OCS REVENUES REACH RECORD HIGH

Operators who provide office coffee service (OCS) are enjoying increased revenues for the third straight year due to higher-margin products, aggressive marketing and more demand.

By Emily Refermat

OCS continues to return strong sales. Whether operators have full-line vending with OCS or focus just on coffee service, revenues for the segment continued to climb in 2012. The aggregate industry revenue for this year's *Automatic Merchandiser* State of the Coffee Service Industry Report increased 5 percentage points to $4.33 billion, a record high in the last 10 years. Single cup is a major factor contributing to OCS revenue growth, now representing more than 20 percent of the brewers in the marketplace. While profitability of single cup is squeezed by competitor price, operators are experimenting with other single-serve alternatives such as generic K-Cups and coffee pods that have better margins.

Also contributing to the increase in revenue was more aggressive marketing by operators in 2012 with sales departments finding more business, including growing businesses as the economy improves. Challenges included increased competition from internet retailers and office supply stores, especially on prices for single cup options.

CHART 1: OCS REVENUES – 10-YEAR HISTORY

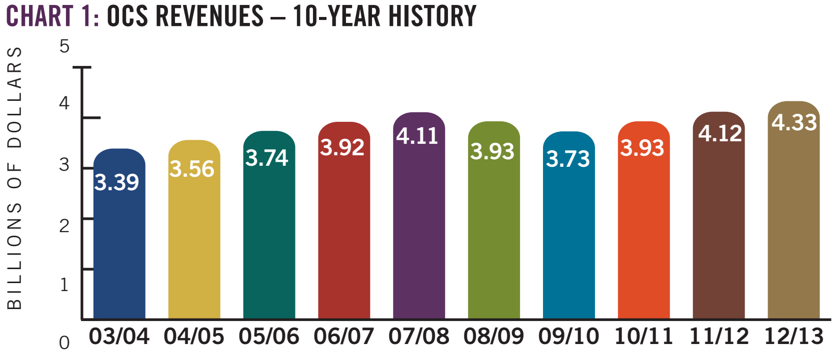
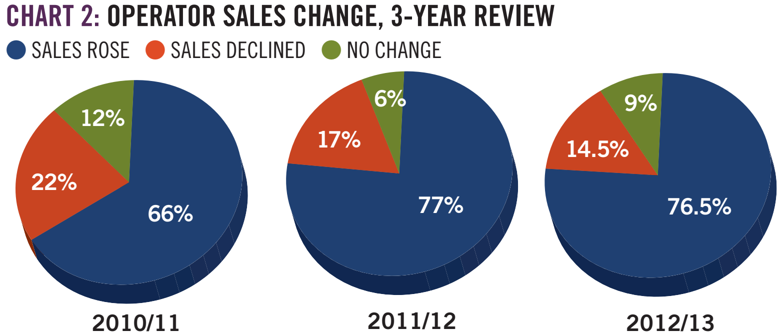


CHART 2: OPERATOR SALES CHANGE, 3-YEAR REVIEW



More than 220 operators from the readership of *Automatic Merchandiser* and VendingMarketWatch.com responded to the OCS survey and provided valuable data and insights, used in the report.

Driving change

Dropping green coffee prices, as seen in chart 3, helped drive higher coffee margins in some cases, although OCS operators heavy in traditional single-cup didn't receive much relief as those prices didn't drop.

To help margins, half of operators again raised prices in 2012, although that represents fewer operators than in 2011, see chart 4a. More than 40 percent made no changes in price. The reason for this is mixed. In some cases, it was due to lots of competition driving acceptable prices, making it difficult for operators to increase them. To maintain profitability in these cases, operators used cost cutting in other areas of their operations, such as in paper goods and services offered. Other operators made no change because they had previously raised prices to a profitable level and coffee consumption increased.

According to the National Coffee Association (NCA), overall coffee consumption is up 5 percent over last year among Americans. In its National Coffee Drinking Trends Report, the NCA reported that 83 percent of U.S. adults now drink coffee, compared to 78 percent from the 2012 report. Daily consumption has remained strong and steady at 63 percent, with those who drink coffee at least once a week up slightly to 75 percent.

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OPERATOR PRICING ACTIVITY

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

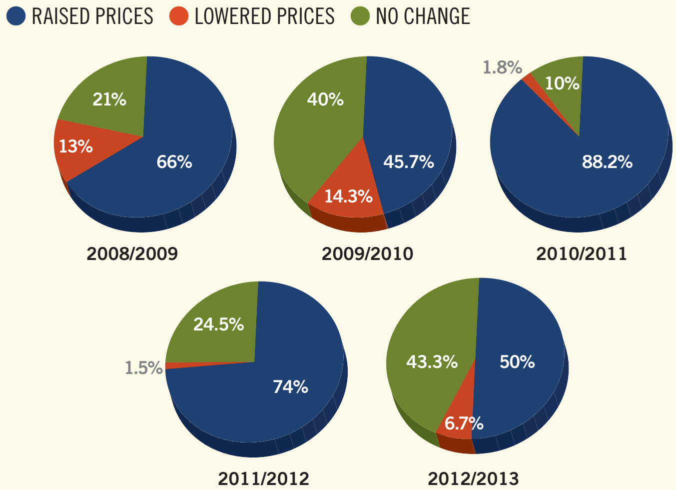


CHART 4B: REVENUE PER CUP IN CENTS PER CUP, FRACTION PACK PLUMBED IN/POUROVER COFFEE, 10-YEAR REVIEW

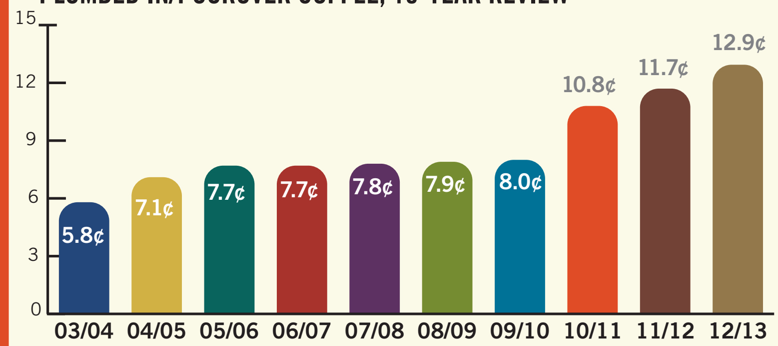
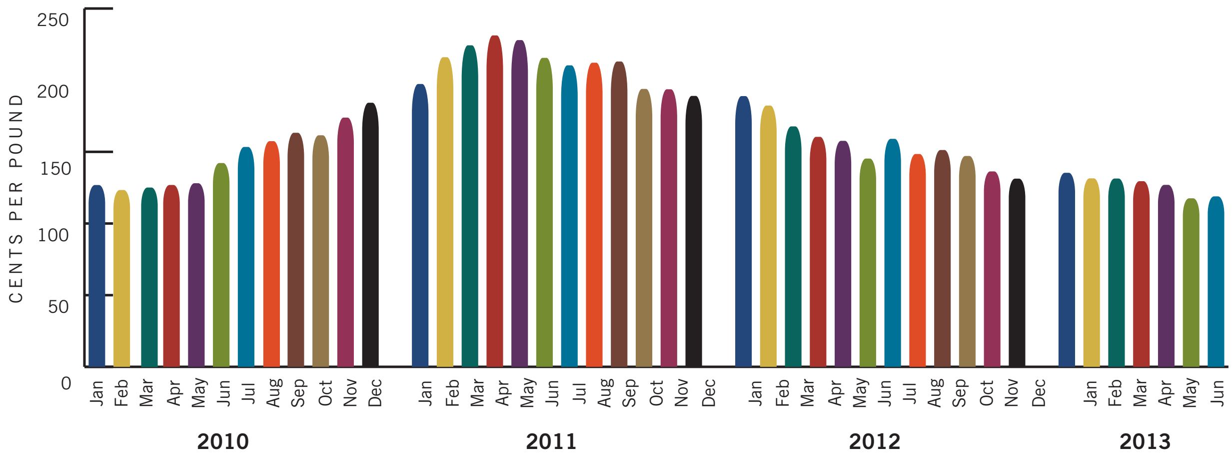


CHART 4C: REVENUE PER CUP, SINGLE-CUP COFFEE, 3-YEAR REVIEW

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

CHART 3: COMPOSITE GREEN COFFEE PRICES, 2009 TO JUNE 2013



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

CHART 5: ACCOUNT POPULATIONS BY SIZE, 2012/2013

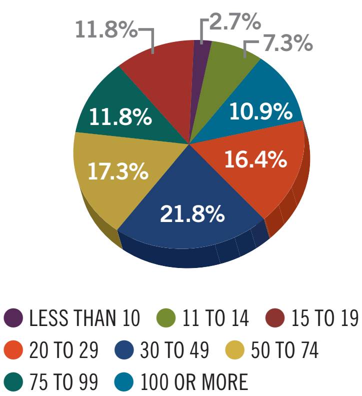
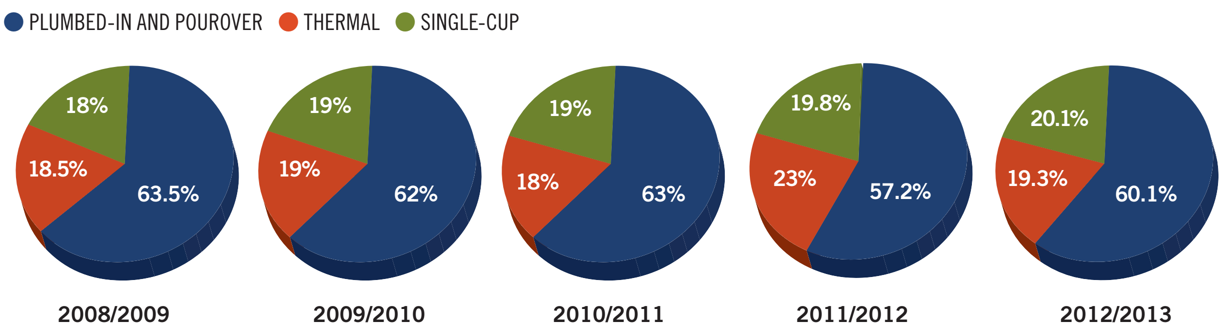


CHART 6: OCS SALES BY PRODUCT CATEGORY, 5-YEAR REVIEW

	08/09	09/10	10/11	11/12	12/13
Private label coffee	27	39.69	28.11	28.23	18.24
National brand coffee	31	21.4	26.92	28.08	24.37
Espresso/cappuccino	2	4.94	3.6	3.77	5.38
Other coffee*	9	4.63	12.07	9.86	17.36
Total Coffee	69	70.66	70.7	69.94	65.35
Other hot beverages	6	7	4.9	5.54	6.39
Soft drinks/juices	3	3.5	5.39	5.73	6.57
Bottled/filtered water	5	4	5.7	4.75	7.29
Creamers/sweeteners	7	5	5.63	6.62	6.48
Cups/paper products	6	5.5	5.41	6.17	6.51
Other	4	4	2.27	1.25	1.88

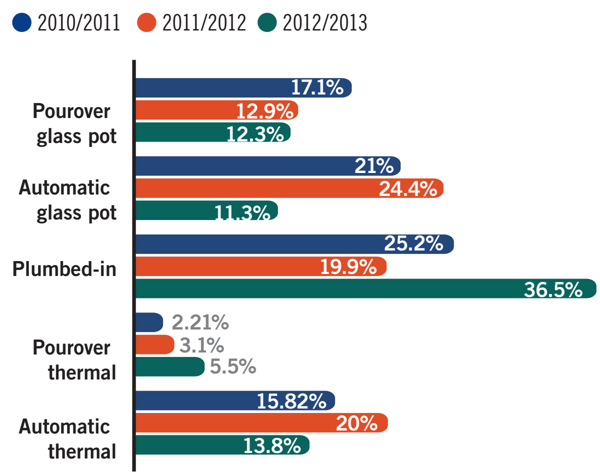
*Includes flavored, whole bean and varietal.

CHART 7A: OCS BREWER BREAKOUT BY TYPE, 5-YEAR REVIEW



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

CHART 7B: PLUMBED-IN, AUTOMATIC AND THERMAL AS % OF TOTAL, 3-YEAR REVIEW



Operators found that despite the recession and price conscious locations, coffee remains a valuable perk employers want to offer employees, especially among new businesses.

Prices increase again

The average price for both single cup and more traditional OCS coffee increased over the past 12-month period, shown in chart 4c and 4b. Single cup increased to 43.1 cents per cup. From operator responses, that number is a median between two industry trends. Either operators increased prices based on supplier/cost increases or dropped prices to remain competitive. If prices dropped, often new equipment and product was offered, such as pod brewers. Single cup is still a powerful trend. Operators report heavy requests by locations for single serve coffee.

The increase in average price per cup for frac pack, plumbed-in and pourover coffee was driven by wholesale price increases and consumers asking for more national brands, as well as heavier pack weights.


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CHART 8: ESTIMATED MARKETSHARE OF SINGLE-CUP BREWER PLACEMENTS IN THE U.S., 5-YEAR REVIEW

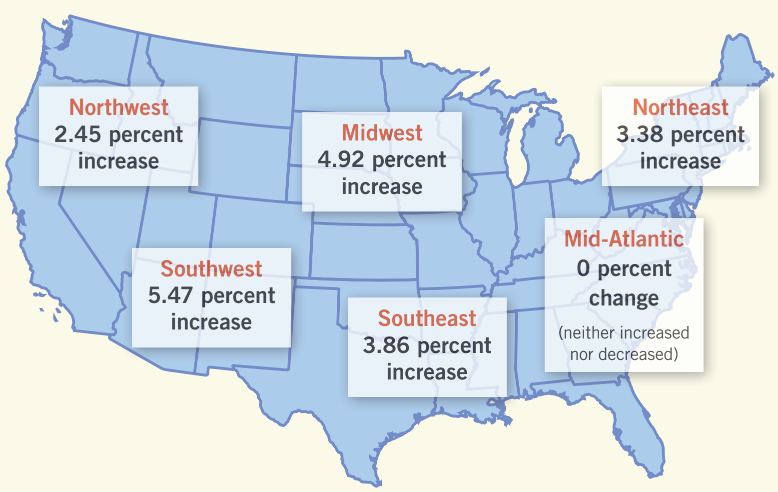
(Editor's note: Responses for 2012/2013 are active brewer placements. Percentages from previous years have been calculated.)

MARKETER	PRODUCT(S)	2008/09	2009/10	2010/11	2011/12	2012/13
Bodecker Brewed	Bodecker	0.31%	0.29%	0.23%	0.26%	0.36%
Cafection	Avalon	3.64%	3.69%	4.10%	3.89%	1.98%
Cafejo	Cafejo	2.29%	2.31%	2.20%	2.36%	2.35%
Crane	Café System, Genesis	1.31%	1.24%	1.11%	0.95%	1.34%
Filterfresh	Filterfresh	2.02%	2.08%	1.65%	1.43%	4.69%
Grindmaster	Grindmaster	1.00%	1.38%	1.26%	1.35%	6.03%
Keurig	Keurig	37.70%	36.79%	43.00%	46.23%	46.22%
Kraft	Gevalia, Tassimo Professional	0.39%	0.60%	0.66%	0.81%	2.91%
LaVazza	Espresso Point, Lavazza Blue	2.09%	2.12%	1.98%	1.68%	2.12%
Mars Drinks	Mars Drinks (Flavia)	36.11%	35.50%	31.80%	30.13%	23.41%
Newco	Smartcup, Freshcup	0.18%	0.30%	0.31%	0.41%	2.15%
Rheavendors	Rhea, Cino,	0.44%	0.44%	0.35%	0.33%	0.05%
Saeco USA	Saeco, Estro	2.76%	2.69%	2.21%	2.00%	0.61%
Sara Lee	Douwe Egberts	0.30%	0.42%	0.51%	0.44%	1.67%
Starbucks	Starbucks	0.80%	0.92%	0.81%	0.75%	1.64%
Technologies Coffea	Coffea	0.00%	0.03%	0.16%	0.22%	0.03%
VE Global Solutions	Venus, Cypris, Juno, Prosyd	1.87%	2.00%	1.91%	1.64%	0.12%
VE Global Solutions	Brio, Colibri, Koro, Korinto, Konvivo	5.94%	6.25%	5.34%	4.61%	1.19%
Wolfgang Puck	Wolfgang Puck	0.50%	0.60%	0.15%	0.31%	0.38%
Other		0.37%	0.35%	0.27%	0.22%	0.76%

OCS locations increase

The average number of OCS locations served by operators went up in 2012, from 2011, by an average of 18 stops. Operators reported that this was due to new sales efforts by their companies as well as a strengthening economy leading to non-vending business growth. Chart 5 shows that in the past 12 months, operators added more accounts in the 20 to 29 person range. This size now represent 16.4 percent of OCS accounts nationwide, whereas last year it was 12 percent. The other account sizes stayed relatively flat, except for those with 100 employees or more. These increased from 7.41 percent in 2011 to 10.9 percent in 2012 as the businesses recovered from the recession and added employees.

Average Total Sales Revenue Change Per Region



Operators have been diversifying the type of account they provide OCS for as well, see chart 9. The percentage of office and business/industry accounts served dropped slightly in 2012, as OCS operators increased their deliveries to restaurants, government locations and even c-stores. The largest jump was in the "other" category, nearly 4 percentage points. This is where many full-line operators placed their micro market OCS sales, which grew especially well in hospitals.

Micro markets were a somewhat surprising trend in OCS. A number of operators, especially those who

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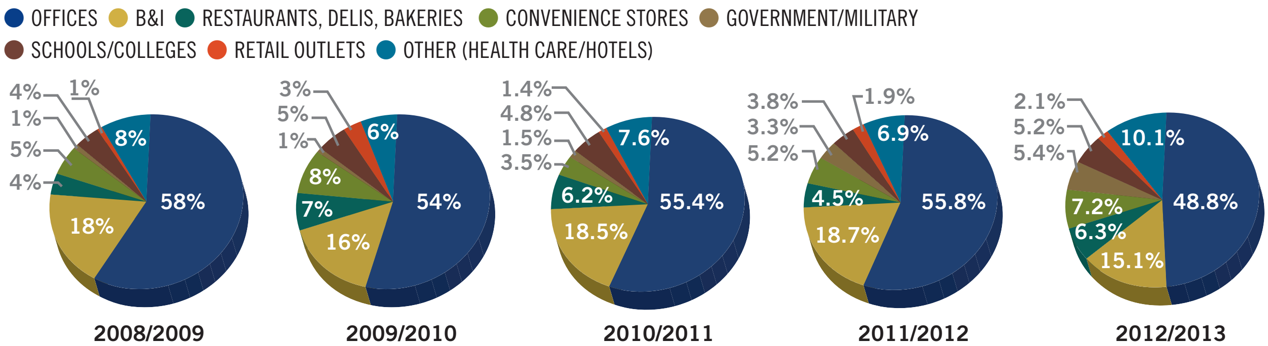
CHART 9: ACCOUNTS BY TYPE, 5-YEAR REVIEW



offer mostly OCS, but had some vending, said they launched micro markets as a way to provide added value to their customer base and as an additional revenue source.

Plumbed-in and pourover brewers rebounded in 2012, closer to previous years, as many locations were and still are more cost conscious. Operators have done a good job of educating locations about the benefits and quality that these brewers can offer, despite heavy requests for single cup.

Single-cup remains strong

In 2012, single cup also experienced a lift to 20.1 percent, see chart 7a. In the population as a whole, 13 percent of people drink coffee made in a single-cup brewer daily, according to NCA data. And ownership of these brewers grew to 12 percent in 2012, increasing from 10 percent the year before, showing just how popular single cup has become.

However, single cup presents a dilemma for operators. Not only is the cost per cup high, which means a higher cost for the location, but the most well-known of these brew-

FUEL CHARGE ACTIVITY

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

YES NO

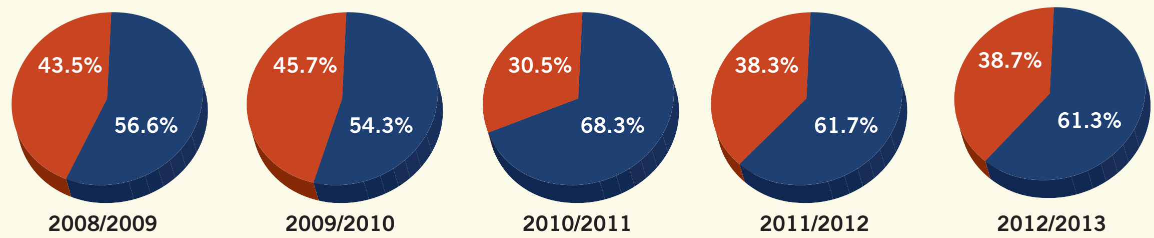


CHART 10B: HOW MANY CUSTOMERS WERE BILLED, 5-YEAR REVIEW

ALL CUSTOMERS ON SELECTIVE BASIS

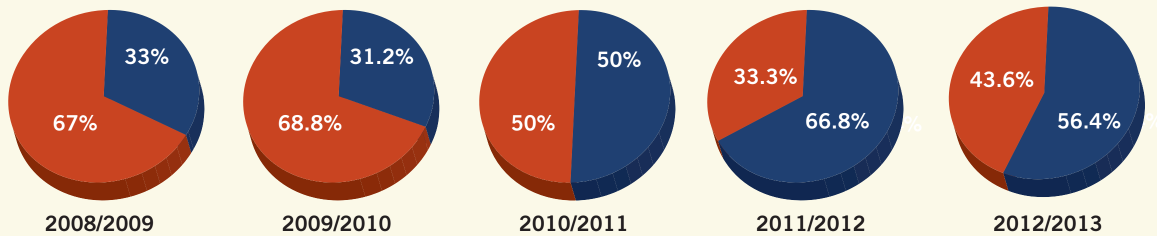


CHART 10C: HOW OFTEN WERE CUSTOMERS BILLED, 5-YEAR REVIEW

ALL DELIVERIES SPECIAL DELIVERIES HALF OF DELIVERIES LESS THAN HALF ALL WHO DON'T OBJECT

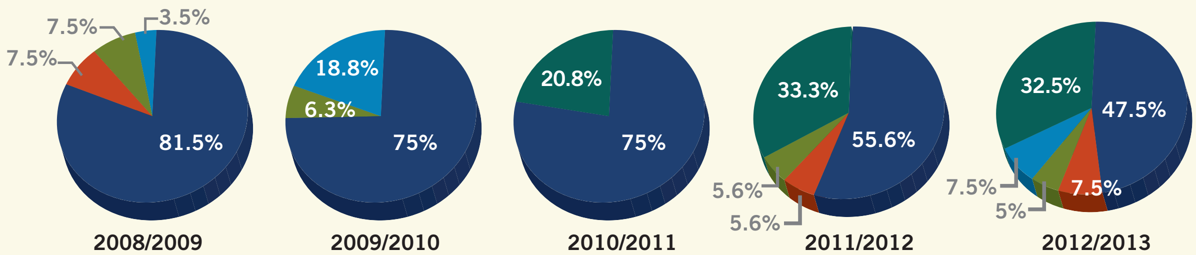
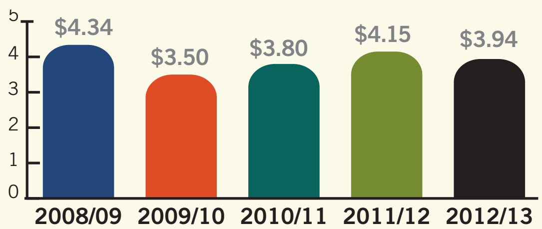


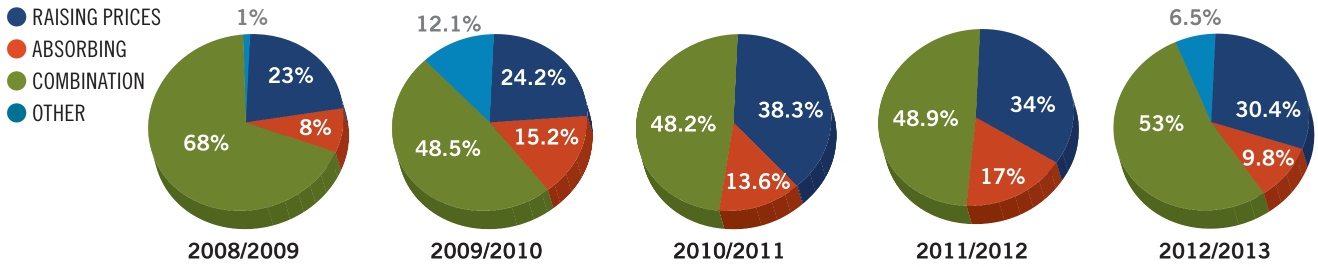
CHART 10D: AVERAGE AMOUNT CHARGED FOR FUEL PER DELIVERY, 5-YEAR REVIEW



ers, at least to the consumer, is available in multiple channels. Keurig has become a well-known brand name in most of the U.S. and its K-Cups® are available for competitive prices in nearly every retail channel, including wholesale on the internet. Operators report difficulty policing their single cup locations and preventing them from buying K-Cups elsewhere.

As a result, OCS operators are experimenting with both generic K-Cups and other, similar cartridges that work in the same brewer. They are also experimenting with alterna-

CHART 11: HOW RISING COSTS ARE BEING HANDLED, 5-YEAR REVIEW



tive single cup machines that discourage pilfering by employees, as this is still a concern among many locations. Pods are seeing a resurgence as equipment manufacturers show the equipment is more reliable than in the past and the pods themselves are considered a "green" alternative to K-Cups. Chart 8 shows how marketshare has shifted over the past 5 years for single cup brewers, with Keurig and Mars Drinks (Flavia) brewers leading, but Newco's are gaining placements.

Another driver behind single cup growth is the popularity of specialty drinks, which have increased sales of machines able to brew cappuccinos and lattes. This is shown in chart 6. Espresso/cappuccino drinks, as a part of the OCS sales, grew almost 2 percent in 2012, while private label and even national brand sales percentages fell. Operators also reported a rise in flavored coffee and varietals or origins (coffee grown in a specific region). Resurgence of bean-to-cup machines have increased whole bean sales.

Chart 6 also shows the shift in the typical OCS customer. While coffee remains strong, its sales share has shrunk in the past 12 months. The product category with the largest gain was bottled and filtered water. Both the drive for healthy products, noted by vending operators, as well as the day part met by water is contributing to this segments' growth.

NAMA sponsored research on the OCS consumer revealed that water is consumed all day, as compared to coffee and tea, which were mostly consumed in the morning.

CHART 12A: HAVE ADDED OR REDUCED STAFF IN THE LAST 12 MONTHS, 5-YEAR REVIEW

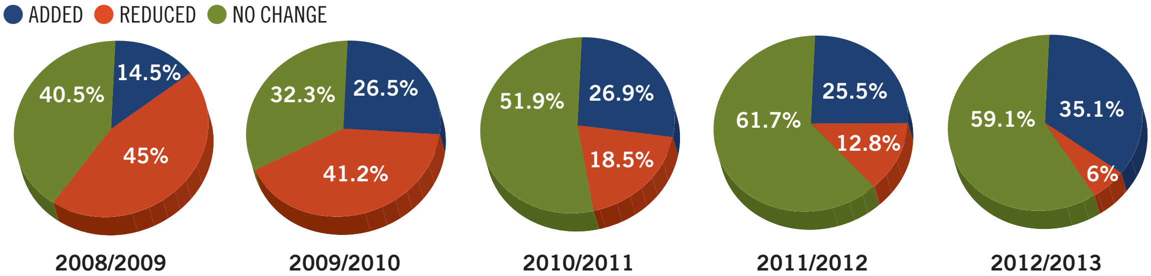
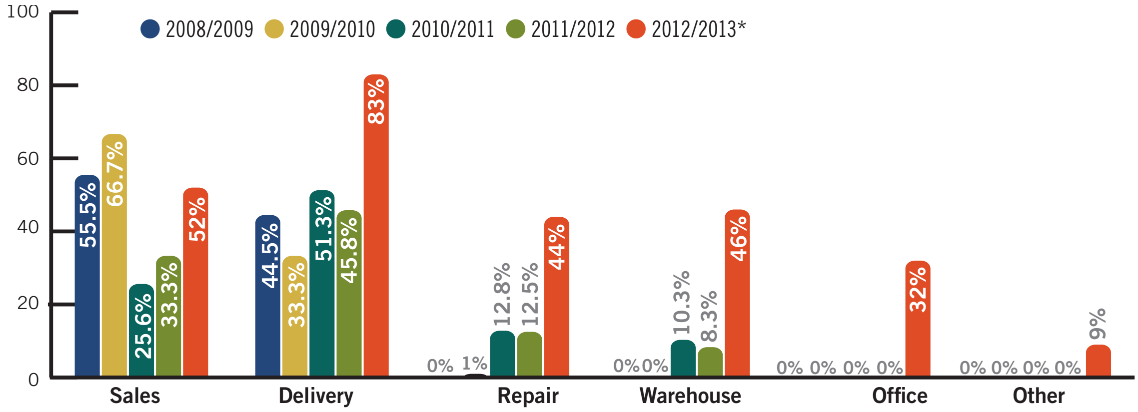


CHART 12B: IF ADDED STAFF, IN WHICH AREAS?



* 2012/2013 includes multiple mentions

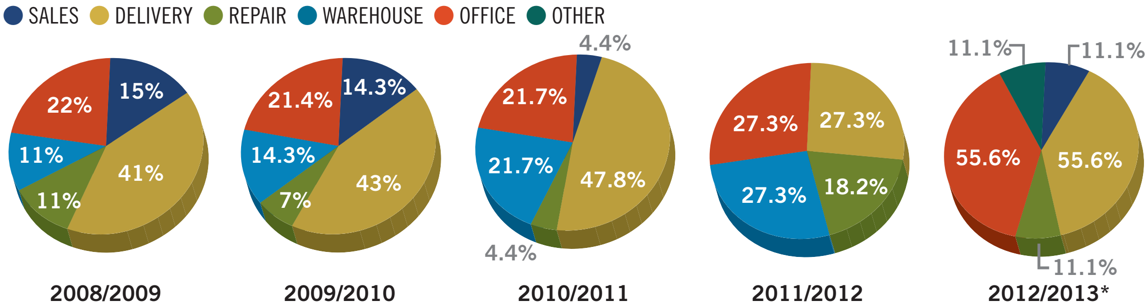
The OCS consumer research also showed that among those employees who did not have any coffee service at their location, 60 percent named filtered water as their top request.

Environmental concerns flat

While locations have been asking about sustainable products for a number of years now, operators haven't reported a lot of movement in this area as far as sales. Therefore, operators haven't invested heavily in green OCS products, leaving the percentage of operators offering these items practically unchanged since 2010, see chart 13a. For operators who did add eco-products to their OCS line-ups, most added coffee with sustainable features, 53.3 percent, followed by products made from recycled material, 30.4 percent. See chart 13b.

The number of OCS companies allowing customers to order online increased in 2012, from 35.29 to 40.2 percent, see chart 14. Many

CHART 12C: IF REDUCED STAFF, WHICH AREAS?



* 2012/2013 includes multiple mentions

OVER *half of operators raised prices and absorbed losses to deal with rising costs.*

operators who added this feature viewed it as having potential for consumer sales as well, with products shipped via UPS.

Dealing with increased costs

More than half of OCS operators reported using a combination of raising prices and absorbing losses when dealing with rising costs, shown in chart 11. Operators raised prices when they felt locations would tolerate increases, especially as many customers were still shopping for OCS service based on price. Also, single cup options being available from outside the channel forced a certain price point for operators.

An increasing percent of operators looked for other means of dealing with increasing costs, such as switching to lower cost alternatives in products and making their businesses more efficient.

Staffing changes

As OCS revenues grew, roughly a third of operators added staff, 35.1 percent in 2012, compared to 25.5 in 2011, see chart 12a. Only 6 percent reduced their staffs. Among the additions, evidence of operation success is shown in chart 12b, where the largest hiring happened in the delivery area in order to handle new business.

For staff additions and reductions, the percentages will show quite a bit of difference from previous years, because operators were allowed to choose all the areas they added or reduced staff, instead of being limited to one area. After delivery personnel, the next area most commonly added was sales people. For the small number of

CHART 13A: HAVE ADDED PRODUCTS THAT ADDRESS ENVIRONMENTAL CONCERNS, 4-YEAR REVIEW

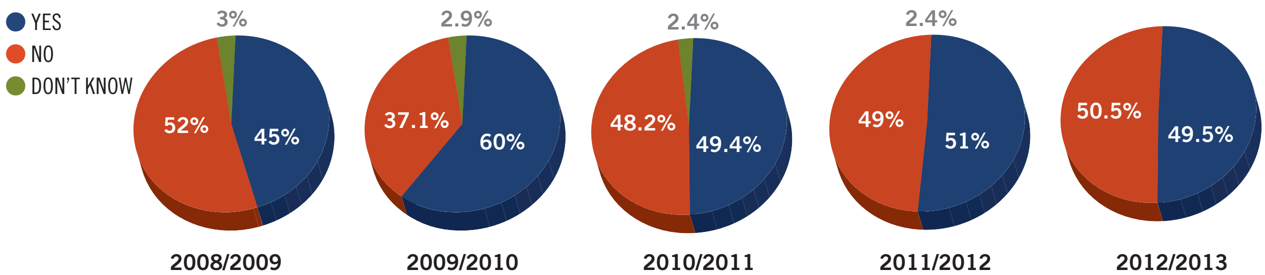


CHART 13B: PRODUCTS ADDED THAT ADDRESS ENVIRONMENTAL CONCERNS

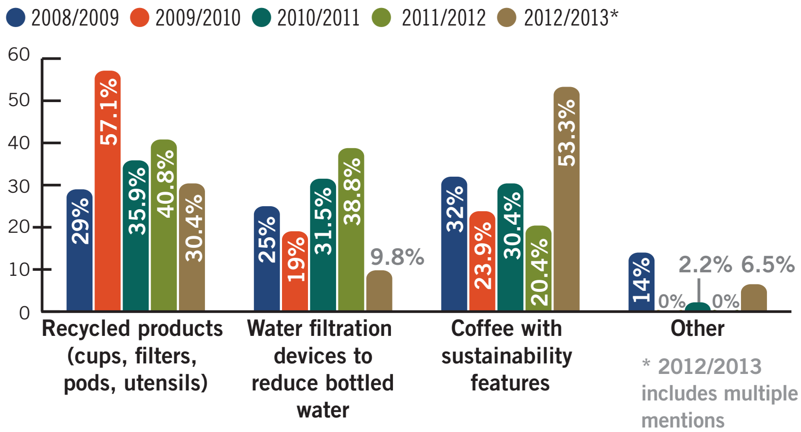
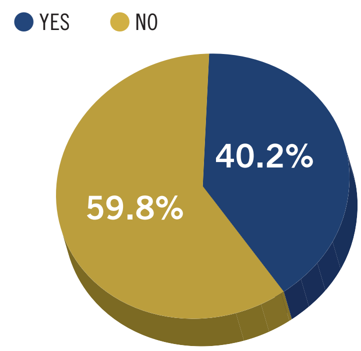


CHART 14: COMPANY CURRENTLY OFFERS ONLINE ORDERING ON ITS WEBSITE



operators who reduced staff, the percents were nearly tied for eliminating delivery and office staff.

Fuel surcharge stagnant

While some OCS operators continued to use fuel surcharges as a way to deal with increased costs, the number did not increase in 2012, seen in chart 10a. What did increase was the number of customers billed, as more operators added the surcharge to all customers, which allowed them to also reduce the amount charged. The average fuel surcharge in 2012 dropped to $3.94 per delivery.

The past 12 months reflects a positive picture for the OCS operator, but it is also a portrait with juxtaposition. Some operators took initiative and aggressively went after new locations and educated existing ones on products that offered higher margins and increased revenues. Other operators found locations, and themselves, in a 'wait and see' pattern based on the economy and politics. Operators adjusted product mixes to accommodate higher end clients, while also introducing options for the value-focused location. Margins were squeezed by fierce competition, but revenues still increased. Despite the seemingly polar business environment, the coffee service industry is squarely in the black. With coffee consumption continuing to rise, the positive swing looks as though it will continue in 2014. | ◀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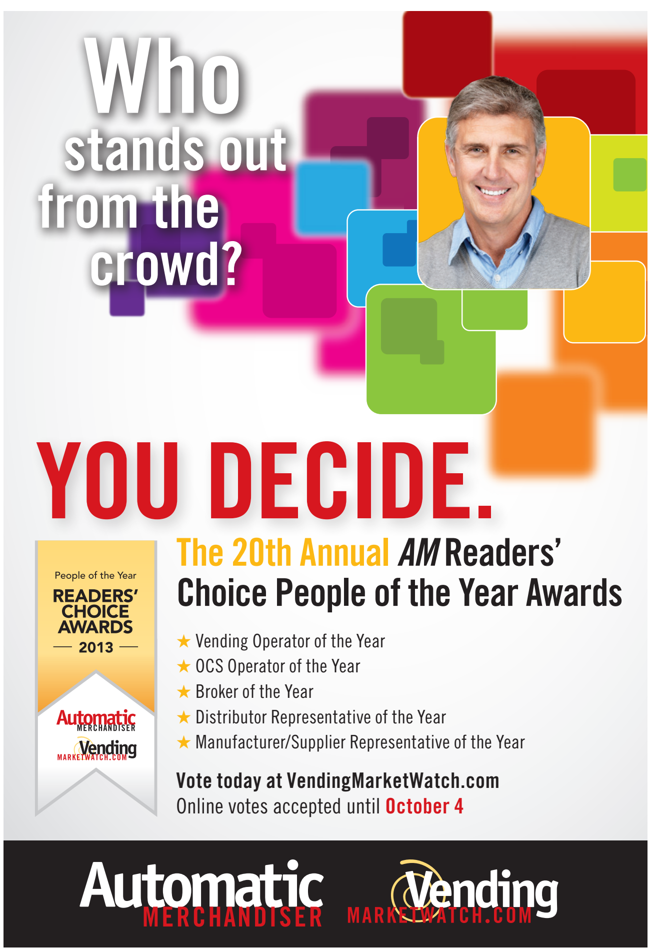
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