cup. This paradigm shift enabled Keurig to offer a single-cup brewing system to offices, capitalizing

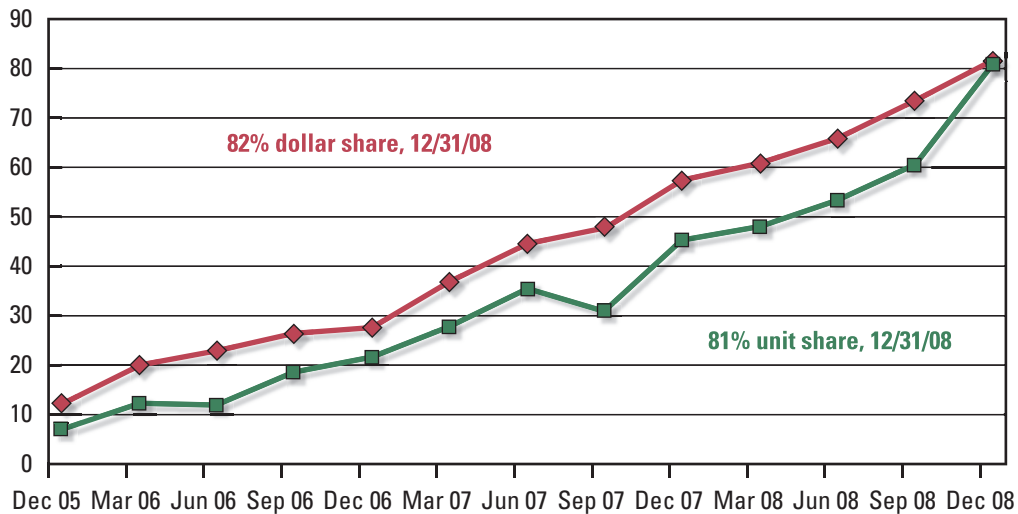


Exhibit 1 Keurig: Number One in Single-Serve at-Home Market

Source: NPD data. Keurig Inc.

on consumer demand to replicate coffeehouse-quality java in the office.

There were approximately 2.6 million coffee brewers in offices nationwide, serviced by a network of approximately 1,700 distributors. Of those offices, GMCR estimated that 12 percent had single-cup brewers and that about half of them were Keurig brewers.¹⁰ While Keurig brewers were estimated to be in 30 percent of offices in New England, national penetration in the office channel was only about 6 percent.

Keurig continued working with its network of Keurig authorized distributors (KADs) to execute office acquisition plans and conduct lead generation, demonstrations, and sampling programs to build Keurig's office coffee business. In addition to Keurig's traditional distributor network, customers such as Office Depot and Staples were helping Keurig grow through their business-to-business solutions for both large- and small-office applications.

Another AFH single-serve opportunity Keurig identified was the hotel market. There were approximately 5 million coffee makers in hotel rooms across North America. Keurig believed that 40 percent of those rooms catered to travelers who would appreciate the benefits of single-serve brewing. The Keurig team went through a rigorous process to develop new brewer concepts for the market. The development of a new "hotel in-room" brewer was one example (see Exhibit 2).

Single-Cup Brewer System Competition

Consumers had many single-cup brewing systems to choose from in North America and throughout the world. Competition in the single-cup brewing system market was increasing as relatively low barriers to entry encouraged new competitors to enter the market, particularly with lower-cost brewers that brewed coffee packaged in

nonpatented pods. Many current and potential competitors had substantially greater financial, marketing, and operating resources than did Keurig. According to Keurig, its primary competitors were Flavia Beverage Systems (manufactured by Mars), the Tassimo beverage system (manufactured and marketed by Kraft), the Senso brewing system (manufactured and marketed by Philips and Sara Lee), and a number of additional single-cup brewing systems and brands. Kraft's Tassimo system was made primarily for at-home use, while the Mars's Flavia system targeted offices.

In a January 2009 *Consumer Reports* article on coffeemakers, pod machines were covered. The article stated, "With pod machines you simply drop in a sealed packet of coffee—no grinding, no scooping, and no mess. But many lock you into the company's coffee, which tends to be pricey, and the results have been unimpressive." According to *Consumer Reports*, "Cuisinart's Cup-O-Matic SS-1, \$200, did best among the pod models tested. It took standard pods or your own grind and lets you pick regular or bold in five cup sizes. It was reasonably quick: about three minutes for the first cup, one minute thereafter. But the model occasionally leaked extra water into the cup, diluting the coffee." *Consumer Reports* also tested the Keurig Breville BKC600XL, \$300. The article commented that the Keurig machine "accepts any K-cup as well as loose coffee grounds. It was fairly quiet but that first cup takes almost four minutes." *Consumer Reports* recommended, "If you want coffee for one in a hurry and you insist on the neatness and convenience of a pod machine, consider the Cuisinart for its flexibility and speed. Otherwise, we recommend our top-scoring to-go model, the Melitta Take2 ME2TM. It's quick, brewed superbly, and costs just \$25." (See Appendix A for a review of the 10 top-selling single-serve coffee makers, as of December 2008.)

THE STEPS TO BRINGING A KEURIG® BREWER TO MARKET

The Keurig team goes through a rigorous process to develop new brewer concepts and bring them to market. Our development of the B130 hotel in-room brewer is a good example.

- 1** The process started with a marketing analysis of industry segments that might benefit from gourmet single-cup brewing. Hotel made sense, as for gourmet coffee in-room, and Keurig's speed and convenience would be attractive to guests.
- 2** Next came meeting with hotel companies to get customer feedback. Keurig placed commercial brewers in several hotels, free of charge, to capture guests' experiences with the brewer.
- 3** Armed with this insight, the Keurig marketing team developed a detailed specification for an in-room hotel brewer. Key factors were identified, such as brewer size (it needed to be small), and a design to avoid having water remain in the brewer between guests. The Keurig engineering team kicked into high gear to determine new technology needed for a hotel room brewer, then designed an engineering prototype.
- 4** Now the fun could begin: product ID work. Keurig takes the look and feel of its brewers very seriously. Several have won design awards. Keurig's outside product ID firm presented dozens of potential looks for the in-room brewer. Once a design was chosen, it was time to turn the product over to Keurig's manufacturing partners.

The result? A brewer that has been a major success and is now found in over 40,000 hotel rooms in North America!



Exhibit 2 Keurig Hotel in-Room Brewer

The History of Keurig

Taking its name from the Dutch word for “excellence,” Keurig was launched in 1990 by Peter Dragone and John Sylvan with the belief that coffee should always be served fresh, whether at home or at the office, just as in a gourmet coffeehouse. Dragone and Sylvan noticed that people were leaving the office in search of a fresh cup of coffee and asked themselves, “Why do we brew coffee by the pot when we drink it by the cup?” From this question, the revolutionary concept of Keurig K-Cup portion-pack brewing was born. In 1994, Keurig secured a patent and came up with a prototype. Two venture-capital firms kicked in \$1 million and gave Dragone and Sylvan one year to prepare a model for mass production. When they missed the deadline, the venture capitalists offered more money but demanded that Nick Lazaris, a veteran executive who once served as chief of staff to West Virginia governor (now senator) Jay Rockefeller, be brought on. In 1998, after eight years of development, Keurig released an industrial-strength, single-serve

machine that delivered a perfect cup of coffee or tea every time.

Keurig was a technology company in the coffee industry. Keurig brewers represented a fusion of technology and design. To maintain and enhance its position as a leader in the gourmet single-cup market, Keurig invested significant resources and capital in engineering and research and development. This led to a strong and growing portfolio of market-leading, proprietary technology. Keurig's integrated engineering team drove fast and innovative product development in all three areas that supported Keurig's single-cup system: brewers, portion packs, and high-speed packaging lines that manufactured the portion packs. Keurig's integrated approach to new product development has resulted in accelerated new product launches since 2004. Keurig employed over 30 degreed engineers from varied disciplines. The engineering team at Keurig included mechanical, software, and nutritional science, as well as quality assurance and industrial engineering. As of 2009,

Keurig held 26 U.S. and 65 international patents covering its portion packs, packaging line, and brewer technology (72 were utility patents and 19 were design patents), and Keurig had additional patent applications in process. The Keurig system was based on three fundamental elements:

1. A patented and proprietary portion-pack system (K-Cup) that used a specially designed filter and was sealed in a low-oxygen environment to ensure freshness (see Exhibit 3).
2. Specially designed, proprietary high-speed packaging lines that manufactured K-Cups at the coffee roaster's facilities using fresh-roasted and ground coffee (or tea).
3. Brewers that precisely controlled the amount, temperature, and pressure of water to provide a consistently superior cup of coffee or tea in less than a minute when used with K-Cups.

Keurig's patented system eliminated the need to measure coffee or water—the two primary culprits for suboptimal java. With the Keurig system, pressurized hot water was filtered through a small plastic pod, called a K-Cup, that combined both filter and coffee (see Exhibit 4).

Keurig maintained a sizable quality control team to assist engineering in establishing quality standards; to communicate standards to all manufacturing partners, roasters, and suppliers; and to audit compliance with Keurig's established standards. The company's emphasis on quality products, easy-to-use features, and innovative technologies earned Keurig high marks in customer

satisfaction, with 94 percent customer satisfaction from tracked brewer purchasers.

A licensing agreement enabled Green Mountain Coffee Roasters to package its high-quality Arabica beans in Keurig's patented container, the K-Cup. GMCR started distributing the new single-cup Keurig premium coffee system to office coffee service and food service providers in 1998. GMCR and Keurig sold the system through select distribution channels. The system featured the single-cup Keurig brewer and eight varieties of Green Mountain coffee, including blends, flavored, decafs, and estate coffees. Keurig's K-Cup packaging guaranteed that each cup of coffee was as fresh as "the first cup of every pot." Keurig's strategy to gain market share in the office market was to sell machines to distributors and encourage them to give the machines away or lease them for a small fee. The economics of the strategy worked for distributors because the real profit was in selling K-Cups. If an office went through 30 or 40 K-Cups per day, a distributor recouped the cost of the machine in less than six months of K-Cup sales.

When Keurig launched its first single-cup brewer for the office market in 1998, it partnered with Green Mountain Coffee to manufacture and sell Keurig's patented K-Cups. Although Green Mountain Coffee was the first roaster to sell its coffee in Keurig's single-cup brewing system, by 2003 GMCR was competing for Keurig's sales with three other North American roasters: Diedrich Coffee, Timothy's, and Van Houtte, a vertically integrated roaster and office coffee distributor in Canada and the United States. Since 2003, Keurig has licensed several additional coffee roasters to package gourmet coffee and teas into K-Cups, all of which paid royalties to Keurig based on the number of K-Cups shipped. For each K-Cup shipped, roasters paid



Exhibit 3 The Keurig K-Cup

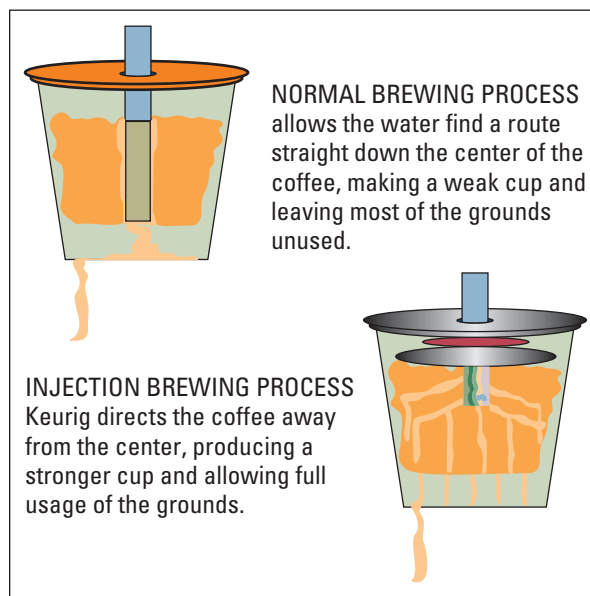


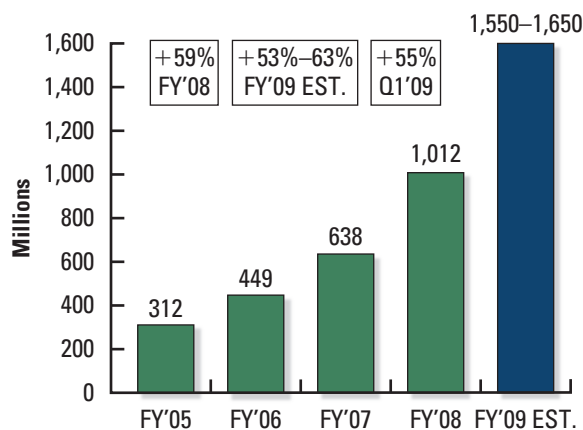
Exhibit 4 Normal versus Injection Brewing Process

Keurig a royalty of approximately \$.04. This unique licensing-agreement system enabled Keurig to offer the industry's widest selection of gourmet-brand coffees and teas in a proprietary single-cup format. The wide coffee selection proved to be a key differentiator for Keurig's brewing system. Consumers could choose from 11 gourmet brands and over 130 varieties of coffees and teas in K-Cups. As of 2006, more than 1 billion cups of Keurig Brewed coffee and tea had been consumed since Keurig launched in 1998.¹¹ Green Mountain Coffee continued to be the leading K-Cup roaster, accounting for 57 percent of K-Cups shipped in fiscal 2008.¹² As of 2008, more than 2 billion K-Cups had been shipped since 1998 (see Exhibit 5).¹³

In 1998, GMCR held a minority investment of less than 5 percent in Keurig, Inc. This partnership with Keurig developed into an important growth driver in fiscal 2000, as the unique Keurig one-cup brewing system gained momentum in the marketplace. K-Cup sales made up 15.7 percent of total sales at GMCR in fiscal 2000. GMCR's partnership with Keurig continued to be an important growth driver in fiscal 2001, with K-Cup sales accounting

for 20.4 percent of total revenue for GMCR. Keurig's ownership structure changed in 2002 as a result of agreements with GMCR and Van Houtte. Keurig sold stock to Van Houtte, raising \$10 million to seed Keurig's at-home business launch. The investment secured Van Houtte a 28 percent ownership position in Keurig. Simultaneously, GMCR invested \$15 million, by acquiring and executing stock options, to purchase 42 percent of Keurig. As a result of these strategic moves, GMCR and Van Houtte joined Memorial Drive Trust (MDT) as the top-three shareholders of Keurig. MDT, an investment advisory firm, had been the primary venture investor in Keurig since 1995 and led Keurig's board of directors. Separate shareholder agreements with MDT, however, restricted both GMCR and Van Houtte from holding a seat on Keurig's board of directors. In a 2002 article, Nick Lazaris was quoted as saying: "Keurig has not had, nor does it expect to have, any single shareholder owning a majority of Keurig's stock. GMCR will be joining Van Houtte and Memorial Drive Trust, as one of Keurig's largest shareholders. Led by Memorial Drive Trust, a U.S. based profit-sharing plan

Exhibit 5 Keurig K-Cup Shipments, All Roasters



Company-wide Keurig brewer and K-Cup portion pack shipments (Unaudited data in thousands)

	52 wks. Ended Sept. 27, 2008	52 wks. Ended Sept. 29, 2007	53 wks. Ended Sept. 30, 2006	Percent Growth 2008	Percent Growth 2007
At Home Brewers (Consumer)	883	422	219	109	93
Away from Home Brewers (Commercial)	100	57	28	75	104
Total Keurig brewers shipped	983	479	247	105	94
Total K-Cups shipped (system-wide)	1,012,356	637,823	448,880	59	42
Total K-Cups sold by GMC	578,939	359,056	255,412	61	41

Source: Keurig Inc.

that has served as the lead venture investor in Keurig since 1995, Keurig's Board of Directors remains fully in control of Keurig's business strategy, and no roaster or other commercial business partner will have a seat on Keurig's Board of Directors."¹⁴ Nick Lazaris defended Keurig's independence from roasters in a letter to Keurig's distributors and other roasters:

Our core strategy remains unchanged: we are committed to a multi-roaster strategy that relies on strong relationships with selected gourmet coffee roasters who take a great deal of pride in the coffee consumption experience that supports the meaning of their brand to consumers.¹⁵

As of 2005, Keurig remained effectively controlled by MD Co. (controlled by MDT), which owned approximately 23 percent of Keurig's capital stock. As a result of contractual limitations and restrictions agreed to by GMCR and certain other stockholders of Keurig, MD Co. retained the ability to elect a majority of Keurig's board of directors, make certain types of amendments to Keurig's certificate of incorporation, and approve or reject a sale of Keurig's business. In June 2006, GMCR completed its acquisition of Keurig for \$104.3 million.

Expanding Keurig's Family of Brands

In addition to offering Green Mountain Coffee and GMCR's affiliated Newman's Own Organics and Celestial Seasonings Tea brands, which were packaged and sold by Green Mountain Coffee, Keurig offered several other North American K-Cup brands as of year-end 2006: Diedrich, Gloria Jean's, Coffee People, Timothy's, Emeril's, Van Houtte, Bigelow, Tully's, and Twinings.

In January 2007, Keurig, Inc., and Caribou Coffee, the second-largest publicly traded gourmet coffee company in the United States in terms of number of retail stores, announced a partnership to market Caribou's gourmet coffees in Keurig K-Cups. "We are proud to welcome Caribou to the Keurig family," stated Nick Lazaris, former president of Keurig. "Caribou is an exceptionally strong brand with a loyal following among gourmet coffee lovers. Our office and home Keurig users will be delighted with Caribou in K-Cups.¹⁶ Under license from Caribou Coffee, Keurig served as the wholesale distributor and a direct retailer for Caribou Coffee K-Cups. In addition, many Keurig premium retail partners added Caribou Coffee K-Cups to the selection of K-Cups already carried in 6,700 stores coast to coast. For the office coffee channel, Caribou Coffee K-Cups were offered through Keurig's authorized distributors for marketing to offices at which Keurig brewers were installed. Caribou marketed both Caribou Coffee K-Cups and Keurig brewers in many of its coffeehouses.

As Keurig gained momentum across the United States, the diversity of the K-Cup brand portfolio increased in importance because regional preferences could not be underestimated as national penetration progressed.

The addition of Caribou Coffee, a strong Midwest brand, helped build K-Cup sales and introduce Green Mountain Coffee to areas beyond its core market.

In September 2008, GMCR announced an asset purchase agreement to acquire the Tully's coffee brand and wholesale business. Tully's was a well-respected specialty coffee roaster, with Pacific Northwest roots and heritage. The Tully's wholesale business division distributed coffee to over 5,000 supermarkets, located primarily in the western states, and also sold coffee in K-Cup portion packs. The Tully's acquisition was designed to provide GMCR with a complementary West Coast brand and business platform to facilitate future geographic growth and brand expansion.

Keurig's Management Information System

Calli Prendergast, vice president of Information Systems at Keurig, stated, "By having e-Commerce (third party) manage our applications (accounting, e-Commerce, and Customer Relationship Management), we can focus on serving our customers better and growing our business." Before Keurig evolved from its traditional away-from-home, business-to-business (B2B) product offering, served through KADs, to a new line of at-home, business-to-consumer (B2C) products, it was evident that a new system was needed to process the large number of transactions Keurig handled each day and incorporate sufficient reserve capacity for the large amount of projected sales growth. It was determined that Keurig could reap significant cost and efficiency benefits by integrating the new system with its existing back-end ERP and front-end CRM system. Keurig contracted ePartners, a Microsoft-based software and services consultancy, to design and implement a system consisting of an integrated suite of products. The complete solution included a system based on Microsoft Dynamics GP (formerly Great Plains), Microsoft Commerce Server, Great Plains Siebel Front Office, and Microsoft SQL Server. The system included a highly customized, easy-to-use, and professional B2B and B2C e-commerce site with full integration to Great Plains and Great Plains Siebel Front Office. The solution was deployed in an application outsourcing (hosted) model for high availability and access throughout the world through ePartners and Data Return. At the outset of Keurig's at-home product line, the e-commerce system served as the only means of order entry for the consumer marketplace. The system increased the efficiency of Keurig's customer service agents (CSAs) by enabling them to gain direct access to the customer's order without having to wait for a report from the accounting department. Issue resolution times decreased significantly, resulting in higher levels of customer satisfaction. The accounting staff also improved their efficiency because the system eliminated the need to retrieve order information for CSAs. The hosted nature of the system allowed Keurig to keep IT costs low, maintain high availability, and focus on selling

Keurig systems. The IT system served as the foundation for Keurig's ongoing business and allowed Keurig to keep pace with the tremendous growth it continued to experience.

Keurig's Organizational Culture under the Leadership of Nick Lazaris

In March 2008, Lazaris resigned to pursue other career opportunities, including teaching entrepreneurial management in a turnaround environment at Harvard Business School. Lawrence J. Blanford, president and CEO of GMCR, said, "On behalf of the entire Board and everyone at GMCR, I would like to thank Nick Lazaris for his outstanding leadership, passion and guidance. I have great admiration for Nick's intelligence, integrity and entrepreneurial skills culminating in creating such an outstanding, fast-growth business. Under his strong leadership, Keurig is now the #1 single-cup office and home coffee brewing system in North America. Nick was appropriately recognized when he received the 2006 Entrepreneur of the Year Award from Ernst & Young."

Robert Stiller, chairman and founder of GMCR, said, "Nick Lazaris truly is a great American entrepreneur. The Keurig brewer was under development for several years prior to Nick joining Keurig, but I credit his great leadership with transforming a promising opportunity into a thriving business by introducing a successful single-cup system to the market. He assembled a talented, creative and deep leadership team at Keurig as well as an extensive and strong supply chain to support its rapid growth."

Lazaris said, "I am very proud of my partners on the Keurig team. . . . Together, we not only developed high quality, innovative single-cup brewing technologies, but we developed innovative 'go to market' strategies to create the single-cup market category and built a defensible position against competitors many times our size."¹⁷

Lazaris received a BS from MIT in 1972 and an MBA from Harvard in 1975. Serving as chief of staff to West Virginia governor Jay Rockefeller in the late 1970s and early 1980s, Lazaris had a learning experience that he carried over to Keurig. Following his stint in the public sector, Lazaris worked for the Barry Wright Corporation, a manufacturer of products that handled and protected data records. In 1989, Lazaris started Carr Picture Frames, where he was the vice president of sales and marketing. He left in 1995 and moved on to Office Specialists, where he was the general manager of the Tech Specialists Division. In 1997 Lazaris was recruited to become president of Keurig, Inc.

At Keurig, Lazaris set clear objectives and regularly measured his progress toward them. His management style placed emphasis on regular communication among the management team by holding weekly meetings. He believed that being able to respond to objectives required effective communication. Lazaris said that he "listens, thinks, analyzes, and acts before making decisions in

business and follows the Keurig mantra: hard work, smart work, and teamwork."¹⁸ Lazaris held over 10 U.S. patents in addition to several international patents. In a September 2004 interview with *Appliance Magazine*, Lazaris stated, "I liken myself to a composer writing a symphony, where each of the senior managers has a role to play, much like a person in an orchestra has an instrument to play."

An entrepreneurial environment was fostered at Keurig that encouraged innovation and independent thinking. The entrepreneurial spirit was defined as a can-do attitude, a determination to succeed in extremely challenging times, and the ability to motivate others to look for solutions during those dark moments. Lazaris said, "An entrepreneur is fundamentally someone who's able to take an idea or a product or service and create an organization that is self-sustaining in the marketplace, generating both sales and profits."

Corporate Social Responsibility Shaped the Organizational Culture at GMCR

Green Mountain was committed to conducting its business in a socially responsible manner. The company believed that doing well financially could go hand in hand with giving back to the community and protecting the environment. In its 2008 annual report, GMCR stated that its success was supported by its long-standing commitment to social and environmental responsibility. That commitment, combined with GMCR's entrepreneurial spirit and highly engaged workforce, enhanced GMCR's competitive advantage and provided the company an "opportunity to create better coffee, and brew a better world." GMCR allocated at least 5 percent of its pretax profits to social and environmental projects every year. GMCR posted its Corporate Social Responsibility Report at www.BrewingABetterWorld.com.

GMCR worked to protect the environment. Waste reduction and responsible energy use were two of its top priorities, and had been since 1983, when GMCR began composting in its retail coffee shops. In 1989, GMCR developed Earth-Friendly coffee filters. More recent examples of GMCR's commitment to protecting the environment included working with International Paper to bring to market the world's first to-go cup made with renewable materials, installing an on-site biodiesel fueling station, and embracing carbon offsets.

As the single-cup coffee market and Keurig brewing systems grew in popularity, GMCR understood that the environmental impact of the system was one of its most significant challenges. Finding a more environmentally friendly approach to the packaging challenge posed by the K-Cup portion-pack waste stream was a big priority for GMCR. The company was actively researching alternatives to the petroleum-based materials that made up the majority of Keurig K-Cup packaging. GMCR commissioned Life-Cycle Analysis in 2008 to help quantitatively understand

the environmental impact of the K-Cup portion pack, as compared to using a typical drip brewer, and identify the best opportunities to reduce its impact. GMCR worked to identify the right definition of *environmentally friendly* for the Keurig system and all its packaging. Since the term *environmentally friendly* can mean many things (carbon-neutral, biodegradable, compostable, petroleum-free, etc.), GMCR was researching what was possible today and tomorrow, taking into account the current state of packaging technology, consumer preferences, community infrastructure, performance requirements, and the demands of the marketplace. GMCR continued to offer the My K-Cup product, a reusable filter assembly that could be refilled by the consumer, could be easily cleaned, and was compatible with all Keurig home brewers presently sold. On the brewer side, all Keurig engineers had been trained in the European RoHS directive, which restricted the use of certain hazardous substances in electrical and electronic

equipment, and GMCR intended that all Keurig brewers be RoHS-compliant by the end of 2008.

Keurig Fueled Sales Growth at GMCR

In fiscal 2008, GMCR net sales increased by \$158.6 million, or 46 percent, as compared to fiscal 2007 (see Exhibit 6). Net sales for the Keurig segment were \$253.6 million in fiscal 2008 (including \$39.2 million of intercompany brewer sales and royalty revenue), an increase of over 188 percent (see Exhibit 7) compared to fiscal 2007. As a reseller, Keurig placed K-Cups and brewers side by side in outlets such as Bed Bath & Beyond, Macy's, and Target, as well as many more. Keurig merchandised brewers and K-Cups in over 16,000 retail outlets in fiscal 2008 (see Exhibit 8). When sold through resellers, Green Mountain coffee is typically one of several roasters represented. Showcasing the entire family of K-Cup roasters accelerated brewer penetration by increasing consumer acceptance outside GMCR's core

Exhibit 6 Summary Financial Data (in thousands except per-share data)

	52 wks. Ended Sept. 27, 2008	52 wks. Ended Sept. 29, 2007	53 wks. Ended Sept. 30, 2006	52 wks. Ended Sept. 24, 2005	52 wks. Ended Sept. 25, 2004
Select Statement of Operations Data:					
Coffee pounds shipped	32,000	26,818	24,613	19,879	17,734
Net sales	\$500,277	\$341,651	\$225,323	\$161,536	\$137,444
Gross profit	\$176,905	\$131,121	\$ 82,034	\$ 56,975	\$ 54,084
Income before equity in earnings of Keurig Inc., net of tax benefit	\$ 22,299	\$ 12,843	\$ 9,406	\$ 9,448	\$ 8,901
Equity in earnings of Keurig, Inc. net of tax benefit	N/A	N/A	(\$936)	(\$492)	(\$1,076)
Net income	\$ 22,299	\$ 12,843	\$ 8,443	\$ 8,956	\$ 7,825
Net income per diluted share	\$ 0.87	\$ 0.52	\$ 0.36	\$ 0.39	\$ 0.35
Weighted average shares outstanding	25,565	24,773	23,727	23,000	22,227
Select Balance Sheet Data: (at end of period)					
Working capital	\$ 79,170	\$ 30,775	\$ 29,150	\$ 17,172	\$ 11,723
Total assets	\$357,648	\$264,527	\$234,006	\$ 91,147	\$ 78,332
Long-term debt	\$123,517	\$ 90,050	\$102,968	\$ 8,748	\$ 17,298
Stockholders' equity	\$139,520	\$ 90,099	\$ 74,940	\$ 60,392	\$ 44,415
Long-term debt/equity	88.50%	90.90%	137.40%	14.50%	38.90%
Return on equity	18.60%	14.80%	12.50%	17.10%	19.70%

Source: Green Mountain Coffee, Inc. 2008, 2007 and 2004 Annual Report

Exhibit 7 Green Mountain Coffee and Keurig: Net Sales (before taxes, in millions)

	Percent Sales Growth				
	2008	2007	2006	2008	2007
Green Mountain Coffee	\$246.7	\$242.0	\$207.6	1.9%	16.6%
Keurig	\$253.6	\$134.8	\$ 24.1	88.1%	4.6%
Inter-company eliminations	\$ 0.0	-\$ 35.1	-\$ 6.4	—	4.5%
Total Company	\$500.3	\$341.7	\$225.3	46.4%	51.7%

Source: Green Mountain Coffee, Inc. 2008 and 2007 Annual Report

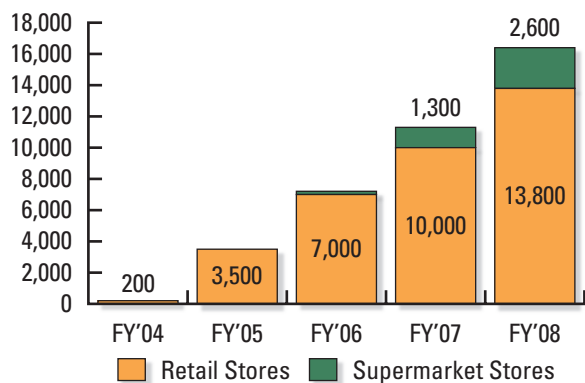


Exhibit 8 Retail Stores and Supermarkets Selling Keurig at-Home Brewers

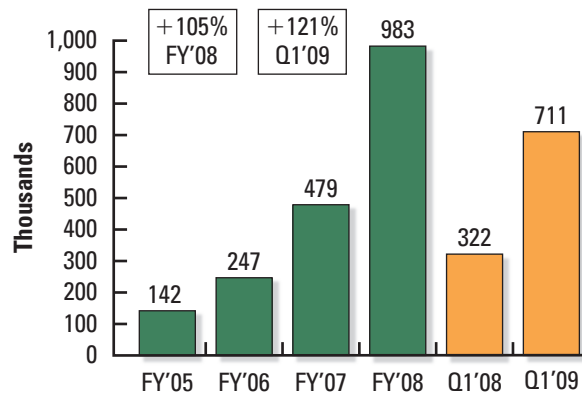


Exhibit 9 Keurig Brewer Shipments (all channels)

market and underscored the variety available through the Keurig system. In fiscal 2008, GMCR shipped 983,000 Keurig at-home and away-from-home brewers, an increase of 105 percent over the previous year's shipments (see Exhibit 9). The number of K-Cups shipped by all licensed roasters increased 59 percent over the previous year.

Challenges Brewing at Keurig

Nick Lazaris led Keurig as a technology-driven company during a time when purchasers of single-serve coffee machines were “innovators” and “early adopters.” These were the customers purchasing new technology, before it had been perfected and before the price came down. In transitioning Keurig from a technology- to a marketing-driven company, Michelle Stacey's challenge was to develop a strategy for transforming an idea that made sense to early adopters—“Why do we brew coffee by the pot when we drink it by the cup?”—into one that made sense to the early majority. The marketing plan refinement and execution would become increasingly

more critical if single-cup brewers approached the tipping point. Keeping in mind that brewers sold today impact pod sales for the life of the brewer, what strategic approach should Keurig adopt under the leadership of Michelle Stacey?

During her career, Stacey had managed the integration of several acquisitions, a relevant experience given the formerly independent Keurig's ongoing integration as a wholly owned subsidiary of GMCR. But the entrepreneurial and innovative culture at Keurig, Inc., that Nick Lazaris had fostered was reminiscent of the old “Bell Labs,” resulting in innovative technology. Was this core competence still relevant as Keurig transitioned from a technology- to a marketing-driven company?

Could elasticity of demand be incorporated into Keurig's strategy given the retail prices of Keurig's at-home brewers and K-Cups, consumer spending trends during the recession, and the value proposition of the K-Cup and My K-Cup versus competitive single-cup brewers and the retail prices at Starbucks?

Exhibit 10 Keurig Senior Management Team

- **Michelle Stacy—President:** Stacy brought more than 20 years of experience to Keurig, including marketing and global business management at the senior executive level with the Gillette Company and then Procter & Gamble (P&G). At P&G, Stacy was vice president and general manager of Global Professional Oral Care, where she managed the Global Professional activities for the Crest and Oral-B brands. Stacy has experience as a vice president of marketing in Blades and Razors and Personal Care. Stacy holds a BA in liberal arts from Dartmouth College and an MBA from Kellogg School at Northwestern University.
- **Dick Sweeney—Cofounder, Vice President of Manufacturing and Operations:** Sweeney cofounded Keurig in 1993 and joined the company full-time as one of its first employees in 1996. He brought to Keurig more than 25 years of experience in manufacturing, product development, and consulting in the area of industrial and consumer appliances. Sweeney has developed several U.S. and international Keurig brewer and packaging patents. Sweeney received his BS from New Jersey Institute of Technology and his MBA from Fairleigh Dickinson University.
- **Kevin Sullivan—Vice President of Engineering and Product Development:** Sullivan is responsible for all engineering at Keurig, including brewer development and K-Cup packaging. He joined Keurig in 2003, bringing more than 20 years of engineering experience in consumer appliances and high-volume consumer disposables. Sullivan earned an MBA from New Hampshire College and a BA in mechanical engineering from the University of Massachusetts–Amherst.
- **Basil Karanikos—Vice President of Packaging Engineering:** Karanikos is responsible for all engineering and product development surrounding Keurig’s K-Cup portion pack, including packaging manufacturing equipment. Karanikos received his BSEE from Worcester Polytechnic Institute, where he also continued his graduate studies.
- **Chris Stevens—Vice President of Sales, At-Work Division:** Stevens is responsible for the North America Sales Organization in Keurig’s Away-from-Home Division. Stevens joined Keurig in 1996, bringing more than 20 years of experience in consumer goods sales and marketing as well as general management. His sales team recruits, trains, and manages all of Keurig’s authorized distributors in the United States and Canada. Stevens received his BS from Notre Dame and completed the Executive Education program at Columbia Business School.
- **Dave Manley—Vice President of At-Work Division and Consumer Direct:** Manley is responsible for Keurig marketing in the channels of away-from-home, Keurig Consumer Direct on www.keurig.com, and hotels. Manley joined Keurig in 2002 after more than 20 years of executive experience in consumer goods sales and marketing. Manley received his BA from DePauw University and his MBA from Purdue University.
- **John Whoriskey—Vice President, General Manager of At-Home Division:** Whoriskey is responsible for Keurig’s At-Home Division, including the retail business. Whoriskey joined Keurig in 2002, bringing over 20 years of experience that included president and VP-level experience in marketing and sales in the home furnishing, gift, and consumer products industries. Whoriskey received his BS and MBA from Boston College.
- **Mark Wood—Vice President of New Business:** Wood is responsible for new business development at Keurig, including managing the relationships with K-Cup licensed roaster partners, and international opportunities. Wood received his BA from the University of Rochester and his MBA from Harvard.
- **Mike Degnan—Vice President, General Counsel:** Degnan manages legal affairs for Keurig, including leadership of outside counsel in the areas of contracts and patents. Degnan received both his BS and JD from Boston College.
- **Ian Tinkler—Vice President of Brewer Engineering:** Tinkler leads Keurig’s brewer engineering effort. Tinkler joined Keurig in 2005, bringing more than 25 years of engineering experience. He holds an MBA from Rockford College and a mechanical engineering degree from Hatfield Polytechnic in England.
- **John Heller—Vice President of Finance:** Heller is responsible for the accounting, finance, and procurement functions at Keurig. Heller joined Keurig in 2007. He received his BS from USMA and his MBA from Duke University and is a licensed CPA.

Appendix A The 10 Top-Selling Single-Serve Coffee Makers*

- 1. Keurig Special Edition B60 (\$149):** “The B60 features a 5.25, 7.25, and 9.25 oz setting for different cup sizes, a programmable clock, blue back lighting and has the ability to adjust the temperature down 5 degrees from 192 F. This is the most pimped out coffee maker we’ve ever owned. The handle on the K-Cup jaws is also tricked out with chrome. The only big difference in the LED features is the ability to adjust the brew temperature. We did adjust it up and down and it works.”
- 2. Keurig Elite B40 (\$99):** “The Keurig Elite B40 features a 7.25 oz Brew, a removable reservoir tank, and auto turn off after 2 hours which you can set on or off. For a single purpose, make me a great cup of coffee machine the B40 at \$99.95 couldn’t be better. The coffee it produces is of the same quality as the B60. Unlike the B60 where you can adjust the temperature, the B40 comes out at 192 F and brews a great cup of coffee.

We think that the Keurig B40 and B60 models are a good buy. We really like the Keurig B60 because of the blue lights and travel mug settings the most. Keurig K-Cups cost \$13.95 for a box of 24 or about \$0.58/K-Cup.”
- 3. Aeropress Single-Serve Coffee Maker (\$30):** “You will need espresso ground coffee from either your grinder or by purchasing some pre-ground coffee, but making a cup of Aeropress coffee is very easy and intended to make one cup of perfect coffee or espresso. To start, you’ll need a decent coffee grinder to get the nice fine grind the Aeropress likes. Once you’ve ground up your coffee to a nice fine grind, the Aeropress comes with a measuring spoon to make sure you put the right amount in the chamber. The Aeropress is an entirely new way to make coffee. You could compare it to a French press but you would be wrong. Because of an almost giant syringe like coffee gadget, you build air pressure by pushing espresso ground coffee through the chamber with a filter paper on the bottom of the Aeropress.”
- 4. Keurig Mini B30 (\$79):** “Keurig recently introduced the Keurig B30 commercial hotel and office coffee brewer followed by the Keurig Mini B30 designed for home and commercial use. The Keurig B30 is very similar to the Keurig B130, but it comes in red, black, and white colored casings, and is also My K Cup compatible. Simply getting a fresh cup of water to use in the Keurig B30 each time was not time consuming, and waiting for the brewer to heat up for the 3 minutes was also not that long of a time. On the larger Keurig models, coffee is more immediate than on the Keurig B30.”
- 5. Braun TA1400 Tassimo (\$169):** “The *Tassimo* utilizes a new hot beverage brewing system in the form of T-Discs. Each T-Disc has a bar code on it to tell the machine how the hot beverage needs to be prepared, and the brewing of the coffee happens inside each T-Disc as water is pushed through it. Tassimo makes: single serve coffee, crema coffee, espresso, lattes, cappuccinos, tea and hot chocolate. Tassimo was the first single-serve coffee system to have liquid milk instead of powdered milk to make cappuccinos and lattes. You don’t have to keep the milk T-Discs cold because they are shelf stable and ultra-pasteurized. By using milk T-Discs to make a latte or cappuccino, the Tassimo eliminates the need for a steam wand or frothing attachment.”
- 6. Hamilton Beach BrewStation Deluxe 12-Cup Coffee Maker:** “The Hamilton Beach (HB) Coffeemaker may make 12 cups total like a typical drip coffee maker, but it dispenses them one cup at a time. The HB has all the bells and whistles you’d expect for a drip coffee maker with the convenience of single serve coffee, however the cleanup and brewing of the coffee takes longer than what you get using a single serve coffee maker like the Senseo or Keurig systems.”
- 7. Keurig Platinum B70 K-Cup Single-Cup Brewer (\$199):** “The difference from the Keurig B70 compared with the B40 and B60 is a smaller footprint, larger reservoir and reduced noise during brewing. There is a new look and design for the Keurig B70. It’s thinner and sleeker than the B60. We liked the new closing mechanism for inserting the K Cup into the Keurig B70, and found it closes easier. We were disappointed that for \$199.95 you didn’t get a charcoal water filter in the B70. Though we use filtered water at SingleServeCoffee.com, many people don’t have this option and it makes a big difference. We hope in the future Keurig offers a water filter option so you get the best cup possible if you don’t have filtered water. We tried coffee from all 3 different models—the B40, B60, and B70—and found the coffee all to be the same when brewed at the standard 7.25 oz setting. We also used the K Cup re-useable coffee filter in all the models and found the coffee to be nearly the same.”
- 8. Bosch Tassimo Suprema Single-Serve Brewer/Hot-Beverage System (\$139):** “The Tassimo hot beverage system has been out in the U.S. for the past two years, and when it launched was made by Braun. In 2007 Tassimo decided they needed to update the system, and went with a new partner—Bosch. The new Bosch Tassimo is completely redesigned. Gone is the loud brewing, the spill back of water after brewing a cup, and the unit heats and brews much faster. We tested the Tassimo TAS4511UC model; there is also a \$99.99 Bosch Tassimo available in select grocery and mass merchandise stores. The main difference in the two models is the water reservoir filtration, and aesthetics. One question that will come up with any single-serve coffee system, “Can I use my own coffee?” Not with the Tassimo hot beverage system, but the *Tassimo* does offer single serve coffee from Starbucks and Seattle’s Best. There are over 30 other coffee blends and flavors available in T Disc format.”
- 9. Bosch Tassimo Suprema:** See review for number 8.
- 10. Breville BKC600XL Gourmet K-Cup Brewer (\$299):** “Breville is widely known for making exceptional small kitchen appliances, and for producing very attractive small appliances. Keurig and Breville teamed up to introduce a high end Keurig brewer designed by Breville. The results were exceptional—a very polished interesting stainless steel design, with Keurig K Cup brewing technology, and all the features you can get in any Keurig machine—including the re-useable My K Cup integrated into the machine, allowing you to use your own ground coffee instead of K Cups, and a charcoal water filter in the tank reservoir. If you want a super attractive K-Cup single serve coffee maker, and are willing to pay \$100 more and get all the features of any Keurig brewer, then the Breville Brewer is for you.. We think the design alone is worth the premium—this brewer screams high end.”

*From SingleServeCoffee.com, December 8, 2008.

Endnotes

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