

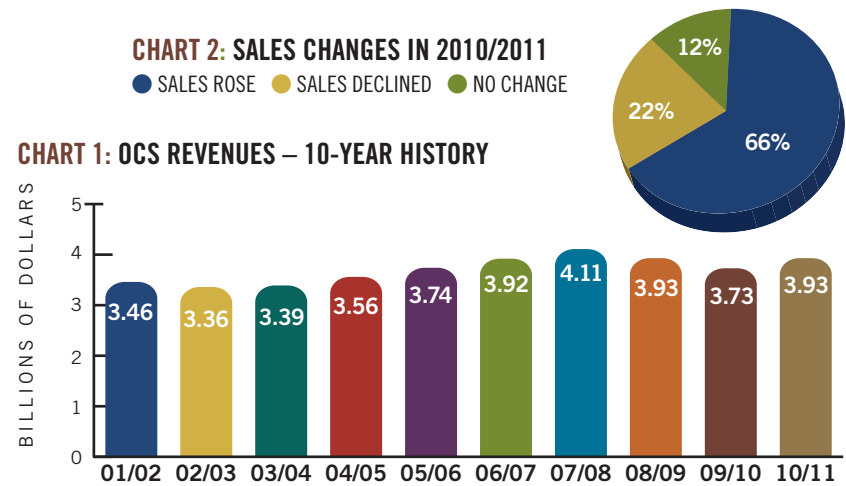
A new PROFESSIONALISM defines OCS

2011: Despite rising coffee prices and a recession, OCS sales rebound.

By Elliot Maras, Editor

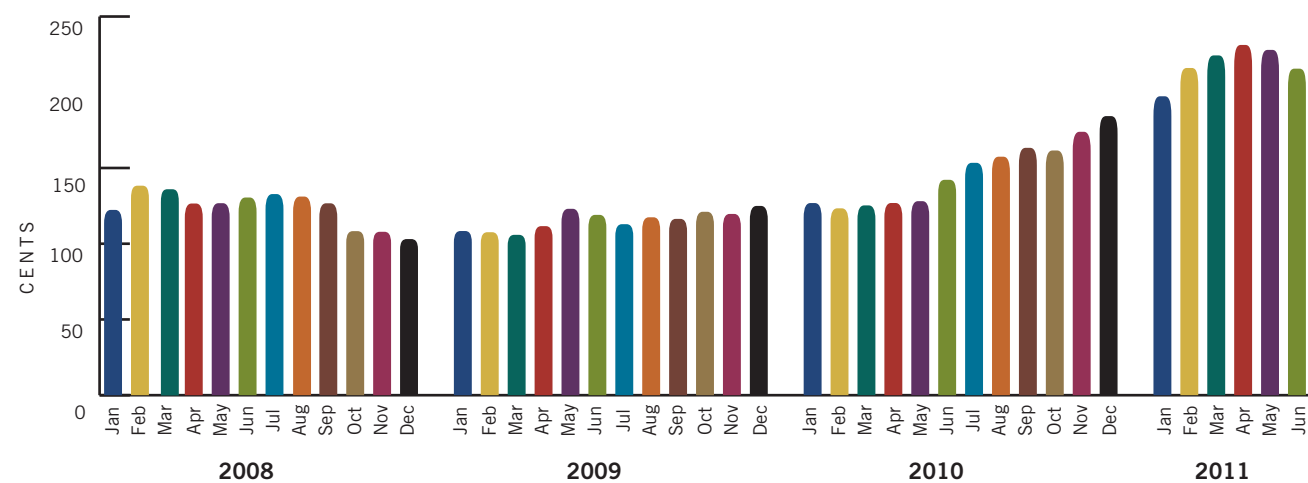
Coffee service has evolved into a highly specialized profession in recent years with a profusion of advanced delivery systems and a wider variety of products, enabling operators to meet diverse customer tastes. Learning how to compete in this new and improved industry requires ongoing commitment to coffee and business management education.

Economic conditions continue to impact OCS along with most industries. However, the consumer's growing appreciation for good coffee, the fact that OCS coffee is free



to the end user, and a willingness on the part of locations to pay for good coffee despite cost pressures have combined to create a unique set of opportunities and challenges for OCS.

CHART 3: COMPOSITE GREEN COFFEE PRICES, 2008 TO JULY, 2011



Source: International Coffee Organization, London, U.K.

A historical review of OCS sales in the last 10 years indicates the economy has less influence on OCS operator sales than the industry's adoption of single-cup delivery systems, the most significant technological change in the industry's history. This is a key reason why the OCS industry suffered less sales attrition since the start of the current recession in the fall of 2007 than the vending industry.

The State of the Coffee Service Industry Report in the 12-month period ending in July of 2011 found aggregate OCS sales rebounded from a 10 percentage point decline in the prior two years by five points in 2011, driven by product price increases. The 2010/2011 report found an unprecedented 88 percent of operators raised prices in the 12-month period.

The vending industry, by contrast, lost 18 percentage points in the 3-year period from 2008 to 2010.

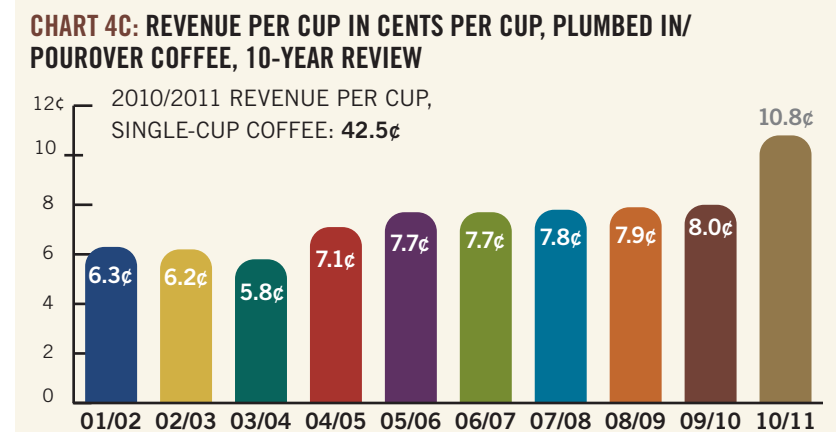
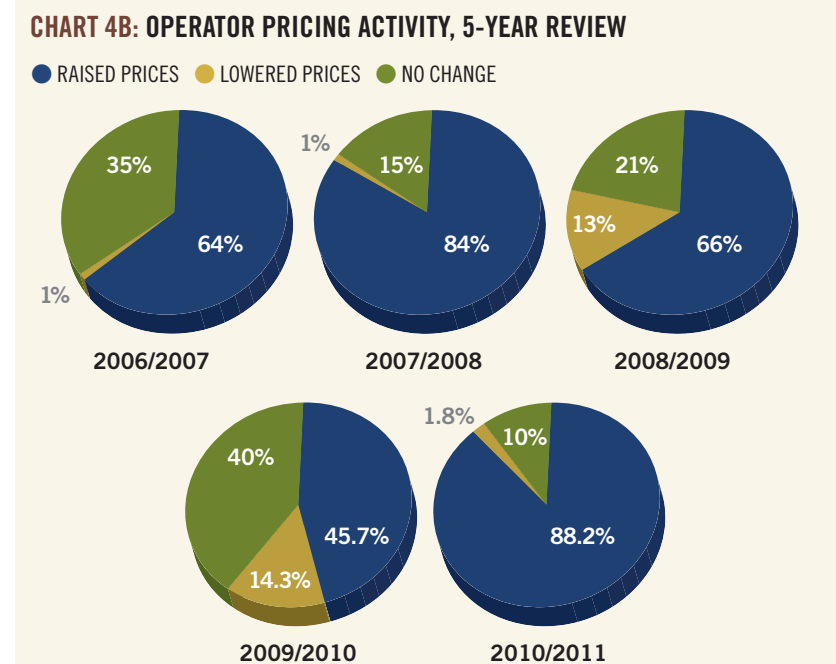
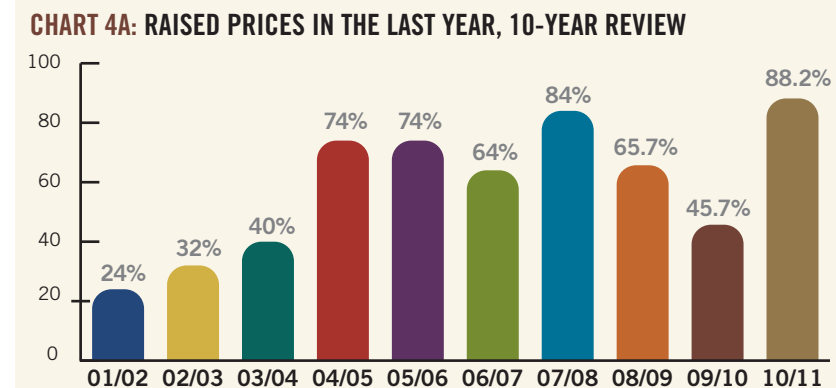
The OCS industry suffered a similar rate of decline in the earlier period of the current recession, but it was able to reverse the downward trend in the most recent 12-month period.

Automatic Merchandiser's analysis of OCS pricing activity in 2010/2011 indicated double digit price increases in the 12-month period, primarily reflecting cost increases from suppliers. Another unique aspect of the operator price increases was that operators raised prices more than once in the 12-month period, in concert with supplier increases. Many operators raised prices three times.

The supplier price increases, reflecting changes in green prices indicated in chart 3, increased with time.

Operators agreed that widespread publicity about higher prices made it easier than ever to pass on higher prices to customers.

OPERATOR PRICING ACTIVITY



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CHART 5: ACCOUNT POPULATIONS BY SIZE, 2010/2011

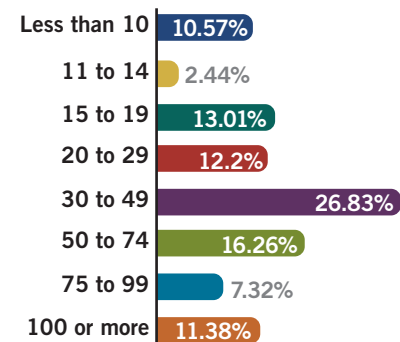


CHART 6: OCS SALES BY PRODUCT CATEGORY, 5-YEAR REVIEW

	06/07	07/08	08/09	09/10	10/11
Private label coffee	23%	23%	27%	39.69%	28.11%
National brand coffee	33	35	31	21.4	26.92
Espresso/cappuccino	3	3	2	4.94	3.6
Other coffee*	8	8	9	4.63	12.07
Total Coffee	68	69	69	70.66	70.7
Other hot beverages	7	5	6	7	4.9
Soft drinks/juices	6	4	3	3.5	5.39
Bottled/filtered water	5	5	5	4	5.7
Creamers/sweeteners	6	7	7	5	5.63
Cups/paper products	6	6	6	5.5	5.41
Other	3	3	4	4	2.27

*Includes flavored, whole bean and varietal.

CHART 7A: OCS BREWER BREAKOUT BY TYPE, 5-YEAR REVIEW

● PLUMBED-IN AND POUR-OVER ● THERMAL ● SINGLE-CUP

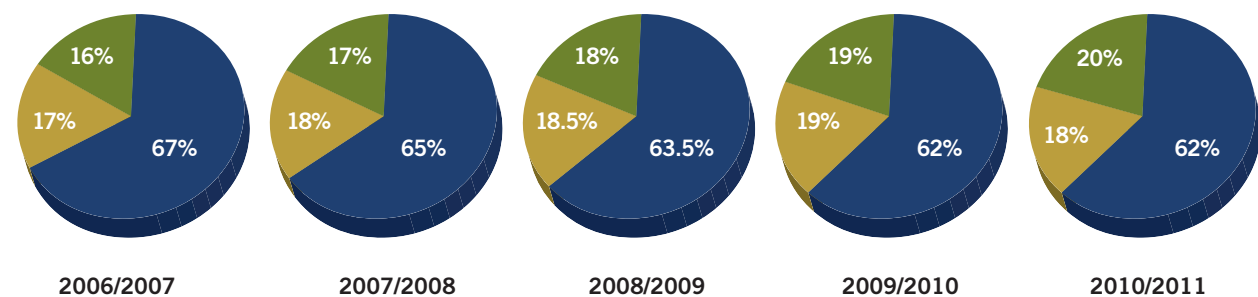
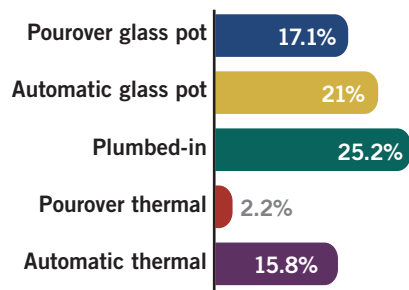


CHART 7B: PLUMBED-IN, AUTOMATIC AND THERMAL AS % OF TOTAL IN 2010/2011



The National Coffee Association (NCA) annual coffee trends study further indicated that consumption of coffee has held steady through the recession. In 2011, the study found 40 percent of those 18 to 24 years old said they drink coffee daily, up from 31 percent in 2010 and on par with 2009's 40 percent. For those 25 to 39 years old, 54 percent said

they drink coffee daily, up from 44 percent in 2010 and ahead of 2009's 53 percent.

NCA reported that gourmet coffee continues to be a significant portion of total coffee consumption, indicating that consumers want to maintain coffee quality even in an uncertain economy.

A consumer survey commissioned by the National Automatic Merchandising Association (NAMA) found consumers overall hold coffee at work in high regard. The survey found that 60 percent of all employed coffee drinkers consider free coffee as an employee benefit; 55 percent of Generation Y consumers (age 18 to 27), 69 percent of Generation X consumers (those born between 1965 and 1976) and 61 percent of baby boomers consider coffee provided by an employer as fresh.

While OCS operators raised coffee prices, they did not charge for fuel as much in 2010/2011 despite spiking fuel costs. As indicated in chart 10a, the number of operators charging for fuel fell to pre-recession levels in 2010/2011.

Among those operators who did charge for fuel, they were more likely to do so on a selective basis than in prior years, indicated in chart 10b.

Operators indicated they were less inclined to seek a fuel charge in addition to passing on higher coffee prices.

Another factor contributing to the OCS industry's revenue growth was the continued expansion of single-cup coffee systems, a trend that began more than 10 years ago.

The fact that single-cup systems continue to expand during a period of low consumer confidence

CHART 8: ESTIMATED SINGLE-CUP BREWER PLACEMENTS IN THE U.S., 6-YEAR REVIEW

(Editor's note: Each number represents total accumulated placements for the given date. Some previous years numbers have been adjusted.)

MARKETER	PRODUCT(S)	2005/06	2006/07	2007/08	2008/09	2009/10	2010/11
Bodecker Brewed	Bodecker	300	2,100	2,600	3,100	3,130	3,160
Café Excellence LLC	Café X Milano	250	250	250	250	250	250
Cafecion	Avalon	24,350	28,150	32,150	36,500	40,000	56,000
Cafejo	Cafejo	5,250	11,250	16,250	23,000	25,000	30,000
Crane	Café System, Genesis	11,150	12,150	13,150	13,150	13,400	15,100
Filterfresh	Filterfresh*	18,030	18,040	18,050	20,300	22,550	22,500
Grindmaster	Grindmaster	0	0	0	10,000	15,000	17,200
Keurig	Keurig	130,629	211,821	345,712	378,420	398,500**	587,500**
Kraft	Gevalia, Tassimo Professional	3,500	3,500	3,900	3,900	6,500	9,000
Lavazza	Espresso Point, Lavazza Blue	NA	NA	17,000	21,000	23,000	27,000
Mars Drinks	Mars Drinks (Flavia)	140,000	250,000	362,500	362,500	384,500	384,500
Newco	Smartcup, Freshcup	1,000	1,800	1,800	1,800	3,300	4,300
Rheavendors	Rhea, Cino,	2,694	3,194	3,644	4,373	4,810	4,810
Saeco USA	Saeco, Estro	22,000	24,200	26,400	27,705	29,125	30,141
Sara Lee	Douwe Egberts	775	775	2,325	3,000	4,500	7,000
Starbucks	Starbucks	2,000	5,000	7,500	8,000	10,000	11,000
Technologies Coffea	Coffea	0	0	0	0	275	2,200
VE Global Solutions	Venus, Cypris, Juno, Prosyd	9,500	12,500	16,500	18,800	21,700	26,100
VE Global Solutions	Brio, Colibri, Koro, Korinto, Konvivo	34,000	42,000	51,500	59,600	67,675	72,950
Wolfgang Puck	Wolfgang Puck	0	0	1,000	5,000	6,500	2,000
Other		6,800	6,800	6,800	3,500	3,500	3,500
Total		412,228	633,530	929,031	1,003,898	1,083,715	1,316,211

* Number includes Filterfresh branded machines, not all machines Filterfresh operates.

** Does not include 480,000 at-home Keurig brewers that were in offices in 2009/2010.

** Does not include 980,000 at home Keurig brewers that were in offices 2010/2011.

demonstrates the high value these systems have earned among account decision makers. The popularity of these systems also reflects the high level of value that consumers place on high quality coffee in general, quantified by rising coffee sales in all retail channels.

SINGLE CUP HAS GEOGRAPHIC DISPARITIES

As single cup has expanded in recent years, the geographic disparity in single-cup's popularity nationwide has become more pronounced. Single-cup systems are considerably more common in the Northeast, followed in order by the West, the Midwest and the South. In all regions, single cup commands stronger penetration in large cities than small population areas.

CHART 9: ACCOUNTS BY TYPE, 5-YEAR REVIEW

	06/07	07/08	08/09	09/10	09/10
Offices	63%	54%	58%	54%	55.4%
Business and industry	20	24	18	16	18.53
Restaurants, delis, bakeries	3	3	4	7	6.23
Convenience stores	3	4	5	8	3.52
Government/military	1	1	1	1	1.45
Schools/colleges	5	6	4	5	4.84
Retail outlets	2	2	1	3	1.42
Other (Health care/hotels)	5	6	8	6	7.61

Where single cup represents the majority of OCS accounts in New York City, they remain virtually unknown in rural Missouri.

The higher cost of operating single-cup systems compared to batch brew systems has resulted in market dominance by very large OCS operators in the markets where single-cup systems are most common.

As a result, the larger operators have begun to define OCS as a professional specialty, more than at any time in the industry's history.

Single-cup system manufacturers have played an undeniable role in this development, a role that extends beyond simply providing products and equipment.

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FUEL CHARGE ACTIVITY

CHART 10A: COMPANY BILLED CUSTOMERS FOR FUEL

- YES
- NO

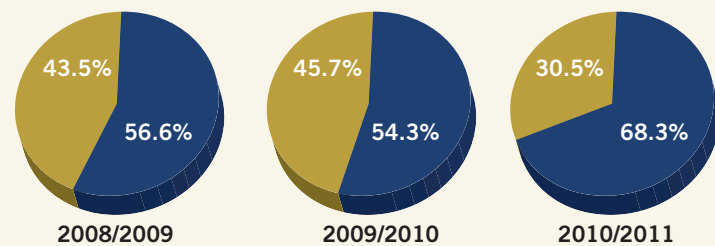


CHART 10B: AMONG THOSE BILLING FOR FUEL, HOW MANY CUSTOMERS WERE BILLED?

- ALL CUSTOMERS
- ON SELECTIVE BASIS

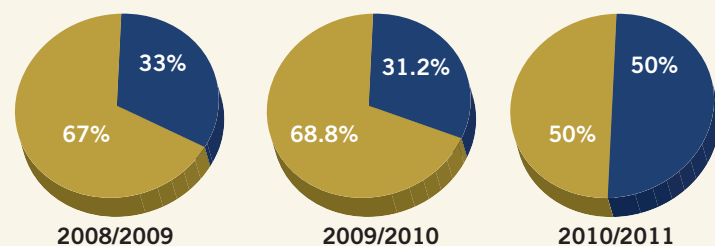


CHART 10C: AMONG THOSE BILLING FOR FUEL, HOW OFTEN WERE CUSTOMERS BILLED?

- ALL DELIVERIES
- SPECIAL DELIVERIES
- HALF OF DELIVERIES
- LESS THAN HALF

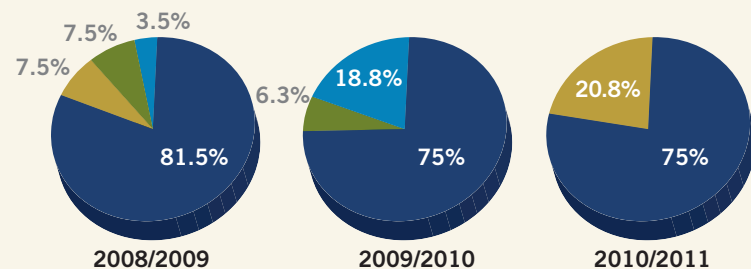
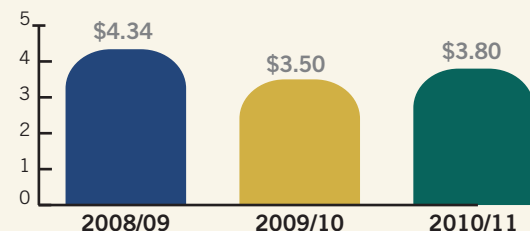


CHART 10D: AVERAGE AMOUNT CHARGED FOR FUEL PER DELIVERY



The larger operators have enjoyed sales, marketing and training support of single-cup system manufacturers, considerably more than their smaller competitors. The importance of this support on these companies' professionalism has been significant. The support has included identifying sales leads, sales training, Website development and marketing materials.

Unlike the manufacturers of the more traditional coffee brewers and fraction pack coffee, the single-cup

system manufacturers have dedicated resources specifically to the development of the OCS market. More traditional equipment suppliers focused on OCS in addition to foodservice. Fraction pack coffee suppliers focused on consumers, foodservice customers and retailers in addition to OCS.

THE OCS PROFESSIONAL EMERGES

The most significant OCS development in 2010/2011 has been the emergence of the OCS professional, an operator more attuned to his cus-

tomers' needs, supported by an organization aggressively focused on meeting these needs in a profitable manner.

For operators willing and able to invest in their operations, single-cup providers have directed them to query their customers to better understand their product preferences. The vast array of products available allows operators to meet a variety of customer needs.

The Internet tools that single-cup providers make available allow operators to communicate product

features and benefits via their own Websites and by email.

Improved marketing professionalism has proved helpful in light of the fact that many OCS customers value better quality products.

One reason these efforts have paid off for OCS operators is that many OCS customers have demonstrated a new willingness to spend money on OCS despite the recession.

While employers in most industries have not rehired workers they laid off since the recession began, many of them enjoyed record profits and were willing to spend money on productivity enhancing benefits like OCS.

Employer willingness to spend on OCS was not uniform; companies exhibiting this tendency were those that better recognized the value OCS has on employee productivity.

Many employers continued to spend less money on all benefits, including OCS. In these cases, OCS operators were able to meet the need to reduce costs by offering less expensive coffee and/or fewer allied products. As indicated in chart 6, coffee has increased as a percent of all OCS sales for the last five years.

While some customers switched away from single cup back to batch brew coffee due to higher prices, a trend first reported two years ago, these incidents were in a minority.

CHART 11: HOW RISING COSTS ARE BEING HANDLED, 3-YEAR REVIEW

- RAISING PRICES
- ABSORBING
- COMBINATION
- OTHER

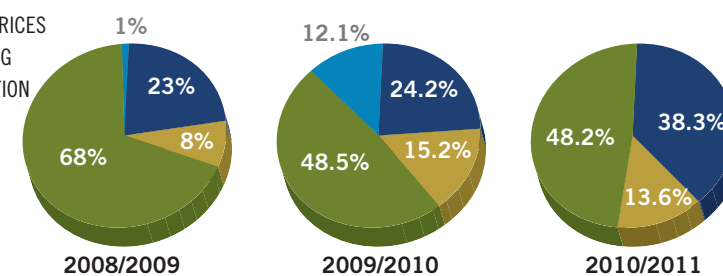


CHART 12A: HAVE ADDED OR REDUCED STAFF IN THE LAST 12 MONTHS, 3-YEAR REVIEW

- ADDED
- REDUCED
- NO CHANGE

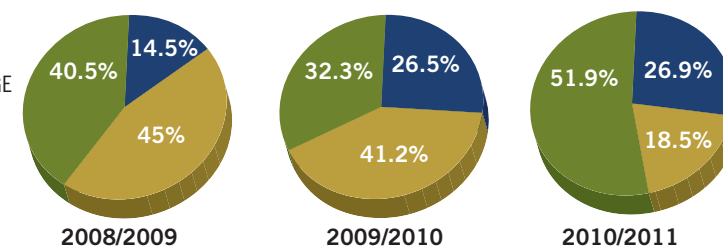


CHART 12B: IF ADDED STAFF, IN WHICH AREAS?

- SALES
- DELIVERY
- REPAIR
- WAREHOUSE

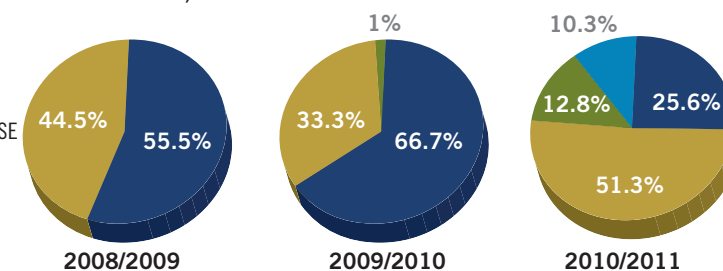
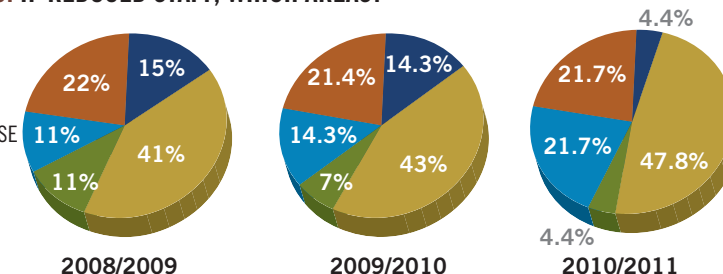


CHART 12C: IF REDUCED STAFF, WHICH AREAS?

- SALES
- DELIVERY
- REPAIR
- WAREHOUSE
- OFFICE



SINGLE CUP VERSUS BATCH BREW

The economics of single-cup systems have also become more favorable to many customers despite rising coffee prices.

The higher price of fractional pack coffee in the last 12-month period reduced the price differential on a percentage basis between fractional pack coffee and single-cup coffee. The elimination of wasted coffee in the single-cup system further appealed to cost conscious customers and OCS operators, both of whom noted that more expensive fractional pack coffee has more expensive waste.

While OCS sales have returned to a growth mode, profitability has been a different matter.

Single-cup systems deliver higher sales, but oftentimes, lower profitability. The dominant single-cup systems are the portion control systems, which are more expensive on a per-serving basis but also less profitable.

In 2010/2011, one sign of the impact of portion control systems was the gain in national brand coffee at the expense of private label coffee, indicated in chart 6. This marked the first year national brand coffee gained market share over the more profitable private label coffee in several years.

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Hence, while single-cup has the capacity to build sales, the OCS operator needs to manage costs better in order to sustain profitability.

K CUP PROFITS A CHALLENGE

The popularity of Keurig K Cups, the dominant single-cup product, has both helped and challenged OCS operators in recent years. The K Cup, the only portion control product that can be in used in both OCS and homeowner brewers, has created the largest following among single-cup coffee consumers.

Where other single-cup brewer manufacturers sought to protect their OCS customers from pilferage by not having a homeowner brewer that accepts the same portion control product as the OCS brewer, Keurig introduced homeowner brewers that accept the same K Cup as the OCS brewer. This resulted in both positive and negative impacts on OCS operators.

On the negative side, OCS operators face more competition for K Cups than they did when OCS was the only channel selling K Cups. Many OCS operators noted the widespread availability of K Cups has reduced its profitability.

Also on the negative side, the temptation to pilfer K Cups for home use is stronger now that homeowners have home Keurig machines.

On the positive side, consumer awareness of the K Cup has fostered a stronger demand for K Cups. By marketing to both workplace and homeowner audiences, Keurig has been able to build the largest audience of any single-cup provider.

In 2010/2011, Keurig's dominance expanded in both the OCS and consumer markets. Chart 8 shows the large increase of OCS Keurig shipments in 2010/2011.

CHART 13A: HAVE ADDED PRODUCTS THAT ADDRESS ENVIRONMENTAL CONCERNS, 3-YEAR REVIEW

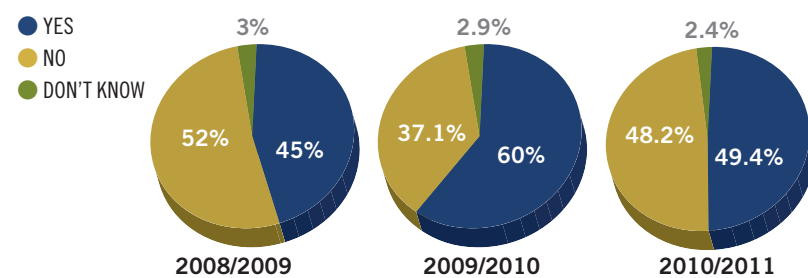
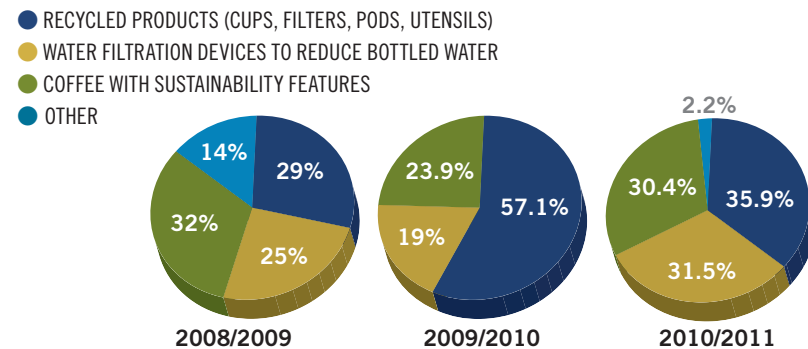


CHART 13B: PRODUCTS ADDED THAT ADDRESS ENVIRONMENTAL CONCERNS



Homeworld Business magazine, which covers the consumer housewares industry, reported that unit sales of single-serve coffeemakers jumped from 2.7 million units in 2009 to 4.1 million in 2010. The magazine's staff confirmed that Keurig represents the majority of these units.

The Beverage Marketing Corp., which studies beverage industry trends, reported the number of portion control packs jumped from 2.425 billion in 2009 to 3.61 billion in 2010.

The National Coffee Association (NCA), in its coffee drinking trends report, noted people who buy the portion control system have become more likely to use it to replace their current brewer.

Perception of the single-cup systems overall also improved, moving from 26 percent who think the systems are excellent or very good in 2007 to 45 percent who think the systems are excellent or very good in 2011, NCA reported.

Concern about employee pilferage of K Cups for home use has not been a major factor for OCS operators.

Attempts to offer alternative single-cup systems continued in 2010/2011, demonstrated by the increases noted in chart 8.

Manual pod systems, which are portion control systems that, unlike cartridge-based systems like Keurig, allow operators to source different coffee suppliers, increased in 2010/2011. Operators agreed that the manual pod systems have improved in quality in recent years.

But operators also agreed that the leading single-cup providers have established dominant market positions that will be hard to displace. Operators noted that customers have demonstrated a willingness to pay higher prices for the leading single-cup products, even during a period of low consumer confidence.

While OCS operators remained frustrated by an inability to increase consumption in 2010/2011, the location downsiz-

ing of the prior two years ebbed, resulting in a stabilization of unit sales. Operators noted that customers recognized OCS provides a tangible employee benefit compared to other benefits, despite the higher cost.

A slight if temporary improvement in consumer confidence nationwide in early 2011 also played a role in the gains reported for all types of coffee retailers. The nation's unemployment rate fell from a high point of 10 percent in the fourth quarter of 2009 to a low point of 8.8 percent in the fourth quarter of 2010 before rising again to 9.2 percent in July 2011.

Operators also noticed that the accounts lost in 2008 and 2009 were less profitable accounts to begin with. Hence, the business that remained was more profitable on a per-account basis.

OCS STRENGTHENS HOLD ON ITS CUSTOMER

Another positive trend was the success that OCS operators scored protecting their business from alternative channels, such as office supply retailers, bottled water operators, membership warehouse clubs, supermarkets and Internet sites. *Automatic Merchandiser* reported last year that these players, particularly office supply companies, became more aggressive in 2009, presumably in response to lower sales in other product segments.

Automatic Merchandiser found in conversations with product

suppliers and research companies that these competing channels lost their share of OCS sales in the last year. Coffee product suppliers confirmed OCS operators' claims that these competing channels primarily cater to smaller OCS customers and were unable to provide service

that customers expect from OCS operators.

The report found that layoffs among OCS operators declined in 2010/2011 compared to the previous two years, indicated in chart 12a.

A similar number of operators added staff in 2010/2011 as in the prior year, but in the recent year, operators hired more people in non-sales positions, indicated in chart 12b. This indicates operators focused more in serving existing customers than in trying to win new ones.

The percent of operators adding products to address environmental concerns declined in 2010/2011, indicated in chart 13a. Operators interviewed noted

that consumers continue to place a strong emphasis on environmental issues, but are not willing to pay more for these items.

OCS operators have the tools to meet the demand for good quality coffee in the office. By investing in all aspects of their business – products, equipment, employees and marketing – OCS operators will continue to prosper. | ◀

CHART 14: COMPANY CURRENTLY OFFERS ONLINE ORDERING ON ITS WEBSITE

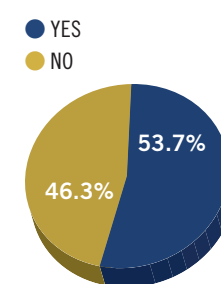


CHART 15: CUSTOMER SERVICE CONTRACTS

