



Coffee sales rise, so do costs

State of the Coffee Service Industry

In the second half of 2013 and start of 2014, the majority of office coffee service providers saw increased revenues, however, an increase in green coffee bean prices and many locations with tight OCS budgets kept the growth moderate. New trends include local roasters and bean-to-cup single-cup brewers.

By Emily Refermat, Editor

Overall, the revenue for the office coffee service segment continued to climb this year reaching \$4.5 billion. While this is modest growth compared to the year before, it is still a record high for the last decade (chart 1). Operators report four main reasons for the rise in coffee sales. In areas where the economy is improving, the number of workplaces offering a beverage program to employees as a perk increased. Growing employee numbers at existing locations also increased OCS revenues. A third reason for better coffee sales is the strong demand for single-cup among consumers. Finally, OCS providers report that the consumer is more educated than ever before about the quality of coffee they drink. If quality and variety is important to the location, these OCS customers are demanding better coffee options and are willing to pay the higher price per cup.

The findings of the 2014 Automatic Merchandiser State of the Coffee Service Industry report are based on input from more than 180 operators from across the U.S. who reported on their OCS businesses. Full-line vending operators, OCS operators who offer vending and OCS-only operators provided the data and insight into the coffee service channel, which continues to break sales records for a fourth straight year.

OCS pulls up totals

A majority, 71.2 percent of OCS providers reported a rise in total operation sales over the last 12 months, in addition to increased coffee sales (chart 2). OCS was reported as the strongest segment of companies' growth. Many operators indicated that increasing coffee sales balanced out stagnant or declining segments, such as vending. Although OCS sales increased, operators saw tighter margins due to the high price of raw green coffee. Since April of 2011, the cost of green coffee has mostly dropped, according to the International Coffee Organization (ICO), see chart 3. However, the price of green coffee spiked in April of 2014 to \$1.70 per pound, up nearly 70 cents from the last quarter of 2013. The price has since gone down in the last several months, but OCS providers are unsure what to expect of green coffee prices for the remainder of 2014. Some coffee-growing countries have reported that crops are being destroyed by drought and leaf rust while others report having a surplus of green coffee. The volatile green prices make it difficult for OCS operators to plan and execute price adjustments to their coffee and service this year.

Many operators reported raising prices and absorbing the increased

THE average price charged to consumers for coffee increased over the past 12-months



CHART 1: OCS REVENUES – 10-YEAR HISTORY

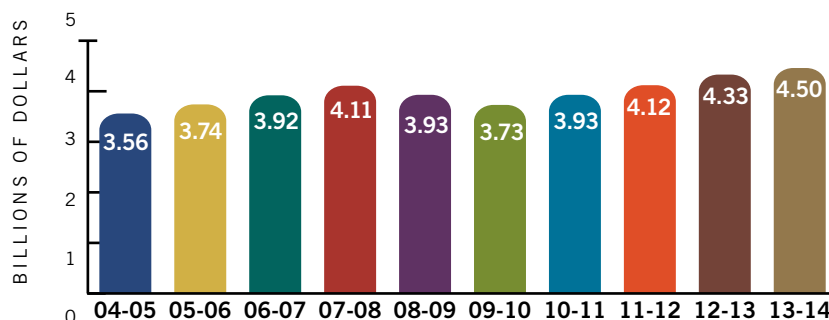
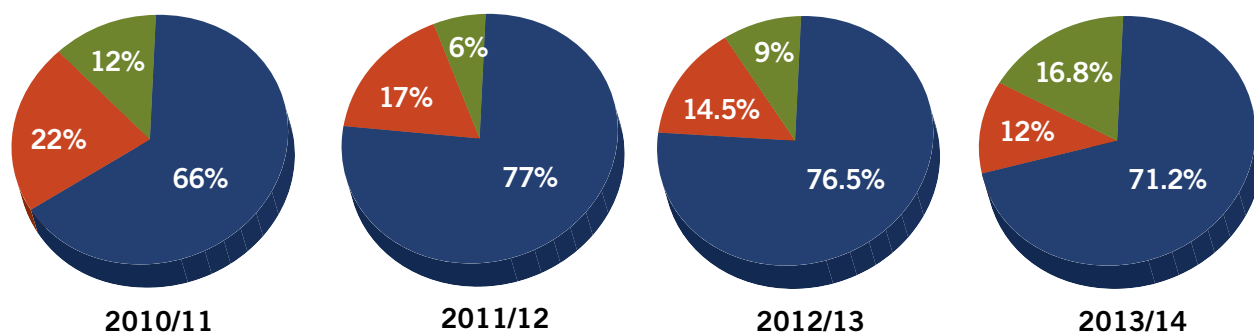
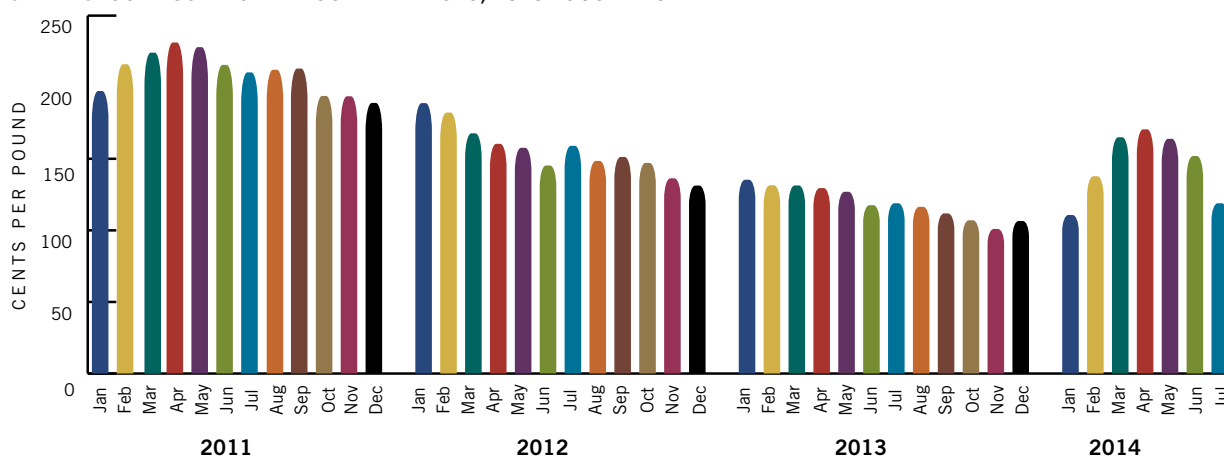


CHART 2: OPERATOR SALES CHANGE, 4-YEAR REVIEW

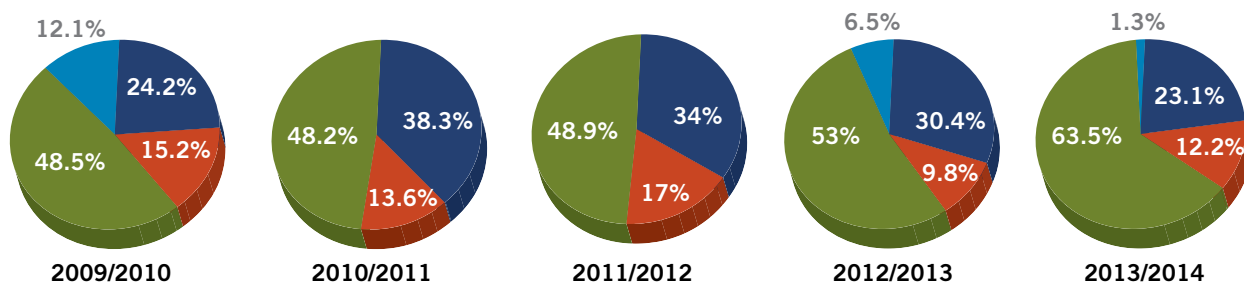
● SALES ROSE ● SALES DECLINED ● NO CHANGE

**CHART 3: COMPOSITE GREEN COFFEE PRICES, 2010 TO JUNE 2014**

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

CHART 3B: HOW RISING COSTS ARE BEING HANDLED, 5-YEAR REVIEW

● RAISING PRICES ● ABSORBING ● COMBINATION ● OTHER



*Other includes changing product mix, divesting business, workforce changes, etc.

costs at the same time (chart 3B), due to competitive pressures from other operators, paper supply companies and direct competition from single-cup cartridge manufacturers.

Prices per cup increased from 2013 to 2014, although not by a significant amount. The national average revenue for fractional pack

coffee was relatively flat at 13 cents per cup, compared to 12.9 cents the year before (chart 4B). Single-cup revenues increased, with prices up 3.4 cents to reach 46.5 cents per cup.

Higher costs of coffee and location price point demands are affecting the types of coffee operators are selling. In the past year, OCS pro-

viders report an increase in private label coffee, which is generally a less expensive option than premium national brands, which slipped in share of sales for 2013/2014.

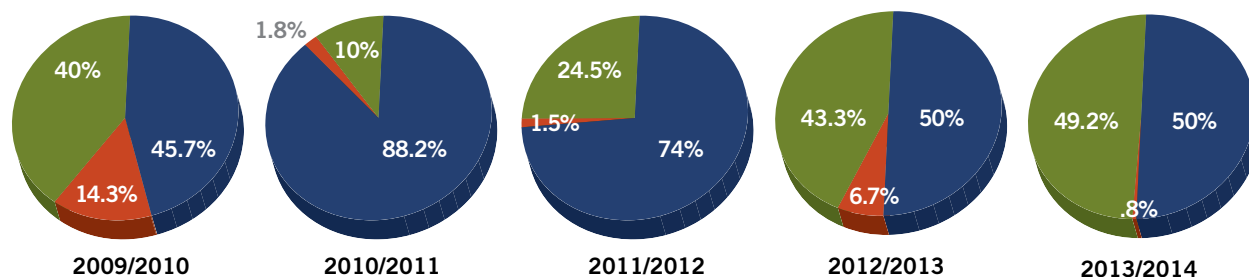
Local roasters meet demands

Possibly a more surprising category change, however, is the emergence

OPERATOR PRICING ACTIVITY

CHART 4A: OPERATOR PRICING ACTIVITY, 5-YEAR REVIEW

● RAISED PRICES ● LOWERED PRICES ● NO CHANGE



of local roasters accounting for 12.5 percent share of sales in OCS (chart 5). This is the first year that the AM 2014 State of the Coffee Service report has included local coffee brands. The decision to include local roasters was based on early indicators of this growing category. Locally roasted coffees are usually less expensive than national, comparable roasts and blends of the same gram per cup. In addition, operators note that local roasters are able to provide a better tasting coffee as there is less time between its roasting and consumption. Part of the popularity of local coffee brands is the 'local' aspect. Several operators stated that customers like to support their community, and locally sourced coffee can be a positive way to do so.

Single-cup remains strong contender

Single-cup was added as another segment of OCS sales in the AM 2014 State of the Coffee Service Industry report. Operators note that over the past year, single-cup has driven revenue increases, but lowers the profit margins in doing so. Single-cup coffee accounts for over 13 percent of OCS sales (chart 5). That is more than the 12.5 percent from local coffee brands and approaching the nearly 20 percent share of sales of national and private label coffees.

CHART 4B: REVENUE PER CUP IN CENTS PER CUP, FRACTION PACK PLUMBED IN/POUROVER COFFEE, 10-YEAR REVIEW

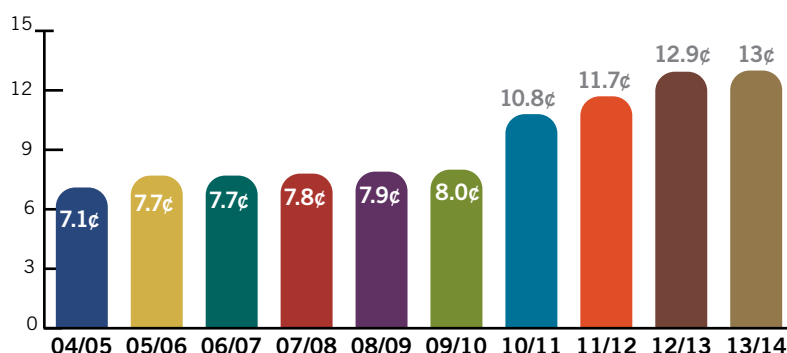


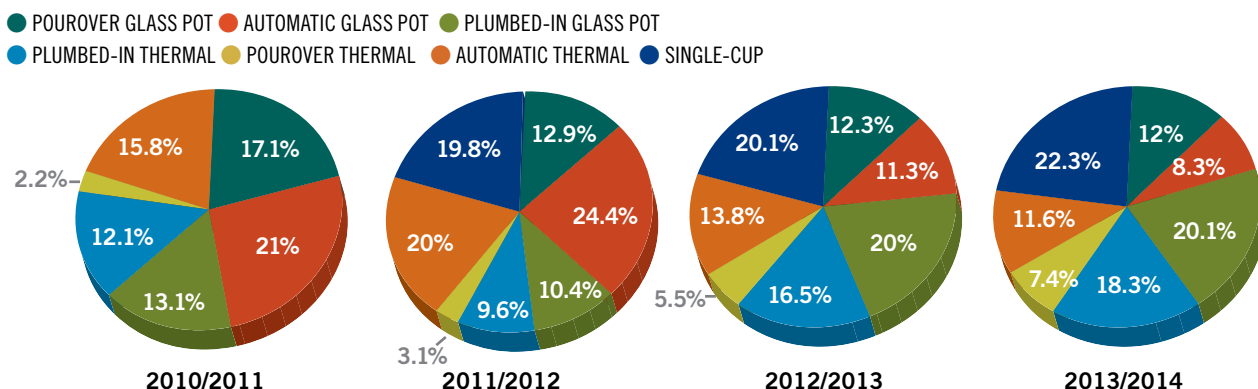
CHART 4C: REVENUE PER CUP, SINGLE-CUP COFFEE, 4-YEAR REVIEW

	2010/2011	2011/2012	2012/2013	2013/2014
Revenue	42.5¢	41.8¢	43.1¢	46.5¢

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

	09/10	10/11	11/12	12/13	13/14
Private label coffee	39.69%	28.11%	28.23%	18.24%	21.79%
Local coffee brands					12.5%
National brand coffee	21.4%	26.92%	28.08%	24.37%	21.88%
Value frac packs					3.45%
Espresso/cappuccino	4.94%	3.6%	3.77%	5.38%	1.85%
K-cups					7.94%
Other single-cup					6.02%
Other coffee*	4.63%	12.07%	9.86%	17.36%	4.75%
Total Coffee	70.66%	70.7%	69.94%	65.35%	80.18%
Other hot beverages	7%	4.9%	5.54%	6.39%	3.97%
Soft drinks/juices	3.5%	5.39%	5.73%	6.57%	1.79%
Bottled/filtered water	4%	5.7%	4.75%	7.29%	3.92%
Creamers/sweeteners	5%	5.63%	6.62%	6.48%	5.24%
Cups/paper products	5.5%	5.41%	6.17%	6.51%	4.48%
Other	4%	2.27%	1.25%	1.88%	0.41%

*Includes flavored, whole bean and varietal.

CHART 6: PLUMBED-IN, AUTOMATIC AND THERMAL AS % OF TOTAL, 4-YEAR REVIEW

As single-cup coffees increase in sales, so does the placement of single-cup brewers. Countertop, brew-by-the-cup machines account for 22.3 percent of brewers placed on location in 2013/2014 (chart 6). As single-cup is more expensive per cup than other types of thermal and pourover OCS options, that likely kept the increase in single-cup brewer placements modest with only a 2.2 percentage-point increase over the prior year. Despite

the number of placements, operators unanimously report that locations are inquiring about single-cup options and prices when searching for coffee service. Operators have seen consumers enthusiastically use single-cup systems when locations are willing to pay for that higher cost option.

Cartridge-style brewers from well-known manufacturers are still the leaders in the single-cup brewer OCS marketplace. Key benefits of

these machines include brand recognition of the coffees available for these systems and their ability to brew coffee-based specialty drinks and personalized beverages.

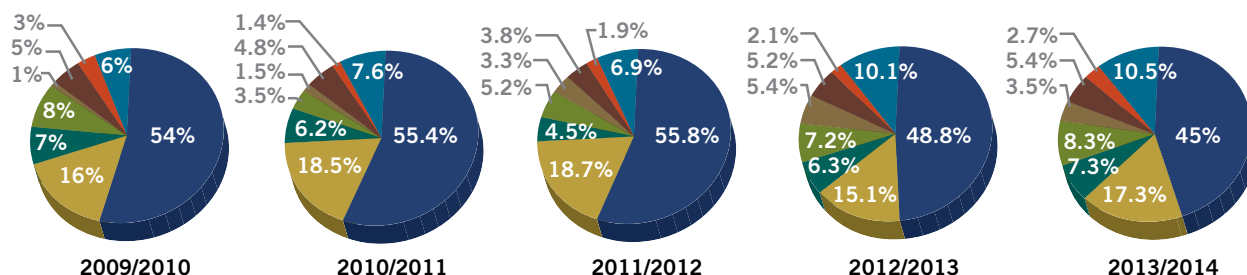
Some locations do not have the budget to offer cartridge single-cup options to their employees, but operators are finding other less expensive ways to give them what they want. One option operators are offering at locations with tighter budgets is

CHART 7: ESTIMATED MARKETSHARE OF SINGLE-CUP BREWER PLACEMENTS IN THE U.S., 5-YEAR REVIEW

MARKETER	PRODUCT(S)	2009/10	2010/11	2011/12	2012/13	2013/14	% Change
Bodecker Brewed	Bodecker	0.29%	0.23%	0.26%	0.36%	0.00%	-0.36
BUNN	Single serve pod brewers					1.60%	
Cafection	Avalon	3.69%	4.10%	3.89%	1.98%	3.25%	1.27
Cafejo	Cafejo	2.31%	2.20%	2.36%	2.35%	0.00%	-2.35
Crane	Café System, Genesis	1.24%	1.11%	0.95%	1.34%	0.31%	-1.03
De Jung Duke	Virtu					0.80%	
Filterfresh	Filterfresh	2.08%	1.65%	1.43%	4.69%	2.93%	-1.76
Grindmaster	Grindmaster	1.38%	1.26%	1.35%	6.03%	0.14%	-5.89
Keurig	Keurig	36.79%	43.00%	46.23%	46.22%	39.62%	-6.60
Kraft	Gevalia, Tassimo Professional	0.60%	0.66%	0.81%	2.91%	3.85%	0.94
LaVazza	Espresso Point, Lavazza Blue	2.12%	1.98%	1.68%	2.12%	0.40%	-1.72
Mars Drinks	Mars Drinks (Flavia)	35.50%	31.80%	30.13%	23.41%	37.52%	14.11
Newco	Smartcup, Freshcup, CX-3	0.30%	0.31%	0.41%	2.15%	1.72%	-0.43
Rheavendors	Rhea, Cino,	0.44%	0.35%	0.33%	0.05%	0.00%	-0.05
Saeco USA	Saeco, Estro	2.69%	2.21%	2.00%	0.61%	0.03%	-0.58
Sara Lee	Douwe Egberts	0.42%	0.51%	0.44%	1.67%	1.94%	0.27
Starbucks	Starbucks	0.92%	0.81%	0.75%	1.64%	2.60%	0.96
Suncana	PodPro					0.53%	
Technologies Coffea	Coffea	0.03%	0.16%	0.22%	0.03%	0.00%	-0.03
VE Global Solutions	Venus, Cypris, Juno, Prosyd	2.00%	1.91%	1.64%	0.12%	1.90%	0.59
Wolfgang Puck	Wolfgang Puck	0.60%	0.15%	0.31%	0.38%	0.11%	-0.27
Other		0.35%	0.27%	0.22%	0.76%	0.75%	-0.01

CHART 8: PERCENT OF NET SALES BY LOCATION TYPE, 5-YEAR REVIEW

● OFFICES ● INDUSTRIAL PLANTS ● RESTAURANTS, DELIS, BAKERIES ● CONVENIENCE STORES
 ● GOVERNMENT/MILITARY ● SCHOOLS/COLLEGES ● RETAIL OUTLETS ● OTHER (HEALTH CARE/HOTELS)

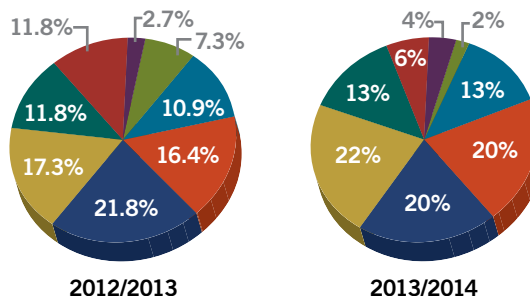


bean-to-cup systems which are slowly gaining market share (chart 7). Bean-to-cup systems allow whole-bean coffee to be stored in a hopper attached to the machine. When a user wants a cup of coffee, the beans are ground and the coffee is prepared instantly to the user's specifications. Many of these units have a touchscreen that can enhance the user experience. And because the bean-to-cup system uses whole beans, the cost per cup is lower than prepackaged single-cup options.

Pod brewers are also showing positive growth. They offer the convenience of prepackaged cartridges and since they are made

CHART 9: ACCOUNT POPULATIONS BY SIZE

● LESS THAN 10
 ● 11 TO 14
 ● 15 TO 19
 ● 20 TO 29
 ● 30 TO 49
 ● 50 TO 74
 ● 75 TO 99
 ● 100 OR MORE



with filter-like paper instead of plastic, are considered more environmentally friendly than many cartridge-style single-cup options. Pods are often less expensive than cartridges as well.

Locations vary

While many OCS customers are asking for better quality coffee or single-cup options, there is still the nagging issue of the price a location is willing to pay for coffee service.

FUEL CHARGE ACTIVITY

CHART 10A: COMPANY BILLED CUSTOMERS FOR FUEL, 5-YEAR REVIEW

● YES ● NO

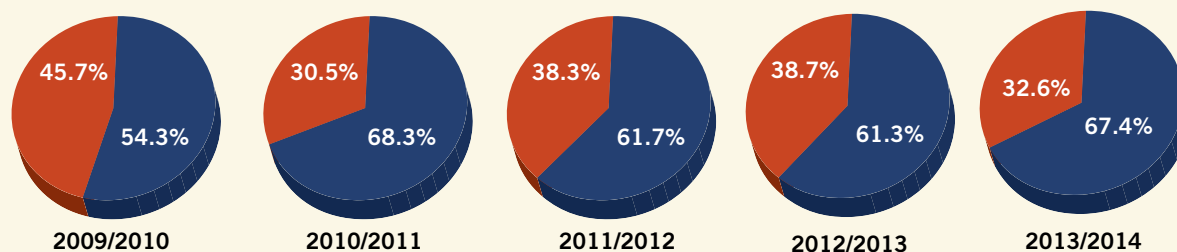
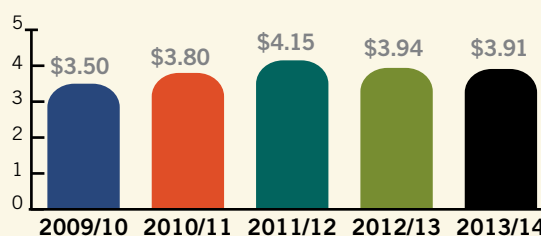
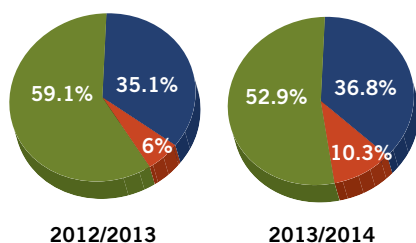
**CHART 10B: AVERAGE AMOUNT CHARGED FOR FUEL PER DELIVERY, 5-YEAR REVIEW**

CHART 11A: HAVE ADDED OR REDUCED STAFF IN THE LAST 12 MONTHS

● ADDED ● REDUCED ● NO CHANGE



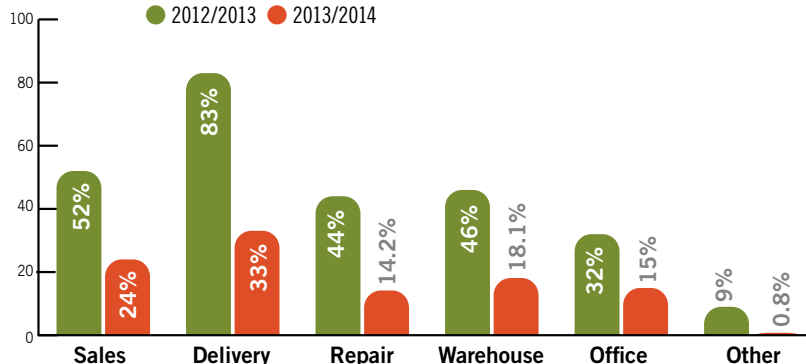
Operators said locations are either price sensitive, meaning they won't pay above a certain amount for coffee service, or they want more products and better service and are willing to pay more money for it. Compared to previous years, operators indicate that fewer locations are balancing coffee service costs versus service demands. If the location's decision comes down to the price of the coffee service, operators have found it difficult to price the coffee for good margins.

Some good news is that the number of workplaces wanting to offer coffee service has increased in the past year. More than half, 57.7 percent, of OCS providers report serving more locations in 2013/2014 than in the previous year. Only 8.7 percent of operators indicated they decreased coffee service at locations.

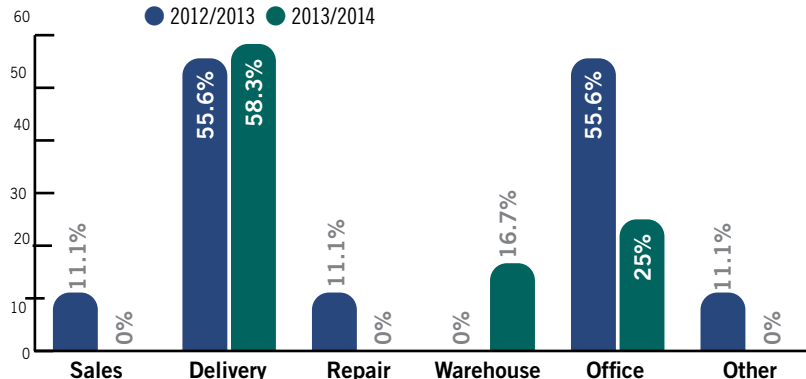
Of the locations adding OCS service, many were small workplaces with less than 10 employees. The share of sales this type of location contributed to the OCS providers'

CHART 11B: IF ADDED STAFF, IN WHICH AREAS?

● 2012/2013 ● 2013/2014

**CHART 11C: IF REDUCED STAFF, WHICH AREAS?**

● 2012/2013 ● 2013/2014



bottom line doubled in 2013/2014 (chart 9). In contrast, operators indicated that for the past year, they reduced service most often at accounts with 11 to 49 employees due to the layoffs and financial challenges at those locations. Larger accounts, those with 50 or more employees, saw the biggest increase in share of sales.

One interesting data point related to the growth of coffee service sales is the decline in sales in office locations. That segment, as a share of

sales, decreased from 48.8 percent to 45 percent in 12 months (chart 8). This drop is likely due to the increase in other types of locations. Operators report an increase percentage of their OCS sales coming from industrial plants, restaurants, convenience stores, schools and retail, supplanting those from offices.

Coffee providers who served large military and government accounts this past year reported revenue declines as a result of the government shutdown.

CHART 12A: HAVE ADDED PRODUCTS THAT ADDRESS ENVIRONMENTAL CONCERNS, 5-YEAR REVIEW

● YES ● NO ● DON'T KNOW

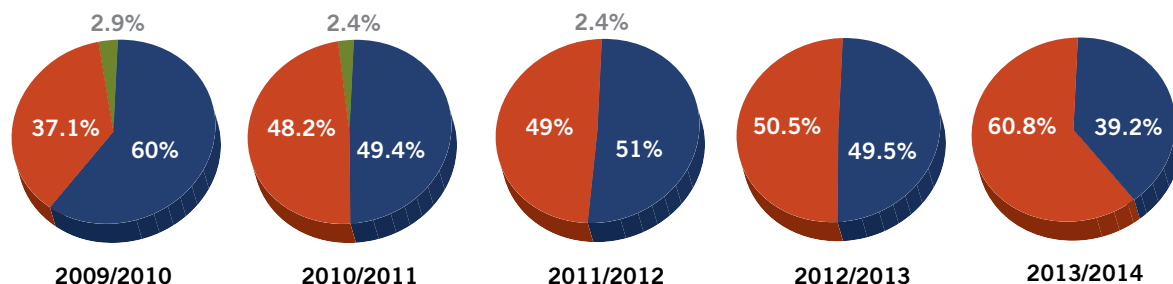
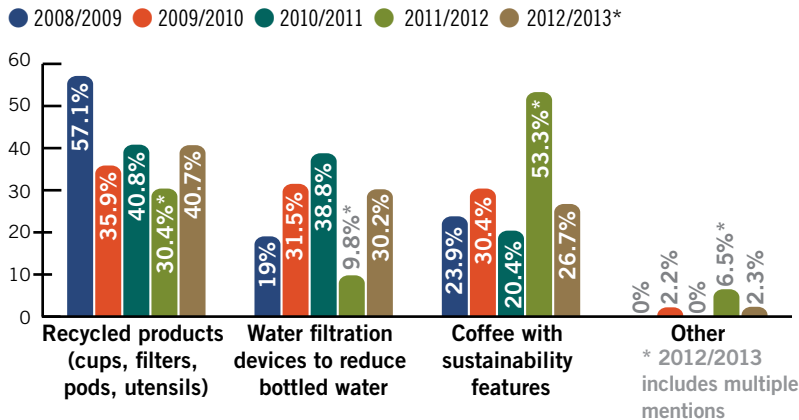
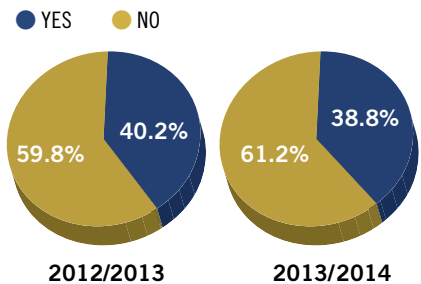


CHART 12B: PRODUCTS ADDED THAT ADDRESS ENVIRONMENTAL CONCERNS, 5-YEAR REVIEW**CHART 13: COMPANY CURRENTLY OFFERS ONLINE ORDERING ON ITS WEBSITE**

Consumers demand better coffee

Consumers are more educated about coffee than ever before and opting for gourmet coffee choices. The National Coffee Association (NCA) reports that 34 percent of Americans consume a gourmet coffee beverage daily, up from 31 percent in 2013, according to the NCA National Coffee Drinking Trends (NCDT) market research study. Daily non-gourmet coffee drinking is down to 35 percent, a drop of 4 percentage points from the year before.

Large offices are also demanding a greater array of nontraditional OCS products, especially in urban areas. Products such as dried fruit and nuts in bulk dispensers, iced beverages, fruit delivery, cold brew and fresh pastry cases are examples of the emerging OCS requests from locations who want to have competitive offerings in order to attract the best employees. Specific demands placed on OCS providers generally varies with geographic placement of the locations.

Coffee ends strong

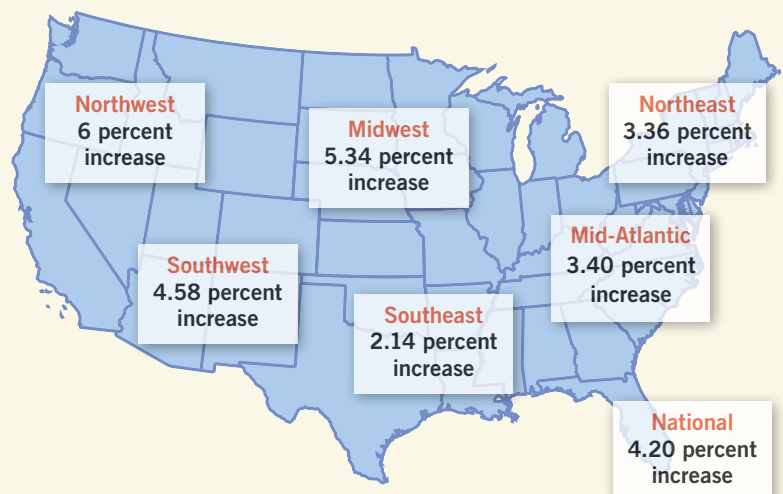
OCS providers had another good year. The improving economy has resulted in locations increasing employee counts and refocusing on coffee as an employee benefit in the workplace. Single-cup is gaining market share and increasing sales as more users focus on individual taste

LARGE offices are also demanding a greater array of nontraditional OCS products, especially in urban areas.

preferences and the ability to create coffee-based drinks. A saturated marketplace remains a challenge for operators especially among price-sensitive locations who shop for the lowest cost without regard for service or quality. Still, local roasters and bean-to-cup systems are some tools operators are using to satisfy the end user's gourmet coffee palate while meeting

the cost of services that the employer is willing to pay. It's a balancing act, especially with the unpredictable future cost of coffee making it hard to establish prices that will produce profitable margins for the next year. Right now, OCS remains a strong business thanks to the coffee-smart consumer and multitude of brewer and coffee options. | ◀

Average Total Sales Revenue Change Per Region

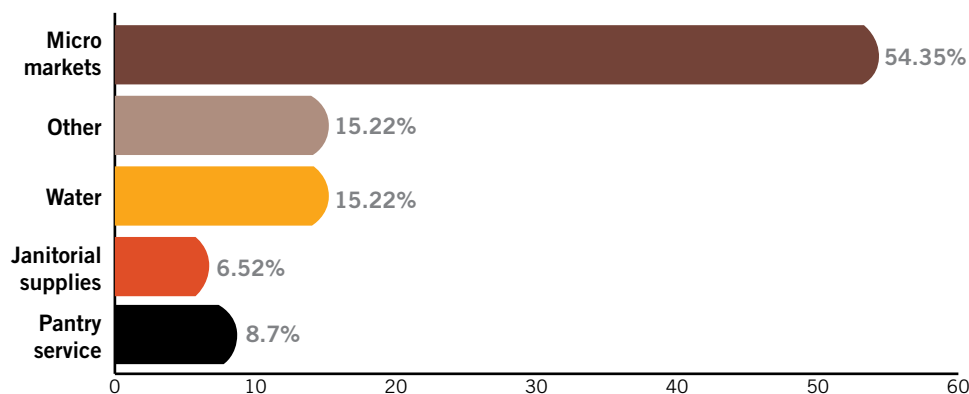


OCS operators expand into micro markets

Micro markets are a fast growing industry segment and OCS operators don't want to be left behind. In the past 12 months, when OCS providers launched new services, many looked to micro markets for added revenue. OCS providers report adding micro markets to diversify offerings, and many are finding that consumers are more willing to pay a higher price for a cup of coffee in a micro market than in a vending machine or traditional office coffee brewer.

► OCS EXPANSION

The 2014 State of the Coffee Industry report found that 33.88 percent of operators expanded into new lines of service. Of those 33.88 percent, more than half of the operators expanded into micro markets. OCS-only operators accounted for 25 percent of those.



► WILLINGNESS TO PAY

Coffee service operators expanding into micro markets are finding new challenges such as what types of coffee sells best in micro markets. The overwhelming majority sees the new business as a way to offer more, higher quality choices to the consumer. Some operators are witnessing unexpectedly low OCS sales in micro markets, however, most operators are reporting an increase in coffee service sales in micro markets due to their ability to offer more premium options and the consumer's willingness to pay more for a better-quality cup of coffee.

Types of coffee service system

For those coffee service operators who expanded into micro markets in 2013/2014, **14.93 percent** placed a bean-to-cup brewer in a micro market location, while **10.45 percent** of coffee service operators reported placing a Keurig single-cup brewer in a micro market location. Flavia drink stations were placed by **7.46 percent** of operators and **23.88 percent** reported placing another type of single-cup brewer. Pour-over, automatic and thermal brewers trailed in micro market placements at **2.99 percent**.

"PEOPLE like many different types of offerings and larger size cups. And they are willing to pay higher prices for a cup of quality coffee versus vending."

Wisconsin-based operator

"SINGLE-CUP systems break and counter-top brewers do not have the necessary capacity and are difficult to service. There is currently not a good, cost-effective solution for coffee in the micro markets."

Roger Sweeney,
Ace Coffee Bar

"IN some cases they (micro markets) have not increased sales from traditional vending."

Dennis P. Dionne BE'S
Coffee & Vending
Service, Inc.

"PREMIUM coffee has sold, even in locations where we provided free, loose grind brew systems."

Texas-based operator

"COFFEE service in general has been a challenge in the markets. Having the proper system for the control of cups continues to be an issue. The cups do not have a bar code for scanning and are frequently picked up for other uses."

North Carolina-based operator