AUTOMATIC MERCHANDISER

2003 STATE OF THE VENDING INDUSTRY REPORT

Sales fall another five points as account downsizing hammers operators for a second year

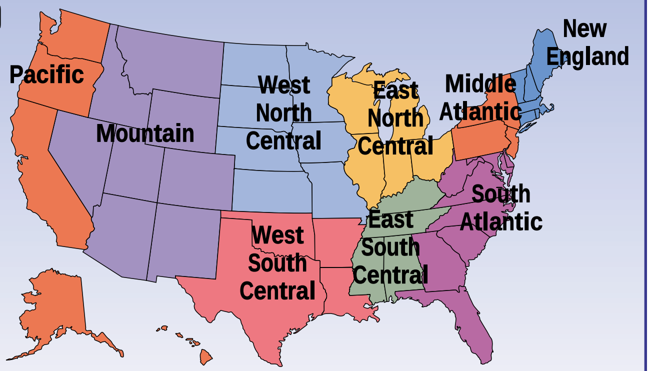
When it rains it pours. The economy of the new millennium reversed the fortunes of the prosperous 1990s for automatic merchandisers. Just as vending operators couldn't find enough help to meet service needs in the mid- and late '90s, the early years of the new millennium delivered diminishing demand. The twin forces of account downsizing and weak consumer confidence resulted in the two worst revenue performing years in the industry's history in 2001 and 2002. Vending industry revenues lost another 5 percentage points in fiscal 2002, following an identical performance in 2001, according to the 2003 *Automatic Merchandiser* State of the Vending Industry Report.

1. 2002 Industry Total: $23.12 billion

(2001 Total: $24.34 billion)

Participants by Region:

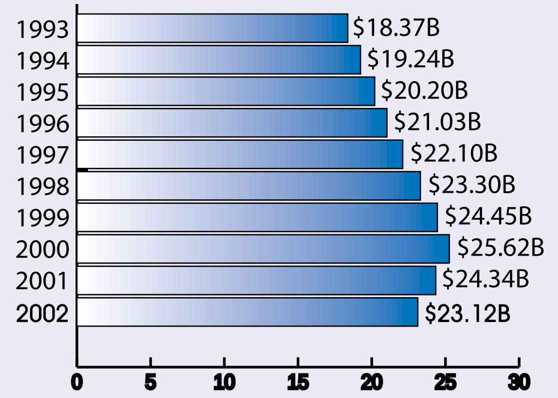
Region	Operators
New England	4%
Middle Atlantic	13
East North Central	19
West North Central	9
South Atlantic	22
East South Central	6
West South Central	7
Mountain	8
Pacific	12



The nation's businesses improved productivity output in fiscal 2002, but this improvement carried two major problems for the vending industry: One was the gain was anemic. The nation's Gross Domestic Product (GDP) rose 2.4 percent in 2002 in inflation adjusted dollars, a slight improvement over 2001, when it declined in each of the first three quarters.

The other, more important issue from the vending industry's perspective was that productivity improved without any corresponding increase in employment. Economists frequently characterized the nation's productivity gain in 2002 as a "jobless recovery." Unemployment reached 5.7 percent of the nation's workforce, the highest since 1992.

2. Industry revenues, 10-year review



Case in point was the automotive industry, which historically served as a barometer of the vending industry's performance. Fiscal 2002 was a healthy year for automakers, who produced 6.5 percent more vehicles in the U.S. than in 2001, according to the Detroit, Mich.-based Automotive News Center. The level of automotive production was comparable to the late 1990s, when the vending industry grew at a healthy pace. The difference was that in 2002, automotive employment did not rise relative to production.

Automakers don't rehire

Automakers, like other manufacturers, were able to achieve higher output with fewer employees, thanks to technology and operational reorganization.

The automatic merchandising industry's aggregate sales in 2002 totaled, $2.318 billion, falling short of the 1998 figure, as indicated in chart 2. The decline that began in 2001 reversed a

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3. Operator sales

Size	Revenue range	% of 2002 operators	Projected 2002 sales	% of 2002 sales	Projected 2001 sales	% of 2001 sales
Small	under $1M	75%	$1.056B	4.8%	$1.179B	5.1%
Medium	$1M - $4.9M	18	2.662B	12.1	3.491B	15.1
Large	$5M - $9.9M	4	1.716B	7.8	2.058B	8.9
Extra large	$10M +	3	16.566B	75.3	16.394B	70.9
Total			$22.000B*		$23.280B*	

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

consistent growth trend since the industry's beginning in the post-World War II era.

Job losses ebb, but no rebound

The location downsizing that began in the second half of 2000 did not subside until the second half of 2002, at which point account populations remained stable.

The Washington, D.C.-based Conference Board reported the fourth quarter of 2001 witnessed the largest downsizing in the U.S. in more than 12 years, with more than 1.4 million jobs lost. The Conference Board reported layoffs in manufacturing subsided in the fall of 2002, but not in the information and telecommunications industries. In addition, the Conference Board reported that service-oriented businesses such as stock brokerage firms, advertising agencies and tourism did not rebound.

Vending operators interviewed for this report concurred that blue collar accounts did not suffer as much as white collar accounts in 2002.

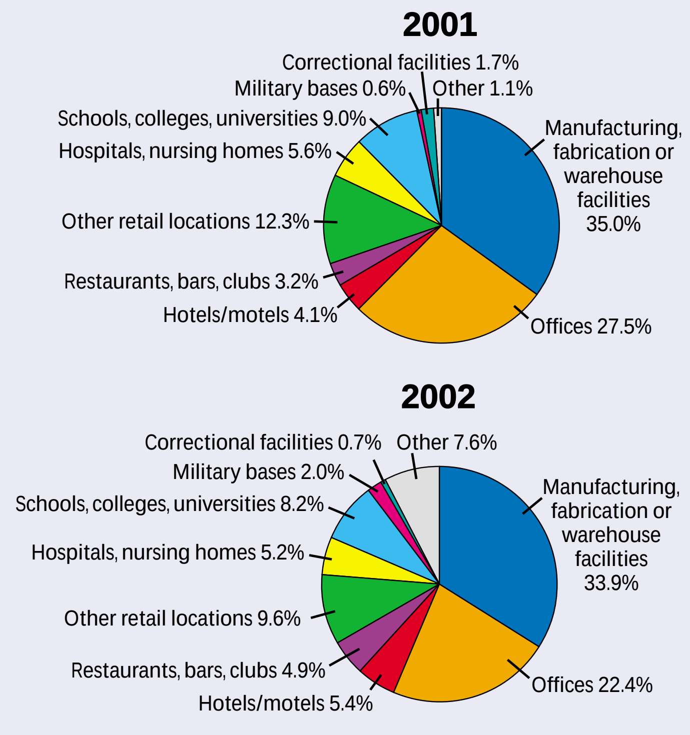
Employers skittish

In the second half of 2002, businesses were skittish about the economy because of the looming war in Iraq. Many companies were reluctant to add employees because they did not know how the war would affect the economy.

More importantly, declining consumer confidence made customers reluctant to spend money. Rising unemployment made workers less secure in their employment. Stagnant wages and cost of living increases also undercut their willingness to spend.

Vending operators responded to the decline in traditional vending accounts by trying to diversify their account base. As indicated in chart 4, the account base in 2002 shifted away from the traditional manufacturing and offices, which collectively accounted for more than half of all accounts. A higher percentage of machines were placed in hospitality accounts; restaurants, clubs and bars; and military bases.

4. Machines installed by location type, 2-year review



Operators diversify accounts

The largest one-year gain was in the number of machines placed in "other" locations. "Other" locations comprised less than 2 percent of all locations on average for the five years prior to 2002, when the number jumped to 7.2 percent. A review of the operator questionnaires revealed these locations included airports, tourist sites, apartment buildings, casinos, postal facilities, recreation centers and other government buildings.

For the second consecutive year, almost every vend product segment lost market share in 2002 at the expense of manual foodservice, which is dominated by the larger operations. For the second straight year, the extra-large operations (those with $10 million and more in sales) increased their share of total industry sales at the expense of other firms.

The only other major product segment to gain market share in 2002 was ice cream, another business dominated by the largest firms. This was mainly due to the continued increase in frozen food machines.

Foodservice outperforms vending

Automatic merchandising typically outperforms the foodservice industry in prosperous times, as it did in 1997 and

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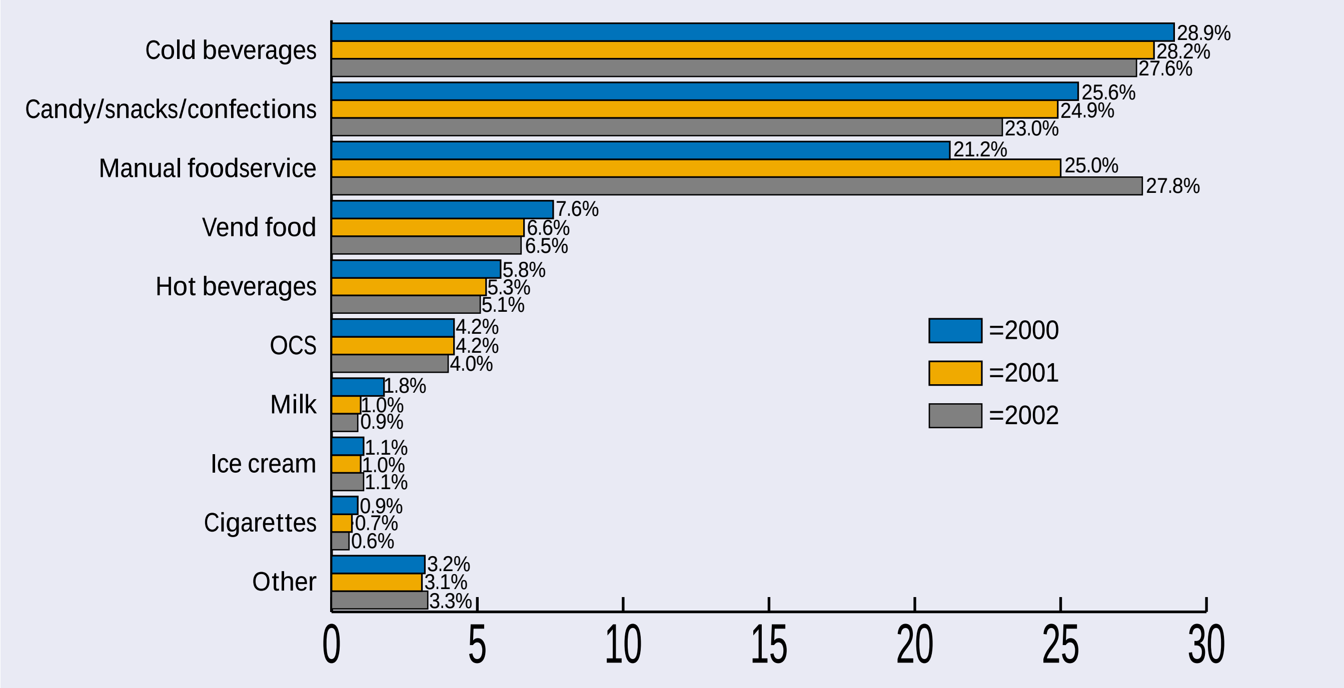
5a. Projected sales by category, 3-year review



1998, and underperforms it in a recession. Hence, for the second consecutive year, the vending industry's performance trailed foodservice. Foodservice sales posted 3.7 percentage point gains in both 2001 and 2002, although the gain in what the National Restaurant Association referred to as "real dollars" versus "current dollars" was less in 2002 at 1.3 percentage points.

The economy's only benefit to vending operators was a gain in available labor. Insufficient labor plagued operators during the prosperous '90s. Another benefit was less employee turnover. Operators noted that employees were less inclined to seek employment elsewhere when jobs became scarcer.

While operators reported less employee turnover, their own labor costs did not remain stable. Low inflation in the cost of consumer goods helped stabilize the cost of living, but employees were paying a larger portion of their own medical benefits. Hence, operators still needed to raise wages to maintain employee morale.

Operators noted labor costs continued to rise in 2002, along with fuel, utilities, healthcare, workers' compensation insurance and business liability insurance.

State and local taxes rise

With more people out of work and businesses earning less money, state and local governments became strapped for cash and sought new taxes. Many operators found themselves saddled with higher sales taxes in 2002.

All businesses noticed a surge in donation requests from charities and nonprofit organizations looking to offset budget cuts. For vending operators, this sometimes translated to requests for free catering and refreshment services.

The number of machines on location declined in almost all categories except for frozen food/ice cream machines, which grew. Frozen food/ice cream machines, however, grew from a much smaller base than the more established equipment categories. Some of the frozen machine growth came at the expense of refrigerated food machines.

Vend prices rise, but not enough

Declining sales made price hikes more imperative than ever in 2002. In retrospect, the price increases announced by product manufacturers at the end of the year gave operators ample justification to seek higher prices. As most of the price charts in this report indicate, prices rose in most product segments in 2002, though not as much as operators deemed necessary.

Price hikes sought in all categories

Many operators noted that they did not seek to limit price increases to just candy, the category where costs jumped the most. Instead, operators used the opportunity to solicit increases in as many areas as possible. Operators often found it is easier to win approval for more than one category at a time than to spread the requests out over time.

Some operators used the candy price hikes to negotiate lower commissions. They noted that many location managers, when confronted with requests to raise prices, opted to lower commissions instead. These managers were cognizant of the importance of high-quality benefits to enhance employee satisfaction during a time of economic insecurity.

In some cases, new taxes, or the expectation of new taxes, made it difficult for operators to raise prices. Some

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5b. Projected sales by category, 3-year review

Category	2000 sales	2001 sales	2002 sales
Cold beverages	$7.40B	$6.86B	$6.38B
Candy/snacks/confections	6.56B	6.06B	5.32B
Manual foodservice	5.43B	6.08B	6.43B
Vend food	1.85B	1.60B	1.50B
Hot beverages	1.49B	1.29B	1.18B
OCS*	1.08B	1.02B	924.92M
Milk	461.20M	243.00M	208.11M
Ice cream	281.80M	243.00M	254.35M
Cigarettes	230.60M	170.30M	138.74M
Other	819.80M	754.50M	763.06M

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

governments taxed vended products over a certain amount; hence, operators were reluctant to exceed that value. Such situations gave operators an incentive to seek lower commissions in lieu of higher prices.

Currency handling updated

Price increases also gave operators more incentive to update currency handling equipment to accept higher denomination bills and pay out dollar coins. The survey revealed more operators upgraded bill changers and validators to handle new currency and provide dollar coin payout.

One downside of higher denomination bill acceptance — mostly 5-dollar bills — was that it encouraged consumers to use the changers and validators to make change, and not necessarily for vend purchases. And while 5-dollar bill acceptance often stimulated spending, it also increased the work load on currency sorters.

Operators continued to have to load their changers with dollar coins since consumers were not in the habit of carrying them around. The U.S. Mint stopped producing the new Sacagewea dollar coins in response to low consumer acceptance.

Dollar coin flops

Operators that continued to order dollar coins found that customers did tend to spend them in the machines. Many operators, however, found that banks began mixing the new dollar coins with the old Susan B. Anthony dollar coins, which consumers frequently mistook for quarters.

Another benefit of dollar coin payout was it reduced the need for bill changers.

Big operators gain share

The continued pressure on the bottom line once again served to drive more of the industry's total sales to the larger operations, as indicated in chart 3.

Extra large companies operated more dedicated milk machines, dedicated ice cream machines, bill changers, higher currency denomination acceptance, dollar coin acceptance, hot drink machines, food machines, fresh food, and manual cafeterias. The larger firms also used more handheld computers, more planograms, more bottles as opposed to can beverages, and charged higher prices for most product categories.

Nutrition issues return

The chorus for restricting soda and snacks in schools grew louder in 2002. The movement gained momentum at the end of 2001, when then Surgeon General Dr. David Satcher called for a series of initiatives to restrict vending machines in schools.

Proposals to restrict soda and snacks in schools played well against a backdrop of widely publicized lawsuits against fast food restaurants for making children fat.

Vending operators generally heard little from their customers about nutrition, and those with school accounts heard didn't hear much from school officials, who tended to be more concerned about the commissions they received from vending in financially struggling times.

But proposals to increase restrictions on school food programs and obesity lawsuits continued to gain headlines in 2002. In response, some of the large product manufacturers announced plans for healthier snacks, including smaller single-serve portions and less sugar and fat.

About the survey

The State of the Vending Industry Report was based on questionnaires completed by a random sampling of 883 readers. The survey generated a 20 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 consumable 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.

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

Cold drinks: bottles keep rolling

The recession did not slow down the replacement of cans by bottles in 2002. The convenience stores made the 20-ounce PET the single-serve configuration of choice several years ago, and the vending industry continued to catch up. Bottles displaced

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cans for the seventh consecutive year, grabbing 44.9 percent of all cold drink sales in 2002.

The gain in bottles was made possible by the growing availability of bottle-capable vending machines by beverage bottlers. This was one product area vending operators were able to expand in without incurring major investment costs, thanks to bottler machine loan programs.

This year, the survey changed the beverage machine categories to better track the emerging glassfront machines. Glassfront machines previously were included as combination bottle/can machines.

The glassfront machines, which displayed a larger variety of product, made inroads in 2002 as bottlers felt more confident in their reliability and increased their purchases. The glassfront machines were introduced in 1993, but were initially stymied by reliability issues.

Glassfront reliability continued to be an issue for some operators in 2002, but newer models were reportedly better.

6a. Cold beverage machines by type, bottler-owned and vendor-owned

	Bottler owned	Vendor owned
Closed front can	1.06M	842,400
Closed front bottle	1.04M	115,500
Closed front combo bottle and can	378,000	42,00
Glassfront	20,000	5,000
Cup	0	30,000
Total	2.478M	1M

Cold beverage sales, 5-year review

% of sales

Type	1998	1999	2000	2001	2002
Can	75.50%	67.70%	62.80%	59.00%	50.20%
Bottle	18.50	27.20	31.50	35.80	44.90
Cup	5.20	4.90	4.90	4.00	4.30
Other	0.80	0.30	0.80	1.10	0.80

Projected total

Type	1998	1999	2000	2001	2002
Can	$4.80B	$4.820B	$4.65B	$4.05B	$3.20B
Bottle	1.17B	1.940B	2.33B	2.46B	2.86B
Cup	331.00M	348.100M	362.60M	274.40M	274.30M
Other	51.00M	2.1.00M	59.20M	75.46M	51.00M

Average cold beverage prices, 5-year review

Type	1998	1999	2000	2001	2002
Can	59 cents	57 cents	59 cents	59 cents	60 cents
Bottle	90	93	98	95	98
Cup	49	47	49	53	53

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

Bottle prices competitive

Bottle pricing remained competitive in 2002, although vendors recovered some of their losses in 2001, when the average bottle price actually fell a few cents.

Glassfronts accounted for a small percentage of the total cold drink machines in 2002, comprising less than 1 percent of the total cold drink machines on location. The vast majority was owned by bottlers. Vending operators primarily used glassfronts on a machine lease basis, which limited their major benefit: greater product variety.

Vending operators using glassfront machines believed they improved sales. Most agreed the glassfronts made better merchandisers that more effectively displayed product variety.

Another benefit glassfronts offered was the ability to vend different configurations — such as bottles, cans and aseptic packages — and thus eliminate the need for second machines. Historically, operators placed a second machine for juice, sports drinks, milk, or other alternative drinks in big accounts. The glassfront allowed all products to be vended effectively in one machine.

This benefit became obvious in 2002 for operators expanding into juices, milk, sports drinks and energy drinks.

Regardless of the type of machines used, vending operators complained that product cost prevented them from earning a good enough margin on bottles. Competition limited the price that vendors could charge for bottles. In most markets, operators could not charge more than $1.00 for a 20-ounce bottle of soda.

Many operators, particularly smaller ones, continued to prefer cans to bottles. Cans were much easier to load and the machines offered more capacity; hence, they needed less service.

Cans were also more profitable. Operators noted that the bottlers' drive to increase bottle sales created more price competition, which resulted in lower profit margins. The same did not hold true, or as true, for cans.

Because of the competitive pricing of bottle soda, some operators who wanted to use the glassfront to merchandise juices, iced teas, water and sports drinks — most of which customers preferred in bottles — opted for a two-machine solution: a can machine for soft drinks and a glassfront for noncarbon-

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ated beverages.

Some locations also insisted on cans. In some industries, such as paper mills, operators noted a bias against plastic. In other situations, manufacturers cited health and safety reasons for not allowing plastic in the work area.

Larger firms charge more for bottles

Extra-large operators vended considerably more bottle drinks in 2002 than other firms, while small operators sold the least. Small operators on average charged less for both cans and bottles.

Cup beverages, a business dominated by large and extra large operators, posted a slight gain as a percent of sales in 2002. The decline in cup vending bottomed out in 2001.

With bottle and can prices rising, some operators noted that cup drinks offered the customer a better value than ever.

New carbonated drinks

The big beverage manufacturers introduced several new carbonated drinks in 2002 in an attempt to revive their core business. But these heavily advertised rollouts failed to boost carbonated sales, which have been flat for several years. Operators interviewed agreed these products did not lift sales for extended time periods.

Many operators interviewed did not carry the new products, claiming they only added to warehousing and delivery work loads for no measurable benefit.

Since most cold drink machines offered limited selections, operators did not see a lot of benefit in adding more products.

Another objection was that most of the new soft drinks were targeted to younger consumers, who were not the main audience in most vending locations.

Some operators further noted that when sales slow down, it makes no sense to take on products that aren't included in manufacturer growth programs since doing so will only cut rebate payments.

The New York City-based Beverage Marketing Corp. reported that carbonated beverages posted a 1.1 percentage point revenue gain in 2002, its lowest in many years and below that of any other cold beverage category.

Candy/snack/confections

Candy price increases — around 10 percent — announced near the end of the year topped operators' concerns in 2002. Smaller increases were also announced for many salted snack and confections. Most operators claimed they were able to pass the increases on to customers, but not without some resistance.

The survey indicated prices rose on most products in this segment. However, the increases did not fully cover the higher costs. The full impact of the higher prices did not materialize in 2002 since most of the prices were not changed until 2003.

One problem operators faced in passing on price increases was they were not able to raise prices enough to

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6b. Top 20 cold beverages in 2002, dollar sales

Rank	Product
1	Coca-Cola 12-oz. Coke Classic
2	Coca-Cola 20-oz. Coke Classic
3	Coca-Cola 12-oz. Diet Coke
4	Dr Pepper 12-oz. Dr Pepper
5	Dr Pepper 20-oz Dr Pepper
6	Pepsi-Cola 12-oz. Pepsi Cola
7	Coca-Cola 12-oz. Sprite
8	Coca-Cola 20-oz. Diet Coke
9	Coca-Cola 20-oz. Dasani Water
10	Coca-Cola 20-oz. Sprite
11	Pepsi-Cola 12-oz. Mountain Dew
12	Coca-Cola 20-oz. Vanilla Coke
13	Pepsi-Cola 20-oz. Pepsi Cola
14	Coca-Cola 12-oz. Barq Olde Tyme Root Beer
15	Pepsi-Cola 12-oz. Diet Pepsi
16	Coca-Cola 20-oz. Pibb Xtra
17	Pepsi-Cola 20-oz. Mountain Dew
18	Dr Pepper 12-oz. Diet Dr Pepper
19	Coca-Cola 12-oz. Mr. Pibb
20	Coca-Cola 12-oz. Fanta Orange Soda

Number of new beverage items introduced in 2002

Category	Total
Soft drinks	42
Tea	5
Juice drinks	13
Sports drinks	1
Water	5

Source: MSA
Vendscape Sales Data

Beverages gaining the most distribution in 2002

Rank	Product
1	Pepsi-Cola 20-oz. Aquafina Water
2	Pepsi-Cola 20-oz. Pepsi Cola
3	Coca-Cola 20-oz. Dasani Water
4	Coca-Cola 12-oz. Cool Nestea
5	Coca-Cola 20-oz. Coke Classic
6	Coca-Cola 20-oz. Minute Maid Lemonade
7	Coca-Cola 12-oz. Fanta Orange Soda
8	Coca-Cola 20-oz. Diet Coke
9	Pepsi-Cola 20-oz. Diet Pepsi
10	Pepsi-Cola 20-oz. Mountain Dew

7a. Candy/snacks/confections, 5-year review

Candy/snack /confection machines

Year	Projected total
1998	1,512,775
1999	1,676,900
2000	1,695,400
2001	1,508,906
2002	1,489,700

Candy/snack/confection revenues

Type	% of total 1998	1999	2000	2001	2002
Candy bars	30.2%	30.9%	26.%	27.4%	28.0%
Bagged/boxed candy	3.3	6.8	4.6	2.7	2.2
Gum/mints	5.7	4.2	4.1	3.7	3.6
Bagged chips	27.8	28.5	31.6	30.3	24.5
Bagged crackers	1.7	3.1	1.6	1.9	1.6
Cracker sandwiches	5.9	4.0	4.5	5.3	12.0
Bagged/jumbo cookies	7.6	5.0	6.3	7.4	5.4
Pastries	12.6	12.7	15.0	14.2	11.8
Nuts	2.2	1.4	2.3	1.7	7.1
Microwave popcorn	2.1	1.8	2.2	2.1	1.9
Meat snacks	--	--	0.9	0.7	1.1
Other	1.0	1.6	0.7	2.6	0.9

Type	Projected total 1998	1999	2000	2001	2002
Candy bar	$1.79B	$1.92B	$1.72B	$1.660B	$1.48B
Bagged/boxed candy	195.40M	422.00M	301.70M	163.620M	117.04M
Gum/mints	337.40M	260.70M	269.00M	224.220M	191.52M
Bagged chips	1.64B	1.77B	2.07B	1.836B	1.30B
Bagged crackers	100.60M	192.40M	105.00M	115.140M	85.12M
Cracker sandwiches	349.30M	248.30M	295.20M	321.180M	638.40M
Bagged/jumbo cookies	500.00M	310.00M	413.30M	448.440M	287.28M
Pastries	746.00M	788.30M	985.00M	860.520M	627.76M
Nuts	130.20M	86.90M	150.90M	103.020M	377.72M
Microwave popcorn	124.30M	111.70M	144.30M	127.260M	101.08M
Meat snacks	--	--	$59.00M	$42.420M	58.52M
Other	5.92M	99.30M	46.00M	157.56M	47.88M

Candy/snack/confection prices, 5-year review

Type	1998	1999	2000	2001	2002
Candy bar	58 cents	58 cents	59 cents	59 cents	61 cents
Bagged/boxed candy	62	65	65	62	64
Gum/mints	42	43	44	43	46
Bagged chips	50	51	$48^{RSS}/70^{LSS}$	$51^{RSS}/70^{LSS}$	$50^{RSS}/70^{LSS}$
Bagged crackers	54	53	54	58	56
Cracker sandwiches	52	51	49	53	54
Bagged/jumbo cookies	60	63	62	62	63
Pastries	69	71	70	73	75
Nuts	53	54	55	57	57
Microwave popcorn	64	66	67	67	67
Meat snacks	--	--	59	62	67

cover rising costs. Operators interviewed said they needed to raise prices 10 cents on most candy and snack items. Only a minority actually attempted to raise prices this much. Among those who did, only a few succeeded.

Operators noted they were able to persuade location managers to raise candy and snack prices by informing them of the higher product costs. Product turns initially suffered before returning to normal levels. The process reportedly took two to six weeks.

Candy/snack/confection prices rise

The pricing history shown on chart 7a indicates prices increased slightly in most categories in the last five years. Operators usually sought higher prices periodically on an individual account basis.

The report indicated that higher pricing likely influenced the product mix in 2002 to some degree. Candy bars, which incurred the highest increases, grew six tenths of a percent of total segment sales in 2002.

The candy price increases helped this product group regain its status as the largest revenue producer in the candy/snack/confection machine. Also contributing to this change was a slight decline in bagged chip sales, caused by a leveling in LSS (large single serve) bag placements that became evident in 2001.

The downsizing in industrial locations hurt LSS bag sales. Larger firms which sold a higher percentage of LSS suffered more from downsizing in this customer base.

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Cracker sandwiches gain

The largest single sales increase in this product group was in cracker sandwiches. This, many observers believe, was a buying-based decision made in response to price hikes in other products. Cracker sandwiches were the lowest costing product. By switching to more cracker sandwiches, operators were able to minimize their exposure to price increases, even though the number of units sold was lower than candy bars, bagged chips or pastries.

Marking a change from last year, the larger operators sold a higher portion of cracker sandwiches in 2002. From a geographic perspective, the South Atlantic region sold the most cracker sandwiches.

Nuts also posted a gain in 2002. This largely reflected strong marketing by key product manufacturers, combined with the product's perception as being healthy.

The only other product to post a share gain was meat snacks, which witnessed some introductions in 2002. Driving some of this growth was the popular Atkins Diet, which included beef jerky. Small operators led the gain in meat snacks, selling more than double the percent of other firms.

The gain in meat snacks was evident

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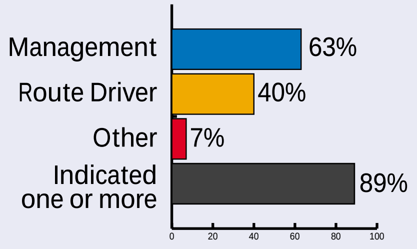
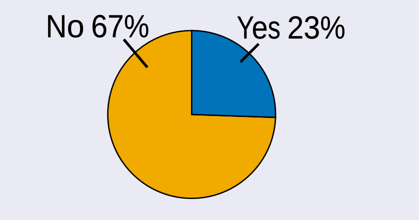
7b. Who is primarily responsible for making candy/snack/confection selections in machines



7c. Drivers are required to use a planogram for candy/snack/confection machine



7d. Top 20 candy/snacks/confections in 2002, dollar sales

Rank	Product
1	Masterfoods USA 2-oz. Snickers Original
2	Masterfoods USA 1.74-oz. M&M's Peanut
3	Masterfoods USA 2-oz. Twix Bar
4	Hershey 1.6-oz. Reese's Peanut Butter Cups
5	Frito-Lay 1.5-oz. Doritos Nacho Cheesier Big Grab
6	Kellogg/Keebler 1.5-oz. Cheez-It Original
7	Masterfoods USA 2.3-oz. Three Musketeers Original
8	Masterfoods USA 1.69-oz. M&M's Milk Chocolate
9	Masterfoods USA 1.42-oz. Skittles
10	Hershey 1.45-oz. Almond Bar
11	Masterfoods USA 2.07-oz. Starburst Original
12	Poore Brothers 1-oz. TGI Friday Potato Skins Cheddar & Bacon
13	Hershey 1.85-oz. Payday
14	Frito-Lay 1.25-oz. Fritos Chili Cheese
15	Hershey 2-oz. Reese's Fast Break
16	Hershey 1.94-oz. Kit Kat Big Kat
17	Frito-Lay 1.5-oz. Ruffles Cheddar & Sour Cream
18	Flowers 4.5-oz. Mrs. Freshley Jumbo Honey Bun
19	Frito-Lay 2.125-oz. Chee•tos Crunchy
20	Nestlé 2.1-oz. Baby Ruth

Source: MSA Vendscape Sales Data

Number of new candy/snack/confections introduced in 2002

Category	Total
Chocolate	2
Non-chocolate candy	17
Gum	0
Mint	0
Salty snacks	55
Crackers	7
Cookies	7
Pastries	8
Nuts and seeds	1
Functional/nutritional	0

Candy/snacks/confections gaining the most distribution in 2002

Rank	Product
1	Hershey 2-oz. Reese's Fast Break
2	Masterfoods USA 1.76-oz. Snickers Almond
3	Masterfoods USA 1.8-oz. Skittles Sour
4	Masterfoods USA 2.05-oz. Milky Way
5	Kraft 1.4-oz. Nabisco Gummisavers Five Flavor
6	Masterfoods USA 1.69-oz. M&M's Milk Chocolate
7	Masterfoods USA 2.07-oz. Starburst
8	Hershey 1.7-oz. Whatchamacallit Bar
9	Hershey 1.63-oz. Reese's Pieces
10	Charms 1.7-oz. Sugar Babies

8a. Hot beverages, 5-year review

Hot beverage machines

Year	Total
1998	386,600
1999	411,000
2000	425,000
2001	399,500
2002	360,200

Hot beverage sales, 5-year review

	% of total				
Type	1998	1999	2000	2001	2002
Fresh-brew regular	55.6%	59.5%	58.1%	54.0%	44.6%
Fresh-brew decaf	7.7	7.4	6.5	6.2	6.5
Fresh-brew specialty/flavored	9.0	8.1	8.4	6.3	7.1
Freeze-dried regular	5.6	6.7	6.5	5.6	7.7
Freeze-dried decaf	0.7	2.0	1.9	1.9	3.0
Freeze-dried specialty	6.0	4.1	9.0	12.4	13.1
Tea	7.6	2.0	1.9	1.9	1.2
Hot chocolate	7.6	8.1	6.5	8.7	10.7
Soup	0	1.4	0.6	1.2	0.6
Other	0	0.7	0.6	1.8	4.8

	Projected total				
Type	1998	1999	2000	2001	2002
Fresh-brew regular	816.00M	880.60M	865.70M	696.60M	526.28M
Fresh-brew decaf	141.00M	109.50M	96.90M	79.98M	76.70M
Fresh-brew specialty/flavored	129.00M	119.90M	125.20M	81.27M	83.78M
Freeze-dried regular	82.00M	99.20M	96.80M	72.24M	90.86M
Freeze-dried decaf	10.00M	29.60M	28.30M	24.51M	35.40M
Freeze-dried specialty	88.00M	60.70M	134.10M	159.96M	154.58M
Tea	105.00M	29.60M	28.30M	24.51M	14.16M
Hot chocolate	105.00M	119.90M	96.80M	112.23M	126.26M
Soup	0	20.70M	8.90M	5.48M	7.08M
Other	0	10.40M	8.90M	23.22M	56.64M

in all retail channels, according to Datamonitor, a United Kingdom-based international research firm.

Coffee struggles on

Declining blue collar work sites hurt hot beverage sales once again in 2002. Hot beverages fell as a percent of total sales for the eighth straight year, despite product and equipment manufacturers' attempts to upgrade offerings.

Because of the high investment required, hot beverage vending has been unable to capitalize on the popularity of specialty coffee to the extent that OCS has. In 2002, the warm winter in the North further hurt coffee consumption.

In 2002, following a trend from the previous year, machines were introduced that offered more product selections to enable operators to cash in on the popularity of specialty coffee. Product manufacturers also offered more specialty blends.

Coffee demographics challenging

One reason these improved offerings failed to revive sales was that hot beverage machines were commonly placed in locations heavily populated by middle-aged, blue collar males. This demographic group was less receptive to specialty coffee than younger and white collar consumers.

The New York City-based National Coffee Association attributed a decline in specialty coffee consumption overall to higher unemployment among young adults in 2002.

Competition for coffee sales grows

Another challenge that continued for hot beverage vending operators in 2002 was competition from other retail channels, such as coffee shops, convenience stores, gas stations, delis and restaurants. Each of these channels was faster than vending to upgrade coffee offerings, and was therefore better able to lure the morning coffee sale.

Convenience stores and gas stations, which many vending operators considered to be their biggest competitors for morning coffee, upgraded their coffee programs in 2001 and 2002, according to convenience store industry trade publications. These presentations included better quality coffee, improved equipment such as airpots, more variety, custom-designed coffee cups in different sizes, and promotional pricing tied to combination purchases.

Even donut chains such as Dunkin' Donuts and Krispy Kreme upgraded their coffee programs to grab more morning sales.

Specialty coffee outlets, for their part, continued to expand at a rapid clip in 2002, according to the Specialty Coffee Association of America.

Vending operators that attempted to fight back using newer product and equipment reported mixed results in 2002. Operators generally reported a better return on investment in white collar sites, where customers were more receptive to specialty offerings.

Operators who reported success noted the importance of using higher quality coffee in conjunction with newer equipment. Hot beverage machines

CONTINUED

8b. Hot beverage prices, 5-year review

Type	1998	1999	2000	2001	2002
Fresh-brew regular	38 cents	36 cents	38 cents	41 cents	44 cents
Fresh-brew decaf	40	36	39	41	45
Fresh-brew specialty/flavored	48	42	51	51	51
Freeze-dried regular	33	36	38	37	41
Freeze-dried decaf	34	36	39	38	42
Freeze-dried specialty	44	45	51	47	54
Tea	37	35	38	40	43
Hot chocolate	38	39	40	42	45
Soup	38	36	35	40	42

required more maintenance than any other machine type.

Larger cups popular

Larger size cups also proved popular in hot drink machines, just as they have in convenience stores and coffee shops. Vending operators, however, were limited in how large a cup they could offer.

The survey did not track cup sizes. Interviews with operators revealed that many expanded beyond the traditional 8.25-, 10- and 12-ounce cups to 14-, 16- and even 20-ounce cups. The larger cups were typically vended along with a smaller cup in a dual cup machine.

Operators offering larger cups noted that the smaller cup oftentimes sold more units, but the upcharge on the larger size cup yielded a much better profit margin.

Some operators claimed 14-ounce cups sold better than 12-ounce cups since they offered a more obvious comparison to products sold at retail. Priced at $1.00, the 14-ounce vend cup was a bargain compared to $2.00 in a c-stores. Not all operators selling 14-ounce cups reported the same experience, however.

Some operators were able to improve coffee sales by switching from dual cup to one larger-size cup. In these situations, the cup was 12 ounces and the audience was usually blue collar males. Most operators experienced with larger cups said the single-size strategy would not work with cup sizes in excess of 12 ounces.

One disadvantage larger size cups brought, operators noted, was longer brew time. This became a problem in locations with limited break periods.

Coffee prices rise

While hot drink sales continued to fall in 2002, the survey reported prices rose for practically every type of coffee vended. This largely reflected the dominance of larger firms in hot beverage vending.

Sales of freeze-dried coffee grew for the third straight year in 2002. Coffee roasters have been able to improve the taste of freeze-dried coffee to the extent that some believed it was hard to distinguish from fresh-brew. Operators further noted that freeze-dried coffee was easier to work with and more profitable.

Some operators argued that blue collar workers always preferred freeze-dried to fresh-brew coffee.

In addition to freeze-dried regular coffee, fresh-brew decaf, fresh-brew specialty, freeze-dried decaf, freeze-dried specialty, and hot chocolate all gained market share in 2002 at the expense of fresh-brew regular coffee and tea.

Operators in heavily industrialized regions, such as East South Central, East North Central, West South Central and West North Central sold the most freeze-dried coffee.

New England led all regions in the amount of fresh-brew regular coffee sold, followed by the South Atlantic, the Pacific and the Mountain regions.

The Mountain region led in the amount of fresh-brew specialty coffee sold, followed closely by the Pacific region. This reflected the high concentration of specialty coffee retailers in the Mountain and Pacific regions.

The Pacific Northwest included a growing number of dedicated specialty coffee vending operators. These operators used countertop, single-cup brewers, the type typically used by OCS operators in larger locations, as vending machines. The machines usually offered specialty drinks popular in the Pacific Northwest, along with regular coffee.

OCS struggles, too

While OCS was not as adversely affected by the nation's economy as vending in 2002, it still lost market share. This was in contrast to 2001, when OCS sustained its market share even as revenues decreased.

The decline in OCS sales in 2002 no doubt reflected the same factors hurting hot beverage vending sales, particularly higher unemployment of younger consumers.

In addition, the industries most affected by the job fallout in the last two years — finance, telecommunications, the Internet, travel and leisure — were among the largest users of OCS services.

Vending operators active in OCS — about a third — noted it was easier to replace lost OCS accounts than lost vending accounts since the universe of OCS accounts, which included work sites with as few as 25 people, was much larger.

The majority of the OCS sold by vending operators was sold to existing vending accounts. Vending operators offering OCS rarely marketed OCS as a stand-alone service.

The OCS numbers reported in the State of the Vending Industry Report include OCS sold by vending operations, not dedicated OCS operations. Revenue from dedicated OCS operations was included in the State of the Coffee Service Industry Report, published in July.

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9a. Food machines, 5-year review

Machine type	1998	1999	2000	2001	2002
Refrigerated	176,753	177,150	177,450	158,050	149,080
Frozen*	13,367	19,017	26,520	33,183	39,718
Heated	1,900	1,900	1,700	1,500	1,500
Ambient	1,200	1,070	1,100	900	900
Food systems (pizza, popcorn, french fries)	1,275	1,580	1,750	1,750	1,800

*Most were used for ice cream.

Vend food sales, 5-year review

	% of sales					Projected total				
Source	1998	1999	2000	2001	2002	1998	1999	2000	2001	2002
Freshly-prepared	62.1%	63.7%	63.4%	54.0%	51.4%	$968.7M	$1.08B	$1.17B	$864.0M	$771.00M
Frozen-prepared	23.5	26.9	28.9	37.9	43.0	366.6M	458.10M	534.60M	606.4M	645.00M
Shelf-stable	9.8	8.2	7.7	8.1	5.1	152.9M	139.60M	142.50M	129.6M	76.50M
Other	4.6	1.2	0	0	0.5	71.7M	20.40M	0	0	7.50M

Vend food prices, 5-year review

Type	1998	1999	2000	2001	2002
Freshly prepared	$1.52	$1.47	$1.67	$1.73	$1.80
Frozen-prepared	1.48	1.44	1.62	1.67	1.64
Shelf-stable	1.20	1.26	1.28	1.28	1.42

Downsizing hurts food sales

Account downsizing made the most unprofitable segment — cold food — even more unprofitable for the second straight year. Hence, in 2002, the number of food machines fell once again, reflecting the decline in traditional manufacturing accounts.

While vending operators usually welcomed any opportunity to remove their often money-losing food machines, the reason for removal in 2001 and 2002 didn't give operators reason to celebrate. Operators removed food machines in 2001 and 2002 because the population accounts could no longer justify them financially.

In removing a food machine from an account, the vending operator lost some of his opportunity to distinguish his service from competitors. The food machine, while unprofitable, often gave operators the chance to provide products that were not readily available from their competitors. By providing high-quality sandwiches and entrées, an operator was often able to solidify customer loyalty.

Removing a food machine also cost vending operators an unknown amount of snack, soda and hot beverage sales that typically accompanied food purchases.

Fresh food declined as a percentage of all food sold in 2002. Unique, fresh food traditionally provided vending operators key selling tools.

In 2002, the percent of fresh food sold in refrigerated food machines fell almost three percentage points, continuing a trend from 2001, which posted an even bigger drop from 2000.

Fresh food suffers

Fresh food sales lost share despite the fact that wholesale food prices fell 1.4 percentage points in 2002, according to the National Restaurant Association. In 2001, wholesale food costs rose, which, following three years of stability, could have accounted for the drop in fresh food sales that year. But in 2002, even a decline in wholesale food costs did not revive fresh food sales.

The decline in fresh food at the expense of frozen prepared food largely reflected the loss in food accounts in general. Operators needed large customer bases to justify an investment in fresh food.

On the other hand, the increase in frozen-prepared food could be credited to an increase in frozen-prepared offerings. Many operators noted that frozen prepared food made major strides in recent years, both in quality and variety.

As the amount of frozen-prepared products grew, operators no longer needed to invest in in-house food preparation.

Small operators were considerably less active in food vending than other operators. Among operators active in food, larger companies used more fresh food.

Fresh food was one category where the tendency of larger companies to charge more did not hold true. As noted in last year's report, small operators

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9b. Frozen/refrigerated food products

Top 15 frozen food products in 2002, dollar sales

Rank	Product
1	White Castle Distributing White Castle Twin Cheeseburger
2	Pierre Foods Pierre Hot & Spicy Chicken Wings
3	Jimmy Dean Foods Rudy's Farm Sausage Twin Biscuit
4	Chef America Hot Pockets Pepperoni Pizza
5	Pierre Foods Big AZ Cheeseburger
6	Schwan's Foods Tony's Pepperoni Pizza
7	Deli Express Ham & Cheese
8	Chef America Hot Pockets Ham & Cheese
9	Pierre Foods Jumbo Bacon Cheeseburger
10	Pierre Foods Chopped Beef Sandwich
11	Pierre Foods Monterey Ranch Chicken With Bacon
12	Bridgford Foods Cheeseburger
13	Jimmy Dean Foods Jimmy Dean Sausage/Gravy Biscuit
14	Raybern Quality Foods Pastrami & Cheese
15	Ruiz Beef Tamale

Top 15 refrigerated food products in 2002, 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	Dannon Yogurt
5	Kraft Foods Breyer's Strawberry Yogurt
6	Kozy Shack Rice Pudding Cup
7	Upstate Farms Peach Yogurt
8	General Mills Colombo Yogurt
9	Dole Pineapple FruitBowls
10	Kraft Foods Breyer's Black Cherry Yogurt
11	Kraft Foods Breyer's Peach Yogurt
12	Kraft Foods Breyer's Red Raspberry Yogurt
13	Kraft Foods Breyer's Blueberry Yogurt
14	Armour Swift Ekrich Butterball Smoked Turkey & Cheese
15	Kraft Foods Breyer's Fat Free Strawberry Yogurt

Editor's Note: Pastry and beverage items were not included in these lists.
Source: *Automatic Merchandiser Magazine.*

charged more for fresh food. This likely reflected the higher cost incurred by companies with less purchasing power.

Frozen machines expand

The growth of frozen food in relation to fresh and shelf stable food also reflected the continued increase in frozen food machines. Frozen food machines, unlike refrigerated food machines, maintained their fast growth in 2002, as indicated in chart 10a.

Many operators found that frozen food machines gave them the option of providing food with less frequent service than refrigerated machines. As noted in last year's report, many operators simply replaced refrigerated food machines with frozen food machines.

Food brands proliferate

Branded, prepackaged food products continued to expand in 2002, including some chain restaurant brands. Operators noted that these name brand items helped improve the food machine's credibility with the consumer. However, operators also noted that these items tended to cost more than other offerings, making them less profitable to sell.

Operators further noted that some of these brands with high consumer recognition were more popular in white collar accounts, which had far fewer food machines.

Most of the top selling food products in 2002 were not brands with high consumer recognition, as indicated in chart 10b.

Milk offers promise

Milk vending emerged as a category with a lot of potential in recent years, given the public's concern about health and the aggressive marketing undertaken by the dairy industry. The State of the Vending Industry report indicated these factors did not contribute to any significant gain in milk vending in 2002, however.

While state and local governments sought to promote milk vending with marketing funds in 2002, the number of milk machines actually decreased, as

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10. Milk sold by machine type

Machine type	% sold	Projected sales
Dedicated milk	35.0%	$72.84M
Cold beverage	4.3	8.95M
Refrigerated food	59.7	124.24M
Other	1.0	2.08M

Milk sales, 5-year review

1998	1999	2000	2001	2002
$280.0M	$399.3M	$461.2M	$243.0M	$208.11M

Dedicated milk machines, 5-year review

1998	1999	2000	2001	2002
42,015	57,530	60,000	56,220	48,000

Milk prices, 5-year review

1998	1999	2000	2001	2002
56 cents	55 cents	54 cents	65 cents	75 cents

did milk vending sales.

The overriding influence on milk vending in 2002 was the economy, with layoffs impacting industrial customers, the largest traditional milk vending accounts.

Milk pricing, on the other hand, continued to rise in 2002, reflecting the popularity of larger pint bottles over the traditional gable cartons.

Dairies slow to act

Dairies were once again slow to make milk available to vending operators in 2002. As a result, product availability was inconsistent across the country. Vend product distributors offered some extended shelf life milk products in 2002. However, these products carried a higher cost than locally produced milk and required a higher selling price, which made them a harder sell.

The dairy industry continued to promote milk vending by holding seminars for dairies and vending operators alike in 2002. Dairy industry officials encouraged dairies to purchase vending machines and lease them to vending operators. Several hundred machines were placed through these efforts nationwide.

A handful of vending operators also found milk machines an entrée into schools that wanted to offer students an alternative to soda.

The survey reported that large and extra-large operators continued to dominate the milk business in 2002. These operators were more likely to have the resources needed to warehouse and transport milk at cool temperatures.

Extended shelf life emerges

The survey further reported that the larger operators sold more extended shelf life milk and sold more milk in dedicated cold beverage machines as opposed to dedicated milk or refrigerated food machines.

The cold beverage machines used were usually glassfront machines since traditional closed-front beverage machines didn't offer total refrigeration. Operators were able to use closed-front machines only by placing the milk in the coldest zones of the machine, but this proved difficult to execute.

Operators found that by moving milk to the glassfront cold beverage machine, they were able to free up space in the refrigerated food machine. The downside of doing this was that in the beverage machine, the product typically incurred a commission, hurting its profitability.

While milk consumption declined steadily since the 1950s, teen milk consumption increased in 2002, according to National Family Opinions WorldGroup's Share of Intake Panel data. Per capita consumption of milk for teens rose from 22 gallons in 2001 to 23.5 gallons in 2002. This followed a 4-year decline in per-capita teen milk consumption, indicating the dairy industry marketing made an impact on teens.

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11. Operator acquisition activity, 5-year review

	1998	1999	2000	2001	2002
% that acquired other operations	13%	16%	16%	12%	8%
% that sold some part of operation	6	6	6	5	5
% that did both of the above	9	6	9	7	4
% that did neither	71	69	68	75	79
No answer	1	2	0	1	4

12. Other types of vending-related sales reported, 5-year review

	% operators involved				
Type	1998	1999	2000	2001	2002
Bottled water	32%	33%	38%	41%	47%
Sundries/toiletries	14	14	13	14	18
Games	11	13	10	11	10
Music	9	9	7	8	9
Bulk vending	12	15	17	13	12
Kiddie rides	4	3	3	3	3
Cooperative service vending	3	3	3	3	2
Condoms	4	5	5	4	3

13. Ice cream sold by machine type

Machine type	% of sales	Projected sales
Combination food/ice cream	52.7%	$134.04M
Old style, 3- and 4-select	10.6	26.96M
Dedicated, new style multiproduct	23.1	58.75M
Dual temperature machine	13.4	34.08M
Other	0.2	0.50M

Ice cream sales, 5-year review

1998	1999	2000	2001	2002
$186.20M	$225.42M	$281.80M	$243.00M	$254.35M

Dedicated ice cream machines, 5-year review

1998	1999	2000	2001	2002
56,487	42,931	44,543	43,046*	48,273**

* Of 33,183 frozen food machines in 2001, shown in chart 9a, 26,546 are included in this number.
** Of 39,718 frozen food machines in 2002, shown in chart 9a, 31,773 are included in this number.

Ice cream prices, 5-year review

	1998	1999	2000	2001	2002
Ice cream	72 cents	72 cents	80 cents	91 cents	98 cents
Frozen confections	$1.13	$1.00	$1.31	$1.49	$1.68

Ice cream continues to grow

The expansion of frozen food machines continued to build ice cream sales in 2002. Equipment manufacturers estimated that close to 80 percent of all frozen food machines vend some ice cream. Vending operators oftentimes purchased the frozen machines intending to use them to sell food primarily, only to end up filling most of the slots with ice cream.

Operators in 2002 again reported that more than half of all ice cream sales were in combination food/ice cream machines.

Newer style frozen food machines enabled operators to remove old style, 3- and 4-select ice cream machines in recent years. In 2001, frozen food machines overtook old style ice cream machines as the main selling tool.

Like most other product segments, ice cream prices increased in 2002 as operators sought to improve margins.

Extra large firms were considerably more active in ice cream vending than other firms in 2002. In many cases, small- and medium-size firms subcontracted larger firms or dedicated ice cream specialists to handle their ice cream business.

More operators sold ice cream in dual chamber machines in 2002. This likely reflected the need to reduce the number of machines in relation to diminishing location populations.

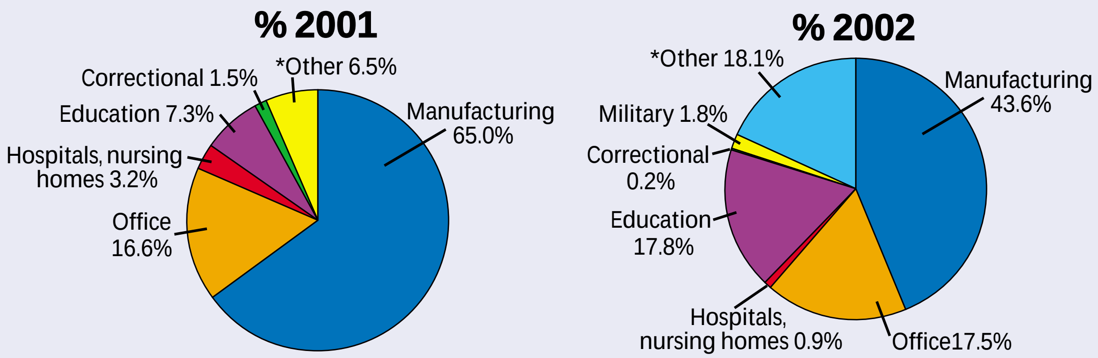
Manual foodservice gains

As the extra-large operations continued to grab market share, manual foodservice sales posted an increase in 2002. Companies active in manual foodservice — the majority of which fell into the extra large group — diversified their customer base in 2002 to minimize exposure to their traditional customers, which downsized.

Technomic Inc., the Chicago-based foodservice research firm, reported that B&I foodservice sales increased its share of total foodservice sales from 5.4 percent in 2001 to 6.1 percent in 2002

As indicated in chart 15, operators increased manual foodservice sales in all account segments at the expense of manufacturing, hospitals and correctional accounts. Notable gains were made in educational accounts.

14. Manual foodservice customer locations, 2001 and 2002



* Includes hotels, motels, car dealers, tourist sites, airports, recreation centers, trucking depots, and other retail establishments.

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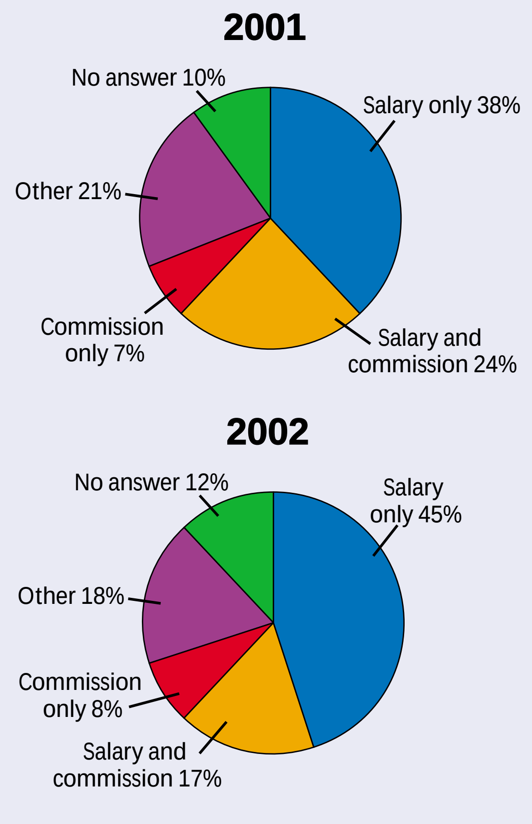
15. How drivers are compensated



A fairly significant gain was also posted in “other” accounts in 2002, which included hotels, motels, car dealers, tourist sites, airports, recreation centers, trucking depots, and other retail establishments.

Gains were also made in office foodservice accounts and military accounts. Information from the National Restaurant Association confirmed a similar increase in military foodservice in 2002. This increase likely reflected higher funding for military operations.

Operators noted that customers were under pressure to reduce subsidies for manual foodservice in 2002. However, in considering their own finances, these customers realized that operators' costs were rising. Hence, those that wanted to keep their cafeterias continued to support them financially.

While costs increased in several areas, wholesale food prices were stable in 2002, according to the NRA. Finding help was also easier, due to higher unemployment.

2003: outlook uncertain

Vending operators believed that 2003 will be slightly better than 2002, but far from the pre-2000 levels. In mid-2003, operators gave mixed reports on sales. Half said sales were recovering while the rest claimed there was no change from the first of the year.

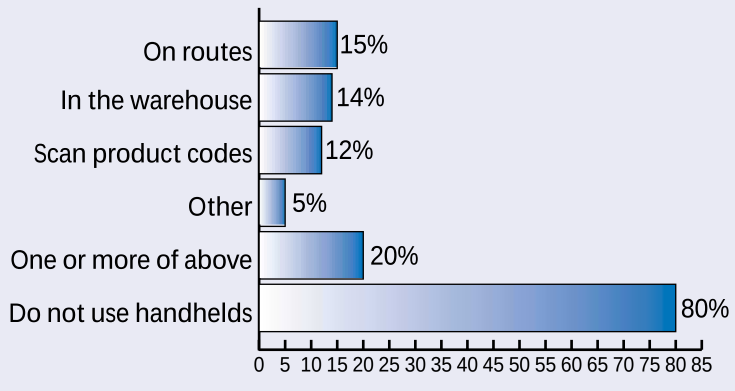
Economic indicators were mixed in mid-2003. The unemployment level shot up to 6.4 percent of the nation's work force in June.

However, *The Wall Street Journal* reported in early June that the average factory work week lengthened from 40.1 to 40.2 hours, although it remained low for the overall work force, and temporary employment rose 58,000. Economists noted that businesses tend to hire temporary workers before adding permanent employees.

It remains to be seen if prosperity will return enough in 2003 to give most operators the confidence needed to invest in technologies that promise to take automatic merchandising to a higher level. Technologies such as credit card enabled machines and remote machine polling offer the ability to make the customer experience far more rewarding.

Whether or not the industry can wait for prosperity to return in full force before making these investments is another question. Competing channels of trade have already begun to utilize cashless and other technologies to enhance customer satisfaction. ●

16. Handheld use



17. Uses of Internet, 4-year review

	1999	2000	2001	2002
Do not use the Internet	38%	38%	25%	27%
Purchasing product or equipment	33	39	44	56
Operate a website	17	20	30	23
Marketing services to customers	15	19	20	27
One or more of the above	53	59	69	69