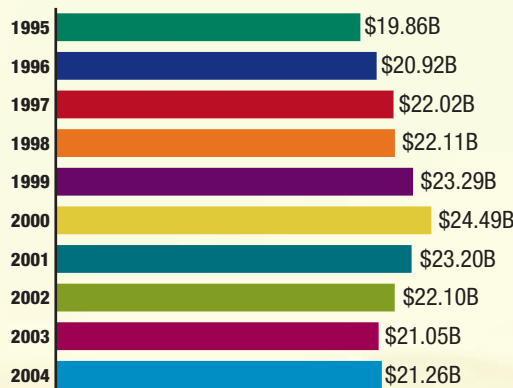


# 2004: Industry sows seeds of recovery as customer downsizing subsides

*Operators lifted revenues by raising prices in 2004, following three years of losses caused by recession. Rising costs make it hard for most to invest in technologies designed to provide greater operating efficiency.*

**By Elliot Maras, Editor**

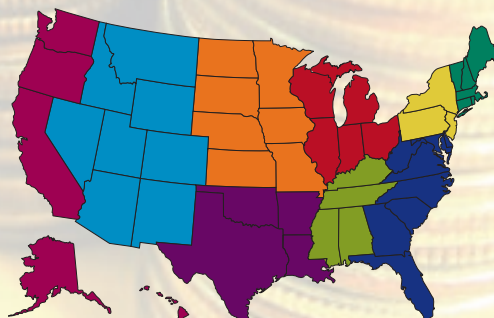
**CHART 1: Industry revenues in billions, 10-year review**



**CHART 2: 2004 Industry total: \$21.26 billion (2003 Total: \$21.05 billion)**

**Participants by region:**

Region	% of Operators
New England	2
Middle Atlantic	12
East North Central	14
West North Central	6
South Atlantic	24
East South Central	9
West South Central	12
Mountain	9
Pacific	14



The vending industry took advantage of a slowly recovering economy in 2004 to post its first sales gain since the current recession began in 2001, according

to the 2005 *Automatic Merchandiser* State of the Vending Industry Report. Aggregate industry sales rose a full percentage point to \$21.26 billion in 2004.

The solitary percentage point gain hardly made up for the 14 points lost in the previous three years, as operators pulled machines by the thousands out of locations suffering declining head counts. And while most work sites stopped shedding jobs in 2004, most of the revenue gain was driven by higher prices, which hardly compensated for rising operating expenses.

The worst part of the 2001 recession appears to be over, but vending operators continue to face a challenging economic environment. The industry's traditional industrial customers continue to minimize payroll through better management, automation and outsourcing.

The survey reported operators secured low single-digit price increases in most product segments in 2004. These

# STATE OF THE VENDING INDUSTRY REPORT

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gains did not match the 5 percentage point rise in commodity prices, as reported by the Washington, D.C.-based National Restaurant Association (NRA). This marked the second straight year the vending industry did not raise prices enough to match commodity price hikes.

The NRA further noted that wholesale food prices rose more in 2003 and 2004 than in any two-year period since 1980 and 1981.

Vending operators also faced higher costs for fuel, employee health benefits, petroleum-based products and paper goods.

## Operators seek diversification

To offset losses in their traditional industrial accounts, operators continued to seek alternative accounts. The manufacturing/warehouse/fabrication facilities that have traditionally been the vending industry's largest customer base fell below 30 percent of the total customers in 2004, although these locations remained the largest single customer group, as indicated in chart 4.

Shifts in the vending industry customer base reflected changes in the nation's work force.

The number of manufacturing jobs in the U.S. fell by 16.9 percentage points from 1995 to 2004 to just over 14.3 million, according to the federal government's Bureau of Labor Statistics.

Operators regained some of their office accounts in 2004, as the technology sector gradually recovered from its setbacks of 2000 and 2001 and both business services and financial service industries continued to expand.

Business services, which include accounting, bookkeeping, architectural, engineering, research, consulting and other professional services, climbed back in 2004 toward its peak employment level in 2000, the BLS reported.

Financial services, comprising finance, insurance and real estate, jumped 19 percentage points from 1995 to 2004. Low interest rates fueled

construction, mortgage lending and real estate buying and selling activity.

News was not all positive on the white collar front in 2004, however. While some telecommunications firms expanded, a "Do Not Call" law took effect in 2004 and eliminated close to a third of the call industry's 6.3 million employees. Call centers were a key growth segment for many vending operators in the late '90s.

The vending industry's expansion into the retail segment continued in 2004, even though this customer base is less profitable than the industry's more traditional locations, due to higher commissions.

The nation's retail employment rose 8.2 percentage points from 1995 to 2004, according to the BLS.

## Operators retreat from schools, jails

In 2004, vending operators recovered some of the losses in the office sector and retreated from schools and correctional facilities. Government accounts such as schools and jails offered some protection from the downsizing that afflicted the private sector, but they carried their own liabilities. Operators found that government accounts tend to be based on commissions and must be periodically rebid.

Schools in particular proved challenging. While more school foodservice officials viewed vending as a way to complement their efforts to feed children in 2003 and 2004, not all of these officials recognized the

benefit of outsourcing the service to professional operators. Many viewed vending operators as competition rather than support.

School sales were also compromised by growing nutrition restrictions in 2004.

For the first time, The State of the Vending Industry Survey separated elementary school, middle school and high schools from colleges and universities. Among the 11.9 percent of the accounts that were education accounts in 2004, about 75 percent were in elementary schools, middle schools and high schools while the balance were colleges and universities.

## Extra-large firms gain share

As usually happens during a recession, the extra-large operators increased their share of vending industry sales, as indicated in chart 3. Extra-large operators (those with \$10 million and more in annual sales) expanded into smaller work sites more aggressively when the recession began to compensate for downsizing in larger accounts. In 2004, these extra large operators increased their total market share at the expense of other operators.

The larger operators had the advantage of being able to invest more resources in new equipment, training, marketing and technology. Technology has proven to be a particularly important advantage when it allows operators to deliver good customer service at less cost.

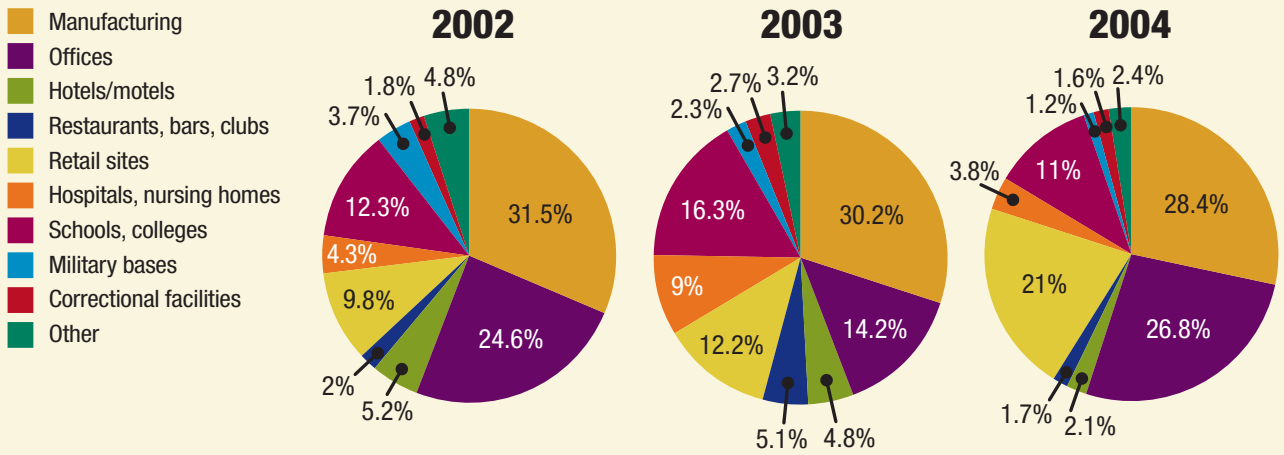
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**CHART 3: Operator sales**

Size	Revenue range	% of 2004 Operators	Projected 2004 sales	% of 2004 sales	Projected 2003 sales	% of 2003 sales
Small	under \$1 million	75%	\$485M	2.4%	\$990M	4.5%
Medium	\$1M - \$4.9M	18	1.33B	6.6	2.96B	14
Large	\$5M - \$9.9M	4	1.07	5.3	1.88	8.9
Extra large	\$10M +	3	17.3	85.7	14.78	72.6
<b>Total</b>			<b>\$20.19 billion*</b>		<b>\$20 billion*</b>	

\*Does not include 5 percent of total industry revenue for machines owned and operated by locations.

**CHART 4: Machines by location type, 3-year review**



State-of-the-art tools such as DEX handhelds allow an operator to account faster and more accurately for cash. It can also give an operator more control over what products are placed in the machine and to know what is and isn't selling. It also allows for route vehicles to be preloaded in the warehouse based on prior sales, resulting in faster filling of machines at less cost.

Greater financial resources also allowed the larger operators to capitalize on more product categories, thus enabling them to maximize their return on overhead. In 2004, the larger operators sold more bottled water, fresh food, ice cream, milk, OCS and manual food on a percentage basis than their smaller competitors.

**Manual food gains share**

For the third consecutive year, manual foodservice represented the largest revenue producer for the automatic merchandising industry. This was consistent with data from the National Restaurant Association, which reported that on-site foodservice contractors outpaced overall foodservice due to more locations outsourcing their foodservice.

As costs for labor, insurance, product and equipment have increased over the years, many corporate customers have

found it easier and more economical to outsource the service to professionals.

The NRA reported that the food-service industry continued to recover from the post 9/11 downturn in 2004, as sales jumped 5.5 points, outpacing the prior two years' 4.4 and 3.8 points, respectively. The foodservice industry traditionally outperforms vending during recessionary periods.

**Higher denomination bill acceptance grows**

Vending operators did adapt more of their machines to higher denomination bill acceptance in 2004. Operators found it made sense to offer higher denomination acceptance in conjunction with currency upgrades. The survey reported that close to a quarter of all operators switched from 3-tube coin changers to 4- and 5-tube changers in 2004, more than in the previous year.

The conversion to higher bill acceptance often included dollar coin payout. The survey reported that close to 10 percent of all bill validators offered dollar coin payout in 2004, a slight increase over 2003.

While more validators took higher denomination bills, many operators continued to see a need for free standing bill changers. Many operators reported that the presence of a free standing bill changer discouraged

consumers from using bill validators to make change, thus minimizing service costs. Validators typically incurred higher service costs than free standing bill changers.

Some operators viewed higher denomination bill validators as a replacement for free-standing bill changers. However, the survey did not report any significant reduction in free-standing bill changers.

Adding higher denomination acceptance to bill validators versus having a free-standing change maker did not always reduce an operator's investment in a location, several operators noted.

Some operators also believed that a free-standing bill changer minimized the change fund needed in a vending bank.

**Investment in technology suffers**

Weak sales growth snagged investment not only in cashless systems, but also in other technologies designed to improve the vending industry's ability to compete against other retail channels. The survey reported little change in the number of operators using handheld computers in 2004.

State-of-the-art software gives operators the ability to track sales more accurately and better tailor product mix to individual location needs. This capability could prove critical as customer preferences have become more diverse.

Two key developments contributed to variances in customer product preferences in recent years: 1) higher awareness about nutrition, and 2) more diverse customer demographics.

Concern about nutrition has become a national issue, and it affected the vending industry in several ways in 2004.

#### **Nutrition concerns increase**

More school districts imposed restrictions on vend products in 2004. While schools did not represent a major customer segment, concerns about nutrition expanded to other accounts.

Many B&I accounts implemented wellness programs designed to reduce health care costs. Oftentimes, this included efforts to restrict vending selections.

While public officials continued to blame poor diets for rising obesity, the aging of the baby boomers also contributed to a higher level of health awareness. In 2004, low carbohydrate diets in particular became more popular. Operators reported a big increase in consumers asking operators for low-carb offerings.

Vending operators responded to health and nutrition concerns in various ways in 2004. All three national vending operations (Aramark, Canteen and Sodexo) and most of the large regional companies offered "better for you" programs.

Some operators simply made customers aware of the fact that many of the products offered already fit into the various "healthy food" definitions. Beef jerky and pork rinds, for instance, are low in carbohydrates.

Operators with state-of-the-art computer systems were able to show account managers what products consumers were and were not buying in the machines. The nutrition issue was cited by many vending operators as an important reason for having the ability to track line item sales.

Operators offered mixed views on whether or not "healthier" items were

actually selling better than they did in the past. Historically, "better for you" items have not sold well in vending. In 2004, many operators reported no change on this front.

In situations where operators placed new products to meet requests for healthier items, the sales did not justify these placements. "Better for you" products typically carried higher price points.

Addressing nutritional concerns wasn't the only reason operators found for using new management software.

#### **Customer demographics diversify**

From a historical perspective, the vending customer has become more diverse in age, gender, ethnicity, race, income and occupation. With a more diverse base of customers to serve, vending operators found more use for management reports that offered insight about customer preferences.

One of the most dramatic examples in recent years has been the influx of Hispanic workers in the U.S. workforce. Locations with a high percentage of Hispanic workers have different needs than job sites populated by non-Hispanic workers.

While operators found more products targeted to Hispanic workers in 2004, those serving predominantly Hispanic consumers still had to source some products outside traditional vending channels to meet customer needs. Vending operators serving this base noted that Hispanic workers paid a premium for products they were familiar with.

#### **About the survey**

The State of the Vending Industry Report was based on questionnaires completed by a random sampling of 880 readers. The survey generated a 19 percent response.

Survey participants were limited to full-line, candy/snack and self-operated

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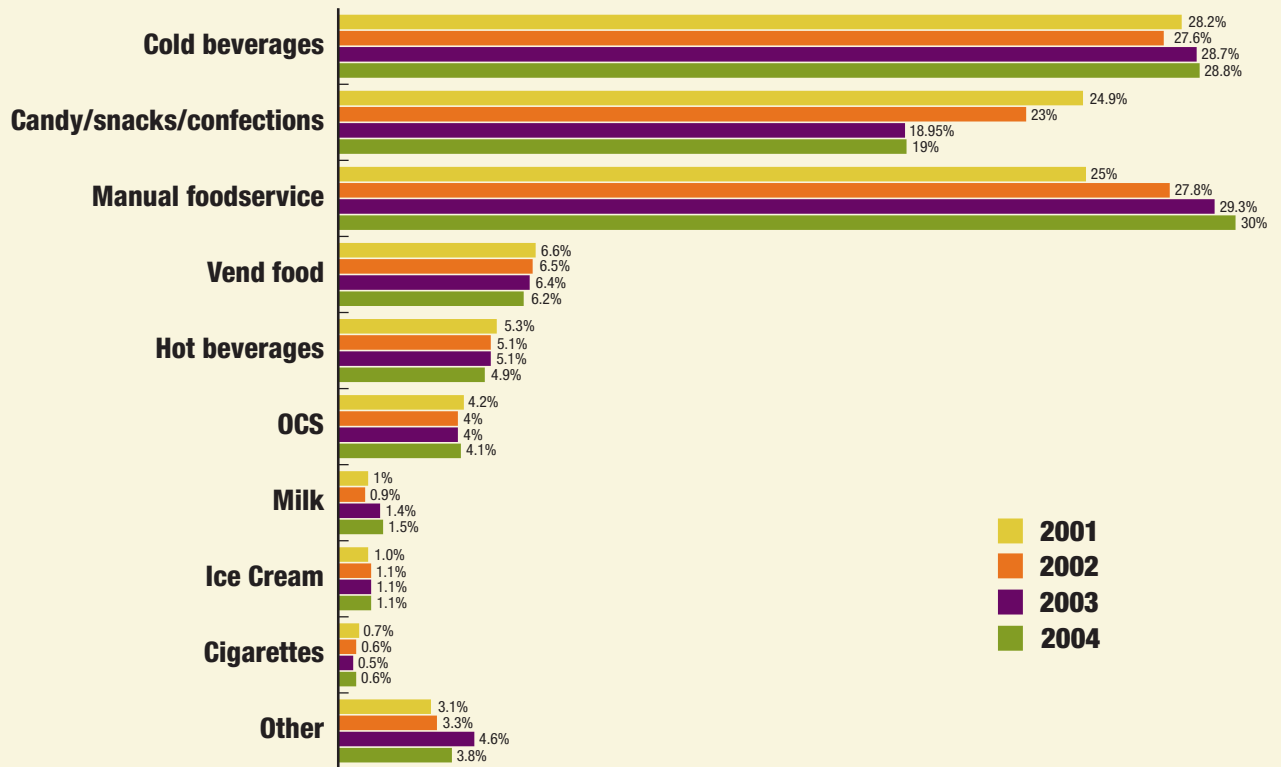
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**CHART 5a: Share of sales by category, 4-year review**



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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 consumable vending merchandise, 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 government, product suppliers and equipment suppliers.

The mailing and tabulating was done by Readex Inc., a Stillwater, Minn.-based industrial research company.

For the second straight year, Pittsburgh, Pa.-based Management Science Associates (MSA) Inc. provided input on vending sales for the State of the Vending Industry Report. MSA receives machine level data from

**CHART 5b: Projected sales by category, 4-year review**

Category	2001	2002	2003	2004
Cold beverages	\$6.54B	\$6.1B	\$6.04B	\$6.12B
Candy/snacks/confections	5.78	5.08	3.99	4.04
Manual foodservice	5.8	6.14	6.17	6.38
Vend food	1.53	1.44	1.35	1.32
Hot beverages	1.23	1.13	1.07	1.04
OCS	0.97	0.88	0.84	0.87
Milk	0.23	0.20	0.29	0.32
Ice cream	0.23	0.24	0.23	0.23
Cigarettes	0.16	0.13	0.10	0.13
Other	0.72	0.74	0.95	0.80

Validata Computer & Research Corp. with the goal of analyzing machine activity. VendScape® machine level sales measures are available through MSA and operational measures through Validata. MSA uses several data sources to report market-wide industry performance. The projected database, ProVen™, is now available through IRI.

The State of the Vending Industry 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.

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

#### **Cold drinks recover**

Cold drink sales posted recovery in 2004, driven largely by an industry-wide move to bottles as opposed to cans. Cold drink sales posted a 1.3 point gain in 2004 following three consecutive years of decline.

Bottles as a percent of sales rose in double digits in 2004, the biggest 1-year gain since they came into the market in the late 1990s. While many vending operators preferred working with cans and found them more profitable, most noted that the consumer strongly preferred bottles. Bottles were not only more fashionable, but more convenient since they are resealable.

Another factor contributing to the sales gain was a slight increase in the number of cold drink machines. The cold drink category was the only major product category in which machine placements grew instead of decreased in 2004. This was due to the fact that most machines were provided by bottlers.

While the double-digit increase in bottles helped drive overall cold beverage sales, vending operators were constrained in their pricing due to competitive pressures.

Small operators still sold more cans than bottles in 2004. The percentage of cans versus bottles bore a direct relationship to the size of the company; the larger the company, the more bottles they sold relative to cans.

Vending operators raised bottle prices 3 points in 2004, as indicated in chart 6c; this did not meet the higher costs that operators paid for bottles in most markets. Retail can prices remained flat in vending in 2004.

Larger size operators charged more for both cans and bottles.

Operators noted that supermarkets continued their long-held practice of using cold beverages as loss leaders and heavily advertised the low pricing. In many cases, operators could not buy these products for the same price they saw retailers advertising.

Cold cup beverage vending, despite being highly profitable, continued to

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decline in 2004. The larger operators also dominated what is left of the cold cup business.

## Glassfronts not yet widely distributed

Vending operators found glassfront cold drink machines helpful in driving sales, but these machines remained a minority of the total number of machines in the field, despite the fact that thousands more were placed in 2004.

Operators found glassfront machines more labor intensive than traditional closed front machines. These machines must be loaded from

the front and, because they have less capacity, they need to be serviced more frequently. Nevertheless, operators agreed that these machines generated significantly higher sales than closed front venders.

Glassfront machines, once they become widely placed, will enable the vending industry to better capitalize on the product variety of that has driven the category's growth at retail, particularly the non-carbonated beverages. Closed front machines can only showcase a limited beverage selection.

## Vendors lag retail in cold drinks

While cold drink sales fared better in 2004 than 2003, vending operators did not keep pace with retail in the carbonated drink sector; carbonated beverage sales posted a 2.7 point gain in 2004, according to The New York City-based Beverage Marketing Corp., which tracks beverage trends. One reason is that bottles have been more established in retail outlets than in vending in recent years.

BMC noted that diet sodas drove most of the growth of carbonated soft drinks in 2004. Overall, carbonated beverages have lost market share to noncarbonated drinks, BMC reported. In 2004, per-capita consumption of carbonated drinks suffered a 0.7 point decline, the sixth consecutive decrease.

Bottled water continued to lead all beverage segments in 2004, posting a 7.5 point sales increase over 2003, BMC reported. Vending operators unanimously agreed bottled water continued to post major growth, although the State of the Vending Industry Survey did not break out beverage product categories.

Many vending operators cited bottled water as their fastest growing product overall in 2004.

Medium, large and extra-large operators were more active in bottled water than small operators.

## Candy/snack/confections improve

Candy, snack and confection sales posted a slight recovery in 2004 following a devastating setback in 2003, as reported in last year's survey. Much of the improvement in 2004 was driven by manufacturer price increases, particularly in candy bars, the segment's largest single revenue generator.

Operators continued to remove snack machines in 2004 as they culled unprofitable accounts. Operators have removed snack machines every year since the recession began in 2001. However, the pace of removal slowed in 2004, as indicated in chart 7a.

**CHART 6a: Cold beverage machines by type, bottlers and vendors**

	Bottler owned	Vendor owned
Can closed front	1.05M	842,400
Bottle closed front	1.03M	115,500
Combo bottle and can closed front	378,000	42,000
Glassfront	60,000	8,000
Cup	0	25,000
<b>Total</b>	<b>2.518 million</b>	<b>1.03 million</b>

**CHART 6b: Cold beverage sales, 4-year review**

### % OF SALES

Type	2001	2002	2003	2004
Can	59.0%	50.2%	43.7%	24.4%
Bottle	35.8	44.9	53.0	74.9
Cup	4.0	4.3	3.0	0.6
Other	1.1	0.8	0.3	0.1

### PROJECTED TOTALS

	2001	2002	2003	2004
Can	\$3.86B	\$3.06B	\$2.64B	\$1.49B
Bottle	2.34	2.74	3.20	4.58
Cup	0.26	0.26	0.18	0.036
Other	0.007	0.005	0.002	.0002

Editor's Note: These totals only apply to the volume sold by vending operators, not bottlers.

**CHART 6c: Average cold beverage prices, 4-year review**

Type	2001	2002	2003	2004
Can	59¢	60¢	62¢	62¢
Bottle	95¢	98¢	98¢	\$1.01
Cup	53¢	53¢	57¢	60¢

Editor's Note: These totals only apply to the volume sold by vending operators, not bottlers.

More stable work site populations in 2004, along with price increases, allowed the segment to recover some of the sales lost over the previous three years.

Candy bars continued a comeback for the third straight year in 2004, following two years of dominance in 2000 and 2001 by bagged chips.

The candy, snack and confection groupings were changed in this year's report, based on input from Pittsburgh, Pa.-based Management Science Associates Inc.

In 2004, the major chocolate companies attempted to support their comeback by introducing large size versions of some of their top selling products. Operators reported mixed results to the large-size candy offerings. The large-size candy required \$1.00 price points to enable the operator to maintain his traditional profit margin.

Operators who reported success with the large-size candy noted that the product typically did not move as fast as the regular size version, but that the higher sales were enough to compensate for the slower turns. Most operators noted that the product performed best among male workers in blue collar locations.

Operators who did not find the large size candy successful blamed consumer reluctance to accept a \$1.00 price point for candy in a vending machine.

**Meat, cheese and nut snacks gain**

Meat, cheese and nut snacks, while small categories compared to candy bars and bagged chips, posted a big increase for the second straight year in 2004. As noted in last year's report, these snacks fit into low-carbohydrate diets which were popular in both 2003 and 2004.

Many operators noted the success of low-carb offerings marked the first evidence of consumers choosing "healthier" options in vending machines.

Operators faced increased scrutiny about the nutritional content of snacks

**CHART 7a: Candy/snack/confection machines, 4-year review**

Year	Projected Total
2001	1,508,906
2002	1,489,700
2003	1,398,600
2004	1,328,670

**CHART 7b: Candy/snack/confection sales, % of total, 2-year review**

	2003	2004
Candy bars	35.02%	34.86%
Gum & mints	3.58	3.37
Potato chips	8.46	8.82
Regular crackers	3.62	3.56
Sandwich crackers	2.12	2.27
Bagged & jumbo cookies	9.01	9.31
Baked goods (confections)	16.94	16.06
Nuts & seeds	1.63	1.74
Popcorn	1.74	1.75
Meat & cheese snacks	0.19	0.27
Other	17.69	18.00

**PROJECTED TOTALS**

Candy bars	\$1.39B	\$1.41B
Gum & mints	0.143	0.149
Potato chips	0.337	0.356
Regular crackers	0.144	0.144
Sandwich crackers	0.084	0.092
Bagged & jumbo cookies	0.36	0.376
Baked goods (confections)	0.676	0.649
Nuts & seeds	0.006	0.07
Popcorn	0.069	0.07
Meat & cheese snacks	0.007	0.01
Other	0.706	0.727

in 2004 due to legislative initiatives and ongoing media focus on obesity. While most operators did not field questions from customers, many noted that location managers asked for healthier alternatives, particularly in larger accounts.

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Operators noted that meeting requests for healthier options was not difficult, thanks to the large number of options available. The candy, snack and confection segment has the largest product variety among all vending segments.

The major snack manufacturers announced healthier product initiatives in 2004 in response to public concerns about obesity. These initiatives included new products that emphasized nutrition in various ways, and package labeling that drew attention to these benefits.

Some operators complained that allocating facings to "healthier" products that did not sell fast required more frequent servicing since it caused the other products to sell faster.

Most, however, found it a non-issue since there were always slow selling products that could be replaced with "healthy" options.

The nationals and most of the large regional vending operations used special labeling programs to meet customers' nutrition concerns. These operators noted that such programs were most useful as selling and customer relations tools and did not result in increased consumption.

Operators continued to give more snack selection authority to management and less to route drivers in 2004. More operators also used planograms, a tool that gives management more control over product selection, in snack machines. The larger companies had more management resources to assume more of the decision-making tasks.

Operators continued to realize the benefit of mandating placement of top-selling products and of rotating the mix regularly, practices which both minimized inventory costs and maximized sales.

vented vending operators from capitalizing on the growing demand for specialty coffee, which has revived coffee sales at retail and even in the OCS sector. Vending machines designed to meet this demand with more product selections carried higher costs. Operators faced having to invest more money in locations with fewer employees in hopes that a better product selection would improve sales.

Operators did raise regular coffee prices for the fifth consecutive year in 2004, but the 4.35 point increase in 2004 did not come close to the 14 point gain reported for major retail coffee prices.

The lone exception was for fresh-brew specialty coffee, which posted a 16 point price hike in 2004, but this segment only accounted for 12.1 percent of hot beverage sales.

Vending operators were hesitant to raise coffee prices when consumers increasingly purchased coffee at other retail venues in 2004. Operators faced more aggressive competition from specialty coffee stores, convenience stores and QSRs in 2004, most of which marketed specialty coffee.

### Vending slow to upgrade coffee

A gain in fresh-brewed specialty coffee sales reported in last year's survey did not sustain itself in 2004. Last year's survey reported a 10.5 point increase in fresh-brewed specialty coffee as a percentage of all hot beverages sold. This marked the first sign that the vending industry was cashing in on specialty coffee, the report noted.

But in 2004, the share of specialty coffee declined 4.5 points, indicating the progress reported in 2003 did not continue as operators sought to minimize investment in the category.

### Freeze-dried posts a gain

The biggest share improvement in 2004 was the 7.7 point gain in freeze-dried regular coffee sold, indicating



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### Hot beverages struggle again

Vendors continued to fight an uphill battle in the hot beverage arena in 2004 as industrial accounts, the main customer base for hot beverage venders, continued to lose population. Hot beverage machines have declined in number every year since 2000.

The rate of decline was less in 2004 than 2003, as indicated in chart 8a, reflecting the ebbing of account downsizing.

The economics of hot beverage vending has pre-

**CHART 7c: Top 20 candy/snack/confections in 2004 dollar sales**

Rank	Product	Average selling price	
		2003	2004
1	Masterfoods USA 1-oz. Snickers Original	65¢	66¢
2	Masterfoods USA 1.74-oz. M&M's Peanut	65	67
3	Frito-Lay 1.75-oz. Doritos Nacho Cheesier Big Grab	75	76
4	Masterfoods USA 2-oz. Twix Bar	66	67
5	Frito-Lay 2.125-oz. Cheetos Crunchy	75	76
6	Kellogg/Keebler 1.5-oz. Cheez-It Original	54	52
7	Masterfoods USA 2.3-oz. Three Musketeers Original	64	65
8	Hershey 1.6-oz. Reese's Peanut Butter Cups	64	65
9	Masterfoods USA 1.69-oz. M&M's Milk Chocolate	64	66
10	Masterfoods USA 1.42-oz. Skittles	68	70
11	Frito-Lay 1.5-oz. Ruffles Cheddar & Sour Cream	70	72
12	Frito-Lay 1.125-oz. Cheetos Crunchy	53	54
13	Kellogg/Keebler 2-oz. Famous Amos Chocolate Chip Cookies	68	67
14	Masterfoods USA 2.07-oz. Starburst Original	68	70
15	Kellogg/Keebler 3.6-oz. Poptarts Frosted Strawberry	79	79
16	Hershey 1.45-oz. Almond Bar	64	65
17	Frito-Lay 1.5-oz. Lay's Chips	73	75
18	Hershey 1.85-oz. Payday	63	65
19	Nestle 2.1-oz. Butterfinger	63	66
20	Frito-Lay 1-oz. Ruffles Cheddar & Sour Cream	51	50

**Candy/snack/confections gaining the most distribution in 2004**

Rank	Product
1	Poore Bros. 1.25-oz. TGI Friday's Mozzarella Sticks
2	Poore Bros. 0.75-oz. TGI Friday's Onion Rings
3	Kraft 1.4-oz. Nabisco Cornnuts Ranch
4	McKee Foods Corp.'s 2.5-oz. Little Debbie Fudge Brownie
5	Frito-Lay 1.5-oz. Lay's Wavy Chips Hickory BBQ
6	Frito-Lay 3-oz. Chili Cheese
7	Hershey 1.55-oz. Cookies 'N Cream Bar
8	Hershey 1.65-oz. S'Mores
9	Hershey 1.95-oz. Milk Duds
10	Interstate Brands Corp. 3.5-oz. Dolly Madison Crème Filled Devil Food Cake
11	Hershey 1.6-oz. Ice Breakers Cinnamon Gum
12	Kraft 1.5-oz. Nabisco Double Stuf Oreo Cookies
13	Snyders of Hanover 1-oz. Salt & Vinegar Chips
14	Kellogg/Keebler 1.4-oz. Austin Quality Cheese On Cheese Crackers
15	Kellogg/Keebler 2-oz. Fudge Shoppe Mini Deluxe Graham

**Number of new candy/snack/confection products introduced to vending**

**2003: 109 2004: 159**

Source: MSA ProVen™ first list, MSA Vendscape all other data.

operators focused more on reducing costs than in meeting new customer expectations in 2004.

Some operators argued that the vend coffee consumer is different from other coffee consumers, which supported a “back to basics” approach. As evidence, regular coffee increased its share of sales for the second consecutive year in 2004, as indicated in chart 8b.

Operators argued that the blue collar consumer, the dominant vend coffee consumer, cares less about specialty coffee than other consumers. Some further argued that many older, blue collar consumers prefer freeze-dried coffee to fresh-brew.

Operators also argued that certain roasters have improved the taste of freeze-

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## CHART 8a: Hot beverage machines, 4-year review

Year	Total
2001	399,500
2002	360,200
2003	350,000
2004	345,000

## CHART 8b: Hot beverage sales, 4-year review

### % OF TOTAL

Type	2001	2002	2003	2004
Fresh-brew regular	54.0%	45.3%	47.2%	49.4%
Fresh-brew decaf	6.2	6.5	7.4	4.8
Fresh-brew specialty/flavored	6.3	7.1	17.6	12.1
Freeze-dried regular	5.6	7.7	4.0	11.7
Freeze-dried decaf	1.9	3.0	1.1	1.0
Freeze-dried specialty	12.4	13.1	7.4	3.5
Tea	1.9	1.2	1.7	1.6
Hot chocolate	8.7	10.7	9.1	10.8
Soup	1.2	0.6	1.1	1.4
Other	1.8	4.8	3.4	3.7

### PROJECTED TOTAL

Fresh-brew regular	\$664.2M	\$511.89M	\$505.04M	\$513.7M
Fresh-brew decaf	76.26	73.45	79.18	49.92
Fresh-brew specialty/flavored	77.49	80.23	188.32	125.84
Freeze-dried regular	68.88	87.01	42.8	121.68
Freeze-dried decaf	23.37	33.9	11.77	10.4
Freeze-dried specialty	152.53	148.03	79.18	36.4
Tea	23.37	13.56	18.19	16.64
Hot chocolate	107.01	120.91	97.37	112.32
Soup	14.76	6.78	11.77	14.56
Other	23.14	54.24	36.38	38.48

## CHART 8c: Hot beverage prices, 4-year review

Type	2001	2002	2003	2004
Fresh-brew regular	41¢	44¢	46¢	48¢
Fresh-brew decaf	41	45	46	49
Fresh-brew specialty/flavored	51	51	56	65
Freeze-dried regular	37	41	42	40
Freeze-dried decaf	38	42	43	41
Freeze-dried specialty	47	54	50	41
Tea	40	43	44	54
Hot chocolate	42	45	48	51
Soup	40	42	45	45

dried coffee and that the market for this coffee is growing among all consumers.

Some operators reported great success with dedicated freeze-dried machines in 2004, and not just in blue collar accounts.

Hot chocolate posted a 1.7 point share gain in 2004.

Extra large operators reported selling the most fresh-brew specialty coffee in 2004, reflecting a larger share of large-size accounts that could justify

the investment in new product and equipment. The extra-large operators also sold far less freeze-dried coffee as a percent of sales.

Some operators were able to reduce investment and also increase product variety by replacing hot beverage machines with single-cup brewers. While single-cup brewers provided less capacity than hot beverage machines, some operators found this to be a good fit in light of account downsizing. Operators converted single-cup brewers to vending machines by fitting them with coin mechs.

In a departure from most product segments, smaller operators charged higher prices on average for coffee than larger operators. This was due to their having less purchasing clout with suppliers, requiring higher price points to secure reasonable profit margins.

### OCS improves for vending operators

The OCS industry recovered from the post 9/11 recession faster than vending, mainly because OCS serves a smaller work site to begin with. Hence, vending operators' OCS sales rose by 3.5 points in 2004.

However, the 3.5 point gain was less than the 5 points the OCS industry for the 12-month period ending in June 2005, as reported in the State of the OCS Industry Report in July. There were several reasons for the discrepancy.

For one, the two reports measured different 1-year periods; the OCS report included the last half of 2004 and the first half of 2005.

Another difference was that the State of the OCS Industry Report included sales of dedicated OCS operators while the State of the Vending Industry Report includes vending operators' OCS sales.

Another difference is that because OCS can be provided profitably to smaller locations than vending, the

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# STATE OF THE VENDING INDUSTRY REPORT

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universe of OCS accounts is much larger than that of vending accounts.

However, the disproportionate increases posted by the OCS industry in recent years was mainly due to the advantages of dedicated OCS sales and service organizations.

Most vending operators that provided OCS offered the service to existing vending accounts and did not target dedicated OCS accounts.

The OCS industry reported recovery beginning in 2003/2004, according to the 2004 State of the OCS Industry Report, where in 2003, vending sales continued to decline.

## OCS responds faster to specialty coffee

OCS operators responded faster to the demand for specialty coffee. Dedicated OCS operators raised prices more than vending operators in 2003 and 2004, largely on account of higher quality coffee offerings.

Dedicated OCS operators were also more willing to upgrade their equipment to provide better quality coffee. Dedicated OCS operators added more single-cup brewers in recent years than vending operators. These are systems that allow OCS operators to provide a coffee house experience in the office environment.

OCS operators have long claimed that OCS is a specialty that requires a dedicated focus. That distinction has become more obvious as OCS becomes increasingly specialized. Successful OCS operators note a rising need for knowledgeable salespeople in addition to higher quality products and equipment.

## Vend food sales drop again

Vend food, like hot beverages, suffered its fifth consecutive revenue decline due to the downsizing of industrial work sites.

Operators generally welcome any opportunity to remove a food machine, since these venders typically lose money. But the fallout in refrigerated

vending machines in the last five years largely reflected the decline of locations with populations large enough to support food machines.

Total food machine placements did not change significantly in 2004, largely due to the continued increase in frozen food machines that served a lot of ice cream. The frozen food machine has posted consistent gains since it was introduced in the early 1990s.

Frozen food machines, which reduce spoilage, allowed operators to provide food to locations not large enough to support a traditional refrigerated machine.

Frozen machines also proved a useful selling tool since they were relatively new compared to other vending machines.

## Frozen food posts biggest gain ever

The gain in frozen machines at the expense of refrigerated machines was a key factor in the 12.4 point gain in frozen food sold in 2004. In 2004, frozen food as a percent of total food sold marked its biggest 1-year increase ever, as indicated in chart 9b, marking the first time frozen food represented the majority of food sold in vending.

Shelf stable food also posted a big gain in 2004, grabbing 16 percent of all food sold, the most ever. The gain in shelf stable food and frozen food reflected operators' focus on minimizing food waste in 2004.

Also contributing to the gain in frozen food sold was an increase in integrated

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### CHART 9a: Food machines, 4-year review

Type	2001	2002	2003	2004
Refrigerated	158,050	149,080	144,700	141,500
Frozen*	33,183	39,718	46,280	48,500
Heated	1,500	1,500	1,500	1,500
Ambient	900	900	800	800
Food systems (pizza, popcorn, french fries)	1,750	1,800	2,300	2,500

\* Most were used for ice cream.

### CHART 9b: Food machine sales, 4-year review

#### % OF SALES

Type	2001	2002	2003	2004
Freshly prepared	54.0%	51.4%	50.7%	26.7%
Frozen-prepared	37.9	43.0	44.5	57.1
Shelf stable	8.1	5.1	4.4	16
Other	0.0	0.5	0.4	0.2

#### PROJECTED SALES

Freshly prepared	\$0.826B	0.740B	0.684B	0.352B
Frozen	0.579	0.619	0.601	0.753
Shelf stable	0.124	0.073	0.059	0.211
Other	0.00	0.01	0.01	0.002

### CHART 9c: Vend food prices, 4-year review

Type	2001	2002	2003	2004
Freshly prepared	\$1.73	\$1.80	\$1.78	\$1.80
Frozen-prepared	1.67	1.64	1.71	1.72
Shelf stable	1.28	1.42	1.36	1.36

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## CHART 9d: Top 15 frozen food products in 2004, dollar sales

Rank	Product
1	White Castle Distributing White Castle Twin Cheeseburger
2	Pierre Foods Buffalo Style Wings
3	Pierre Foods Big AZ Beef Charbroil With Cheese
4	Jimmy Dean Foods Rudy's Farm Sausage Twin Biscuits
5	Nestlé Hand Held Foods Group Hot Pockets Pepperoni Pizza
6	Schwan Foods Tony's Pepperoni Pizza
7	Pierre Foods Bacon Cheeseburger
8	Nestlé Hand Held Foods Group Hot Pockets Ham & Cheese
9	Pierre Foods A-1 Chopped Beefsteak Sandwich
10	Jimmy Dean Foods Sausage Twin Biscuits
11	Schwan Foods Tony's Supreme Pizza
12	Pierre Foods Jumbo Cheeseburger
13	Pierre Foods Monterey Ranch Chicken
14	Pierre Foods Barbecue Wings
15	Landshire Poor Boy

## Top 15 refrigerated food products in 2004, dollar sales

Rank	Product
1	Kraft Foods Oscar Mayer Turkey/Cheddar Lunchables
2	Kraft Foods Oscar Mayer Ham/Cheddar Lunchables
3	Kraft Foods Oscar Mayer Ham/Swiss Lunchables
4	Nestle Nesquik 14-oz. 1% Chocolate PET
5	Nestle Nesquik 14-oz. 1% Double Chocolate PET
6	Nestle Nesquik 14-oz. 1% Strawberry PET
7	Nestle Nesquik 16-oz. Very Vanilla PET
8	Nestle Nesquik Chocolate Milk Shake
9	Nestle Nesquik Strawberry Milk Shake
10	Kraft Foods Breyer's Strawberry Yogurt
11	Nestle Nesquik 1% 14-oz. Vanilla PET
12	Nestle Nesquik 16-oz. Double Chocolate PET
13	Nestle Nesquik 16-oz. Chocolate PET
14	Kraft Foods Breyer's Strawberry/Banana Yogurt
15	Nestle Nesquik 16-oz. Strawberry PET

Source: Vendchannel, 800-999-4271

food systems in 2004, although this remained a small percentage of all food machines. Integrated food systems heat and serve food from a frozen state.

In 2004, integrated machines were introduced with Kraft Foods and Tyson Foods branding. These machines proved useful selling tools in large locations.

Operators found integrated food systems useful in locations that did not have second shifts. These machines were considerably more expensive than other food machines; hence, the application was limited to very large locations.

The larger operators continued to sell more fresh food than their smaller competitors. Large and extra-large operators continued to market freshly prepared food as a key selling point.

Price increases were smallest in the food segment in 2004 among all vend product categories. Operators did not come close to matching increases at retail, nor did they cover higher product costs.

### Manual foodservice rises

During recessionary periods, manual foodservice typically increases as a percentage of total industry sales due to extra-large operators' gains in the total customer base. This continued to be the case in 2004 as the vending industry only posted a moderate sales gain.

In 2004, extra-large operators were the only operators for which manual foodservice increased as a percent of total sales. The large accounts that these operators serve usually require on-site manual feeding as a condition for having vending machines. Manual feeding in and of itself, like vended food, is usually not a profitable business.

*Automatic Merchandiser* only tracks manual food sales for companies that also provide vending, which does not include the majority of manual foodservice providers in the U.S. Vending operators involved in manual feeding did not perform as well in 2004 as dedicated manual foodservice operators,

based on information from The National Restaurant Association.

The NRA noted that managed foodservice increased at a faster pace than the total foodservice, which posted a projected 5.5 point revenue gain in 2004. The vending industry, by contrast, increased manual feeding sales by 2.38 points, according to *Automatic Merchandiser*.

This indicated that on-site manual feeding, like OCS, has become a specialty that requires a dedicated commitment.

### Milk continues to grow

For the second straight year, milk led all product segments in percentage growth in 2004, posting a 10.3 point gain. This represented the result of several years of aggressive marketing by the dairy industry, which targeted the vending industry for growth.

In addition to marketing support from dairy processors, milk vending has benefited from the development of new packaging (pint-size, PET bottles), extended shelf life formulations and national branding.

Improvement also reflected better product distribution. Much vended milk is produced by local dairies. Operators noted that product availability was more consistent in 2003 and 2004 than in earlier years.

Milk was the only segment in which vending out-performed retail. The vending industry's 10.3 point gain nearly doubled the 5.6-point gain for total retail milk sales in 2004, as reported by the Beverage Marketing Corp.

Supporting this gain was an increase in dedicated milk placements, as indicated in chart 10c. Dairy organizations in many regions subsidized machine purchases.

Also supporting the revenue gain was a 24.3 point milk price increase in 2004. This increase was largely due to the popularity of PET bottles, which carried higher price points than the older milk cartons.

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The report noted a double-digit increase in the percentage of milk sold in cold drink machines versus dedicated milk machines and refrigerated food machines in 2004, even though food machines continued to vend the majority of milk sales. Ten of the top 15

selling refrigerated food products listed in chart 9d are national name brand milk products.

This shift in part reflected the increase in glassfront cold beverage machines, which operators credited with doing a much better job merchan-

dising cold drinks than closed front machines.

Many schools were particularly interested in milk machines as a way to offer a healthier alternative to soda. Some schools purchased and serviced

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## CHART 10a: Milk sold by machine type, 3-year review

### % OF SALES

Type	2002	2003	2004
Dedicated milk	35%	22.2%	18.3%
Cold beverage	4.3	18.9	30.2
Refrigerated food	59.7	58.9	51.4
Other	1.0	0	0

### PROJECTED SALES

Type	2002	2003	2004
Dedicated milk	\$70M	\$64.38M	\$59.24M
Cold beverage	8.60	54.81	96.94
Refrigerated food	119.40	170.80	164.48
Other	2	0	0

## CHART 10b: Milk sales, 4-year review

2001	2002	2003	2004
\$230M	\$200M	\$290M	\$320M

## CHART 10c: Dedicated milk machines, 4-year review

2001	2002	2003	2004
56,220	48,000	53,000	56,000

## CHART 10d: Milk prices, 4-year review

2001	2002	2003	2004
65¢	75¢	78¢	97¢

## CHART 11a: Ice cream sales, 4-year review

2001	2002	2003	2004
\$230M	\$240M	\$230M	\$230M

## CHART 11b: % of ice cream sales by machine type, 3-year review

Machine type	2002	2003	2004
Combination food/ice cream	52.7%	48.6%	50.8%
Old style, 3- and 4-select	10.6	11.4	10.3
Dedicated, new style multiproduct	23.1	29.7	34.8
Dual temperature machine	13.4	9.9	4.1
Other	0.2	0.4	0

### PROJECTED SALES

Machine type	2002	2003	2004
Combination food/ice cream	\$126.48M	\$111.78M	\$116.84M
Old style, 3- and 4-select	35.44	26.22	23.69
Dedicated, new-style multiproduct	55.44	68.31	80.84
Dual temperature machine	32.16	22.77	9.43
Other	48.0	92.0	0

## CHART 11c: Dedicated ice cream machines, 4-year review

2001	2002	2003	2004
43,046*	48,273**	54,835***	55,935****

\* Of 33,183 frozen food machines in 2001, 26,546 are included in this number.

\*\* Of 39,718 frozen food machines in 2002, 31,773 are included in this number.

\*\*\* Of 46,280 frozen food machines in 2003, 35,054 are included in this number.

\*\*\*\* Of 48,500 frozen food machines in 2003, 37,100 are included in this number.

## CHART 11d: Ice cream prices, 4-year review

Type	2001	2002	2003	2004
Ice cream	\$0.91	\$0.98	\$0.97	\$1.09
Frozen confections	\$1.49	\$1.68	\$1.31	\$1.12

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their own machines, while others outsourced the job to vending operators.

## Ice cream sales steady

The fact that ice cream sales sustained sales volume in 2004 underscores the unrealized growth potential in this segment. Most ice cream machines were located in industrial accounts, where population declined the most.

Driving the growth in ice cream was the continued placement of dedicated frozen machines that offered both frozen food and ice cream, along with a 12.38 point average price increase, indicated in chart 11d.

## Outlook for 2005 uncertain

Business conditions did not change significantly in 2005, except that costs continued to climb, particularly in the areas of product and fuel. Employers were not

re-hiring in large numbers, indicating vending operators will continue to face more pressures on their bottom lines.

Average gasoline prices jumped from around \$1.80 per gallon at the beginning of 2005 to \$2.39 in July, according to the Department of Energy.

While economic indicators showed promise at the end of 2004 and in the first quarter of 2005, these trends did not continue in the second quarter, according to the Conference Board.

Economic indicators have been mixed through 2005.

Consumer confidence was reported to be improving. The Conference Board's Consumer Confidence Index, which had increased in May, improved further in June. The Consumer Confidence Survey is based on a representative sample of 5,000 U.S. households.

In June, Global Insight, a Cambridge, Mass. economic consulting firm, noted that employment has boomed in transportation, professional services and construction, but still declined in manufacturing, print publishing and telecommunications. The growth in global trade sent transportation and warehousing businesses on a hiring spree; trucking firms added 75,000 jobs since June 2003.

Public concern about nutrition also promises to continue to challenge the vending industry.

## New technologies challenge operators

Change doesn't come fast in the vending industry. An industry dominated by small entrepreneurs facing a shrinking customer base, rising competition and higher operating costs has a rough time using new technologies and strategies to compete in the changing marketplace. ■

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