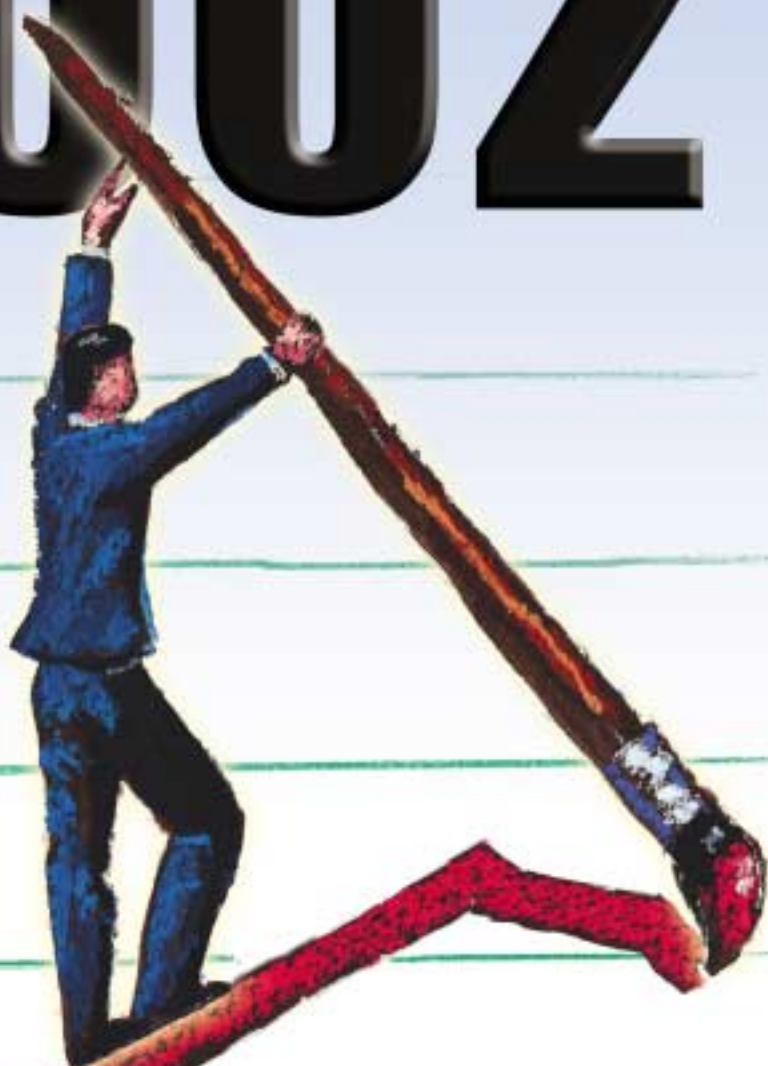


# 2002



**Automatic Merchandiser**

**2002 State of the Vending  
Industry Report**

# State of the Vending Industry Report

## Customer downsizing pulls top line down 5 percentage points for vending operators in 2001

BY ELLIOT MARAS, EDITOR

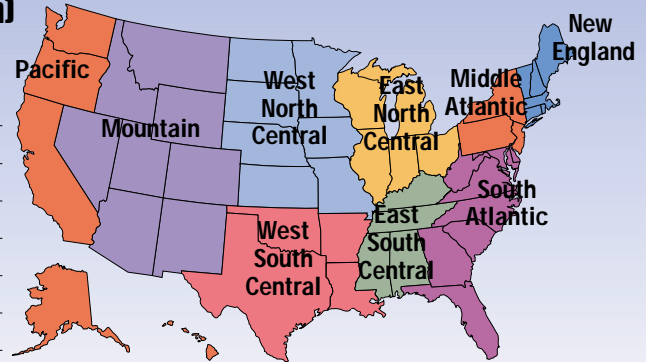
**N**ational employment trends came across loud and clear on vending operator's revenue ledgers in 2001. The customer downsizing that began in the second half of 2000 continued through 2001, chopping 5 percentage points from the industry's aggregate annual sales. Industry sales in 2001 totaled \$24.34 billion, according to the 25th *Automatic Merchandiser* State of the Vending Industry Report. Customer downsizing was exacerbated by an unforeseen national tragedy in the fourth quarter, making fiscal 2001 one of the worst years ever in the automatic merchandising industry's history. Sales fell almost to the 1998 level, reversing a growth trend that has been consistent for more than a decade.

### 1. 2001 Industry Total: \$24.34 billion

(2000 Total: \$25.62 billion)

#### Participants by Region:

Region	Operators
New England	4%
Middle Atlantic	12
East North Central	18
West North Central	7
South Atlantic	20
East South Central	6
West South Central	11
Mountain	5
Pacific	16
No answer	2



The 2001 recession affected both the emerging high-tech and the traditional manufacturing sectors of the economy. The fallout in traditional manufacturing was particularly damaging, as it remained the automatic merchandising industry's primary customer base.

Regions with a lot of manufacturing, such as the South Atlantic, New England, West North Central and East North Central regions, suffered significant layoffs. This delivered disproportionate sales losses in vend product categories more prevalent in blue-collar accounts, such as hot beverages, pastries and fresh food.

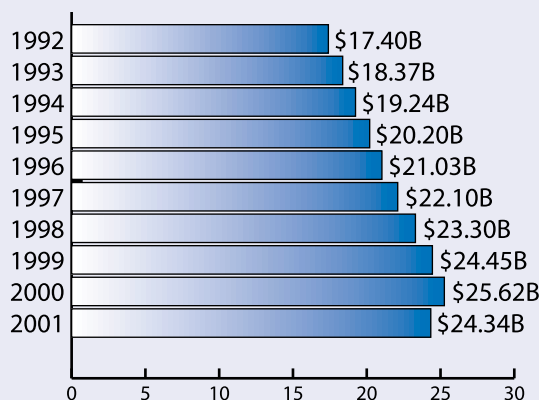
As indicated in chart 5, every vend product segment lost market share in 2001 at the expense of manual foodservice, which gained share, and OCS, which maintained its share. The strength of manual foodservice in comparison to other segments reflected the impact of the extra-large and large operations on total industry performance. The larger companies accounted for the majority of the foodservice business, which was concentrated in the largest accounts.

OCS, by contrast, sustained market share since it catered to smaller size accounts — which experienced less downsizing than larger accounts. Vending operators active in OCS were able to replace lost OCS accounts more easily than vending accounts.

Hence, in 2001, sales shifted to the

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### 2. Industry revenues, 10-year review



# State of the Vending Industry Report

## 3. Operator sales

Size	Revenue range	% of 2001 operators	Projected 2001 sales	% of 2001 sales	Projected 2000 sales	% of 2000 sales
Small	under \$1 million	75%	\$1.179 billion	5.1%	\$1.415 billion	5.8%
Medium	\$1 M - \$4.9 M	18	3.491	15.1	3.780	15.5
Large	\$5 M - \$9.9 M	4	2.058	8.9	2.800	11.5
Extra large	\$10 M +	3	16.394	70.9	16.400	67.2
Total			\$23.12 billion*		\$23.280 billion*	

\* Does not include 5 percent of total revenue for in-house and self-operated machines.

more damage on the Mid Atlantic region's economy. Operators serving accounts in Manhattan lost some large customers and, in some cases, their equipment as well. The Conference Board reported

two ends of the industry's customer base — the extra large accounts, dominated by foodservice, and the smallest accounts, dominated by OCS.

Automatic merchandising typically outperforms the foodservice industry in prosperous times, as it did in 1997 and 1998, and underperforms it in a recession. Foodservice industry sales grew by

3.7 percentage points in 2001, according to the National Restaurant Association's 2002 Restaurant Industry Forecast, compared to a 5.4-point growth rate the previous year.

Employers in the financial and "dotcom" industries, concentrated in the mid-Atlantic and Pacific regions, laid off the most employees, according to the

Conference Board, a Washington, D.C.-based organization that studies economic trends. The impact of this loss was less severe than that of traditional manufacturing, since it accounted for a smaller part of the market.

The Sept. 11th tragedy exacerbated the recession, adding the travel and leisure industries to those severely affected, and inflicting even

that the fourth quarter of 2001 witnessed the largest downsizing in the United States in more than 12 years, with more than 1.4 million jobs lost.

Interviews with operators confirmed that those serving the industries most affected by the 2001 recession — automotive, textiles, internet, telecommunications, aerospace, finance and hospitality — witnessed the biggest fallout in same-location sales.

### Labor supply expands

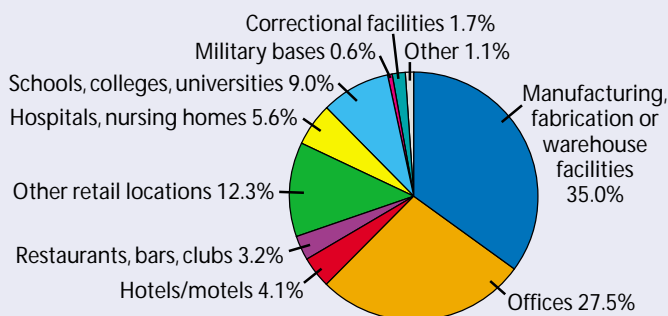
The only positive trend for operators was a more favorable labor market. Throughout the prosperous 1990s, operators complained of not being able to find qualified help. When layoffs began in April of 2001, most operators found they no longer had trouble finding qualified help. The situation also alleviated some of the pressure to raise employee compensation, delivering a small dose of relief to operators' suffering balance sheets.

Also on the positive side were stable product costs and fuel prices. The only product area where costs increased was in food. More than offsetting these positive factors, however, were skyrocketing costs for medical, worker compensation and business liability insurance.

Fiscal 2001 brought other challenges as well. The security concerns caused by the Sept. 11th tragedy created time-

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## 4. Machines installed by location type



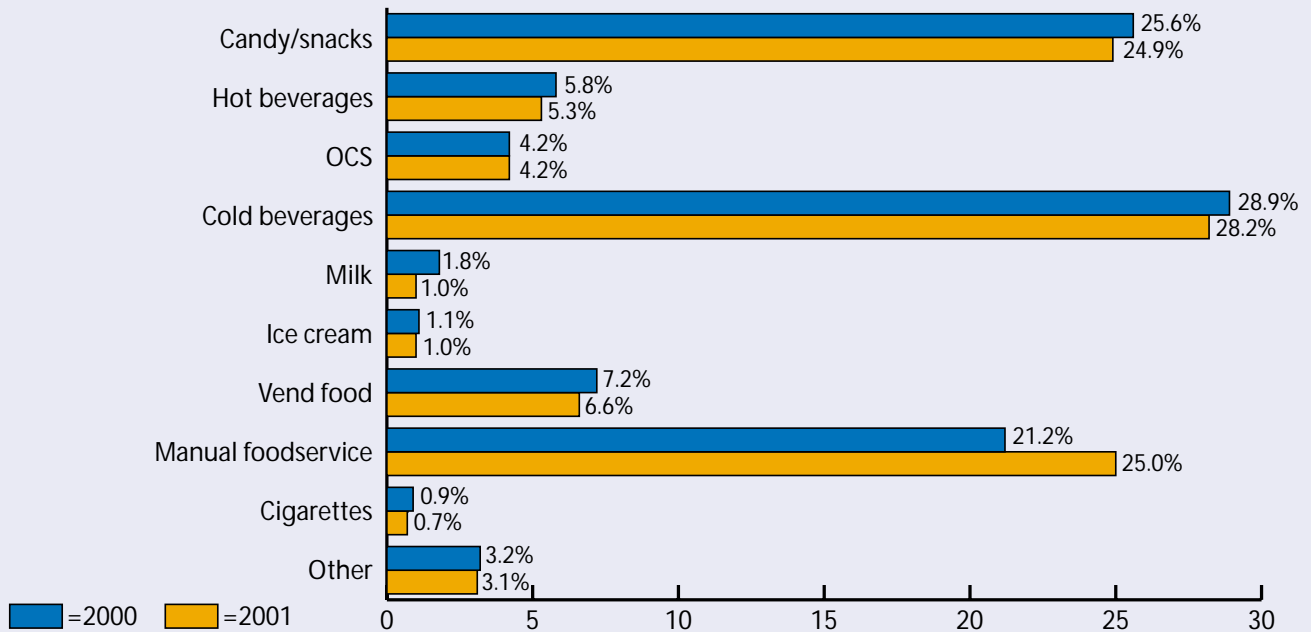
### 4a. Purchasing sources four-year review

Source	% expenditures from this source			
	1998	1999	2000	2001
Vend/OCS distributors	34.9%	42.7%	37.9%	44.2%
Foodservice distributors	15.6	20.7	17.7	8.9
Warehouse clubs	3.2	2.1	2.3	3.4
Manufacturer direct	14.9	9.7	8.7	9.5
Beverage bottlers	29.5	23.6	30.6	32.4
Outside commissaries	1.1	0.7	2.6	1.3
Other	0.8	0.3	0.2	0.4

Editor's Note: Different sample bases for each year.

# State of the Vending Industry Report

## 5. Projected sales by category, two-year review



consuming inconveniences for many operators. Many customers implemented security clearances for deliveries. Some operators viewed this as a benefit, however, since it raised vending's visibility with accounts and forced communication between route drivers and account personnel.

Consolidation among operating

companies took a slight breather in 2001, as indicated in chart 7. In recent years, rising operating costs and market saturation made acquisition a logical avenue to continued growth. Further fostering this trend were low loan rates — which continued through 2001 — along with the benefits of economies of scale.

One explanation for the slowdown in acquisitions was that many operators felt they would get a better selling price for their company when better times return.

While the percent of operators reporting involvement in acquisitions declined for the first time in four years in 2001, the extra large firms continued to grab a bigger portion of the total industry sales, as indicated on chart 3. The extra-large companies have been able to grow their market share by offering more services, providing

state-of-the-art equipment, utilizing state-of-the-art management tools such as machine planograms and handheld computers, offering higher wages, and enjoying more clout with product and equipment suppliers.

### Large operations continue to expand

Major operator acquisitions in 2001 included the following: Woburn, Mass.-based USRefresh sold most of its OCS business to Westwood, Mass.-based Filterfresh Corp. and most of its vending to Brockton, Mass.-based All Seasons Services Inc.; Compass North America (Canteen Vending Services Inc.) acquired Portland, Ore.-based Estey Corp.; and foodservice giant Sodexo Services Inc. developed a separate management team for vending and bought several companies.

Vendors overwhelmingly agreed that while operator consolidation continued, there was no let-up in competitive pressures. While the number of opera-

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### 5a. Projected sales by category, two-year review

Category	2000 sales	2001 sales
Candy/snacks	\$6.56B	\$6.06B
Hot beverages	1.49B	1.29B
OCS*	1.08B	1.02B
Cold beverages	7.40B	6.86B
Milk	461.20M	243.00M
Ice cream	281.80M	243.00M
Vend food	1.85B	1.60B
Manual foodservice	5.43B	6.08B
Cigarettes	230.60M	170.30M
Other	819.80M	754.50M

\* Refers only to OCS sold by vending operations. Does not include OCS sold by dedicated OCS operations.

# State of the Vending Industry Report

tors in some markets decreased, the remaining players became stronger.

Operators responded to customer downsizing in 2001 by reallocating capital resources, reorganizing routes, postponing capital investments, and reassigning employee tasks. Many operators interviewed reported reducing staff by not filling positions vacated by attrition. Operators, like other business owners, have always preferred to downsize by postponing replacements rather than laying off employees. In some cases, however, layoffs were necessary.

## Operators address morale issues

As in other recessions, the downturn hurt employee morale. Operators interviewed noted that open communication with employees was the best remedy for this challenge. Many met with employees to discuss their financial challenges, explain changes in employee roles and company practices, and ask for their support. In some cases, operators reorganized their routes so that drivers could share the more lucrative stops.

While sales declines undercut expansion plans, most operators recognized the need to improve their sales efforts in order to replace lost business. The survey did not measure the number of employees assigned to particular positions, but many operators who reported reducing their staffs maintained sales positions. Many also reported spending more of their own time selling to replace lost business.

Vendors also reduced operating costs by putting their own purchases, such as utilities and insurance, out for bids.

Expansion into glassfront cold drink machines, which holds potential to improve cold beverage sales, did not materialize in 2001. Expansion into frozen food machines continued in 2001, although at a slower pace than in the previous eight years.

## VEND WEST SERVICES CASHES IN ON 20-OUNCE BOTTLE VARIETY WITH GLASSFRONT COLD DRINK MERCHANDISERS

Vend West Services Inc. of Coos Bay, Ore. has a knack for keeping clear of recessions. In the late 1980s and early 1990s, the Pacific Northwest as a whole evaded the industrial woes of that downsizing era.

The region wasn't so lucky in the more recent recession. As the home base of Microsoft, much of the Pacific Northwest blossomed with the high-tech boom of the middle and late 1990s, only to suffer the consequences when that industry imploded.

West Vend Services, fortunately, wasn't much affected, noted Lou Leberti, president. His market, which is located about 220 miles south of Portland, never hosted a lot of high-tech companies. As a result, he's been able to invest in technology and provide services that keep him competitive with the ever-aggressive cold beverage bottlers.

Leberti is grateful for recent cold beverage innovations. As the 20-ounce PET bottles have become more popular, he's been able to capitalize on these products, thanks to glassfront cold drink machines. He operates about 35 of the machines, and finds they increase his sales and profitability.

In locations where he replaces a can machine with a glassfront filled with bottles, Leberti has witnessed a 12 to 15 percent sales lift. The increase does not taper off, he added.

Leberti does not rely on bottlers for his glassfront machines. While Coca-Cola has an exclusive on the newest bottle drop glassfront merchandiser, Leberti owns 35 earlier models.

Operators have mixed experiences with the glassfront machines. The earliest versions had some technical issues. As reliability improved, operators found the service more demanding. The machines have less capacity per facing, so the machines need to be serviced more frequently.

"Our maintenance department has done a great job of maintaining them," Leberti said.

He also recognized that the servicing takes longer. "It's just a situation where it just takes more time."

Leberti also acknowledged that the glassfront machines require a training process. But he's found the increased sales justifies the extra time and expense. The 20-ounce PET bottles grab a higher price point, and are preferred by consumers over cans.

Leberti has installed four-tube coin mechs in his glassfront drink machines, and equipped them with dollar coin payout. This facilitates the purchase process.

Leberti has found the glassfront machines particularly successful in schools, pulp mills and hospitals.



**Lou Leberti has noticed a sustained 12 to 15 percent boost in cold beverage sales in his glassfront machines.**

One exception to this trend to "lay low" was the percent using the Internet for business purposes, which grew faster than in prior years, as indicated on chart 17. The Internet is a technology that is changing business and personal life in

many ways.

Many large operators active in foodservice ordered product online using proprietary exchanges with foodservice providers. Operators of all sizes were able to save time ordering aftermarket



equipment parts online. A handful of operators active in OCS began to take OCS orders online.

Another exception to the tendency to postpone capital outlays was a continued updating of currency handling equipment in 2001, which increased over 2000. Operators needed to upgrade bill changers and validators to accept new \$5 and \$10 currency designs. Upgrades of bill changers and validators continued at the same rate — more than 6 percent — as the prior year.

The number of bill changers remained relatively stable in 2001, despite a slight gain in the percentage of machines equipped with bill validators, which would theoretically replace the need for bill validators. This likely reflected a desire to maximize transactions using all available tools.

### \$5 bill acceptance grows

The growth in \$5 bill acceptance supported a similar increase in dollar coin payout in 2001. This was because machines that accepted high denomination bills but didn't pay out dollar coins quickly emptied out of coins. Hence, operators found it made sense to offer dollar coin payout in conjunction with \$5 bill acceptance.

The percent of machines paying out the dollar coin increased in 2001, although it remained very small at about 6 percent. Operators reported less difficulty procuring supplies of the dollar coin and more success getting customers to use it. Typically, operators noted it took a few weeks after the machines started paying out dollar coins for customers to stop hoarding them and use them in the machines.

Operators generally believed that paying out dollar coins and accepting \$5 bills encouraged consumer spending. However, it also required additional capital investment, which many chose to postpone in 2001 because of the

poor economy.

Dollar coin payout also often required an upgrade to four-tube coin changers. This not only required a new changer, but more cash remained in the machine. In addition, the acceptance of \$5 bills also raised the need for new bill sorting equipment since sorting \$5- and \$1 bills manually is very labor intensive.

The percent of operators using handhelds remained flat in 2001, as most did not wish to invest in new computer systems. The percent utilizing DEX (Digital exchange), telemetry technologies, cashless solutions, satellite vehicle tracking and electronic security systems, advances that promised significant operational savings, also remained miniscule.

The recession was not the only reason these new technologies did not grow significantly in 2001, however, as vendors have always been slow to adopt new technologies.

With the economy in tatters, product suppliers, several of whom consolidated in 2001, held off on product introductions. Operators cited this as another factor undercutting their efforts to stimulate sales.

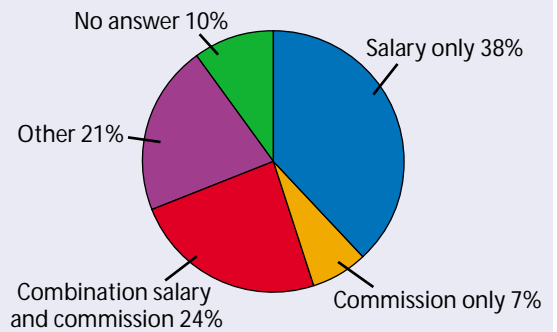
Fears of across-the-board product cost increases did not materialize as more manufacturers merged in 2001. However, neither did any of the benefits some operators hoped manufacturer consolidation would bring. Some operators hoped larger suppliers, with larger research and development resources, would introduce more products and provide more marketing support.

### More suppliers consolidate

Supplier consolidations announced in 2001 included:

- Philip Morris, owner of Kraft Foods Inc., finalized its purchase of Nabisco

## 6. How drivers are compensated



Holdings Corp. Kraft Vending & OCS announced a marketing organization including Kraft and Nabisco brands for vending and OCS.

- Kellogg Co. finalized its acquisition of Keebler Co.
- PepsiCo Inc. finalized its acquisition of Quaker Oats Co., which owns Gatorade and South Beach Beverage Co. PepsiCo announced a new marketing organization combining Frito Lay Inc., Gatorade, Tropicana and Quaker.

Lack of new products also made it difficult for operators to raise prices. As the pricing information in this report indicates, prices barely rose in 2001. Prices rose the most in the food category, where many of the larger operators were able to introduce new menu items in their commissaries.

Recessions typically raise customers' tendency to seek higher commissions and lower selling prices. Operators interviewed agreed that while this pressure reared its head in 2001, it was not as big a factor as it was in the last recession in 1990/1991. One reason was that customers recognized that vending operators faced the same cost increases — such as fuel, wages and benefits — that they themselves faced. Another reason operators cited was the success of their own efforts to communicate automatic merchandising's value as an

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important employee benefit.

Fiscal 2001 saw the beginning of a renewed public interest in child nutrition that gave momentum to new regulatory initiatives. The U.S. Department of Agriculture called for stricter guidelines for school food, including new restrictions on vending machines in schools. At the end of 2001, Surgeon General Dr. David Satcher called for a series of initiatives to restrict vending machines in schools.

Concern over child nutrition supported an earlier movement to oppose exclusive beverage vending contracts in schools. Prior to 2001, consumer groups were pressuring school districts to stop awarding large, exclusive cold drink vending contracts in exchange for financial support. This movement initially offered opportunity to vending operators who historically lost these accounts to large cold drink bottlers.

Growing concern about child nutrition also gave rise to milk vending initiatives in schools. In 2000, the dairy industry launched a program to market

dedicated milk machines in schools. These efforts emphasized the nutritional benefits of milk and included tests nationwide, which continued through 2001. The tests indicated a ready market for milk vending in secondary schools.

The concern about children's nutrition extended beyond the cold drink arena, however. Public officials began calling for new restrictions on vending machines in schools.

## About the study

The *Automatic Merchandiser* State of the Industry Report was based on questionnaires completed by a random sampling of 1,834 readers. The survey generated a 24 percent response.

Survey participants were limited to full-line, candy/snack and self-operated vending businesses that sold candy, snacks, confections, cigarettes, hot beverages, cold beverages, refrigerated food, frozen food, ice cream and manually served food. The sampling did not include music and game operators whose main business was not consum-

able merchandise vending, soft drink bottlers whose main business was not vending, or ice cream distributors whose main business was not vending.

Aggregate revenue and equipment figures for the report were based on a total operator universe of 9,000 vending operations in the U.S., along with data from the government, product suppliers and equipment suppliers. The mailing and tabulating were done by Readex Inc., a Stillwater, Minn.-based industrial research company.

The report's revenue and equipment figures include machines operated by business locations for their own use, known as in-house and self-operated machines. This portion is estimated to be about 5 percent of the total industry.

## 1990s prosperity fades

The 1990s prosperity began to erode in the second half of 2000 with the "dotcom" crash, as reported in last year's State of the Vending Industry Report. Operators serving a lot of these companies were the first to report a fall-off in sales. Employment in the financial services sector held up in 2000 despite falling stock values, according to the Conference Board, until 2001, when even that sector suffered layoffs.

The decline in Internet-related and financial sector employment was particularly devastating to the mid-Atlantic and New England regions, which also suffered layoffs in manufacturing.

The "dotcom" crash hurt the Pacific region as much as any region. The Pacific region also suffered a fallout in aerospace manufacturing.

Both the East North Central and East South Central regions were hurt by dwindling heavy industrial manufacturing activity.

The automotive sector, the largest single automatic merchandising customer, experienced a weak year in 2001. Automotive production grew by

## 7. Acquisition activity, four-year review

	1998	1999	2000	2001
% operations that acquired other operations	13%	16%	16%	12%
% operations that sold some part of operation	6	6	6	5
% that did both of the above	9	6	9	7
% that did neither	71	69	68	75
No answer	1	2	0	1

## 8. Other types of vending-related sales reported, four-year review

Type	% operators involved			
	1998	1999	2000	2001
Bottled water	32%	33%	38%	41%
Sundries/toiletries	14	14	13	14
Games	11	13	10	11
Music	9	9	7	8
Bulk vending	12	15	17	13
Kiddie rides	4	3	3	3
Cooperative service vending	3	3	3	3
Condoms	4	5	5	4

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1.29 percentage points in the U.S. in 2001, according to the Detroit, Mich.-based Automotive News Center. This was less than half the prior year's increase, and well below those of the mid

## 9. Cold beverage machines, four-year review

Year	Projected total
1998	1,487,840
1999	1,613,800
2000	1,650,300
2001	1,554,583

(Editor's note: These totals do not include all bottler-owned machines loaned to vending operations, or machines placed by bottlers that don't have separate vending organizations.)

and late 1990s. The slowdown not only affected automobile plants, but factories that supplied these plants. These slowdowns hurt the East South Central and East North Central regions the most.

The South Atlantic region was not as affected by Internet-related woes as some other regions, but it was hurt by the drop in tourist trade that resulted from the Sept. 11th tragedy.

The West South Central regions fared better than most, thanks to a reasonably healthy energy industry and an expanding export industry. One negative factor in the West South Central region however, was a decline in telecommunications employment, which also hurt the Mountain region.

Following is a more detailed analysis of the major product segments.

### Cold drinks: bottles replace cans

Bottles continued to replace cans for the sixth consecutive year. Bottles grabbed 35.8 percent of all cold drink sales in 2001, growing at the same rate as the previous year. Once again, the increase was driven largely by the rise in bottle-capable machines. Dedicated bottle and combination bottle/can machines accounted for 39.3 percent of all machines on location, a marked gain over the 22.4 percent in 2000, which was only slightly higher than the 21.9 percent in 1999.

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## Cold beverage machines by type, four-year review

Machine type	% of total				Projected total			
	1998	1999	2000	2001	1998	1999	2000	2001
Can	78.1%	68.8%	69.7%	52.5%	1,162,003	1,111,894	1,155,200	816,156
Bottle	7.2	18.5	12.8	21.4	107,124	298,553	213,400	332,681
Cup	4.1	2.6	2.7	2.9	61,001	41,958	44,600	45,083
Dedicated can juice	5.2	5.7	4.6	4.5	77,368	91,986	77,000	69,956
Combination bottle/can	5.0	3.4	9.6	17.9	74,392	54,869	158,400	278,270
Other	0.4	0.9	0.6	0.8	5,952	14,524	1,700	12,437

## Cold beverage sales, four-year review

Beverage type	% of sales				Projected total			
	1998	1999	2000	2001	1998	1999	2000	2001
Can drinks	75.5%	67.7%	62.8%	59.0%	\$4.80B	\$4.82B	\$4.65B	\$4.05B
Bottle drinks	18.5	27.2	31.5	35.8	1.17B	1.94B	2.33B	2.46B
Cup drinks	5.2	4.9	4.9	4.0	331.00M	348.10M	362.60M	274.40M
Other	0.8	0.3	0.8	1.1	51.00M	2.10M	59.20M	75.46M

## Average cold beverage prices, four-year review

Beverage type	1998	1999	2000	2001
Can beverage	59 cents	57 cents	59 cents	59 cents
Bottle beverage	90	93	98	95
Cup beverage	49	47	49	53



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Unit bottle sales grew, but flat selling prices undercut profits in the expanding bottle business.

The surge in bottle capable machines brought more price competition to the business, as the average bottle price fell in 2001 for the first time in six years, as indicated in chart 9.

The survey indicated that the larger operators placed more bottle machines and sold a higher percentage of bottle drinks. Larger operators also succeeded in charging slightly more for bottles than smaller competitors.

One advantage larger operators had in the bottle business was a greater ability to operate dedicated cold beverage routes, which has proven a more cost-efficient way to inventory and deliver bottle beverages.

Operators of all sizes noted that machine loan programs from beverage

bottlers offered them the fastest way to get into the growing bottle business.

Several operators interviewed reported subcontracting their cold drink business to full-service beverage bottlers. This relieved them of the costs and hassles associated with bottles. Bottles, being larger and bulkier than cans, required more warehouse space, took more room on the truck, increased some risk exposure and insurance costs, were heavier for drivers to load, and increased wear and tear on delivery vehicles.

## Many still prefer cans to bottles

The costs involved in expanding into bottles caused many operators to continue to prefer cans, which offered lower selling price but a higher gross profit margin. Operators noted that many consumers, particularly older and female consumers, continued to prefer

cans over bottles. In many blue-collar work sites, workers cannot carry bottles to their work areas. Cans, on the other hand, can be consumed in the break room faster than bottles.

While most operators agreed pricing pressure was less intense for cans than bottles, most were nonetheless unable to raise can prices in 2001. One reason cited was supermarkets' practice of offering mark-downs on can multipacks as promotional loss leaders.

While larger operators were able to charge slightly more for bottles than smaller operators, can prices were more equitable among all size operators.

Dedicated can juice machines declined as a percent of total cold beverage machines for the second consecutive year. Juice companies recognized that many operators preferred other forms of marketing support to



dedicated juice machines. As only a minority of locations could support dedicated juice machines in addition to carbonated soft drink machines, operators preferred price discounts and generous rebates to dedicated juice machine programs.

### **Dedicated machine programs continue**

The decline in dedicated can juice machines did not signal any lack of interest in dedicated machines for other alternative beverages, however. The larger sports drink, ready-to-drink-tea and bottled water manufacturers continued to support dedicated machine programs in 2001. Sports, ready-to-drink teas and bottled water were usually marketed in bottle machines rather than can venders.

Overall, the number of machine loan

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## **FLAVORED AND MINERAL-ENHANCED WATERS GIVE AN ADDED PUSH TO THE BOOMING BOTTLED WATER BUSINESS**

Bottled water continues to be the fastest growing segment of the cold beverage business. The percentage of vending operators selling bottled water has increased every year for the past seven years, and in recent years, sales have consistently posted double-digit gains.

To sustain this growth, some manufacturers have introduced fruit-flavored, zero-calorie spring water. These fruit-enhanced waters have taken on a life of their own, with sales more than doubling every year for the past three years.

One cold drink manufacturer, Veryfine Inc., has further developed the flavored water business with vitamin-enhanced water.

In 1999, Veryfine Inc. introduced Fruit<sub>2</sub>0<sup>®</sup>, a lightly fruit flavored natural spring water sweetened with SPLENDA<sup>®</sup> sweetener, containing no calories and no carbonation, in six flavors. Fruit<sub>2</sub>0<sup>®</sup> sales have more than doubled every year.

Veryfine followed Fruit<sub>2</sub>0<sup>®</sup> with Fruit<sub>2</sub>0<sup>®</sup> Plus, a natural spring water fortified with herbs and vitamins in three flavors. Combined, Fruit<sub>2</sub>0<sup>®</sup> and Fruit<sub>2</sub>0<sup>®</sup> Plus are the fastest selling water brands in U.S. convenience stores. According to Chicago-based Information Resources Inc., Fruit<sub>2</sub>0<sup>®</sup> and Fruit<sub>2</sub>0<sup>®</sup> Plus sold 260 units per store for the 24 weeks ending Feb. 23, 2002.

# State of the Vending Industry Report

## 9a. Top 20 cold beverages in 2001, dollar sales

### Rank Product

1	Coca-Cola 12-oz. Coke Classic
2	Pepsi-Cola 12-oz. Pepsi Cola
3	Pepsi-Cola 20-oz. Pepsi Cola
4	Coca-Cola 12-oz. Diet Coke
5	Coca-Cola 20-oz. Coke Classic
6	Dr Pepper 12-oz. Dr Pepper
7	Pepsi-Cola 12-oz. Mountain Dew
8	Pepsi-Cola 20-oz. Mountain Dew
9	Pepsi-Cola 20-oz. Aquafina Purified Water
10	Pepsi-Cola 20-oz. Diet Pepsi
11	Pepsi-Cola 12-oz. Diet Pepsi
12	Coca-Cola 20-oz. Diet Coke
13	Coca-Cola 12-oz. Sprite
14	Coca-Cola 20-oz. Sprite
15	Dr Pepper 20-oz. Dr Pepper
16	Coca-Cola 12-oz. Cool Nestea
17	Lipton 20-oz. Lipton Brisk Lemon Tea
18	Quaker Oats 20-oz. Gatorade Wide Mouth Fruit Punch
19	Coca-Cola 12-oz. Barq Olde Tyme Root Beer
20	Dr Pepper 12-oz. Diet Dr Pepper

Source: MSA Vendscape™ Market Watch Report

programs from alternative cold drink manufacturers decreased. In 2001, only a handful of large sports drink, ready-to-drink-tea and bottled water manufacturers offered such programs.

The survey did not measure the number of glassfront cold drink machines. However, interviews with machine manufacturers and vending operators alike confirmed that the number did not rise much in 2001 as some had anticipated in 2000, when the Coca-Cola Co. sanctioned a glassfront machine.

### Glassfront machines increase slowly

While glassfront cold drink machines had been available for several years, most were plagued with technical issues. In 2001, the new Coke machine was heralded as a major improvement.

With enhanced reliability, glassfront

cold drink machines offered the hope of providing a much-needed boost to the cold drink business. The machines provided better merchandising than closed-front venders, particularly the ability to present a wider product selection. Tests indicated the machines increased sales.

The Coca-Cola Co.'s glassfront rollout got off to a late start in 2001. This, along with the reluctance of bottlers to invest in new equipment, minimized the machines' availability in 2001.

Operators using glassfront models reported mixed results in 2001. The glassfronts required more service than closed-front machines. There was also less capacity per column, leaving operators the choice of either doubling up on columns or stocking more variety. While greater product variety was one of the machine's purposes, maintaining the

variety required additional labor, transportation and warehouse costs.

Last year's State of the Vending Industry Report indicated a decade-long drop in cold cup machine placement had leveled off. This trend continued in 2001, as the survey once again reported a slight gain in cup machine placements.

But while machines increased, sales dipped. Cup drinks, like cans, lost market share to bottles once again in 2001.

### Cold drink sales falter overall

The cold drink sector's weak performance in 2001 largely reflected the state of the cold beverage industry as a whole. According to the New York City-based Beverage Marketing Corp. (BMC), which studies beverage trends, carbonated soft drinks (CSDs) posted their third consecutive soft year in 2001, with retail sales growing only 2.5 percentage points. CSD volume has increased 0.5 points per year for the last three years.

While far and away the largest cold drink category, CSDs lost share of retail sales in 2001, as did juice drinks and milk. Sports drinks and bottled water were the only beverages among those typically sold through vending machines to gain share of total retail sales in 2001.

Bottled water was the only category to grow sales in double digits at 18.4 percentage points in 2001, outside of energy drinks, a brand-new category that was barely visible in vending machines.

Energy drinks, a European import that first emerged in U.S. bars on the West Coast in 1997, found their way to vending in 2001. The nutrient-enhanced drinks came in tall cans and commanded exceptionally high prices. They were popular with young people and posted double-digit sales increases every year through 2001. Several beverage companies, including Coca Cola Co., Snapple Beverage Co., South Beach Beverage Co.

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# State of the Vending Industry Report

(owned by PepsiCo) and Anheuser-Busch announced energy drink rollouts.

The category leader, Red Bull North America, tested some dedicated Red Bull

machines on the West Coast in 2001. But for the most part, the category was barely visible in vending.

Sports drinks posted an 8.4-point

volume gain. The leading player, Gatorade, received a major boost after PepsiCo acquired Quaker Oats and formed a new marketing division combining Gatorade, Topicana, Frito Lay and Quaker.

Coca-Cola responded with a strong marketing push for its sports drink, Powerade.

A decline in the amount of milk sold in cold drink machines in 2001 reflected the negative trend of the milk category in general, as discussed on page 52. The BMC also reported producer volume of milk fell in 2001, following an increase the previous year that was driven by aggressive dairy industry marketing.

## Candy/snacks tough it out again

While the economy was once again the main factor, the fact that most operators chose to postpone computer upgrades in 2001 partly accounted for the candy/snack/confection segment's weak performance. Candy, snacks and confections, more than any product segment, stands the most to gain when operators upgrade their data retrieval and computer systems.

Being the most SKU (stock keeping unit) intensive product segment, candy/snacks/confections required more management than other vend product categories. Operators equipped with tools such as handheld computers that can measure item-level change and quickly assess the financial ramifications of a menu change were better able to determine the most profitable product mix.

One reason the large and extra large operators reaped higher sales was that the management of these larger firms was more involved in machine menu planning and used more handheld computers. This was particularly important in the candy/snack/confection segment, which by far has the most SKUs to manage.

The larger the company, the less authority the route drivers had in making

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## VETERAN INDEPENDENT FINDS SEVERAL ADVANTAGES IN HIS LIFE AFTER ACQUISITION

Life was not easy being an independent vending operator in a region that was suffering a lot of workplace downsizing. Steve and Dawn Melillo, who operated Melillo Vending & Amusements Inc. in Brockport, Pa., were facing some tough decisions as the economy worsened in western Pennsylvania in the middle 1990s.

Having been raised in the business started by his father, Steve Melillo knew something had to be done to ensure the success of the enterprise he had inherited and nurtured. Not only were the accounts downsizing, but operating costs were rising. Medical benefits, insurance premiums, and fuel costs were all costing more each year.

There was not a lot of capital available to reinvest in equipment and vehicles. Product costs were also rising. Being a seven-route operation, the company did not have a lot of buying clout with suppliers.

Melillo did not want to simply cash out, however. He liked the business, and felt an obligation to his employees, some of whom he had known for more than 20 years. With the right support, he knew the operation could prosper.

"We didn't just want it to go away," Melillo said. "We didn't want to break it up. We wanted to keep our vision intact. So we went out and researched who was available."

From reading *Automatic Merchandiser*, Melillo was aware that Brockton, Mass.-based All Seasons Services Inc. was a large operation that preferred to acquire companies with existing management in place. It seemed like an opportunity for Melillo to stay with the business and preserve jobs for his employees. He placed a call to All Seasons Services.

"I never called anybody else," Melillo said. He liked the fact that his negotiations were kept confidential. He didn't want to alarm his employees or his customers that he was negotiating a change in ownership.

The transaction was completed in March. Steve Melillo is now a sales executive for All Seasons Services' Brockport, Pa. operation while Dawn is operations manager. All of the employees were kept, and most have seen their salaries and benefits improve. "The employee has more in his pocket because the benefit price went down (as a result of a larger buying power)," Melillo said. The employees now have a retirement plan and dental insurance, which they didn't have previously.

In his new role, Melillo likes being able to focus on one job now instead of several. He used to have to worry about finances and personnel in addition to marketing and operations. Now there are entire departments handling those functions. "All those different things are taken care of," he said. "I don't have to worry about those things any more." Going from an owner to an employee has been a transition for Melillo. He is glad that his employer understands this.

All Seasons Services Inc.'s capital resources have put the operation in a stronger competitive position, Melillo noted. He now has professional marketing materials, and the drivers have new trucks.

At home, Steve and Dawn now have more time to enjoy life without the constant worries that a business demands.



# State of the Vending Industry Report

product selections. Larger companies also used more planograms. However, even the larger operators did not implement DEX/UCS technology in 2001, mostly for cost reasons.

DEX/UCS, among its various

benefits, gives the operator the ability to quickly and accurately measure column sales. To utilize DEX/UCS, however, operators must have DEX-capable machines and integrate the DEX/UCS data with their software.

Another reason for the category's weak showing in 2001 was the lack of innovative new products, which has plagued the category since Famous Amos came out in the early 1990s.

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## 10. Candy/snacks/confections, four-year review

### Candy/snacks/confections machines, four-year review

Year	Projected total
1998	1,512,775
1999	1,676,900
2000	1,695,400
2001	1,508,906

### 2001 snack machines by type

Machine type	% of total	Projected total
Glassfront	83.5%	1,252,392
Columnar candy/pastry	4.5	67,901
Honor boxes	10.0	150,890
Other*	2.5	37,723

\*Includes tabletop and combination machines

### Candy/snacks/confections revenues, four-year review

Category	% of total				Projected total			
	1998	1999	2000	2001	1998	1999	2000	2001
Candy bars	30.2%	30.9%	26.2%	27.4%	\$1.79B	\$1.92B	\$1.72B	\$1.660B
Bagged/boxed candy	3.3	6.8	4.6	2.7	195.40M	422.00M	301.70M	163.620M
Gum/mints	5.7	4.2	4.1	3.7	337.40M	260.70M	269.00M	224.220M
Bagged chips	27.8	28.5	31.6	30.3	1.64B	1.77B	2.07B	1.836B
Bagged crackers	1.7	3.1	1.6	1.9	100.60M	192.40M	105.00M	115.140M
Cracker sandwiches	5.9	4.0	4.5	5.3	349.30M	248.30M	295.20M	321.180M
Bagged/jumbo cookies	7.6	5.0	6.3	7.4	500.00M	310.30M	413.30M	448.440M
Pastries	12.6	12.7	15.0	14.2	746.00M	788.30M	985.00M	860.520M
Nuts	2.2	1.4	2.3	1.7	130.20M	86.90M	150.90M	103.020M
Microwave popcorn	2.1	1.8	2.2	2.1	124.30M	111.70M	144.30M	127.260M
Meat snacks	-	-	0.9	0.7	-	-	59.00M	42.420M
Other	1	1.6	0.7	2.6	5.92M	99.30M	46.00M	157.560M

### Average price points, four-year review

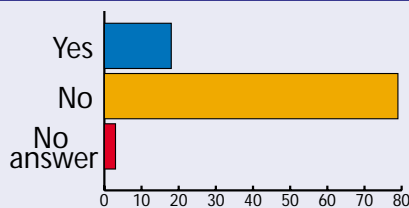
	1998	1999	2000	2001
Candy bar	58 cents	58 cents	59 cents	59 cents
Bagged/boxed candy	62	65	65	62
Gum/mints	42	43	44	43
Bagged chips	50	51	48 RSS,70 LSS	51 RSS,70 LSS
Bagged crackers	54	53	54	58
Cracker sandwiches	52	51	49	53
Bagged/jumbo cookies	60	63	62	62
Pastries	69	71	70	73
Nuts	53	54	55	57
Microwave popcorn	64	66	67	67
Meat snacks	-	-	59	62

# State of the Vending Industry Report

## 10a. Who is primarily responsible for making candy/snack/confection selections in machines

Management	64%
Route driver	40%
Other	7%
Indicated one or more	89%

## 10b. Drivers are required to use a planogram for candy/snack/confection machine



Several product manufacturers consolidated in 2001, creating the promise of more new products, more marketing and merchandising support. However, the recessionary economy and internal organizing slowed down these developments.

Within the candy/snack/confection category, bagged chips commanded the largest percent of sales for the second consecutive year in 2001. Last year's survey reported bagged chips unseated candy bars as the top revenue producer for the first time.

### Candy bars regain some ground

In 2001, candy bars regained some of the ground lost to bagged chips, marking candy bars' first upward movement in three years. The gain, as slight as it was, most likely reflected a leveling off in large single serve (LSS) placements.

LSS as a percent of bagged chip sales held steady in 2001. This was the second

## 10c. Top 20 candy/snacks/confections in 2001, dollar sales

Rank	Product
1	Masterfoods USA 2-oz. Snickers Original
2	Masterfoods USA 1.74-oz. M&M's Peanut
3	Frito-Lay 1.75-oz. Doritos Nacho Cheesier Big Grab
4	Masterfoods USA 2-oz. Twix Bar
5	Kellogg/Keebler 1.5-oz. Cheez-It Original
6	Frito-Lay 2.125-oz. Chee•tos Crunchy LSS
7	Hershey 1.6-oz. Reese's Peanut Butter Cups
8	Masterfoods USA 2.3-oz. Three Musketeers Original
9	Masterfoods USA 1.42-oz. Skittles
10	Masterfoods USA 1.69-oz. M&M's Milk Chocolate
11	Masterfoods USA 2.07-oz. Starburst Original
12	Frito-Lay 2.25-oz. Fritos
13	Frito-Lay 1-oz. Lay's Potato Chips
14	Hershey 1.45-oz. Almond Bar
15	Frito-Lay 1.7-oz. Chee•tos Crunchy
16	Frito-Lay 1.25-oz. Fritos Chili Cheese
17	Frito-Lay 1.5-oz. Ruffles Cheddar & Sour Cream
18	Kellogg/Keebler 2-oz Famous Amos Chocolate Chip Cookies
19	Kellogg/Keebler 3.6-oz. Strawberry Pop-tarts
20	General Mills 1.75-oz. Traditional Chex Mix

Source: MSA Vendscape™ Market Watch Report

year the survey measured LSS sales, and LSS once again commanded about 10 percent of all bagged chip sales. LSS bagged chip sales began to level off in 1999.

The downsizing in industrial accounts hurt LSS chip sales more than other product segments in both 2000 and 2001. The larger firms suffered more from the downsizing in this customer base than smaller firms, and sold a higher percentage of LSS.

Aside from candy bars, bagged crackers, cracker sandwiches and bagged/jumbo cookies all gained market share within the candy/snack/confection segment in 2001. Categories losing share besides bagged chips included bagged/boxed candy, gum/mints, pastries, nuts, microwave popcorn and meat snacks.

All of the categories that gained share in 2001 included a large number of national name brand products, underscoring the importance of strong brands in vending. To be fair, some of the categories losing share also included name brand players. This was because other factors, such as weak marketing support and the small number of product introductions, also came into play.

The pastry category was a segment that continued to suffer from lack of product innovation. This was not confined to the vending channel.

The pastry category has long relied on regional and local suppliers. Hence, performance has often varied by region and locale, based on the strength of these brands.

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# State of the Vending Industry Report

## 10d. Top 15 gum and mint products in 2001

### RankProduct

1	Wm. Wrigley Jr. Co. Wrigley Doublemint
2	Adams CinnAburst
3	Kraft Foods Lifesavers 5 Flavor
4	Kraft Foods Lifesavers Wintergreen
5	Adams MintAburst
6	Wm. Wrigley Jr. Co. Wrigley Juicy Fruit
7	Wm. Wrigley Jr. Co. Wrigley Big Red
8	Kraft Foods Lifesavers Peppermint
9	Wm. Wrigley Jr. Co. Wrigley Spearmint
10	Hershey Foods Ice Breakers Mint
11	Hershey Foods Carefree Bubble Gum
12	Kraft Foods Lifesavers Spearmint
13	Adams Certs Peppermint
14	Hershey Foods Carefree Spearmint
15	Wm. Wrigley Jr. Co. Wrigley Winter Fresh

Source: VSA Inc.

Heavy layoffs in industrial accounts also hurt pastry sales. In last year's report, the pastries received an artificial boost with the inclusion of toaster pastries in the grouping.

Nuts also lost market share in 2001, largely due to industrial layoffs in the South, where they have historically been more popular. The product's perception as having high nutrition and an uptick in product introductions bodes well for

the long term, however.

Among the categories that gained market share in 2001, bagged cookies and bagged crackers both benefited from the perception of fitting consumers' on-the-go lifestyles. These items, supported by strong name brand recognition, fit the demand for snacks that can be eaten in transit or easily consumed at different periods of time.

Bagged crackers, it should be noted, was a growth area that was dominated by the smaller operators. The only other "winning" category where this also held true in 2001 was candy bars.

The larger operators generally charged higher prices for candy/snack/confections. The exceptions were gum/mints and meat snacks, also segments in which small operators sold more than larger competitors on a percentage basis.

## TEXAS REFRESHMENTS LOOKS FORWARD TO USING ALL FROZEN MACHINES TO SERVE FOOD

Industrywide, food had a tough year, but frozen machines keep on growing. In Midland, Texas, some major corporations — such as a new stadium and a wireless phone company — gave the economy a shot in the arm recently. Texas Refreshments Inc. hasn't missed a beat offering the best branded food, which, according to co-owner Albert Tucker, keeps improving.

Some of the name brand frozen-prepared food products have enabled the company to raise its food prices, noted Tucker. They now charge \$3.00 for Pierre chicken wings and a Big AZ sandwich.

About half of all food machines are frozen machines, and Tucker looks forward to the day when all of his food machines will be frozen. The frozen machine requires less service since there is no waste. He normally reserves one shelf in each machine for ice cream with the balance for food.

The frozen machine, with its less intensive service requirements, enable Texas Refreshments to provide food in a location with as few as 70 people, Tucker said. This makes his company more competitive, as food continues to stay high in demand.

To facilitate the high-ticket sales, Texas Refreshments keeps its machines stocked with dollar coins. They are presently in the process of installing more four-tube coin mechs so the mechs don't empty out of quarters. Customers are increasingly using \$5 bills, Tucker noted. The company also invested in a two-pocket bill sorter to make it easier to separate \$1s and \$5s.



**Albert Tucker has found brand names enable him to charge more for food products.**

### Honor box placements grow

The survey reported a growth in honor box placements in 2001. This likely reflected the growth in small locations, which starkly contrasted the downsizing in large locations. Operators active in honor snacks were able to maintain and increase customer counts.

The financial challenges facing honor snack operators in recent years — such as rising operating costs and pricing pressure — reduced the number of large operators. While the survey did not measure the number of honor box operators, product suppliers confirmed a steady influx of newcomers in recent years.

### Coffee still needs a jolt

Give the industry credit for perseverance. No matter how hard it gets hammered, it keeps fighting back.

With industrial accounts hurting

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# State of the Vending Industry Report

## 11. Hot beverages, four-year review

Year	Machine Total
1998	386,600
1999	411,000
2000	425,000
2001	399,500

more in 2001 than in 2000, what could one expect but a further decline in a category that largely relies on an industrial customer base?

Vend coffee sales in 2001 were further impeded by an unseasonably warm winter in the Northern states, which followed the Sept. 11 tragedy. Since the survey indicated that hot beverage machines were more concen-

trated in the New England and East North Central regions, the weather's impact was especially severe.

For the seventh straight year, hot drink revenues lost market share, as indicated in chart 5. As in 2000, vendors continued to invest in equipment to serve better quality beverages.

The vending industry once again

CONTINUED

## Hot beverage machines by type, four-year review

Type of machine	% of total				Projected total			
	1998	1999	2000	2001	1998	1999	2000	2001
Fresh-brew, preground	49.4%	52.5%	54.5%	55.8%	189,989	215,775	231,625	222,921
Fresh-brew, whole bean	32.0	29.7	29.8	32.3	122,712	122,067	126,650	129,038
Dedicated freeze-dried	15.3	12.3	10.4	6.9	58,150	50,553	44,200	27,566
Single-cup	3.3	5.0	5.3	4.8	15,629	20,550	22,525	19,176
Other	0	0.5	0	0.3	0	2,055	0	799

## Hot beverage sales, four-year review

Type	% of total				Projected total			
	1998	1999	2000	2001	1998	1999	2000	2001
Fresh-brew regular	55.6%	59.5%	58.1%	54.0%	\$816.0M	\$880.6M	\$865.7M	\$696.60M
Fresh-brew decaf	7.7	7.4	6.5	6.2	141.0M	109.5M	96.9M	79.98M
Fresh-brew specialty/flavored	9.0	8.1	8.4	6.3	129.0M	119.9M	125.2M	81.27M
Freeze-dried regular	5.6	6.7	6.5	5.6	82.0M	99.2M	96.8M	72.24M
Freeze-dried decaf	0.7	2.0	1.9	1.9	10.0M	29.6M	28.3M	24.51M
Freeze-dried specialty	6.0	4.1	9.0	12.4	88.0M	60.7M	134.1M	159.96M
Tea	7.6	2.0	1.9	1.9	105.0M	29.6M	28.3M	24.51M
Hot chocolate	7.6	8.1	6.5	8.7	105.0M	119.9M	96.8M	112.23M
Soup	0	1.4	0.6	1.2	0	20.7M	8.9M	5.48M
Other	0	0.7	0.6	1.8	0	10.4M	8.9M	23.22M

## Hot beverage prices, four-year review

	1998	1999	2000	2001
Fresh brew regular	38 cents	36 cents	38 cents	41 cents
Fresh-brew decaf	40	36	39	41
Freeze-dried regular	33	36	38	37
Fresh-brew specialty	48	42	51	51
Freeze-dried decaf	34	36	39	38
Freeze-dried specialty	44	45	51	47
Tea	37	35	38	40
Hot chocolate	38	39	40	42
Soup	38	36	35	40

# State of the Vending Industry Report

raced to catch up with convenience stores, quick-serve restaurants and coffee shops, all of which upgraded their offerings to include more specialty coffee. The number of specialty coffee stores and sales through these stores reached new highs in 2001 and even outpaced the previous year's growth rate, according to the Specialty Coffee Association of America.

## Freeze-dried specialty coffee grows

The only positive news was that once again, sales of freeze-dried specialty coffee products increased, in keeping with the consumer's growing appreciation for these products.

As indicated in chart 11, sales of

freeze-dried specialty coffee grew for the second straight year, as did hot chocolate. Fresh-brew specialty sales dipped in 2001, following a slight gain in 2000. This category, however, was smaller than freeze-dried specialty coffee.

While equipment manufacturers offered machines with more selections and more attractive graphics, the cost of these machines prohibited vending operators from using them. The high machine cost made it difficult for vending operators to provide these machines to strengthen the merchandising and variety of their hot beverage program.

Branded machine fronts met mixed reviews from operators in 2001.

The survey reported pricing for

fresh-brew regular coffee, which accounted for most hot beverage sales, edged up a few cents in 2001, as indicated in chart 11. Vending coffee pricing nevertheless trailed other channels by a large spread.

The report indicated the placement of single-cup brewers dipped a few points in 2001, following four consecutive increases. Single-cup brewers represented another tool to enable operators to provide specialty coffee in locations too small to support free-standing hot drink machines.

## OCS holds its own

While hot beverage machines presented operators their biggest challenge in 2001, for many, OCS offered their only bright spot. OCS was the only category other than manual foodservice to sustain its market share in 2001, even though total sales suffered. Operators were able to sustain their OCS market share more easily because there was more opportunity to add customers.

The survey measured OCS sales by operators active in both vending and OCS, not dedicated OCS operator sales.

The report indicated large operators were more active in OCS than small ones. Hence, most operators involved in OCS had the means to allocate resources to develop that business.

OCS sales were highest in the mid-Atlantic and New England regions.

Operators' efforts to lure consumers with specialty drinks, through vending and OCS, will pay off as the popularity continues to grow.

The 2002 National Coffee Association Coffee Drinking Trends Survey reported that specialty coffee continued to build the coffee drinking population. The study, based on telephone interviews with 2,950 people 18 years old and older, reported that both consumption and the number of coffee drinkers grew in 2001

CONTINUED

## NAME BRANDS HELP PIEDMONT VENDING RAISE PRICES FOR BOTH HOT BEVERAGES AND FRESH FOOD

Vendors serving the industrial Southeast faced one of their toughest years ever in 2001. Many operators carefully scrutinized their hot beverage and refrigerated food machines, which cost more than other machines and therefore require higher sales to generate a sufficient return on investment.

Piedmont Vending Inc., based in Hickory, N.C., found branded offerings a great help keeping price points up in these two critical areas.

Aaron Speagle, vice president, was able to raise his food prices, thanks in large measure to the name brand offerings from Best Express Inc. Best Express offers national name brand products both in frozen form and through a licensed fresh food program. Piedmont Vending assembled Best Express sandwiches in its commissary, following the specifications mandated by the program.

A key benefit of the fresh food program is the cost the operator can save assembling the product in his own commissary, Speagle noted. The national name brand sandwiches such as Aunt Jemima fetched \$1.50 and higher price points.

Branding also helped Speagle raise some of his coffee prices. He retrofitted some hot drink machines with Maxwell House graphics and charged 30 to 45 cents for 8.25-ounce cups of coffee.

"The brands do sell the product better," Speagle noted.

The company reacted to the recession by restructuring some routes, reassigning some employees to new roles, and cutting back on employee travel. Speagle also pared his stock keeping units (SKUs) in an effort to maximize his rebates.



**Branded offerings helped Aaron Speagle in the two product segments that most needed it recently: fresh food and hot beverages.**

# State of the Vending Industry Report

## 12. Food machines, four-year review

Machine type	1998	1999	2000	2001
Refrigerated	176,753	177,150	177,450	158,050
Frozen*	13,367	19,017	26,520	33,183
Heated	1,900	1,900	1,700	1,500
Ambient	1,200	1,070	1,100	900
Food systems (pizza, popcorn, french fries)	1,275	1,580	1,750	1,750

\*Most were used for ice cream.

## Vend food sales, four-year review

Source	% of sales				Projected total			
	1998	1999	2000	2001	1998	1999	2000	2001
Freshly prepared	62.1%	63.7%	63.4%	54.0%	\$968.7M	\$1.08B	\$1.17B	\$864.0M
Frozen-prepared	23.5	26.9	28.9	37.9	366.6M	458.10M	534.60M	606.4M
Shelf-stable	9.8	8.2	7.7	8.1	152.8M	139.60M	142.50M	129.6M
Other	4.6	1.2	0	0	71.7M	20.40M	0	0

## Vend food prices, four-year review

Type	1998	1999	2000	2001
Freshly prepared	\$1.52	\$1.47	\$1.67	\$1.73
Frozen-prepared	1.48	1.44	1.62	1.67
Shelf-stable	1.20	1.26	1.28	1.28

despite the recession. It further noted that in the last five years, the number of "daily gourmet coffee drinkers" increased from 7 million to 27 million.

### Food sales fall for first time

Many operators welcomed it. Vend food, the one category that doesn't turn a profit, lost market share in 2001 for the first time ever. And while some operators were glad to sell less in an unprofitable category, the 13.5-percentage point decline in food sales simply reflected the industry's overall drop in sales. Food machines were confined to the larger accounts, which led the population losses, which made 2001 the worst year ever.

The larger operators who owned the majority of the food machines suffered the fallout in food sales disproportionately in 2001.

The decade-long growth in food

machine placements came to a halt in 2001, although placements did not fall as much as revenues. The fact that sales dropped more than machine placements indicated the category was even more unprofitable than usual in 2001.

The only positive development on the food front was a 3.4 percentage point gain in average food prices. Food was the one category where operators experienced some success raising prices in recent years. Growing product availability enabled operators to add new products with higher price points, although most claimed it was still difficult to break the \$2.00 price ceiling in 2001.

The slight price gain would have improved profitability were it not for the fact that food costs rose disproportionately in 2001. According to the National Restaurant Association, wholesale food prices posted a 3.2 percentage point gain in 2001, following a miniscule 0.6 point

gain in 2000 and even decreases the previous two years.

The wholesale price gain was mostly confined to bulk food as opposed to prepackaged food. This accounted for the near 10 percentage-point dip in freshly prepared food as a percent of sales in 2001, at the expense of frozen prepared and shelf-stable food, as indicated in chart 12.

Freshly prepared food held its ground the five years prior to 2001. Frozen-prepared food during that period grew mainly at the expense of shelf-stable food.

Low wholesale food prices during the four-year period ending 2001 encouraged operators to maintain in-house fresh food preparation.

In 2001, larger operators increased their use of both frozen-prepared and shelf-stable food. Prior to 2001, the use of

CONTINUED

# State of the Vending Industry Report

**Chart 12a. Top 20 refrigerated and frozen food products in 2001**

Rank	Product
1	White Castle Distributing White Castle Cheeseburger
2	Jimmy Dean Foods Rudy's Farm Sausage Twin Biscuit
3	Kraft Foods Oscar Mayer Turkey/Cheddar Lunchables
4	Pierre Foods Pierre Hot & Spicy Chicken Wings
5	Kraft Foods Oscar Mayer Ham/Cheddar Lunchables
6	Chef America Hot Pockets Pepperoni Pizza
7	Kraft Foods Oscar Mayer Ham/Swiss Lunchables
8	Schwan Foods Tony's I-W Pepperoni Pizza
9	Chef America Hot Pockets Ham & Cheese
10	Entenmann's Thomas Plain Bagel with Cream Cheese
11	Pierre Foods Pierre Jumbo Bacon Cheeseburger
12	Pierre Foods Pierre Monterey Ranch Chicken with Bacon
13	Schwan Foods Tony's I-W Supreme Pizza
14	Pierre Foods Pierre Jumbo Cheeseburger
15	Entenmann's Thomas Cinnamon Raisin Bagel with Cream Cheese
16	Jimmy Dean Foods Jimmy Dean Sausage/Gravy Biscuit
17	Pierre Foods Pierre BBQ Chicken Wings
18	Jimmy Dean Foods Jimmy Dean Sausage Biscuit Twin
19	Specialty Brands Posada Shredded Beef Chimichanga
20	Pierre Foods Pierre Jumbo Spicy Chicken Breast Sandwich

Source: VSA Inc.

shelf-stable food was almost confined to small operators.

While food prices rose in 2001, food

was one category in which larger operators charged lower prices than small ones. With food, the larger operators

used their superior buying power to be more price competitive. This trend held in 2001, despite the larger companies' disproportionate sales declines.

Frozen food machines grew for the seventh consecutive year in 2001. However, the rate declined as operators postponed equipment purchases.

Restaurant brand food products continued to expand in 2001, but not at the pace of the previous year.

## Frozen food machines increase

The survey did not measure how much food vendors sold through frozen food machines as opposed to ice cream.

Operator interviews revealed that most carried a mixture. In recent years, the balance moved to food as more operators replaced refrigerated machines with frozen machines to reduce costs.

Frozen food machines required less frequent service than refrigerated machines, and they significantly reduced food waste.

Location downsizing undercut equipment manufacturers' attempts to expand frozen food placements by offering free food to offset purchase costs in 2001.

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## IDEAL SERVICES CORP. IMPROVES ITS COFFEE MARGINS AS A LICENSED SEATTLE-BASED JAVA TRADING CO. ROASTER

Vend coffee has faced a tough time in recent years, due largely to the unfavorable economics brought about by customer downsizing. Some vending/OCS operators, such as Greeley, Colo.-based Ideal Services Corp., have utilized the customized roasting services of a licensing roaster to be more competitive in both OCS and hot beverage vending.

The father/son team of Arlo and Tyler Richardson have signed on as a licensed roaster for Seattle, Wash.-based Java Trading Co. As a licensee, Ideal Services Corp. has the use of Java's proprietary, computerized roasting equipment and the Java name. The state-of-the-art equipment enables the Richardsons to customize their vend and OCS coffee roasts to color and taste specifications. The equipment includes roasting, grinding and packaging functions.

The Richardsons find this to be a big advantage, as coffee preferences vary by market.

Ideal Services has arranged to roast for some large retail accounts in its market as well, Tyler Richardson noted.

Besides being able to offer a better quality roast, the on-site roasting offers a savings for the OCS coffee, Richardson said. He claims the margins are 15 percent better than buying OCS packaged coffee.

Richardson said the Java coffee, which he markets as his private label, has won him OCS accounts.



**Tyler Richardson finds Java Trading graphics help sell hot beverages.**

# State of the Vending Industry Report

## 13. Milk sold by machine type

Machine type	Percent	Projected sales
Dedicated milk	39.65%	\$96.35M
Cold beverages	7.00	17.01M
Refrigerated food	51.95	126.24M
Other	1.4	3.40M

### Milk sales, four-year review

1998	1999	2000	2001
\$280.0M	\$399.3M	\$461.2M	\$243.0M

### Dedicated milk machines, four-year review

1998	1999	2000	2001
42,015	57,530	60,000	56,220

### Milk prices, four-year review

1998	1999	2000	2001
56 cents	55 cents	54 cents	65 cents

An attempt to develop machines specially designed to provide branded, take-home meals failed in 2001. About 60 machines were tested featuring high-priced, branded frozen food entrées (\$4.95 to \$6.95) in locations separate from traditional vending banks. The machines took credit cards only — no cash — and were monitored over the Internet via wireless telemetry.

The take-home machine test marked the automatic merchandising industry's first attempt to capitalize on the growing demand for take-home meals, a challenge that the entire foodservice industry struggled to address in 2001.

Fiscal 2001 was hardly a year for high expectations for food systems — high-ticket machines that heat and serve frozen food. The leading provider of these systems in the U.S., KRh Thermal Systems LLC, continued to market its multiple-selection Hot Choice® machine. In 2001, the company added more name brand products to its portfolio. The systems have the capability of expanding the availability of national name brand

products in vending.

### Milk grows slowly

Milk, a small but highly promising category in 2000, fell victim to the economy in 2001.

This marked the second year the State of the Vending Industry Report specifically measured milk sales.

Prior to last year's report, milk was combined with other dairy products. The change was made because of the dairy industry's growing interest in the vending channel.

The double-digit sales growth reported in 2000

reflected the rising popularity of the plastic, resealable, pint-size bottle. Milk processors' attempts to capitalize on the preferred package benefited all retail channels in 2000, including vending.

Dairy processors recognized the potential to expand sales through vending and sponsored several tests in 2001, all of which demonstrated the success of the new milk package.

Several factors prevented the vending industry from capitalizing on the pint-size milk bottle in 2001.

One factor was the downsizing in accounts where milk was vended. The majority of milk continued to be sold through refrigerated food machines, which lost business due to account downsizing in 2001.

### Dairies slow to accommodate vending

Another factor — also related to the economy — was the slowness of the dairy processors to make product available to vending operators. Many dairies did not ship product in quantities suitable to vending operators. Even

those vendors that went out of their way to find sources encountered difficulty.

Another factor was the lack of name brand products — a long-standing problem for milk. A handful of national name brand products was introduced in 2000, but regional processing and distribution facilities failed to materialize nationwide. Dairy industry consolidation facilitated this effort, but availability was inconsistent in different geographic areas.

Still another factor was product cost. The national name brand milk products cost more than the traditional products. Hence, operators needed to charge more for the name brand products, a process that initially met customer resistance.

Milk did post the largest price increase of any category in 2001, as indicated in chart 13.

The milk vending tests in 2001 indicated the best results in the glass-front, bottle drop machine, as opposed to closed front machines. But as noted in the cold drink discussion, glassfront beverage machines were slow to emerge in 2001.

The Got Milk!/Milk Marketing Campaign also encouraged dairies to get into the vending business. In 2001, very few did so.

The survey indicated a near doubling of milk sales through cold beverage machines in 2001, which came at the expense of dedicated milk machines. Operators were able to vend milk in dedicated beverage machines more easily than in traditional, dedicated milk machines.

Milk offered operators a product to address nutritional concerns that became more evident in 2001, particularly among secondary schools. As schools came under pressure to improve the nutrition content of food sold in cafeterias, vending operators found milk a popular alternative. Vending tests

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# State of the Vending Industry Report

## 14. Ice cream sold by machine type

Machine type	Percent	Projected sales
Combination food/ice cream	53.2%	\$129.3M
Old style, 3- and 4-select	18.6	45.2M
Dedicated, new style multiproduct	24.2	58.8M
Dual temperature machine	1.2	2.9M
Other	2.8	6.8M

### Ice cream sales, four-year review

1998	1999	2000	2001
\$186.2	\$225.42M	\$281.8M	\$243M

### Dedicated ice cream machines, four-year review

1998	1999	2000	2001
56,487	42,931	44,543	43,046*

\*Of the 33,183 frozen food machines shown on page 48, 26,546 are included in this number

### Ice cream prices, four-year review

	1998	1999	2000	2001
Ice cream	72 cents	72 cents	80 cents	91 cents
Frozen confections	\$1.13	\$1.00	\$1.31	\$1.49

revealed that flavored milk was more popular than white milk in schools, even though preferences varied by geographic market.

Milk has even more growth potential as aging baby boomers become more health conscious. Data from the Beverage Marketing Corp. indicated that low-fat milk posted significant long-term gains through the last decade at the expense of whole milk.

The larger operators continued to dominate the milk business in 2001. Extra large operators on average carried five times as many milk machines as even the large operators.

But because large players operated more traditional, dedicated machines, they carried fewer of the new packages and charged lower average prices.

Milk machines were most concen-

trated in the West North Central, East North Central and New England regions.

### Ice cream machines upgrade

Frozen food machines overtook old style, 3- and 4-select venders in 2001, but the growth was not enough to offset the impact of customer downsizing, leaving ice cream sales flat. In the last few years, ice cream vending operators replaced the old style 3- and 4-select machines with new, multi-product machines capable of carrying more variety. This resulted in a continuous rise in ice cream prices, as indicated in chart 14.

Extra large vendors operated the majority of ice cream machines in large industrial locations which suffered significant layoffs in 2001.

The report indicated more medium-size operators expanded into ice cream

in 2001 as they bought more frozen food machines. As a result, medium-size operators expanded their share of ice cream sales in 2001. But the extra-large operators continued to monopolize ice cream business.

### Ice cream specialists evolve

Ice cream vending continued to exist as a specialized business. Most full-line vendors subcontracted their ice cream business to larger operators or dedicated ice cream operators in 2001. The number of dedicated ice cream operators, while still estimated at less than 50 nationwide, has increased in the last three years.

The survey also indicated a doubling in the number of dual-temperature ice cream machines, although from a very small base of machines. These machines merchandise ice cream along with food and snacks. Extra-large players operated almost all of these dual-temperature machines.

Most ice cream machines were located in the South Atlantic and New England regions.

While the introduction of multi-product machines promised higher sales per location, the higher investment made it difficult for operators to build this business quickly. The multi-product machines required a higher return on investment than the less expensive 3- and 4-select machines. Minimum population requirements for multi-product machines ranged from 300 to 700.

The multi-product machines also required more product variety, which posed another challenge. As with frozen food and milk, operators found it difficult to find reliable product sources in many geographic regions. Vending product distributors only carried a small amount of ice cream, and most ice cream distributors were not set up to cater to vending operators. In recent years, consolidation

CONTINUED

# State of the Vending Industry Report

in the ice cream industry actually reduced, not increased, the number of ice cream distribution sites.

Long term, consolidation among ice cream manufacturers will benefit ice cream vending. The manufacturers' immediate attention is on their larger retail channels.

Ice cream industry observers pegged ice cream vending potential at around 250,000 machines in the U.S. As with frozen food, the number of machines needs to grow before product manufacturers allocate resources to vending.

Ice cream manufacturer consolidation will also strengthen national name brands, which will benefit all classes of trade.

## Cafeterias struggle once again

As industrial accounts downsized, vending operators bolted the cafeteria business as fast as possible. The cafeteria business — once an enticing challenge to operators looking to move into the "big leagues" — was relegated to a small number of specialists for the second consecutive year.

In 2001, the extra-large operations did more than 90 percent of all cafeterias, a sharp change from the late 1990s when medium- and large-size firms expanded into this segment.

The National Restaurant Association reported that "noncommercial restaurant service" (which encompasses foodser-

vice operators not involved in vending) posted a 2.1 percentage point gain in 2001, one of its weakest years ever, following a 2.9-point gain in 2000.

## Foodservice sales dip

Foodservice performance in industrial and commercial accounts was even weaker. According to the NRA, foodservice sales fell 11.1 percentage points in the two-year period ending in 2001.

The NRA further noted that traditional foodservice continued to lose business to more convenient dining formats, such as fast food restaurants and convenience stores.

For the second straight year, many full-line vending operators in 2001 opted to partner with foodservice specialists when bidding on accounts that required cafeterias. The majority of accounts with both vending and foodservice, however, were served by large operators that provided both services.

The extra large operators, besides monopolizing the largest accounts, were the only operator group with the expertise needed to provide manual foodservice. Cafeterias required significant training in sanitation and safety practices. Foodservice regulations continued to increase at all levels of government as safety and sanitation concerns grew again in 2001.

On the positive side, help was easier to find in 2001, a problem that plagued foodservice operators during the 1990s. Labor costs also stopped rising as fast in 2000 and 2001.

On the downside, however, food product costs rose in 2001. According to the NRA, wholesale food prices posted a 3.2 percentage point gain in 2001, following a miniscule 0.6 point gain in 2000 and

even decreases the previous two years.

White collar cafeterias — a promising segment during the "dotcom" boom in the 1990s — fell from most operators' radar screens in 2001. The survey indicated the traditional industrial accounts increased their dominance of the cafeteria customer base.

The financially strapped industrial customers were less inclined to subsidize cafeterias in 2001 than in 2000, when cafeteria sales were flat against the prior year.

The majority of foodservice accounts were located in the South Atlantic, West north central, West South Central and New England regions.

## 2002: Outlook uncertain

Vendors generally agreed there were signs of business recovery in mid-2002, but they had not made up for the losses suffered in 2001. Nor were they optimistic that improvement was on the way, given an eroding stock market and other negative economic reports.

The most immediate economic indicator affecting vendors is employment, which had not recovered from the 2001 recession. Most operators reported that customers were beginning to rehire workers, but very slowly.

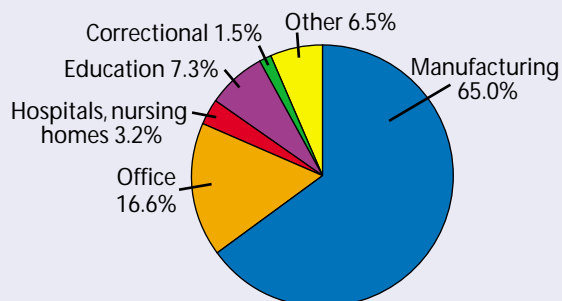
According to the Labor Department, employment dropped for 13 consecutive months through April 2002 before rising in May. But while employers were not rehiring, many were expanding their work schedules. The average work week rose to 34.3 hours from 34.2 hours, and in manufacturing, it rose from 31.1 to 40.9 hours.

The tendency not to rehire was based on hesitancy about the economy long term. Besides a weak stock market, news about corporate scandals raised fears about new business regulations.

The fact that employers were not rehiring did not mean the economy was

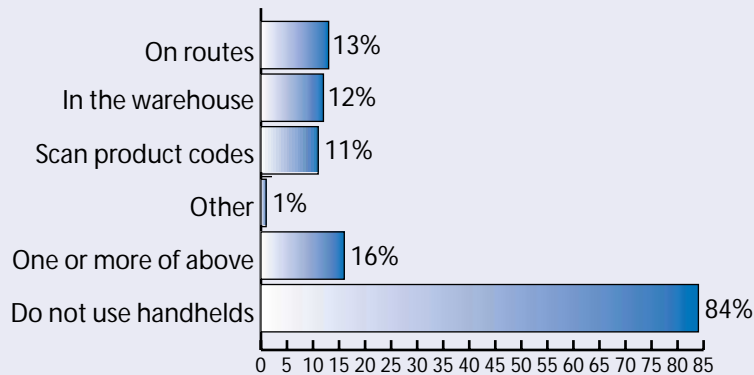
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## 15. Manual foodservice customer locations in 2001





## 16. Handheld use



## 17. Uses of internet, three-year review

	1999	2000	2001
Do not use the Internet	38.0%	38.0%	25%
Purchasing product or equipment	33.0	39.0	44
Operate a web site	17.0	20.0	30
Marketing services to customers	15.0	19.0	20
One or more of the above	53.0	59.0	69
No answer	9.0	3.0	6

shrinking. According to *The Wall Street Journal*, output per hour worked expanded at 8.4 percent in the first quarter and more than a 3 percent annual rate in the second quarter.

Expectations in the automotive sector, the largest single industry automatic merchandisers serve, were not positive. According to the Detroit, Mich.-based Automotive News Center, U.S. automobile production was expected to fall by 9.5 percentage points in 2002.

### Operating costs to hold steady

On the positive side, most operating costs were not expected to rise significantly in 2002. Inflation remained low in the first half of the year, as did fuel costs. Wholesale food costs, which spiked in 2001, were not expected to rise as much in 2001. According to NRA, wholesale food costs were expected to rise 1.8 percentage points in 2002 following a 3.2-point gain in 2001.

Another positive sign for foodservice, according to the NRA, has been continued growth in disposable personal income. Real disposable personal income was expected to grow 2.1 points in 2002.

### Foodservice outlook challenging

The foodservice industry was expected to see sales rise by 3.9 points in 2001, slightly better than the 3.7 points reported in 2001, according to the NRA. However, the noncommercial sector was only expected to grow by 1.3 points, marking an even weaker year than 2001.

An uptick in product introductions — particularly in the cold drink segment — bodes well for 2002. The soft drink giants gave the carbonated category some new sizzle this year in an effort to jump-start this core part of their business: Vanilla Coke, Pepsi Blue, and Dr Pepper Red Fusion.

Snack manufacturers, for their part, have introduced some new package sizes

and shapes. Some salty snacks have been repackaged in candy size packages, allowing salty snacks to fit into candy columns. Others have been repackaged in bottles, enabling salty snacks to be vended in beverage machines.

With reorganizational work behind them, the major candy/snack manufacturers that merged in 2001 are expected to utilize their new marketing and R&D strength to rejuvenate the candy/snack segment.

More manufacturers of ethnic snack and beverage products expanded into vending this year, promising new opportunities for operators serving heavily ethnic markets.

### Legislative issues gain steam

Challenges on the legislative and regulatory fronts are expected to continue this year as schools come under fire to do something about child obesity. While many school districts have considered restricting vending machines, others have recognized vending's potential to help improve children's nutrition.

The dairy industry has taken an active role in educating school officials about the benefits of milk vending as an alternative to soft drink machines.

The investments operators made in their currency handling equipment in the last two years will pay off in higher sales in 2002. Outlays for new computer systems, DEX/UCS data retrieval and telemetry will also continue, paying long-term dividends.

The glassfront cold drink merchandiser, for its part, represents a more cost efficient alternative to placing additional beverage machines at a location.

In the long term, technology promises to make automatic merchandising a better accepted venue for snacking and dining. In the short-term, the industry faces serious challenges as locations continue to downsize. AM