

2003: Industry loses another 5 points as employers curtail manpower needs

Vending operators suffer another year of account downsizing as American industry becomes more productive with fewer workers. The good news is the worst is over, as growth resumes in 2004.

By Elliot Maras, Editor

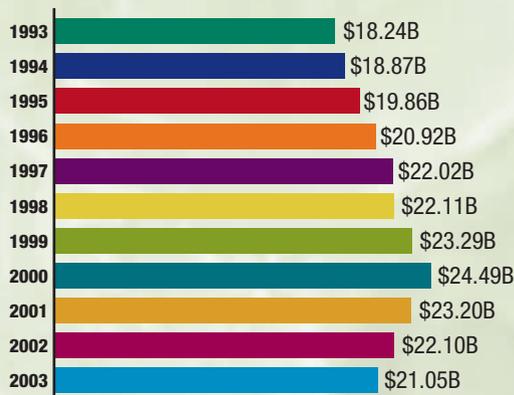
CHART 1: 2003 Industry total: \$21.05 billion (2002 Total: \$22.1 billion)

PARTICIPANTS BY REGION:

Region	% of Operators
New England	4
Middle Atlantic	12
East North Central	14
West North Central	9
South Atlantic	23
East South Central	5
West South Central	8
Mountain	9
Pacific	16



CHART 2: Industry revenues in billions, 10-year review



The best news about fiscal 2003 for the automatic merchandising industry is that it's over. One of the most difficult years in the industry's history

was characterized by continued account downsizing, economic uncertainty, rising public anger toward the food industry, and higher operating costs.

The 2004 *Automatic Merchandiser* State of the Vending Industry Report revealed that industry sales dropped 5 percentage points for the third consecutive year. Industry sales in 2003 totaled \$21.05 billion, which was just shy of the 1998 total. With the economy still shedding jobs for the third consecutive year, vending operators once again pulled machines by the thousands out of locations in an attempt to offset rising operating costs.

Fiscal 2003 also witnessed continuing attempts to diversify the customer base. While manufacturing sites still represented the largest single customer segment, in 2003 more machines were placed in schools than in offices, as indicated in chart 4. This represented the biggest change in account mix in

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years, as offices have historically ranked second only to manufacturing sites.

The decline in the office segment reflected the ongoing fallout from the high-tech, telecommunication and information industries that began in 2000. These customer segments fueled much of nation's prosperity in the '90s and suffered disproportionately in the recent recession. Fiscal 2003 marked the second consecutive year that vending operators reported bigger losses in white collar accounts than blue collar work sites, although downsizing afflicted both groups.

Business began to rebound at the end of 2003, operators reported.

2003: work hours dropped

The Washington, D.C.-based Conference Board, which tracks economic trends, reported that work hours fell in late 2001 to the lowest level since early 1991, and did not begin to recover until the end of 2003. "Help wanted" advertising fell to its lowest point in 40 years through the same period.

Civilian unemployment rose from a 30-year low of 4 percent in 2000 to over 6 percent in mid 2003. As noted in last year's report, this represented a reversal of fortune for automatic merchandisers, whose only complaint in the middle and late '90s was not being able to find enough employees to handle the workload.

The U.S. economy lost 2.7 million jobs during the recent downturn, outpacing the 1990/1991 recession, which shed 1.4 million jobs. The recent downturn was also twice as long.

While most operators reported improvement in 2004, most did not expect to fully recover all the business lost in the previous three years for a long time. This is because American industry — blue collar and white collar alike — has learned how to produce more with fewer workers.

The last two years were the first time in history that industrial produc-

tion gains did not benefit the automatic merchandising industry.

Vendors raise prices

The State of the Vending Industry Report indicated that vending operators raised their prices in some product categories, but the price increases were not enough to offset the losses in either per-location sales or machine placements. Price gains, where they occurred, were only a few cents on average in most cases. This reflected selective increases on an account-by-account basis as opposed to "across the board" increases.

Retail vend prices took low percentage point increases in some of the major product categories: can beverages, 3.3 points; candy bars, 1.6 points; and large size bag chips, 2.8 points. The largest gain for a major product category was regular size bag chips at 4 points. Some higher increases were taken in some of the smaller revenue generators: fresh-brew regular coffee, 4.5 points; frozen-prepared food, 4.2 points; and milk, 4 points.

While the report did not measure profitability, economic indicators suggested 2003 was a difficult year. Vending operators took cost increases in some major product categories. The big candy manufacturers announced price hikes of 10 to 11 percent at the end of 2002, the first significant increases in seven years.

In addition, wholesale food prices jumped 5.2 percentage points in 2003 after falling by 1.2 points in 2002, according to the Washington, D.C.-based National Restaurant Association (NRA).

Operating costs rise

Operating costs also increased in 2003, notably in healthcare and fuel. The average price for a gallon of regular gasoline was \$1.60 in 2003 compared to \$1.30 in 2002, according to the U.S. Energy Administration.

Rising costs gave vending operators a double whammy: Besides raising their own operating costs, these increases

also hurt consumers' disposable incomes, which made people reluctant to spend on meals and refreshments.

2003 witnessed its fair share of natural and unnatural disasters. Sales were unexpectedly jolted in mid-August when a major electrical outage took machines out of service for a few days in the Northeast and the Upper Midwest. In mid-September, Hurricane Isabel destroyed buildings and power lines for three days in North Carolina, Virginia, Maryland and Delaware.

Currency upgrades continue

Currency upgrades also continued to add cost in 2003. The government introduced a new design for the 20-dollar-bill in 2003, following earlier redesigns of the 5- and 10-dollar bills. Upgrades of bill changers and validators continued at the same rate in 2003 as in the previous two years at about 6 percentage points.

Operators viewed higher denomination bill acceptance as a way to support higher product prices. Higher denomination bill acceptance also necessitated dollar coin payout, which in turn required more 4- and 5-tube coin changers.

While operators unanimously were disappointed in the poor circulation of the Sacagawea Golden Dollar in 2003,

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This year's report alters industry revenue projections by 4.4 percent

The revenue totals for previous years reported in this year's State of the Vending Industry Report have been revised from previous reports by a negative 4.4 percentage points. This change has been made based on input from Management Science Associates Inc.

MSA has projected retail sales for the vending industry based on machine level sales.

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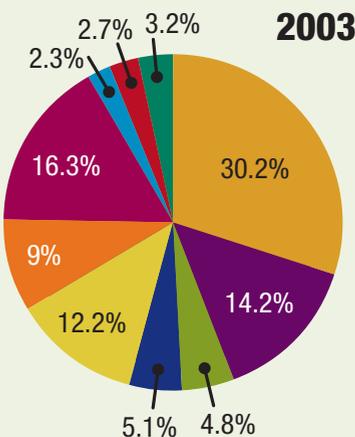
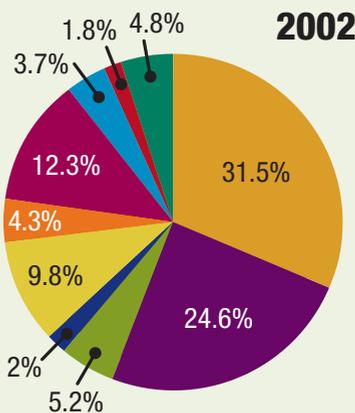
CHART 3: Operator sales

Size	Revenue range	% of 2003 Operators	Projected 2003 sales	% of 2003 sales	Projected 2002 sales	% of 2002 sales
Small	under \$1 million	75%	\$990 million	4.5%	\$1.01 billion	4.8%
Medium	\$1M - \$4.9M	18	2.96 billion	14	2.56	12.1
Large	\$5M - \$9.9M	4	1.88	8.9	1.63	7.8
Extra large	\$10M +	3	14.78	72.6	15.8	75.3
Total			\$20 billion*		\$21 billion*	

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

CHART 4: Machines by location, 2-year review

- Manufacturing
- Offices
- Hotels/motels
- Restaurants, bars, clubs
- Retail sites
- Hospitals, nursing homes
- Schools, colleges
- Military bases
- Correctional facilities
- Other



most nonetheless continued to provide it to support higher denomination bill acceptance. Operators reported that in time, dollar coins paid out began circulating back to the machines, reducing the need to replenish their supplies of dollar coins.

Operators also reported ongoing frustration with banks mixing the unpopular Susan B. Anthony dollar coins with the new ones.

Vending lags behind foodservice

Vending once again trailed the foodservice industry in 2003. Foodservice typically rebounds from an economic downturn faster than vending. In prosperous times such as the '90s, vending out performs foodservice. In recessionary times, the reverse holds true.

In 2003, the foodservice industry realized a 3.6 percentage point gain in sales and a 1.3 gain in inflation-adjusted sales, the NRA reported.

Manual food leads revenue gains

For the second consecutive year, manual foodservice represented the largest revenue producer for automatic merchandising. This can be credited to the fact that manual foodservice was dominated by the larger companies that have the resources to invest in higher quality products, better management systems, employee training and marketing.

Foodservice operators can also react faster to changing consumer demand since much of the food is prepared on-site. In 2003, consumers responded

more favorably to better quality products. Astute foodservice operators were able to upgrade their offerings and capitalize on this demand.

Manual foodservice also benefited from the trend of many industrial companies to outsource their foodservice programs in order to save costs.

Largest and smallest get squeezed

Rising operating costs historically drive market share to both the extra-large and small operators. The larger operators have the financial resources to meet rising costs and at the same time offer a wider variety of products and services. The small operators enjoy the advantage of low overhead.

In 2003, for the first time in several years, these trends reversed, as indicated in chart 3.

When account downsizing began in 2000, the extra large operators (operators with \$10 million and more in annual sales) began taking on more smaller accounts to make up the shortfall in large size accounts (accounts with more than 500 people).

Large operators (\$5 million to \$9.9 million in sales) and medium-size operators (\$1 million to \$4.9 million in sales) similarly began taking smaller accounts (accounts with as few as 100 people).

By 2003, the extra-large operators took on as many smaller accounts as they could without compromising profits, and were competing against operators with lower overhead. Unable to gain more accounts, they began losing market share to smaller size operators.

The large and medium-size operators, meanwhile, took accounts away from small operators to compensate for their shortfall in larger accounts.

Operator acquisition slows

Extra large operators did not grow by acquisition in 2003 as much as in previous years. Fiscal 2003 witnessed only one major operator acquisition: Compass Group's bought Hayward, Calif.

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based Delicor. Acquisitions among extra large companies were more frequent in previous years.

The logical reason for fewer acquisitions among the larger companies was there were fewer such companies available for sale. Another reason was that sellers wanted to wait until prosperity rejuvenated their ability to fetch a higher price.

Investment in technology lags

Suppressed revenues also limited operators' ability to invest in new technologies that offer new customer benefits. Where quick-serve restaurants, convenience stores and specialty retailers introduced more cashless options and broadband wireless Internet connectivity to entice customers, vending operators fell behind in the race to offer customers new technology.

There was no significant change in the percent of operators using DEX (digital exchange) handheld computers, which allow for more accurate cash accounting and the ability to match selections to account preferences based on line-item sales.

Nutrition concerns rise

While the survey reported a gain in education accounts in 2003, this occurred against a backdrop of heightened criticism of the nutritional content of vend products, particularly soda, in schools.

The push for more school accounts came largely at the request of school foodservice officials, who viewed vending as a way to increase their own revenues. To the extent that vending operators met these requests, they found themselves involved in debates over the nutritional content of vended products.

The chorus of criticism of vending in schools grew louder in 2003. This criticism began in 2001 when the Surgeon General called for restricting vending in schools. Fueling this criticism were two widely publicized lawsuits accusing McDonald's of making teenagers fat.

About the survey

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

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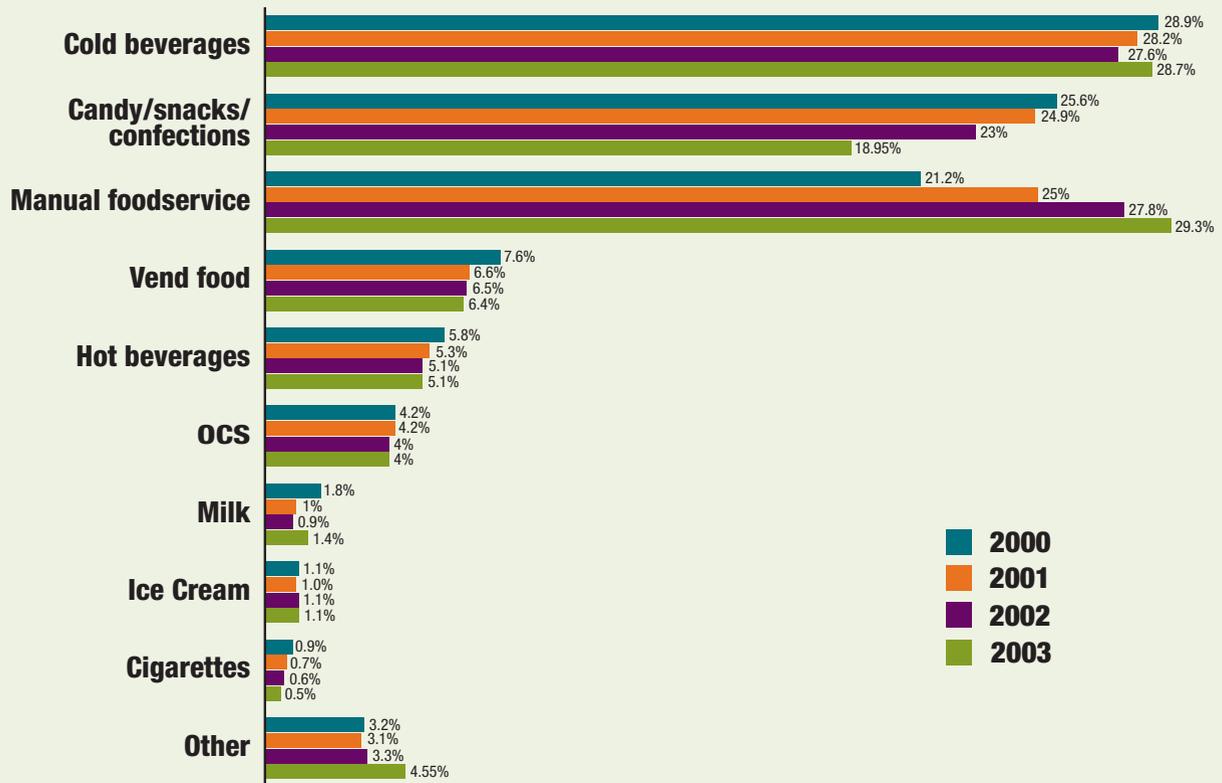
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CHART 5a: Projected sales by category, 4-year review



whose main business was not consumer package goods 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 government agencies, product suppliers, and equipment suppliers.

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

MSA provides input

This year's report included input from Pittsburgh, Pa.-based Management Science Associates Inc., the world's largest processor of disparate sales and marketing data sources. MSA teamed with Validata® Computer & Research Corp. to collect machine-level data with the goal of analyzing and reporting marketwide product performance.

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

Category	2000	2001	2002	2003
Cold beverages	\$7.08B	6.54B	6.1B	6.04B
Candy/snacks/confections	6.27	5.78	5.08	3.99
Manual foodservice	5.19	5.8	6.14	6.17
Vend food	1.86	1.53	1.44	1.35
Hot beverages	1.42	1.23	1.13	1.07
OCS	1.03	0.97	0.88	0.84
Milk	0.44	0.23	0.20	0.29
Ice cream	0.27	0.23	0.24	0.23
Cigarettes	0.22	0.16	0.13	0.10
Other	0.78	0.72	0.74	0.95

The machine database, VendScape®, includes approximately 54,000 vending machines across the cold beverage and candy/snack/confection segments.

Additionally, MSA has unveiled an industry projected data source, ProVen™, for the candy/snack/confection segments.

The State of the Vending Industry Report's revenue and equipment figures

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

Following is a more detailed analysis of the major product segments. Input on the cold beverage and candy/snack/confection segments was provided by MSA.

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

	Bottler owned	Vendor owned
Can closed front	1.06 million	842,400
Bottle closed front	1.04 million	115,500
Combo bottle and can closed front	378,000	42,000
Glassfront	40,000	8,000
Cup	0	30,000
Total	2.518 million	1.04 million

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

% OF SALES

Type	2000	2001	2002	2003
Can	62.8%	59.0%	50.2%	43.7%
Bottle	31.5	35.8	44.9	53.0
Cup	4.90	4.0	4.30	3.0
Other	0.80	1.10	0.80	0.30

PROJECTED TOTALS

Can	\$4.45B	\$3.86B	\$3.06B	\$2.64B
Bottle	2.23	2.34	2.74	3.20
Cup	0.35	0.26	0.26	0.18
Other	0.006	0.007	0.005	0.002

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

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

Type	2000	2001	2002	2003
Can	59¢	59¢	60¢	62¢
Bottle	98¢	95¢	98¢	98¢
Cup	49¢	53¢	53¢	57¢

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

Cold drinks: the curse of bottles

The fact that cold beverages, one of the few product segments to report a gain in machine placements in 2003, suffered a sales dip underscored the extent of account population downsizing.

The dual forces of supplier-subsidized equipment and the growth of higher-priced bottles over cans should have been more than enough to compensate for weakened demand. But such was not the case.

While bottles gained market share at the expense of cans for the eighth consecutive year in 2003 (as noted in chart 6b), pricing of single-serve bottles

remained flat, as indicated in chart 6c. This was largely because of competitive pressure from retailers, and in many cases, competition from bottlers who operate their own vending machines.

While 20-ounce bottles commanded a higher price point than 11.5-ounce cans, vending operators quickly realized the profit margins were lower due to the competitive situation noted above. While many vending operators preferred selling cans because they were more profitable and easier for employees to work with, consumer demand, fed by bottler-driven marketing, forced the continued move to bottles.

In 2003, for the first time, bottles displaced cans as the top selling package configuration in cold drink vending.

The top 20 cold drink beverages reported by MSA in 2003, shown in chart 6d, included two more 20-ounce drinks than in 2002.

Vending operators did raise prices slightly for cans in 2003, indicating less competitive pressure for this package.

Cold cup beverage vending, despite being highly profitable compared to bottles and cans, continued to decline.

Glassfront placements slow

Cold beverage sales would have benefited from more aggressive placement of glassfront beverage machines, but weak sales made it difficult for operators to invest in new equipment. Glassfront machines merchandise product better and offer more variety. While the report indicated the number of glassfronts doubled in 2003, it was from a small base and did not represent much more than 1 percent of all machines.

In many cases, operators didn't see a lot of benefit in glassfronts when the additional facings were controlled by a bottler. Most glassfront machines were bottler-loaned.

Many operators were also reluctant to use the machines based on negative experiences with early models that were less reliable.

Another issue with glassfronts was that they only made sense in high population sites where the demand for greater product variety was viable. In sites with smaller populations, the sales of alternative products were not high enough to justify the extra time needed to load and place additional stock keeping units. Glassfronts, even the newer, more reliable models, proved more service intensive than the traditional closed-front machines and took more time to fill.

Vending operators initially welcomed the introduction of glassfront cold drink machines, thinking they would

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CHART 6d: Top 20 cold beverages in 2003, dollar sales

Rank	Product
1	Coca-Cola 12-oz. Coke Classic
2	Pepsi-Cola 20-oz. Pepsi Cola
3	Coca-Cola 20-oz. Coke Classic
4	Pepsi-Cola 12-oz. Pepsi Cola
5	Coca-Cola 12-oz. Diet Coke
6	Pepsi-Cola 20-oz. Mountain Dew
7	Dr Pepper 12-oz. Dr Pepper
8	Coca-Cola 20-oz. Diet Coke
9	Pepsi-Cola 20-oz. Aquafina Water
10	Pepsi-Cola 20-oz. Mountain Dew
11	Pepsi-Cola 20-oz. Diet Pepsi
12	Pepsi-Cola 12-oz. Diet Pepsi
13	Coca-Cola 20-oz. Dasani Water
14	Coca-Cola 12-oz. Sprite
15	Coca-Cola 20-oz. Sprite
16	Dr Pepper 20-oz. Dr Pepper
17	Coca-Cola 12-oz. Barq Olde Tyme Root Beer
18	Coca-Cola 12-oz. Cool Nestea
19	Dr Pepper 12-oz. Diet Dr Pepper
20	Cadbury Schweppes 20-oz. Snapple Lemon Iced Tea

BEVERAGES GAINING THE MOST DISTRIBUTION IN 2003

Rank	Product
1	Pepsi-Cola 12-oz. Sierra Mist
2	Pepsi-Cola 20-oz. Sierra Mist
3	Coca-Cola 12-oz. Cool Nestea
4	Coca-Cola 20-oz. Dasani Water
5	Lipton 20-oz. Lipton Brisk Lemonade
6	Dr Pepper 12-oz. Dr Pepper
7	Coca-Cola 20-oz. Minute Maid Lemonade
8	Coca-Cola 12-oz. Coke Classic
9	Coca-Cola 20-oz. Sprite
10	Coca-Cola 20-oz. Diet Coke

NUMBER OF NEW COLD BEVERAGE ITEMS INTRODUCED IN 2003: 82

Source: MSA Vendscape sales data.
Data excludes sales by bottlers.

do for beverages what glassfront snack machines did for snacks in the 1970s. Cold beverages, however, is a much more labor-intensive business than snacks. The addition of more stock keeping units means more work.

Because the expanded facings were not more available, operators could not cash in on categories as quickly as retailers did in 2003.

Vending lags behind retail

Total cold beverage sales for all retail categories actually posted a 2.6 percentage point gain in 2003, according to the New York City-based Beverage Marketing Corp. Cold beverage vending, by contrast, lost 1 point.

Soda as a percent of total cold beverage sales gained market share in vending in 2003, MSA reported, while it declined in retail. This indicated that vending operators did not take full advantage of some of the faster growing cold beverage product segments, notably bottled water.

The vending industry did not match the disproportionate growth of some of the non-carbonated categories in 2003. This was obvious in comparing the findings of the Beverage Marketing Corp., which tracked total industry sales, and MSA, which tracked vending sales.

The 2003 comparisons were as follows, with retail sales change followed by vending sales change: soft drinks — 1.5 percent, 1.17 percent; fruit beverages — -1 percent, -6.31 percent; tea — 1.3 percent, 3.11 percent; bottled water — 6.2 percent, 2.1 percent; sports drinks — 12 percent, -22.8 percent.

Tea was the only beverage segment in which vending outperformed retail. (Vending outperformed retail in milk sales as well, but milk in this report is categorized as its own segment.)

The survey reported that larger vending operators sold more bottles than smaller operators, and on average charged more for them.

The larger operators were more likely to own their own machines, giving them the ability to offer more variety. They also carried more purchasing clout with suppliers, giving them more incentive to carry the higher-costing alternative beverages.

Candy/snacks/confections

The candy/snack/confection segment, the crux of many full-line vending operators' businesses, took the biggest hit of all product categories in 2003.

Operators have been removing snack machines from locations every year since 2000, when the recession began, as indicated in chart 7a. The rate of removal intensified in 2003 at 6.1 percentage points, following rates of about 1 percentage point in both 2001 and 2002.

Machine removals contributed to a 21.45 percentage point decline in the category's sales in 2003, the only category to post a double-digit decline. This represented the biggest 1-year decline in the segment's history.

Also contributing to the fallout was an overall change in consumer health consciousness, which turned consumers away from snack machines. Given the limited selections vending operators can offer compared to other retailers, vending operators were not able to provide as many alternative products with high health perception.

Much of this consumer mindset can be credited to rising popularity of low-carbohydrate diets. Vending operators did not have a lot of low-carbohydrate options to offer in 2003. More such products became available in 2004.

The major snack and confection manufacturers were quick to recognize the consumer demand for healthier products, and announced initiatives to provide new formulations in 2003. Manufacturers also met this concern by offering more nutrition information on packages.

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Nuts and meat snacks grow

Every type of candy, snack and confection lost sales in 2003, with the exception of nuts and meat snacks, as indicated in chart 7c. These findings were confirmed by MSA Inc., which provided projected sales in this category for the first time in 2003.

Nuts and meat snacks both fit into low-carb diets, which operators overwhelmingly agreed were popular with consumers in 2003. This trend became noticeable to most operators in the second half of the year, and gained momentum in the fourth quarter.

Smaller operators lead

Interestingly, smaller operators were faster to capitalize on the rising popularity of nut and meat snacks than larger operators. The report indicated small and medium-size operators sold more of

these products than large and extra-large competitors.

This pattern was particularly strong for meat snacks, which posted the biggest sales gain of all in 2003 within the candy/snack/confection group. For the second straight year, small operators sold more than twice as much meat snacks in 2003 than medium, large and extra-large operators.

Small operators were able to capitalize faster on a new demand since they were less committed to long-term buying contracts. Small operators have long claimed they are able to react to customer requests faster than larger operators.

Low-carb dieting brought the first real change to consumer buying habits in vending, operators noted. Requests for healthier products were nothing new, but in the past, operators claimed that these requests did not result in any change in buying habits.

Another sign of this change was the emergence of several dedicated healthy product vending machines at the end of 2003. While these specialty machines were rare, they increased in 2004 as the low-carb movement gained strength.

Candy continues a comeback

Candy bars commanded the largest share of sales for the second straight year in 2003, strengthened by price increases that operators passed on to customers. Bag chips unseated candy bars as the top category in 2000 and 2001, mainly as a result of the move to large single serve (LSS) bags, then fell back in 2002 and 2003.

The candy price hikes in 2003 further supported a comeback for candy that began in 2000. Candy lost share of machine facings in the '90s due to aggressive marketing by snack manufacturers. In 2003, snack facings lost share to the

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CHART 7a: Candy/snack/confection machines

Year	Projected total
2000	1,695,400
2001	1,508,906
2002	1,489,700
2003	1,398,600

CHART 7b: Candy/snack/confection revenues, % of total

Type	2000	2001	2002	2003
Candy bars	26.0%	27.4%	28.0%	28.7%
Bagged/boxed candy	4.6	2.7	2.2	2.6
Gum/mints	4.1	3.7	3.6	3.2
Bagged chips	31.6	30.3	24.5	25.5
Bagged crackers	1.6	1.9	1.6	2.2
Cracker sandwiches	4.5	5.3	12.0	7.7
Bagged/jumbo cookies	6.3	7.4	5.4	5.0
Pastries	15.0	14.2	11.8	11.8
Nuts	2.3	1.7	7.1	8.9
Microwave popcorn	2.2	2.1	1.9	2.1
Meat snacks	0.9	0.7	1.1	1.8
Other	0.7	2.6	0.9	0.5

CHART 7c: Projected total

Type	2000	2001	2002	2003
Candy bar	\$1.63B	\$1.58B	\$1.42B	1.15B
Bagged/boxed candy	0.29	0.16	0.11	0.10
Gum/mints	0.26	0.21	0.18	0.13
Bagged chips 1.98	1.75	1.24	1.02	
Bagged crackers	0.10	0.11	0.08	0.10
Cracker sandwiches	0.28	0.31	0.61	0.31
Bagged/jumbo cookies	0.39	0.43	0.27	0.20
Pastries	0.94	0.82	0.60	0.47
Nuts	0.14	0.10	0.36	0.34
Microwave popcorn	0.14	0.12	0.10	0.08
Meat snacks	0.05	0.04	0.06	0.07
Other	0.04	0.15	0.04	0.02

CHART 7d: Candy/snack/confection prices, 4-year review

Type	2000	2001	2002	2003
Candy bar	59¢	59¢	61¢	62¢
Bagged/boxed candy	65¢	62¢	64¢	71¢
Gum/mints	44¢	43¢	46¢	46¢
Bagged chips	48RSS/70LSS	51RSS/70LSS	50RSS/70LSS	52RSS/72LSS
Bagged crackers	54¢	58¢	56¢	60¢
Cracker sandwiches	49¢	53¢	54¢	53¢
Bagged/jumbo cookies	62¢	62¢	63¢	66¢
Pastries	70¢	73¢	75¢	74¢
Nuts	55¢	57¢	57¢	59¢
Microwave popcorn	67¢	67¢	67¢	68¢
Meat snacks	59¢	62¢	67¢	66¢

CHART 7e: Top 20 candy/snacks/confections in 2003, dollar sales

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

CANDY/SNACKS/CONFECTIONS GAINING THE MOST DISTRIBUTION IN 2003

Rank	Product
1	Masterfoods USA 1.76-oz. Snickers Almond
2	Kellogg/Keebler 2-oz. Famous Amos Chocolate Chip Cookies
3	Poore Brothers 1.75-oz. TGI Friday's Cheddar & Bacon Potato Skins
4	Frito-Lay 0.75-oz. Funyuns
5	Frito-Lay 0.875-oz. Munchos
6	Masterfoods USA 1.42-oz. Snickers Munch
7	Masterfoods USA 1.74-oz. M&M's Peanut
8	Frito-Lay 2.25-oz. Fritos Flavor Twists Honey BBQ
9	Masterfoods USA 2-oz. Twix Bar
10	Masterfoods USA 2-oz. Snickers Original
11	Kraft Nabisco 1.75-oz. Oreo Cookies
12	Kellogg/Keebler 1.3-oz. Rice Krispies Treats
13	McKee Foods 3.6-oz. Little Debbie's Zebra Cake
14	Frito-Lay 1-oz. Harvest Cheddar Sunchips
15	Kraft Nabisco 0.75-oz. Peppermint Lifesavers

NUMBER OF NEW CANDY/SNACK/CONFECTIONS INTRODUCED IN 2003: 109

Source: MSA Vendscape sales data.

STATE OF THE VENDING INDUSTRY REPORT

CONTINUED

slowdown in LSS as well as the lack of offerings that fit into low-carb diets.

Whether or not candy continues to gain facings could depend on which product group can more successfully meet new diet preferences, providing the consumer trend continues. LSS bags remained stagnant for the second straight year in 2003 after leveling off in 2001. While the LSS bags commanded a higher price point and a bigger profit margin than regular size bags, many operators believed they also delivered slower turns, compromising total snack sales.

Larger operating firms sold more LSS chips than small firms.

Most product manufacturers focused on developing new products to meet the new consumer preferences in 2003.

Smaller operators sold more candy as a percentage of sales in 2003 than larger operators.

A Frito-Lay Inc. branded snack machine was tested in 2003. The high-capacity machine was placed in schools and large industrial sites. The results were inconclusive and the test continued in 2004.

Hot beverages: specialty coffee rises

Hot beverage vending showed some signs of improvement in 2003, even though the negative sales trend of the past several years continued. The lone positive finding in 2003 was a significant gain in specialty fresh-brew sales, indicated in chart 8b. This marks the first evidence of the vending industry capitalizing on the demand for better quality coffee.

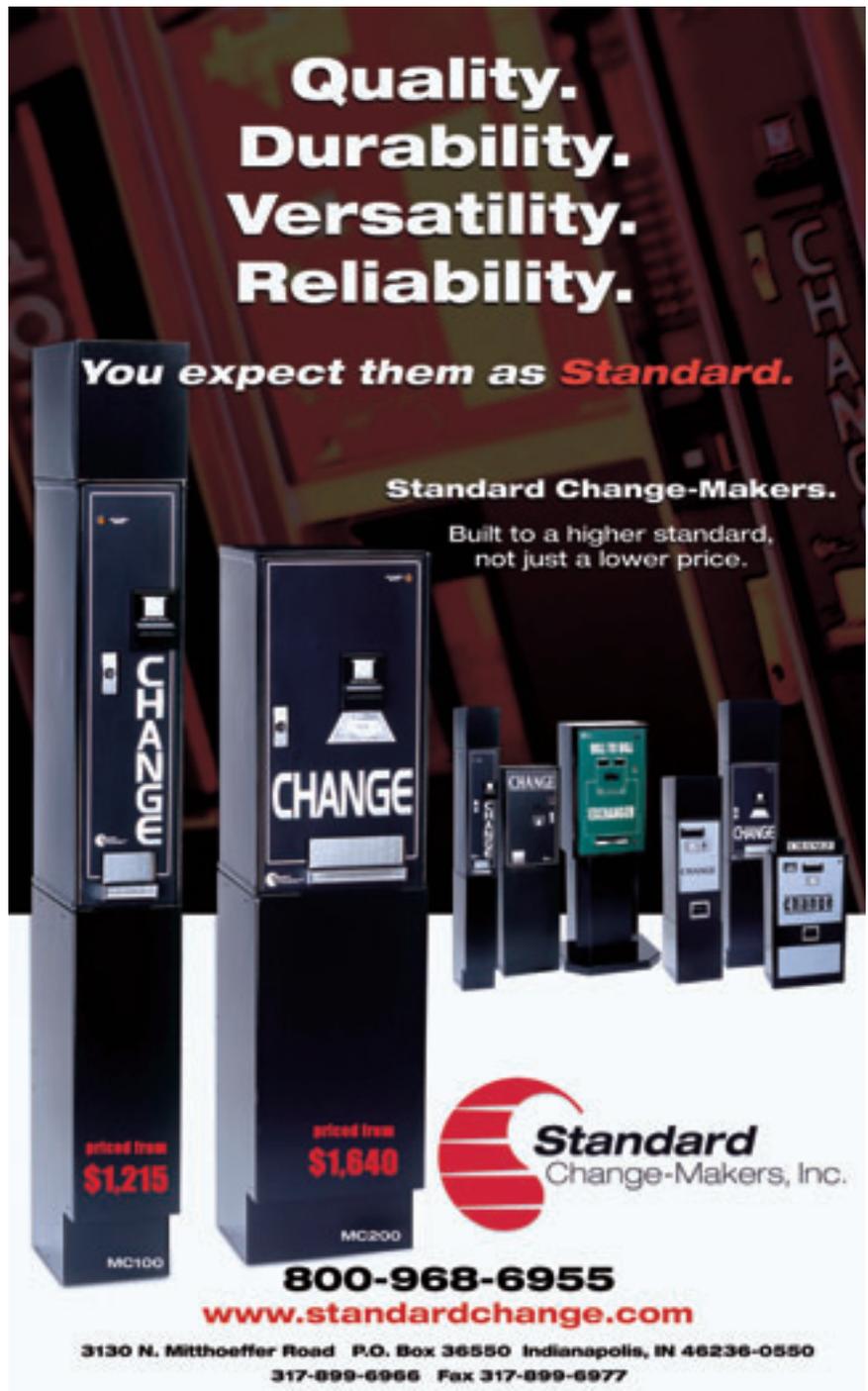
The vending industry has been even slower than the OCS industry to cash in on the specialty coffee revolution that began in the early '90s. The growth in specialty coffee stores, convenience stores and other retailers has rejuvenated coffee consumption in the U.S., but vending, and until very recently, OCS, has not been able to deliver the new products consumers are seeking.

The vending industry has been at a disadvantage in meeting this challenge since a high capital investment is required to provide better quality hot beverages. The number of locations where such an investment would be feasible has declined in the last few years. Hot beverage machines in particular are concentrated in the large industrial

locations that have suffered the most account downsizing.

Hot beverage machines once again declined in number for the fourth straight year in 2003, indicated in chart 8a. This was the biggest machine decline next to candy/snack/confection machines. Sales in this segment fell 5.3 percentage points,

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the most next to candy/snacks/confections.

The 130-percentage-point rise in fresh-brew specialty coffee sales (indicated in chart 8b) was due to the availability of more flavored and

varietal coffees from major coffee roasters. Operators charged more for this product than any other hot beverage selection, indicated in chart 8c.

To maximize hot drink sales, operators must provide both regular coffee,

which continues to command the biggest portion, and specialty offerings. To do this, they must use machines capable of providing extra selections. Machines with expanded offerings were introduced in 2001.

In addition to more product selections, operators needed to use better quality coffee to win sales from more discriminating consumers. This required investment in product, equipment, and personnel.

Larger cup sizes also proved important. The survey did not track cup sizes, but several operators noted the importance of offering cup sizes that invited comparison to convenience stores and specialty coffee shops. Many operators expanded beyond the traditional 12-ounce size to 14, 16, and even 20 ounces.

Larger-size cups proved challenging in blue collar sites, however, where employees were frequently restricted from carrying larger cups.

The gain in fresh-brew specialty coffee in 2003 came mostly at the expense of fresh-brew regular coffee and freeze-dried specialty coffee. The only other hot beverage selections to post a sales gain in 2003 were fresh-brew decaf, tea and soup.

In a departure from other product segments, smaller operators charged higher prices for coffee than larger competitors. This could have been due to less purchasing clout that required higher pricing to secure profitable margins.

Vend food declines, too

Vend food sales did not suffer as much as the industry as a whole in 2003, which can be viewed as both positive or negative, depending on how the business is viewed.

Vending operators usually welcome any opportunity to remove a food machine from a location since the machines are usually not profitable.

CONTINUED

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

Year	Total
2000	425,000
2001	399,500
2002	360,200
2003	350,000

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

% OF TOTAL

Type	2000	2001	2002	2003
Fresh-brew regular	58.1%	54.0%	45.3%	47.2%
Fresh-brew decaf	6.5	6.2	6.5	7.4
Fresh-brew specialty/flavored	8.4	6.3	7.1	17.6
Freeze-dried regular	6.5	5.6	7.7	4.0
Freeze-dried decaf	1.9	1.9	3.0	1.1
Freeze-dried specialty	9.0	12.4	13.1	7.4
Tea	1.9	1.9	1.2	1.7
Hot chocolate	6.5	8.7	10.7	9.1
Soup	0.6	1.2	0.6	1.1
Other	0.6	1.8	4.8	3.4

PROJECTED TOTAL

Fresh-brew regular	\$825.02M	\$664.2M	\$511.89M	\$505.04M
Fresh-brew decaf	92.3	76.26	73.45	79.18
Fresh-brew specialty/flavored	119.28	77.49	80.23	188.32
Freeze-dried regular	92.3	68.88	87.01	42.8
Freeze-dried decaf	26.98	23.37	33.9	11.77
Freeze-dried specialty	127.8	152.53	148.03	79.18
Tea	26.98	23.37	13.56	18.19
Hot chocolate	92.3	107.01	120.91	97.37
Soup	8.53	14.76	6.78	11.77
Other	8.53	23.14	54.24	36.38

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

Type	2000	2001	2002	2003
Fresh-brew regular	38 cents	41 cents	44 cents	46 cents
Fresh-brew decaf	39	41	45	46
Fresh-brew specialty/flavored	51	51	51	56
Freeze-dried regular	38	37	41	42
Freeze-dried decaf	39	38	42	43
Freeze-dried specialty	51	47	54	50
Tea	38	40	43	44
Hot chocolate	40	42	45	48
Soup	35	40	42	45



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CHART 9a: Food machines, 4-year review

Type	2000	2001	2002	2003
Refrigerated	177,450	158,050	149,080	144,700
Frozen*	26,520	33,183	39,718	46,280
Heated	1,700	1,500	1,500	1,500
Ambient	1,100	900	900	800
Food systems (pizza, popcorn, french fries)	1,750	1,750	1,800	2,300

* Most were used for ice cream.

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

% OF SALES

Type	2000	2001	2002	2003
Freshly-prepared	63.4%	54.0%	51.4%	50.7%
Frozen-prepared	28.9	37.9	43.0	44.5
Shelf stable	7.7	8.1	5.1	4.4
Other	0.0	0.0	0.5	0.4

PROJECTED SALES

Freshly-prepared	\$1.18B	\$0.826B	0.740B	0.684B
Frozen	0.537	0.579	0.619	0.601
Shelf stable	0.143	0.124	0.073	0.059
Other	0.00	0.00	0.01	0.01

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

Type	2000	2001	2002	2003
Freshly-prepared	\$1.67	\$1.73	\$1.80	\$1.78
Frozen-prepared	1.62	1.67	1.64	1.71
Shelf stable	1.28	1.28	1.42	1.36

But the food machine also allows the operator to win snack and beverage sales that he wouldn't otherwise get. Hence, removing the food machine oftentimes means losing a customer to a fast food restaurant or a convenience store.

Food sales declined by 1 percentage point in 2003. While continuing the downward trend of the past four years, this figure was less damaging than the 5 points the industry lost altogether.

This indicated that operators maintained food machines to maximize their overall opportunities.

The food segment posted a 1.3-point gain in machine placements in 2003, as indicated in chart 9a. Much of the increase, however, was driven by frozen food machines,

CHART 9d: Top 15 frozen food products in 2003, dollar sales

Rank	Product
1	White Castle Distributing White Castle Twin Cheeseburger
2	Pierre Foods Big AZ Cheeseburger
3	Chef America Hot Pockets Pepperoni Pizza
4	Pierre Foods Buffalo Style Wings
5	Pierre Foods Jumbo Bacon Cheeseburger
6	Schwan Foods' Tony's Pepperoni Pizza
7	Pierre Foods Jumbo Cheeseburger
8	Chef America Hot Pockets Ham & Cheese
9	Pierre Foods Jumbo Jalapeno Cheeseburger
10	Jimmy Dean Foods Rudy's Farm Sausage Twin Biscuits
11	Schwan Foods' Tony's Supreme Pizza
12	Pierre Foods A-1 Chopped Beefsteak Sandwich
13	Pierre Foods Monterey Ranch Chicken With Ranch
14	Pierre Foods Southern Fried Chicken Breast
15	Bagel Plain with Cream Cheese

TOP 15 REFRIGERATED FOOD PRODUCTS IN 2003, DOLLAR SALES

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

Source: Vendchannel, 800-999-4271

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

% OF SALES

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

PROJECTED SALES

Type	2002	2003
Dedicated milk	\$70M	\$64.38M
Cold beverage	8.6	54.81
Refrigerated food	119.4	170.8
Other	2	0

CHART 10b:
Milk sales, 4-year review

2000	2001	2002	2003
\$440M	\$230M	\$200M	\$290M

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

2000	2001	2002	2003
60,000	56,220	48,000	53,000

CHART 10d:
Milk prices, 4-year review

2000	2001	2002	2003
54¢	65¢	75¢	78¢

which are largely used as ice cream merchandisers.

Milk leads growth

Milk led all product categories in sales growth in 2003, posting a 45 percent gain. This double-digit growth, confirmed by MSA Inc., reflected the aggressive marketing

of dairy processors, specifically to the vending channel.

Fiscal 2003 brought the first positive results from these marketing initiatives, following years of decline. Sales grew in other retail outlets as well, according to the Beverage Marketing Corp., marking a long-awaited turnaround. Total retail milk sales rose 2 percentage points in 2003.

Supporting milk sales growth was a 10.4 percentage point gain in the number of dedicated milk machines in 2003, indicated in chart 10a. Dairy processors subsidized many of the machine purchases.

However, chart 10a also indicates that most of the sales gain occurred in cold beverage machines and refrigerated food machines.

The growth of glassfront beverage machines with their expanded facings supported more milk placements.

The biggest gain in milk sales came through refrigerated food machines, which accounted for nearly 60 percent of all vend milk sales. This growth occurred despite a 2.9 percentage point decrease in the number of refrigerated machines, noted in chart 9a. This would indicate that most of the growth occurred in industrial accounts, long the mainstay of milk vending.

Offsetting the decline in refrigerated machines, however, was an increase in dedicated milk machines, mostly in larger industrial accounts and school accounts.

Schools in particular were receptive to milk machines as a way to offer a perceived healthier alternative to soda. In some cases, schools purchased and serviced their own machines. In other cases, they purchased machines and hired vending operators to service them.

Ice cream suffers

Ice cream sales took a 4.2 percentage point hit in 2003, despite a 13.6 point gain in machine placements. The decline reflected the fallout in the industrial account base, where ice cream machines are dominant, as well as the growing popularity of low-carb diets.

The decline also makes sense given 2003's negative results for vend food. Much ice cream is sold in frozen food machines, which are mainly located in industrial accounts.

Dedicated, new-style, multi-product merchandisers continued to replace the old style, 3- and 4-select machines. The new style machines grabbed a bigger share of ice cream sales in 2003 at the expense of all other types of ice cream venders, as indicated in chart 11b.

Vend ice cream sales are expected to increase along with the placement of more new style machines. These machines are capable of offering an expanded variety of product, and can offer the higher ticket, premium products that consumers prefer over the traditional products sold in older style machines.

Frozen food machines offering both food and ice cream once again accounted for the biggest portion, nearly half, of all ice cream sales.

2004: Recovery under way

Vending operators unanimously agreed that 2004 brought improvement. While the vending industry is often the last to experience the results of economic growth, operators noted that account downsizing slowed and many customers were rehiring.

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

2000	2001	2002	2003
\$270M	\$230M	\$240M	\$230M

CHART 11b: % of sales by machine type, 2-year review

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

PROJECTED SALES

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

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

2000	2001	2002	2003
44,543	43,046*	48,273**	54,835***

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

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

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

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

Type	2000	2001	2002	2003
Ice cream	\$0.80	\$0.91	\$0.98	\$0.97
Frozen confections	\$1.31	\$1.49	\$1.68	\$1.31

The nation's unemployment began to recover in the first quarter of 2004, according to the U.S. Department of Labor. The jobless rate averaged 5.6 percent every quarter to date in 2004, compared to 5.9 percent in 2003. Disposable personal income, an important indicator for all consumer industries, is projected to grow 3 percent in 2004, versus the 2.6 percent in 2003, according to the NRA.

Operators can do their part to facilitate their growth by investing in new equipment and technology. The newer products and equipment enable vending operators to offer a higher level of customer service, which strengthens consumer perception of the industry. ■

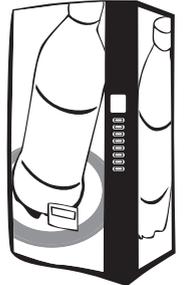
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