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Automatic MERCHANDISER

State of the Vending Industry Report

OPERATORS STRUGGLE WITH MARKET DEMANDS page 44

2006: Operators battle rising costs, challenging market

The vending industry still fails to win its fair share of growth in a prosperous economy. Operators remain slow to invest in new technology that will strengthen their competitive position.

By Elliot Maras, Editor

Fiscal 2006 was not a year of great expectations for the vending industry.

The industry remained constrained by the same forces that have stymied its growth since the end of the "dotcom" implosion of the late 1990s, which was its last prosperous period. Worksite downsizing ebbed after 2002, but the vending industry has not been able to share in the nation's economic growth due to several industry specific challenges.

Fiscal 2006 matched 2005's growth rate; aggregate sales increased by 3 percentage points to a total $22.54 billion.

The industry's challenges, identified by *Automatic Merchandiser* in a special "Wake Up Vending" series in 2006, rest on its reliance on an operating model that evolved in the old industrial economy. That was an economy dominated by large work sites with captive audiences.

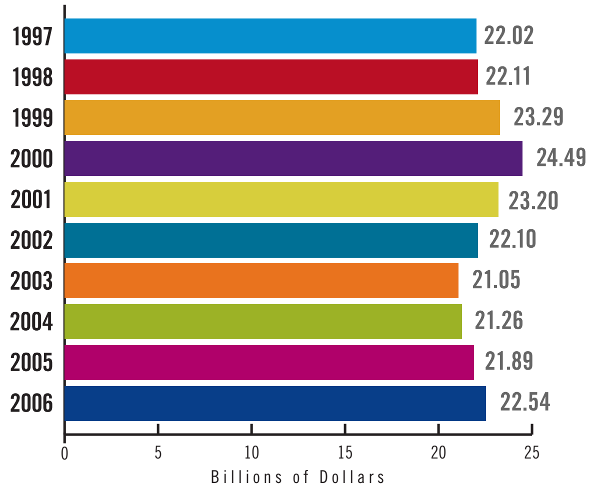
As the manufacturing base has given way to a service and technology economy, the vending industry must adapt to new customer needs.

NEW MARKET REALITIES EMERGE

In the current operating environment, locations have fewer employees, employees have more diverse lifestyles and product preferences, and they typically are free to leave the work site for meals. Hence, the vending operator, to be competitive, must cater to a demographically diverse audience with products that are competitive with other retail outlets.

The State of the Industry Report in recent years has examined the industry's performance in comparison to that of the overall foodservice industry. Based on this criterion, the vending industry once again trailed its retail competition in 2006.

CHART 1: INDUSTRY REVENUE IN BILLIONS, 10-YEAR REVIEW



According to the National Restaurant Association, foodservice sales rose by 5 percentage points in 2006. This marked the second consecutive 5-point gain for foodservice, and a total 16-point gain for a 3-year period, compared to the vending industry's seven points in this 3-year period.

Automatic Merchandiser magazine does not regard sales growth as the most important financial measurement. However, given the increasing operating costs, industry observers recognize that vending operators must increase sales in order to maintain profitability.

Historically, vending revenues reflected overall economic output. The last four years, by contrast, represents the first period in which vending revenues have failed to keep pace with gains in industrial growth.

The vending industry's aggregate revenue, indicated in chart 1, largely tracked the nations' economic productivity up until 2002.

VENDING NO LONGER TRACKS THE ECONOMY

An examination of three recent economic cycles demonstrates the recent slowdown in vending sales relative to overall economic conditions.

From 1997 to 2000, the nation's gross domestic product (GDP), the value of goods and services produced in the U.S., averaged about 4.2 percentage points per year, according to the U.S. Commerce Department.

Vending industry revenues, based on *Automatic Merchandiser's* historical data, slightly exceeded this growth rate.

When GDP plummeted below 2 points in both 2000 and 2001, vending performance reflected the downward trend.

In 2004 through 2006, GDP rebounded, averaging about 3.45 points growth per year while vending sales only averaged 2.33 points.

In retrospect, vending industry revenues rose in concert with the U.S. economy in the 1997 to 2000 period, suffered with the economy during the 2000/2001 recession, but did not keep pace during the 2002 to 2006 expansion.

COMPETING RETAIL CHANNELS OUTPACE VENDING

Automatic Merchandiser, in its "Wake Up Vending" series, noted that competing foodservice channels, by contrast, posted strong sales growth in the recent period. Foodservice sales increased about 5 points annually for the past four years.

The vending industry's 3 percentage point revenue increase in 2006 largely reflected price increases driven by product manufacturers. This was the second consecutive year the report noted that revenue increases were mainly due to operators passing on higher prices from their suppliers, as opposed to adding customers or selling more to existing customers.

The *Automatic Merchandiser* "Wake Up Vending" series called for a stronger commitment to professionalism in response to a more demanding business environment. The series noted that vending operators need to invest more in equipment, technology, personnel and education in order to compete with retailers who are capturing more of the consumer's spending.

The "Wake Up Vending" series noted that the equipment, technology and product suppliers have given the industry tools to compete more effectively, but that vending operators need to be willing to make longer term investments in order to use these new tools.

The survey indicated that not a lot of progress was made in investing in new equipment or technology.

About the survey

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 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.

For the fourth 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 several route automation software providers with the goal of analyzing machine activity.

MSA markets two data services to report on industry performance; IntelliVen™, which monitors machine level sales activity, and ProVen™, a dollar based projection service which calculates item volume, turns and distribution at the total U.S., region and class of trade levels.

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.

2006: U.S. ECONOMY PROSPERS

The nation's economy continued to grow in 2006, but the growth did not come from larger work sites. The Bureau of Labor Statistics reported that about 1.9 million new jobs were created in 2006, marking the third straight year of overall job growth.

For several years, economists have noted that most U.S. work sites employ less than 100 workers, which means most are not viable locations for vending banks based on existing operating cost structures.

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CHART 2: OPERATOR SALES

Size	Revenue range	% of 2006 Operators	Projected 2006 sales	% of 2006 sales	Projected 2005 sales	% of 2005 sales
Small	under $1 M	75%	$1.006 B	4.7%	$936 M	4.5%
Medium	$1M - $4.9M	17	2.355 B	11	2.41 B	11.6
Large	$5M - $9.9M	5	2.526 B	11.8	2.35 B	11.3
Extra large	$10M +	3	15.524 B	72.5	15.1 B	72.6
Total*			$21.413 B		$20.79 B	

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

JOB GROWTH BOTH HELPS AND HURTS

The nation's comparatively low unemployment – the unemployment rate remained well below 5 percentage points in 2006 – affected vending operators in both positive and negative ways.

This historically low unemployment resulted in upward pressure on wages, which resulted in high consumer confidence in 2006. Higher consumer confidence creates a greater willingness to spend discretionary income, which benefits all retailers.

Wages rose about 4 percent in 2006, according to The Conference Board.

At the same time, stronger wage pressure typically makes it harder for vending operators to retain good workers without raising their salaries.

The National Automatic Merchandising Association (NAMA) Operating Ratio Report found that payroll as a percent of sales increased in 2006 – however slightly – from 25.1 to 25.2.

ECONOMY BECOMES MORE WHITE COLLAGE

Another reason that the nation's economic growth did not help the vending industry is that the employer base is becoming more service and technology driven as opposed to manufacturing based. Vending operators have long noticed that blue collar accounts, on average, generate 20 percent to 50 percent more sales than white collar accounts.

The automotive sector, a large manufacturing segment that historically generated plenty of work for vending and foodservice operators, experienced its third consecutive poor year in 2006, according to the Detroit, Mich.-based Automotive Information Center. Automotive production in North America actually declined by 2.6 percentage points in 2006, following two years of very weak gains.

Manufacturing accounts continued to represent the largest single share of vending machines, as indicated in chart 3 on page 48. What this actually indicates, however, is that the vending industry has not been able to shift its customer base in tandem with the nation's overall economy.

The Labor Department reported that non-manufacturing sectors have been growing at the expense of manufacturing for several years.

ENVIRONMENT CHALLENGES MEDIUM-SIZE FIRMS

With costs continuing to rise and location population counts not following suite, the operating environment continued to favor the larger and smaller operating companies in 2006. Medium-size companies, those with $1 million to $4.9 million in sales, lost market share to their smaller and larger competitors, as indicated in chart 2.

Many operators noted there were fewer medium-size companies in most major markets compared to several years ago.

The largest companies have the resources to compete in a more challenging environment while the smallest companies enjoy the benefits of less overhead.

Larger firms also have the ability to offer a wider variety of services, particularly manual foodservice, which has accounted for the largest share of the industry's volume in the last six years.

OPERATOR CONSOLIDATION CONTINUES

Consolidation among operating companies continued in 2006 as many operators viewed acquisition as the only way to grow. However, there were fewer acquisitions among extra large companies (companies with more than $10 million in

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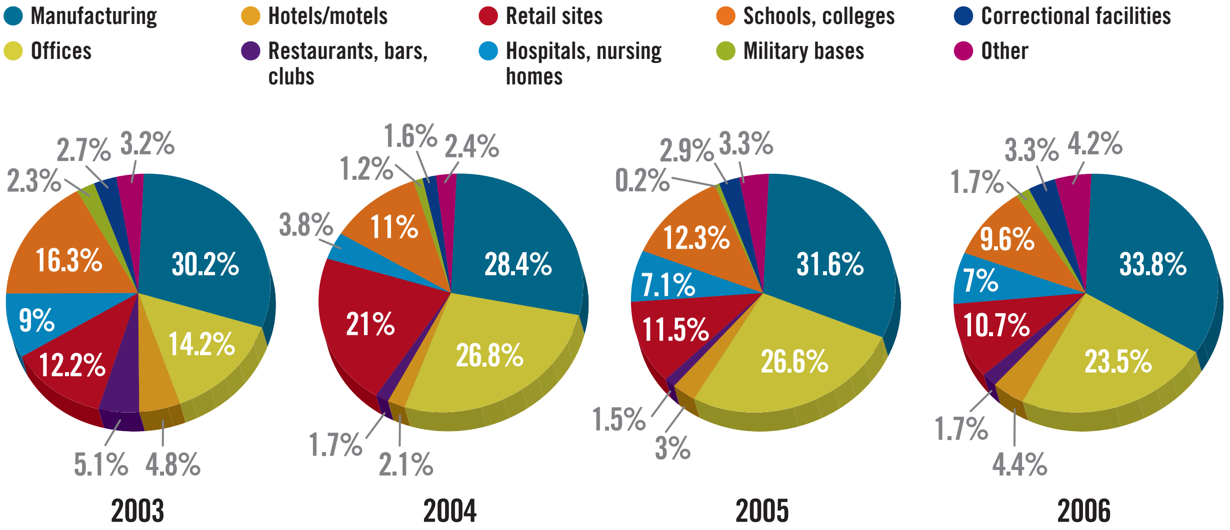
CHART 3: MACHINES BY LOCATION, 4-YEAR REVIEW



* Cooperative service vending, music, games, bulk vending, bottled water, sundries, toiletries, condoms, kiddie rides, other foodservice revenue.)

annual sales) than in previous years. This was because most extra large companies interested in selling had already sold.

The only multi-state operator acquisition in 2006 was Overland Park, Kan.-based Treat America's purchase of Omaha, Neb.-based The Swanson Corp.

The national operations continued to expand through acquisition in 2006. The largest of the largest, Compass Group, continued to sign more independents as franchisees.

SOME EXTRA LARGE OPERATIONS DIVEST

There were also divestitures in 2006 of some extra large operations, indicating the challenges that even extra large companies face in the current operating environment. Clairvest Group Inc., a Toronto, Canada-based merchant bank, divested Consolidated Vendors Corp. (CVC), a Muskegon, Mich.-based vending operation with branches throughout Michigan. The company reported estimated annual sales over $50 million in 2001. Clairvest sold the CVC business to four Michigan vending operations.

Lance Inc., a Charlotte, N.C.-based snack manufacturer which operated vending routes throughout the Southeast, divested most of its route business in 2006. Lance had acquired Tom's Foods Inc., a Columbus, Ga.-based snack manufacturer that also operated vending routes, in 2005.

There was more than usual acquisition activity among equipment suppliers in 2006, which reflected the challenged state of the industry. Crane Merchandising Systems acquired two major equipment manufacturers: Automatic Products International ltd. and Dixie Narco Inc. These acquisitions resulted in a major consolidation of equipment manufacturers.

OPERATORS SLOW TO INVEST

The survey indicated that operators did not invest heavily in new technology in 2006, which many observers believe holds the key to future growth. There was little increase in either of the two technologies that suppliers have noted as promising: cashless card readers and telemetry-based remote machine monitoring systems.

While only a handful of operators invested in these technologies, system suppliers continued to conduct experiments designed to demonstrate growth opportunities for operators.

MasterCard PayPass™ introduced its contactless credit card to vending, in cooperation with USA Technologies Inc. The two companies announced plans to equip 5,000 vending machines with contactless payment capability in 12 major cities.

"Open" credit and debit card systems for vending have been available for several years. While the percentage of operators utilizing these systems increased each of the past two years, the growth was not significant. The majority of operators, when asked, did not believe the investment needed justified the potential return.

In addition to a need for hardware, operators must also pay processing fees for "open" credit and debit card systems.

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CHART 4A: SHARE OF SALES BY CATEGORY, 4-YEAR REVIEW

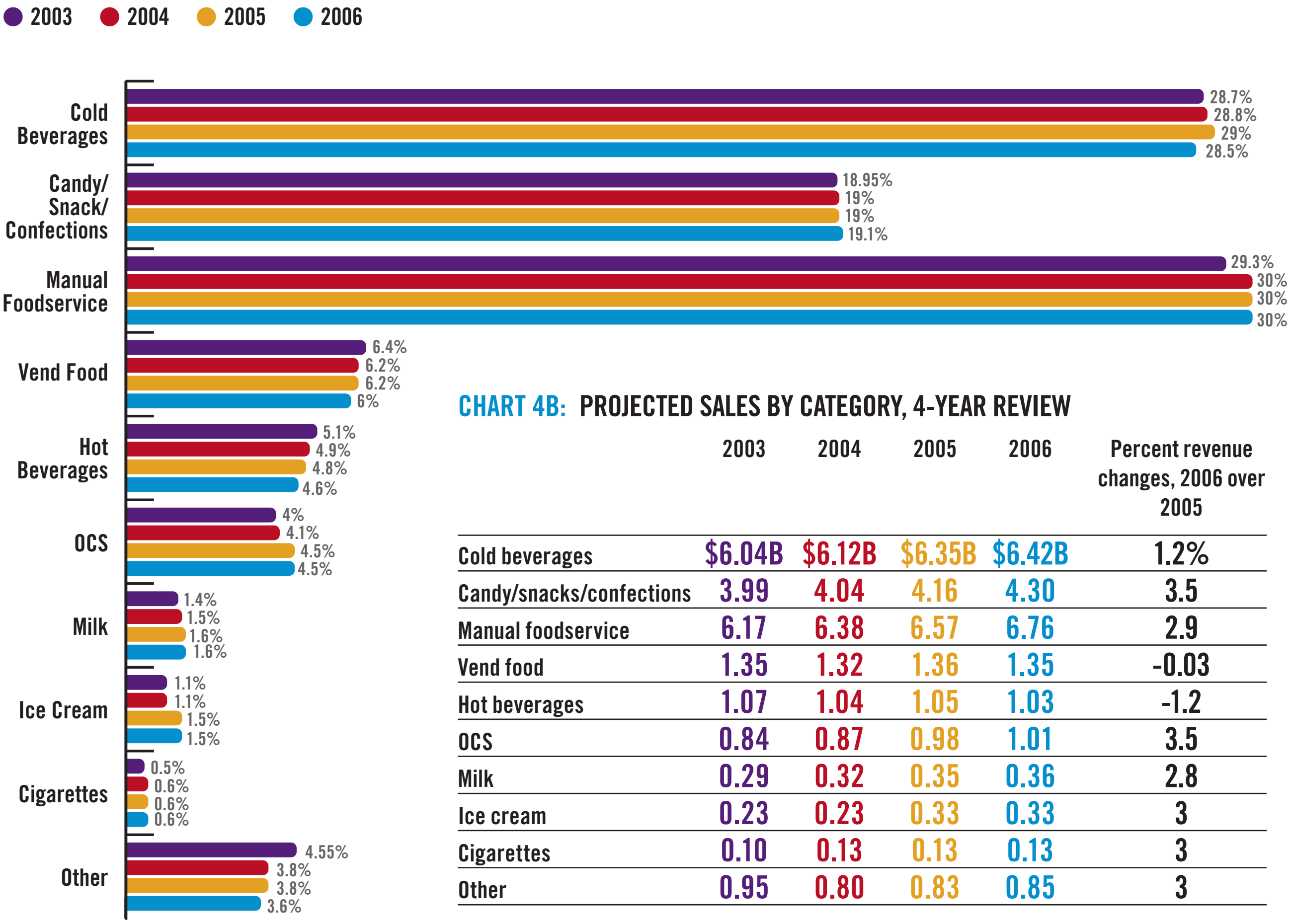

CHART 4B: PROJECTED SALES BY CATEGORY, 4-YEAR REVIEW

	2003	2004	2005	2006	Percent revenue changes, 2006 over 2005
Cold beverages	$6.04B	$6.12B	$6.35B	$6.42B	1.2%
Candy/snacks/confections	3.99	4.04	4.16	4.30	3.5
Manual foodservice	6.17	6.38	6.57	6.76	2.9
Vend food	1.35	1.32	1.36	1.35	-0.03
Hot beverages	1.07	1.04	1.05	1.03	-1.2
OCS	0.84	0.87	0.98	1.01	3.5
Milk	0.29	0.32	0.35	0.36	2.8
Ice cream	0.23	0.23	0.33	0.33	3
Cigarettes	0.10	0.13	0.13	0.13	3
Other	0.95	0.80	0.83	0.85	3

The majority of operators who installed "open" card systems did not report enough increase in sales to warrant installing card readers on more machines. The majority did not report double digit sales increases, even when the credit card readers were installed in their largest locations.

The slow acceptance of "open" credit card systems indicates the vending industry faces a "Catch 22"; many operators say they are waiting for these systems to become more established before investing in them, but they cannot become better established until more operators invest.

CASHLESS FACES CHALLENGES

One reason why "open" cashless systems did not generate higher sales is that consumers are not accustomed to seeing card readers on vending machines. Some speculated that consumers need to become accustomed to seeing and using credit cards in vending machines.

Providers of "closed" cashless systems designed for captive audiences also introduced enhancements in 2006.

TECHNOLOGY INNOVATIONS CONTINUE

Bill recyclers that allow customers to receive bills as change from vending machines increased in 2006, making it easier for customers to use larger bill denominations.

Some operators reported that bill recyclers were especially useful in food machines, which have larger value transactions. Some claimed that providing $5 bills in change encouraged more purchases.

Some also noted that bill recyclers reduced the need for free-standing bill changers.

Other technological innovations were introduced in 2006.

Digital touch screens that offer interactive and promotional capabilities were demonstrated on vending machines at vending trade shows.

A fully-automated, self checkout market that uses radio frequency identification (RFID) technology was introduced to a handful of vending customers in 2006.

All of these technologies require an upfront investment. Many require modern machines or special retrofits.

NAMA released a consumer survey in 2006 that indicated the public remains largely unaware of vending technology. The survey, not coincidentally, also reported that consumers continue to hold vending in low esteem compared to other retail venues.

The consumer survey found that the most positive perceptions consumers hold of vending have to do with convenience while negative perceptions focus on lack of healthy products, lack of variety and overall poor value.

HEALTH ISSUES CONTINUE TO ALARM CONSUMERS

Fiscal 2006 was a challenging year from a public relations standpoint as the media continued to focus attention on nutrition issues.

Much of the news in 2004 and 2005 focused on schools. In 2006, the move to mandate nutrition restrictions extended to other government buildings and, to a lesser extent, business and industry locations.

While most of the nutrition restrictions were not directed at vending locations, the publicity caused more location managers to ask questions about nutrition. Vending operators almost unanimously agreed in 2006 that more customers raised questions about the nutritional content of their offerings.

To help operators address these concerns, NAMA extended its Balanced for Life program to business and industry customers in 2006. In addition, product manufacturers introduced more products that were associated with better nutrition in 2006.

Vending operators mostly viewed the nutrition issue as a distraction. While more customers asked for healthier options, vending operators did not report any increase in sales for these items, with the exception of bottled water.

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

COLD BEVERAGES: PRICE INCREASES HURT

Cold beverages, historically one of the most profitable vend product segments, became one of the most price competitive categories in 2006 due to manufacturer price increases, a trend that gained momentum in 2007.

The cold drink segment declined as a percent of total sales in 2006, due mainly to operators' inability to raise prices. Most operators claimed they were not able to raise prices as much as needed to sustain profits.

Operators reported being unable to increase the prices above a certain ceiling due to competitive pressure and customer resistance.

CHART 5A: COLD BEVERAGE MACHINES BY TYPE, BOTTLERS AND VENDORS, 3-YEAR REVIEW

	Bottler owned			Vendor owned		
	2004	2005	2006	2004	2005	2006
Can closed front	1.06M	1M	1M	842,000	830,000	830,000
Bottle closed front	1.04M	1.03M	1.03M	115,500	115,000	115,000
Combo bottle and can closed front	378,000	378,000	378,000	42,000	42,000	42,000
Glassfront	40,000	92,715	118,800	8,000	12,285	16,200
Cup	0	0	0	30,000	20,000	15,000
TOTAL	2.518M	2.5M	2.527M	1.037M	1.019M	1.018M

The pricing situation largely reflected the pressure the major bottling companies faced due to a declining demand for soda, the lion's share of their business. The current emphasis on health and nutrition, driven strongly by aggressive marketing by noncarbonated product manufacturers, resulted in less consumption of soda in favor of bottled water, ready-to-drink iced teas, energy drinks and even coffee.

The Beverage Marketing Corp. (BMC), which tracks beverage trends, reported that Cadbury Schweppes, the third largest carbonated drink manufacturer, was the only soda maker to increase soda sales in 2006.

Many vending operators noted that Cadbury Schweppes gained market share due to more favorable pricing on many products. Many operators increased their use of Cadbury Schweppes' products for secondary facings, although not the core products.

BOTTLE GROWTH TAPERS

The increase in bottles at the expense of cans leveled off in 2006, having achieved more than three quarters of all vend beverage sales.

In some cases, operators opted for bottles due to more favorable pricing.

Operators also noted that customer package preference varied. Certain customers preferred cans while others preferred bottles. Preferences were noticed among both location managers and end users.

Many operators continued to prefer cans since they found them easier to work with.

GLASSFRONTS EXPAND SLOWLY

Glassfront beverage machines continued to gain placements in 2006, but still only represented a small percentage of machines. The slow growth of glassfronts continued

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to undercut the vending industry's ability to capitalize on rising consumer demand for more variety.

The rollout of glassfront beverage machines was delayed for a while in 2006 by mechanical issues, operators reported. Operators agreed that the newer models were more reliable.

Many operators preferred glassfronts in larger locations and primarily for slower selling products. Because glassfronts hold less capacity, they need to be serviced more frequently in order to prevent empty facings.

Most operators using glassfronts agreed they merchandise product better than the more traditional machines and generate 20 to 50 percent higher sales.

Besides presenting product more effectively, glassfronts allow operators to carry products that don't always fit in closed front machines, such as energy drinks and cold coffee products.

NONCARBS LEAD BEVERAGE GROWTH

Several of the leading non-carbonated liquid refreshment beverages, most of which are owned by the major soft drink companies, enjoyed exceptionally strong growth in 2006, according to BMC. BMC noted that leading cold drink brands included carbonated soft drinks, sports beverages, bottled water, ready-to-drink tea and coffee, fruit beverages and energy drinks.

A sports beverage, two fruit beverage brands and two bottled waters ranked among the top 10 selling products in 2006, according to BMC. All but one of these recorded double-digit volume growth during the year.

While most vending operators did not service a lot of school accounts in 2006, the nation's beverage manufacturers publicly committed to stop selling soda in schools, a development that many beverage industry observers think will support continued growth of noncarbonated beverages.

The BMC reported that beverages offering functional benefits grew two to three times faster than conventional refreshment beverages.

Vending operators concurred that bottled water continued to be among their fastest growing products in 2006. Many operators also noted strong growth in energy drinks and green teas.

Cup beverage machines continued to decline in 2006. Operators still using cup machines noted that sourcing syrup was hard.

Operators using cup machines also claimed that the cold cup remains popular with consumers.

CHART 5B: COLD BEVERAGE SALES, 4-YEAR REVIEW

TYPE	% OF SALES 2003	2004	2005	2006
Can	43.7%	24.4%	23.5%	23.5%
Bottle	53.0	74.9	76	76
Cup	3.0	0.6	0.5	0.5
Other	0.3	0.1	0	0
PROJECTED TOTALS				
Can	$2.64B	$1.49B	$1.489B	$1.509B
Bottle	3.2	4.58	4.818	4.882
Cup	0.18	0.036	0.0317	0.032
Other	0.002	0.002	0	0

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

CHART 5C: AVERAGE COLD BEVERAGE PRICES, 4-YEAR REVIEW

TYPE	2003	2004	2005	2006
Can	62¢	62¢	67¢	67¢
Bottle	98¢	$1.01	$1.08	$1.08
Cup	57¢	60¢	59¢	66¢

CANDY, SNACKS CONFECTIONS INCREASE

The candy, snack and confections segment experienced more revenue growth in 2006 than it had in several years, but the gain was largely driven by manufacturer price increases.

Operators struggled to raise prices, but were constrained by competitive pressure and customer resistance beyond a certain price point.

In 2006, vending operators improved on the pricing gains made in both of the prior years. The past three years marked improvement over 2003, when the segment suffered a revenue decline.

Chart 6C on page 56 indicates that the prices for the top selling products increased more on average in 2006 than in either of the prior two years. Among the 16 products that were among the top 20 selling items in both 2005 and 2006, the average price gain exceeded 3 cents. The top selling products were compiled by Management Science Associates Inc. (MSA).

LARGE SIZE CANDY PLACEMENTS INCREASE

Some of the increases were due to more placements of large size candy bars in 2006. Large-size candy bars, introduced in 2004, commanded higher price points than

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CHART 6A: CANDY/SNACK/CONFECTION MACHINES, 4-YEAR REVIEW

YEAR	PROJECTED TOTAL	YEAR	PROJECTED TOTAL
2003	1,398,600	2005	1,328,760
2004	1,328,670	2006	1,328,760

CHART 6B: TOTALS BY CATEGORY AND SUBCATEGORY

	PROJECTED REVENUE	% SALES OF TOTAL	SHARE CHANGES FROM 2005
CANDY	$1.506B	35%	-0.09%
Chocolate candy	1.044	24.25	-0.40
Gum	0.089	2.01	-9.4
Mint/hard roll	0.044	1.03	-1.55
Non-chocolate/toffee	0.331	7.7	3.83
SNACKS	$2.798B	65%	3.87%
NUTRITION SNACKS	0.101	2.36	-2.77
Breakfast bars	0.0082	0.019	10.21
Cereal	Negligible	0.001	100
Fruit snacks	0.043	1	1.5
Functional bars	Negligible	0.002	-25.07
Granola bars	0.101	2.35	65.41
Rice cakes	Negligible	0.001	10.07
Trail mix	0.107	2.5	-37.65
BAKED GOODS	0.823	19.12	2.98
Cakes/brownies	0.005	0.013	-43.59
Cereal snacks	0.056	1.3	23.22
Crème-filled cake.	0.056	1.3	-3.23
Danish	0.086	2	4.51
Donuts/gems	0.043	1	-2.38
Honey buns	0.051	1.2	-5.12
Muffins	0.004	0.1	13.1
Pies	0.008	0.2	1.11
Regular cookies	0.274	6.37	-1.16
Sandwich cookies	0.118	2.75	6.35
Sweet rolls	0.038	0.09	50.78
Unfilled cakes	0.008	0.2	-6.8
Misc. (Poptarts)	0.112	2.6	9.36
CRACKERS	0.258	6.0	3.77
Regular crackers	0.158	3.67	5.26
Sandwich crackers	0.099	2.3	1.59
FOOD SNACKS	0.03	0.7	-13.12
Meat snacks	0.03	0.7	-12.47
Meat and cheese	Negligible-	—	-39.37

traditional bars. MSA found large size candy increased its share of total confection sales from 7.2 percent in 2005 to 9.12 percent in 2006.

One large size candy bar, Hershey 2.25-ounce Reese's Peanut Butter Cups, made the list of the top 20 selling products and was the only item with an average selling price in excess of $1.00. Interestingly, the more established, 1.5-ounce version of this product also made the top 20.

The increase in large size candy placements may account for the tapering of the decline the candy segment has been experiencing for several years.

CANDY'S DECLINE BOTTOMS OUT

Salted snack sales continued to increase market share in 2006 at the expense of candy, but candy's market share loss of 0.09 points was less than the previous year's 0.49 points, indicating that the decline is bottoming out.

While candy lost market share in 2006, candy revenue still increased. Because candy lost market share, any increase within the segment will be disproportionately

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SNACKS CONTINUED

	PROJECTED REVENUE	% SALES OF TOTAL	SHARE CHANGES FROM 2005
NUTS AND SEEDS	$0.067B	1.57%	1.72%
Almonds	Negligible	0	-100
Cashews	0.004	0.1	-22.75
Mixed nuts	0.004	0.1	27.61
Peanuts	0.058	1.35	4.62
Pistachio nuts	Negligible	—	-92.07
Pumpkin seeds	Negligible	—	33.23
Sunflower seeds	Negligible	—	-5.65
SALTY SNACKS	1.513	35.15	5.37
Cheese curls	0.229	5.32	4.27
Corn/tortilla chips	0.437	10.16	4.08
Onion rings	0.021	0.5	100
Popcorn	0.064	1.49	6.95
Potato chips	0.36	8.37	-0.17
Potato sticks	Negligible	—	-9.14
Pretzels	0.163	3.8	-0.83
Snack mix	0.077	1.8	-0.8
Misc. salty snacks	0.152	3.54	30.18

CHART 6C: TOP 20 CANDY/SNACK/CONFECTIONS IN DOLLAR SALES, 4-YEAR REVIEW

#	PRODUCT	AVERAGE SELLING PRICE 2003	2004	2005	2006
1	Masterfoods USA 2-oz. Snickers Original	65¢	66¢	67¢	70¢
2	Frito-Lay 1.75-oz. Doritos Nacho Cheesier Big Grab	75	76	76	78
3	Masterfoods USA 1.74-oz. M&M's Peanut	65	67	67	71
4	Frito-Lay 2.125-oz. Cheetos Crunchy	75	76	76	79
5	Kellogg/Keebler 1.5-oz. Cheez-It Original	54	52	52	55
6	Masterfoods USA 2-oz. Twix Bar	66	67	67	71
7	Kellogg/Keebler 3.6-oz. Pop Tarts Frosted Strawberry	79	79	77	81
8	Kellogg/Keebler 1.7-oz.Rice Krispies Treat	NA	68	70	74
9	Frito-Lay 1.5-oz. Lay's Chips	73	75	74	76
10	Mrs. Freshley's 4.5-oz. Jumbo Honey Bun	NA	NA	73	77
11	Masterfoods USA 2.17-oz. Skittles	68	70	70	74
12	Hershey 2.25-oz. Reese's Peanut Butter Cups	NA	NA	NA	1.04
13	Frito-Lay 1.125-oz. Cheetos Crunchy	53	54	54	59
14	Frito-Lay 3-oz. Fritos	NA	73	73	76
15	Frito-Lay 2.25-oz. Fritos Chili Cheese	NA	73	73	76
16	Hershey 1.5-oz. Reese's Peanut Butter Cups	64	65	74	76
17	Masterfoods USA 1.69-oz. M&M's Milk Chocolate	64	66	67	70
18	Nestle 2.1-oz. Butterfinger	NA	NA	NA	71
19	Kellogg/Keebler 2-oz. Famous Amos Chocolate Chip Cookies	68	67	65	68
20	Masterfoods USA 2.13-oz. Three Musketeers Original	64	65	66	68

CHART 6D: CANDY/SNACK/CONFECTIONS GAINING THE MOST DISTRIBUTION IN 2006

#	PRODUCT
1	Hershey 1.5-oz. Kissables
2	Frito-Lay 1.5-oz.Wavy Chips Ranch
3	Frito-Lay 1.5-oz. KC Master Hot & Spicy BBQ
4	Just Born 2.12-oz. Mike & Ike Original
5	Kraft Nabisco 1.5-oz. Ritz Bits Cheese
6	Frito-Lay 2.75-oz. Doritos Blazin' Buffalo Ranch
7	Top Marketing Group 1.74-oz. Garfield Chocobites Peanut
8	Frito-Lay 1.75-oz. Fiery Habanero
9	Hershey 1.61-oz. Kit Kat Extra Krispy
10	Frito-Lay 1.25-oz. Funyuns
11	Frito-Lay 1.5-oz. Sunchips Garden Salsa
12	Nestle 1.5-oz. 100 Grand Bar
13	Kellogg/Keebler 3.6-oz. Pop Tarts Frosted Strawberry
14	Hershey 0.75-oz. Breathsavers Wintergreen
15	Frito-Lay 1.39-oz. Cheetos Cheddar Crackers

CHART 6E: NUMBER OF NEW CANDY/SNACK/CONFECTION PRODUCTS INTRODUCED TO VENDING

2003	2004	2005	2006
109	159	206	181

Source: Management Science Associates Inc. ProVen data.

larger than if the segment's market share remained the same size.

Some candy manufacturers positioned large size candy bars as an opportunity to improve candy sales in response to higher prices being charged for traditional candy.

Some operators added large size candy in response to rising manufacturer prices beginning in late 2005. The strategy was to offer a better value in order to justify a higher price point. However, not all operators responded to the higher prices this way.

Many operators opted to limit their candy offerings to the top selling items and allocate more facings to snacks.

While large size candy sales increased in each of the last three years, the use of this type of item, designed to fetch a $1.00 or more selling price, did not become standard. As noted, only one of the top 20 selling items listed in chart 6C was a large size candy product.

Some operators found that as candy prices gradually increased in each of the last two years, consumer acceptance for the larger size offering improved. Operators noted that manufacturer prices did not increase for the "dollar" candies.

Operators who reported success with large size candy noted the importance of allocating a sufficient number of facings to these items. Some noted that if there were too few facings, such products looked out of place in a machine.

Some operators noted that it is necessary to have more than four facings to create a perception of legitimacy for

CONTINUED ►

large size candy. Some said that it helped to group the products together.

Many operators became discouraged when they first offered large size candy bars due to poor customer response. Hence, they were not willing to give them the "second chance" that some operators found successful in 2006.

Some operators also felt that it made no sense to add large size candy when they were trying to accommodate customer requests for "healthier" offerings, a movement that most operators agreed gained momentum in 2006.

NUTRITION RESTRICTIONS AFFECT SNACKS

Schools and governments continued to enact nutrition restrictions for school vending machines in 2006.

While schools only represented a small percentage of vending locations, the publicity about the issue made location managers in traditional vending accounts more concerned about employee wellness.

Several major food and snack manufacturers in 2006 publicly stated their support for school nutrition guidelines adopted by the Alliance for a Healthier Generation, a joint initiative of the William J. Clinton Foundation and the American Heart Association.

Many U.S. businesses adopted employee wellness programs which included an emphasis on healthier food choices in the work place.

NAMA responded to this by adapting its "Balanced for Life" materials from the school environment to the work place.

Operators did not report significant growth in "better for you" items in general.

MSA data revealed a mixed record.

Sales of products identified as "nutritional" snacks were flat in 2006, as indicated in chart 6B on page 54. "Nutritional" snacks collectively lost 2.77 category share points in 2006. The most noteworthy losses were in functional bars and trail mixes. Granola bars and breakfast bars, in contrast, posted gains, as did cereal snacks.

Nuts and seeds, which also have a healthy connotation with many consumers, posted a slight gain in 2006, according to MSA.

HOT BEVERAGES KEEP STRUGGLING

Coffee, once a thriving vending category, continued to struggle in 2006, as the segment's sales trended below that of the vending industry as a whole. The hot beverage segment has yet to find a way to participate in the consumer's rediscovery of coffee as a refreshment of choice.

CONTINUED ►

CHART 7A: HOT BEVERAGE MACHINES, 4-YEAR REVIEW

2003	2004	2005	2006
350,000	345,000	344,000	343,000

CHART 7B: HOT BEVERAGE SALES, 4-YEAR REVIEW

TYPE	% OF TOTAL 2003	2004	2005	2006
Fresh-brew regular	47.2%	49.4%	45.11%	47.08%
Fresh-brew decaf	7.4	4.8	9.68	4.99
Fresh-brew specialty/flavored	17.6	12.1	8.37	10.17
Freeze-dried regular	4.0	11.7	7.42	4.99
Freeze-dried decaf	1.1	1.0	NA	NA
Freeze-dried specialty	7.4	3.5	5.16	8.75
Tea	1.7	1.6	1.47	2.37
Hot chocolate	9.1	10.8	13.26	13.24
Soup	1.1	1.4	0.79	2.51
Other	3.4	3.7	8.74	5.88
PROJECTED TOTALS				
Fresh-brew regular	$505M	$513.7M	473.6M	$488.2M
Fresh-brew decaf	79.18	49.92	101.6	51.76
Fresh-brew specialty/flavored	188.32	125.84	87.88	105.46
Freeze-dried regular	42.8	121.68	77.7	51.74
Freeze-dried decaf	11.77	10.4	NA	NA
Freeze-dried specialty	79.18	36.4	54.12	90.74
Tea	18.19	16.64	15.43	24.57
Hot chocolate	97.37	112.32	139.23	137.29
Soup	11.77	14.56	8.29	26.02
Other	36.38	38.48	91.77	60.97

CHART 7C: AVERAGE HOT BEVERAGE PRICES, 4-YEAR REVIEW

TYPE	2003	2004	2005	2006
Fresh-brew regular	46¢	48¢	50¢	53¢
Fresh-brew decaf	46	49	60	48
Fresh-brew specialty/flavored	56	65	61	59
Freeze-dried regular	42	40	48	48
Freeze-dried decaf	43	41	NA	NA
Freeze-dried specialty	50	41	55	56
Tea	44	54	44	48
Hot chocolate	48	51	50	51
Soup	45	45	46	60

Vending operators have not, as a whole, invested in the latest state-of-the-art equipment that allows more variety, better quality products and more modern aesthetics.

This is mainly due to the high cost of the equipment and the decline in work site populations necessary to justify such an investment. The report indicated vending operators did not raise prices in the hot beverage segment as much as they did in some other product categories.

Coffee retailers, by contrast, raised prices in 2006. As noted in the *Automatic Merchandiser's* State of the Coffee Service Industry Report in July, the OCS industry took advantage of this opportunity.

OCS GROWS AGAIN

OCS was among the vending industry's brighter spots for the second consecutive year in 2006. Vending operators active in OCS, like dedicated OCS operators, upgraded their product and equipment offerings to meet a more demanding coffee consumer. They were thereby able to increase their OCS sales.

The NAMA Operating Ratio Report, like the State of the Vending Industry Report, also found a gain in OCS revenue as a percent of vending sales for the third straight year in 2006. The NAMA survey participants increased OCS and cooperative vending service sales from 12.5 percent to 13.5 percent to 17.4 percent, respectively, from 2004 through 2006.

Vending operators active in OCS found that market offered more growth opportunities than vending, both in terms of adding sales to existing accounts and in finding new accounts.

Because coffee retailers nationwide raised prices in 2006, operators encountered less resistance to price increases for office coffee than they did for candy and soda.

In addition, operators were able to increase sales by offering countertop, single-cup brewers. These systems proved popular among locations interested in offering coffee house quality coffee in the work place.

COFFEE SERVICE HELPS LOCATIONS KEEP EMPLOYEES ON SITE

Vending operators active in OCS, like dedicated OCS operators, offered location managers a way to prevent employees from leaving the office to get coffee at a restaurant or coffee house.

The OCS market also offered more opportunity for finding new customers since there are lower population requirements for OCS than for vending. While work sites with population counts in excess of 100 have become harder to find, sites with as few as 50 people are considerably more plentiful. Most vending operators with a dedicated OCS organization can profitably serve an OCS account with 50 employees.

VEND FOOD STRUGGLES

Food sales were unable to sustain the improvement posted in 2005 and returned to the downward trend that began in 2000. Last year, the report claimed a 2.9-point sales gain, ending an erosion in vend food sales caused by

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CHART 8A: FOOD MACHINES, 4-YEAR REVIEW

TYPE	2003	2004	2005	2006
Refrigerated	144,700	141,500	140,000	138,500
Frozen*	46,280	48,500	51,000	54,300
Heated	1,500	1,500	1,500	1,500
Ambient	800	800	800	800
Food systems (pizza, french fries)	2,300	2,500	2,900	3,100
TOTAL	195,580	194,800	196,200	198,200
Frozen food machines as a percent of total	23.6%	24.8%	25.9%	27.4%

* Most were used for ice cream.

CHART 8B: FOOD MACHINE SALES, 4-YEAR REVIEW

TYPE	% OF SALES 2003	2004	2005	2006
Freshly-prepared	50.7%	26.7%	30%	28%
Frozen-prepared	44.5	57.1	57	57
Shelf stable	4.4	16	13	15
Other	0.4	0.2	0	0
PROJECTED TOTALS				
Freshly-prepared	$68.4M	$35.2M	$40.7M	$37.85M
Frozen	60.1	75.3	77.3	77.06
Shelf stable	5.9	21.1	17.6	20.28
Other	0.04	0.02	0	0

CHART 8C: AVERAGE VEND FOOD PRICES, 4-YEAR REVIEW

TYPE	2003	2004	2005	2006
Freshly-prepared	$1.78	$1.80	$1.90	$1.93
Frozen-prepared	1.71	1.72	1.85	1.86
Shelf stable	1.36	1.36	1.67	1.71

CHART 8D: TOP 20 FROZEN FOOD PRODUCTS IN 2006, DOLLAR SALES

#	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	Nestle Hot Pocket Pepperoni Pizza
5	Jimmy Dean Foods Rudy's Farm Sausage Twin Biscuit
6	Schwan Foods Tony's Pepperoni Pizza
7	Pierre Foods Bacon Cheeseburger
8	Don Miguel Mini Beef Tacos
9	Pierre Foods Barbecue Wings
10	Chef America Hot Pockets Ham & Cheese
11	Pierre Foods A-1 Chopped Beefsteak Sandwich
12	Best Express Foods Oscar Mayer Lunchables Turkey & Cheddar
13	Jimmy Dean Foods Sausage Twin Biscuit
14	Chef America Hot Pockets Meatball Mozzarella
15	Schwan's Foods Tony's Supreme Pizza
16	Pierre Foods Big AZ Bubba Twin Chili Dogs With Cheese
17	Pierre Foods Southern Fried Chicken Breast
18	Pierre Foods Fast Choice Double Beef Stacker With Cheese
19	Pierre Foods Jumbo Cheeseburger
20	Ruiz Foods El Monterrey Beef & Bean

CHART 8E: TOP 20 REFRIGERATED FOOD PRODUCTS IN 2006, DOLLAR SALES

#	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	Kraft Foods Handisnacks Butterscotch Pudding
5	Kraft Foods Original Easy Mac Cups
6	Nestle Nesquik Chocolate Milk Shake
7	Dannon Yogurt Blended Variety Pack
8	Nestle Nesquik Strawberry Milk Shake
9	Nestle Nesquik 14-oz. 1% Chocolate PET
10	Nestle Nesquik 14-oz. 1% Double Chocolate PET
11	Kraft Foods Easy Mac Cups Triple Cheese
12	Kraft Foods Handisnacks Banana Split Pudding
13	Nestle Nesquik 16-oz. Double Chocolate PET
14	Nestle Nesquik 14-oz. 1% Strawberry PET
15	Breyer's Fruit On Bottom Strawberry Yogurt
16	General Mills Yoplait Strawberry Yogurt
17	Nestle Nesquik 16-oz. Very Vanilla PET
18	General Mills Yoplait Strawberry/Banana Yogurt
19	Kraft Foods Breyer's Fruit On Bottom Strawberry/Banana Yogurt
20	Nestle Nesquik 1% 14-oz. Vanilla PET

Source: Vendchannel, 800-999-4271

account downsizing. The 1-year upward change reversed in 2006.

The decline in vend food sales can be viewed either negatively or positively.

Many operators welcomed less food since the category is generally unprofitable.

However, lower food sales also reflected fewer machines in the field and less activity in locations that have food machines. Lower food sales indicated activity in all product segments was less than it would have been if food sales were higher.

The decline in food sales can be directly traced to a continuing slide in the number of refrigerated food machines, which dominated food vending.

The decline in refrigerated food machines was more than matched by an increase in frozen food machines and integrated food systems. However, frozen food machines and integrated food systems, which are newer, remained a much smaller segment of the food business.

OPERATORS RAISE FOOD PRICES

The food business was one of the few segments where operators were able to raise selling prices in 2006. Operators usually find it easier to raise food prices than snack or beverage prices since the offerings do not lend themselves to easy comparisons to products in other retail channels. Operators also have more flexibility in what products they offer since the category isn't ruled by specific "core" items like the snack and soda segments.

Operators found it important to raise food prices in 2006 to attempt to compensate for the profit squeeze they suffered.

The food segment itself did not experience the cost inflation that operators suffered in other categories in 2006.

According to the National Restaurant Association, wholesale food costs rose 0.6 percent in 2006. This brought relief following higher increases in each of the prior three years. Wholesale food prices increased 1.8 points in 2005, 5.6 points in 2005 and 5.5 points in 2003.

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CHART 9A: MANAGED COMMERCIAL FOODSERVICE SALES, 2-YEAR REVIEW

CHART 9B: AVERAGE ANNUAL SALES INCREASE FOR MANAGED COMMERCIAL FOODSERVICE FROM 2004 TO 2007

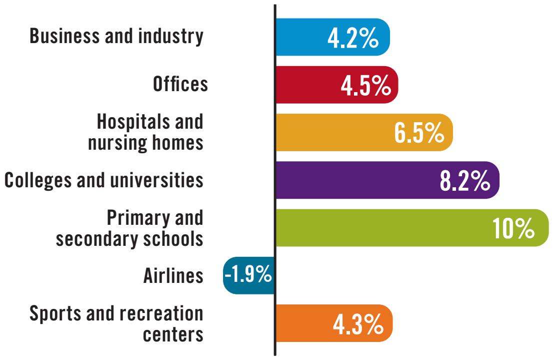
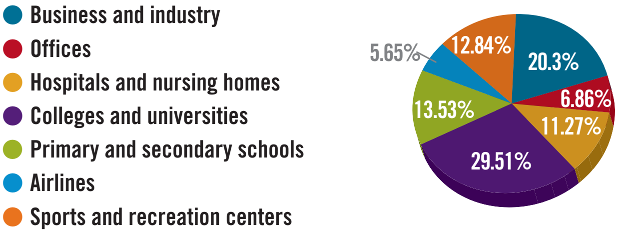


CHART 9C: MANAGED COMMERCIAL FOODSERVICE BY ACCOUNT TYPE IN 2006



Source: National Restaurant Association

Fiscal 2006 marked the third straight year that frozen food as a percent of sales did not increase. This occurred despite the fact that more frozen food machines were added in 2006.

The gain in frozen food machines didn't benefit frozen food sales as much as it might have because these machines were also used to vend ice cream.

Frozen food machines offered some operators a way to continue to provide food economically in locations that suffered population losses. Frozen food machines do not need to be serviced as frequently as refrigerated food machines since frozen product does not spoil.

For accounts too small to support a full-size refrigerated machine that insisted on fresh food, operators also had the option of using dual temperature machines that have both ambient and refrigerated areas. These machines, however, do not offer the advantage of reduced service frequency due to the requirements of refrigerated food.

Operators serving accounts large enough to support refrigerated machines usually found locations preferred having both fresh and frozen-prepared food in the machine rather than only frozen-prepared food. Many customers preferred freshly-prepared food because they think it tastes better. Many also find it more convenient since it heats faster.

Integrated food systems also increased in 2006. These systems that keep food in a frozen state and heat it at the point of sale are expensive and service intensive, but they meet the needs of consumers eating on the run in high traffic locations.

MANUAL FOODSERVICE MAINTAINS ITS SHARE

Manual foodservice maintained its share of business in 2006 but, as in 2005, this segment did not grow as much as it had in prior years. The NAMA Operating Ratio Report found that manual foodservice actually declined as a percent of vending sales in each of the last two years.

The stabilization of manual foodservice within the vending industry largely reflected the condition of the extra large operations that dominated this segment.

Extra large operations have not been able to expand sales by adding customers since the availability of large work sites has decreased. Nor were they able to grow by adding additional services because they already added as many new services as deemed possible.

As with smaller size operators, extra large operators had to rely on raising prices to grow in 2006.

The manual foodservice segment did allow more options for raising prices than vending since main entrees are prepared from scratch.

Manual foodservice operations can respond to new consumer trends with new products faster than vending operators. Many offered more ethnic items such as Mexican and Asian entrees, along with deli style, vegetarian and gourmet offerings.

MILK HOLDS ITS OWN

Milk remained a healthy segment in 2006, capitalizing on a recovering market. Milk continued to benefit from rising consumer perception as a healthy product. The dairy industry continued its aggressive marketing of milk in 2006. The national media campaign in 2006 emphasized milk's benefit as an alternative to soda.

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CHART 10A: MILK SOLD BY MACHINE TYPE, 4-YEAR REVIEW

TYPE	% OF SALES 2003	2004	2005	2006
Dedicated milk	22.2%	18.3%	20%	18%
Cold beverage	18.9	30.2	33	28
Refrigerated food	58.9	51.4	47	54
Other	0	0	0	0
PROJECTED TOTALS				
Dedicated milk	$64.38M	$59.24M	$70M	$64.8M
Cold beverage	54.81	96.94	115.5	100.8
Refrigerated food	170.8	164.48	164.5	194.4
Other	0	0	0	0

CHART 10B: MILK SALES, 4-YEAR REVIEW

2003	2004	2005	2006
$290M	$320M	$350M	$360M

CHART 10C: DEDICATED MILK MACHINES, 4-YEAR REVIEW

2003	2004	2005	2006
53,000	56,000	58,000	56,000

CHART 10D: AVERAGE MILK PRICES, 2-YEAR REVIEW

	2005	2006
Traditional gable cartons	64¢	64¢
Plastic Bottles	$1.02	$1.02

Milk sales in all retail channels increased every year since 2002, according to the Beverage Marketing Corp. In 2006, milk consumption rose for the first time since 2002.

This indicates consumer appreciation for milk has improved, most likely as a result of health concerns and aggressive marketing by the dairy industry.

Milk sales through vending machines did not post as much growth in 2006 as in the previous two years, but the segment held the gains it made since 2002. Milk vending posted a comeback since 2002, driven largely by the introduction of plastic bottles, extended shelf and better packaging graphics.

SALES THROUGH DEDICATED MILK MACHINES LOSE SHARE

The amount of milk sold in dedicated milk machines fell off in 2006, following a gain the previous year. In 2005, more operators took advantage of machine leasing programs that were supported by milk processors.

The State of the Vending Industry survey did not track the number of dedicated milk machines leased, but interviews with operators indicated that these initiatives did

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CHART 11A: ICE CREAM SALES, 4-YEAR REVIEW

2003	2004	2005	2006
$230M	$230M	$328M	$338M

CHART 11B: ICE CREAM SALES BY MACHINE TYPE, 4-YEAR REVIEW

TYPE	% OF SALES 2003	2004	2005	2006
Combination food/ ice cream	48.6%	50.8%	48%	47%
Old style, 3- and 4-select	11.4	10.3	11	10
Dedicated, new style multiproduct	29.7	34.8	37	40
Dual temperature machine	9.9	4.1	4	3
Other	0.4	0	0	0

PROJECTED TOTALS

TYPE	2003	2004	2005	2006
Combination food/ ice cream	$111.8M	$116.8M	$157.4M	$158.8M
Old style, 3- and 4-select	26.22	23.69	36.08	33.8
Dedicated, new-style multiproduct	68.31	80.84	121.36	135.2
Dual temperature machine	22.77	9.43	12.12	10.14
Other	92.0	0	0	0

CHART 11C: DEDICATED ICE CREAM MACHINES, 4-YEAR REVIEW

2003	2004	2005	2006
54,835*	55,935**	57,935***	$60,935****

* Of 46,280 frozen food machines in 2003, 35,054 are included in this number.
** Of 48,500 frozen food machines in 2004, 37,100 are included in this number.
*** Of 51,000 frozen food machines in 2005, 39,000 are included in this number.
**** Of 54,300 frozen food machines in 2006, 42,000 are included in this number.

CHART 11D: ICE CREAM PRICES, 4-YEAR REVIEW

TYPE	2003	2004	2005	2006
Ice cream	97¢	$1.09	$1.14	$1.15
Frozen confections	$1.31	$1.12	$1.27	$1.27

not grow in 2006. Operators also reported that it was difficult to sustain dedicated milk machines without ongoing supplier support.

Refrigerated food machines continued to account for the majority of vend milk sales in 2006. Milk sold in refrigerated food machines declined at the expense of cold beverage machines beginning in 2002, but this trend reversed in 2006.

The survey did not track the different types of milk sold in vending; i.e., extended shelf life (ESL) versus regular milk, regular versus flavored, or different size packages.

More ESL products were introduced in 2006, offering the advantages of longer shelf life and not requiring temperature controlled transport or warehousing. ESL offerings also featured national name brands and more professional graphics.

OPERATORS PREFER FRESH MILK

Most vending operators indicated they continued to source milk from local dairies and opted for fresh milk as opposed to ESL products. This was true despite the fact that a survey sponsored by the Milk Processor Education Program (MilkPEP) and conducted by the Beverage Marketing Corp. in 2006 found vending operators were more open to using ESL milk than in the past. The survey found operator concerns about ESL decreased in 2005.

In addition, both the Coca-Cola Co. and Pepsi-Cola Co. bottling organizations introduced initiatives for branded, 14-ounce, shelf stable milk in 2006.

Many operators claimed that ESL milk, despite its advantages, was less profitable than fresh milk. ESL products cost more than fresh milk but could not necessarily fetch a higher selling price.

Many operators also noted that regular milk continued to be more popular than flavored varieties, which comprised the majority of ESL offerings.

Some operators further noted that flavored milk sales did not sustain over time. This was true in both school and non-school locations.

In school locations, operators noted that not all flavored milk offerings met nutrition requirements.

Most operators also noted that the big bottling organizations did not win business because of the branded milk programs mentioned above. Operators said they did not notice these milk offerings in bottler operated machines.

ICE CREAM KEEPS GROWING

Ice cream, while not a large segment, grew at the same rate of the industry overall in 2006. Ice cream continued to benefit from the steady increase in frozen vending machine placements that began in the mid 1990s.

It is estimated that as many as half of all frozen food machine facings went to ice cream in 2006. In many instances, operators placed frozen food machines in response to requests for food, but found it more profitable to use ice cream.

The ice cream category also benefited from improved product distribution. Ice cream manufacturers were able to take advantage of a network of vend product distribution centers that became established nationally in 2005.

Consumer trends also supported ice cream sales. Appreciation for ice cream has improved in recent years due to the popularity of higher priced, gourmet type items and fat-free and low-fat ice cream.

Overall consumption of ice cream increased in the mid single digits, according to ice cream manufacturers.

The development of frozen machines that offer multiple products and price points in recent years created a new group of dedicated ice cream vending specialists. Many of these specialists served as ice cream subcontractors for full-line vending operators.

Due to the cost of investment in ice cream inventory and the liabilities involved in potential melt downs, many full-line operators found it easier to subcontract the ice cream business to dedicated ice cream specialists.

Integrated, point-of-sale, ice cream preparation and delivery systems were also introduced to vending in 2006. This technology, which has been used in traditional retail establishments, enables instantaneous aeration, flavoring and freezing of ice cream mixes that can be served in less than a minute.

2007: OUTLOOK CHALLENGING

With 2007 at the mid point, vending operators continue to face a challenging environment, with cost pressures rising even more than in 2006.

Early in 2007, cold beverage suppliers socked vending operators with what many called unprecedented price increases of as much as 25 percent. Coca-Cola Enterprises, the nation's largest bottler, said increases were necessary due to higher costs for raw goods and aluminum.

Many vending operators felt it was impossible to pass on the soda price increases needed to sustain a reasonable profit.

Other product manufacturers also raised prices as the year progressed.

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NAMA operating ratio report notes improvement in 2006

The National Automatic Merchandising Association (NAMA) 2007 Operating Ratio Report found that its vending operator members made some financial improvement in 2006. The NAMA report is based on results from a select group of operators. This year's report included 109 firms.

The NAMA report found that aggregate sales rose 4.3 percentage points in 2006, surpassing the 3 points that *Automatic Merchandiser* reported.

The NAMA report, which measures numerous financial ratios, found that operators posted a 1.7 point pre-tax profit in 2006. This marked the second straight year of profit recovery, and surpassed the 1.5-point profit reported in the previous year

While the NAMA reports indicated financial progress, operator performance remained poor in comparison to other periods. Pre-tax profit was in the high single digits in 1998 and 1999.

The NAMA report also found that return on assets increased in 2006 to 5.6 points. Return on assets in both 2005 and 2006 was only slightly above the 5-point figure that most financial analysts view as the minimum acceptable level of profitability.

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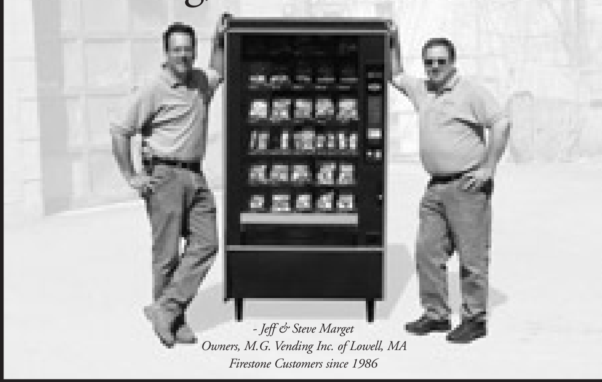

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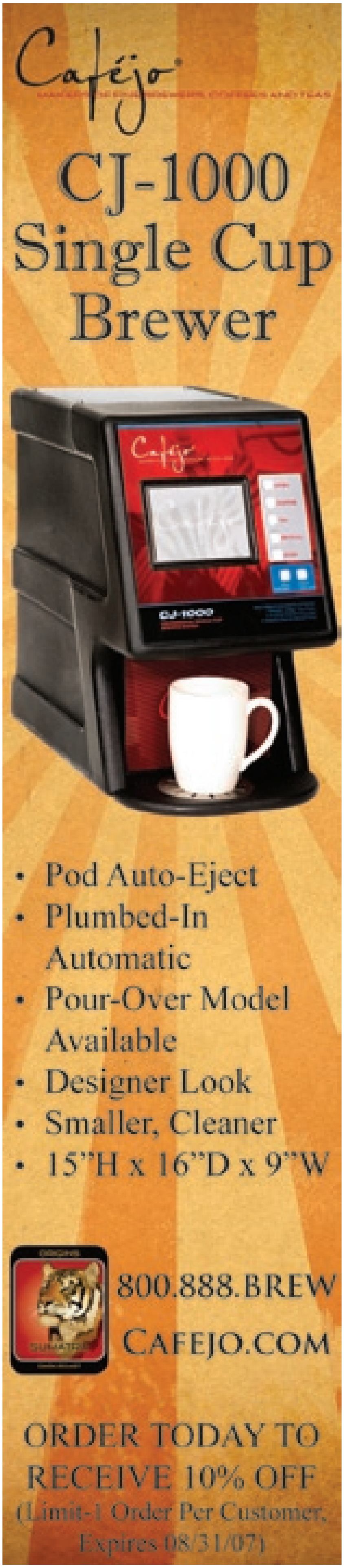

In addition to higher product costs, gasoline prices shot up in 2007. Average price for a gallon of gasoline rose from $2.30 in January to $3.20 in June, according to the Energy Information Administration. This further hurt vending operators' bottom lines.

INFLATION HURTS DISPOSABLE INCOME

Higher gasoline prices affected vending operators in another way as well; the higher prices cut into consumers' disposable income. Many operators claimed they noticed a direct correlation between higher gasoline prices and lower vending sales.

Some operators noticed the opposite effect; higher gasoline prices encouraged customers to take more meals at work rather than driving off to a restaurant.

The higher energy costs are also expected to add more costs to food prices, which will result in even more product price inflation.

Rising employee benefit costs, particularly health care and workers compensation, also continue to plague vending operators.

Still another challenging factor is continued job growth. The nation's unemployment remained at 4.5 percent through the first half of the year, a near record low.

While higher employment helps retail industries because consumers have money to spend, it also drives up wages, hurting operators' bottom lines. The Conference Board reported that the annual 4 percent increase in wages carried over from 2006 into 2007.

COMPETITION FROM OTHER CHANNELS

Vending operators will continue to face stiff competition from other foodservice channels. The National Restaurant Association reported that fast food restaurant sales, which outpaced overall foodservice sales in 2006, is expected to leap by 6 points in 2007.

Fast food restaurants have been quick to introduce consumer conveniences such as contactless credit card acceptance.

Health and nutrition continue to be an issue as more consumers ask for healthier products.

The many challenges affecting vending operators offered no indication of subsiding in 2007. To improve their profitability, vending operators need to evaluate their assumptions about how much they need to invest in equipment, technology, personnel and training.

In order for vending operators to succeed in the new market, they need to utilize state-of-the art equipment and technology, which requires a greater upfront investment than was needed in the past. |◀

Automatic Merchandiser 'Wake Up Vending' Action Plan:

- **Raise prices.**
- **Cut commissions**
- **Partner with your customers, but for real**
- **Invest in your employees**
- **Get up to speed on health and nutrition**
- **Get back in the coffee business**
- **Become an industry leader**

Economic conditions vary by region

As always, there were regional variances in economic conditions in 2006, as noted by the National Restaurant Association.

The Mountain region (Montana, Idaho, Wyoming, Nevada, Utah, Colorado, Arizona and New Mexico), while one of the smallest in population, was one of the fastest growing economies, led by Las Vegas, one of the nation's fastest growing cities.

The Pacific region (California, Oregon, Washington, Alaska and Hawaii) also continued to post strong economic growth, regaining much of the productivity lost during the "dotcom" implosion in 2000 and 2001.

The South Atlantic region (Delaware, Maryland, Washington, D.C., West Virginia, Virginia, North Carolina, South Carolina, Georgia and Florida) was one of the stronger regional economies.

The West South Central region (Texas, Oklahoma, Arkansas and Louisiana) also posted strong growth, recovering from Hurricane Katrina in 2005.

The West North Central region (North Dakota, South Dakota, Minnesota, Nebraska, Iowa, Kansas and Missouri) experienced flat growth.

The East South Central region (Kentucky, Tennessee, Mississippi and Alabama) posted moderate growth.

New England (Vermont, New Hampshire, Maine, Massachusetts, Rhode Island and Connecticut), Middle Atlantic (New York, New Jersey and Pennsylvania) and East North Central (Wisconsin, Michigan, Illinois, Indiana and Ohio) were slow growth regions in terms of jobs and population.

Marketplace

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