

MilkPEP/DMI School Milk Vending Test – Executive Summary

Test Shows School Milk Vending Is A Significant Opportunity

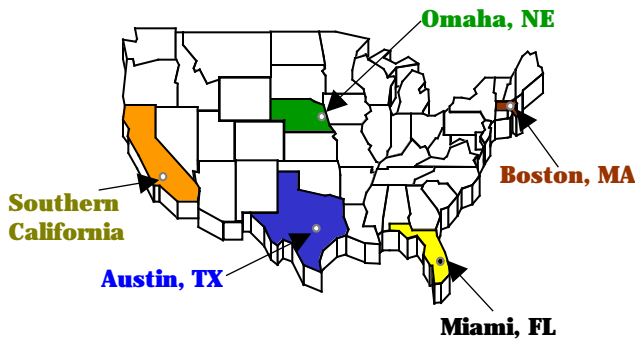
Test Objective and Methodology: A national test made up of 86 machines in 5 diverse markets to evaluate the school vending opportunity

The primary objective of the test was to evaluate the opportunity for milk vending in schools, to understand:

- The volumetric and profitability potential for school milk vending
- The operating dynamics of vending milk
- The optimal products and machine placement

Business models for dairy processors and third-party vendors

Vending machines were placed in middle and high schools across the country in 5 diverse markets



- Vending machines featured youth-targeted got milk?® milk mustache celebrity graphics and:
 - 45 product facings/glass front
 - 360 unit capacity
 - Advanced refrigeration system with temp guard and auto shut-down
- Test design required at least three flavors and each market had an average of 5 SKUs

Test Background: School milk vending could spearhead a strong push for milk consumption in schools

Kids drink milk in school because they like it, but also because they “have to”

- When there are more attractive options, kids quite often choose them over milk
- School milk has negative characteristics and associations for many students

- Why kids drink school milk:
 - They like milk
 - Gatekeeping by school/parents
 - It is free with lunch
 - Chocolate milk is a “treat”

Kids have told us what they don’t like about school milk

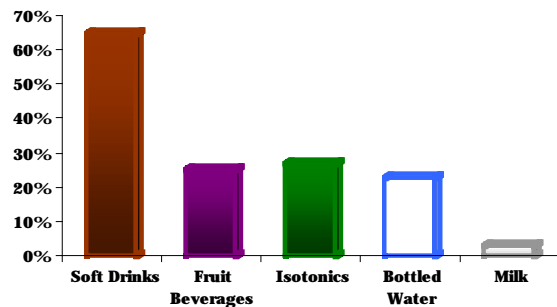
- Available only during meals
- Bad packaging (small, leaky cartons)
- Limited flavors and fat level options
- Image is “uncool”, beverage kids “have to take”
- Warm from sitting on lunch line
- Have to wait in line to get it

Vending addresses students’ concerns

- Available throughout the day, before and after school
- Portable, resealable plastic 16oz. bottles
- Wide variety of flavors and fat contents
- Perceived as higher end, “cool” beverage that kids get to select and buy
- Kept very cold until dispensed
- Freedom from waiting on line

Vending also addresses key concerns of processors, schools and parents – but to date there is very little milk vending in schools

Presence of Competitive Beverages in Vending 2000



- Processors can profit on value-added products
- Vending prices are market-competitive and outside the school bid system
- Vending machines serve as billboards for milk
- Milk is a healthy choice in the vending area at school

Important Learnings from the Test: There is demand for school milk vending

- Kids will eagerly buy milk from vending machines in schools

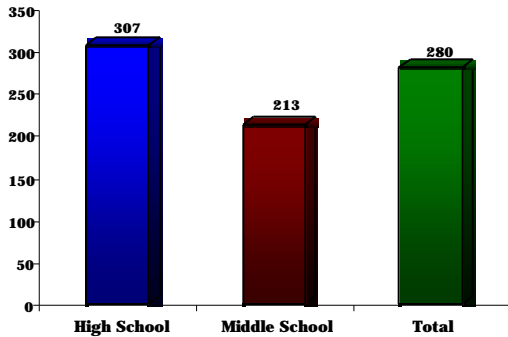
- Average weekly sales per machine were 280 units
- School population was the major driver of velocity
- 68% of students bought vended milk
- About 30% of users purchased vended milk once a week while less than 20% only used the machine once
- The average vended milk per capita consumption was 0.20 units/week

- “It’s great and it’s very nutritious for those with calcium deficiencies”
- “Handy; don’t have to stand in line”
- “I like it; it gives us more choices besides soda”
- “I like it because it gives us more variety and more milk”

The few negative comments from students focused on cost and the machines

- “It cost too much for too little; better deal through the lunch line”
- “All the milk has too much fat in it”
- “I think it is too easy to flip over the machine and get free milk”
- “Sometimes there is milk in the machine and it says sold out”

Average Milk Unit Vender Sales per Machine per Week



Participating processors were very pleased with the test

- “I wish we’d done this ten years ago!”
- “The test served as an awakening for single-serve milk through vending”
- “I’m surprised the kids accepted the [vended] milk so well”
- “The branding opportunities through school vending will have a lasting effect”
- “Vending is the best thing to happen to milk since the ‘Chug’”

- Vending will be the preferred venue for kids to buy flavored milk, especially products not available on the lunch or a la carte lines
 - Flavors outsold white milk nearly 9 to 1
- Milk vending can be a profitable business, for both processors and/or vending operators given the right product mix, pricing and operational components
- Commissions to schools may be necessary
- Placing two machines in larger schools produced similar or greater per cap consumption than average
- Not all schools are appropriate for milk vending
 - Given the learnings from the test, consumption drivers can be identified
 - School size
 - Economic factors
 - Machine Access
- There was no evidence of significant lunch line milk cannibalization
 - When asked what students would have bought instead of vended milk 37% responded CSDs and 27% responded fruit beverages
- Spoilage was not a significant issue/expense

There is no single approach to school milk vending – many models will be tried

There are at least four viable business models

- Third-Party Operation
- Processor Full-Service
- Processor/School Cooperative Service
- School Self-Operation

Key considerations in selecting the appropriate model include school size and volumetric potential

- Processor margins differ by model – maximized with processor full-service
- However, use of a third-party operator keeps processor out of the “equipment business”, minimizes cost and infrastructure requirements and can help them get good school placements
- Involving the schools in vender operation (i.e. filling) provides strong margins to both processor and school, while utilizing school labor

Student reaction to milk vending at school was overwhelmingly positive

School Milk Vending Potential Opportunity is Estimated Nationally at 130 million 16-oz. units

The bulk of the school milk vending opportunity will be in large middle and high schools

- In large schools vend operators, processor full service, school self-op or some combination are appropriate models
- Use of various (untested) operating models can make vending in all but the smallest schools profitable
 - Third-party operated vending can not be supported by the volumes at smaller schools

Overall the school milk vending opportunity is estimated to offer incremental sales of up to 131 million 16-oz. units per year

- The potential for up to 131 million units represents 16.3 million gallons per school year – a potential increase of about 4% in school milk volume
- Roughly two-thirds of the volume opportunity would come from larger middle/high schools
- Upside potential could be realized with additional machine placements, new flavors/products, etc. driving higher per cap consumption and sales

The ripple effect from an improved school milk image is perhaps the more important potential benefit, generating lifelong milk loyal consumers

- Additionally, a full-blown national school milk vending presence could generate 10 billion cost-free consumer impressions per year
 - A comparable bus shelter program, for example, would cost \$12-\$15 million

Several business issues for school milk vending were raised during the test

- Many of these issues are familiar hurdles for vend operators but not currently for processors
- Machine selection: cost and graphic capabilities are crucial
- Vender placement: high traffic areas with all day access are optimal
- Commission rates: Test commissions averaged about 7.5%, a level significantly below that for most other product vending. Schools generally expect beverage vending (from soft drink experience) to provide commissions of 20-30%; however, actual

commission will depend on competitive circumstances

- Machine content: competitive constraints in schools may limit non-dairy options
- Competitive response: other beverage companies may try to disallow milk vending
- Vandalism: vandal-proof cages and bolt-downs may be necessary to deter vandalism
- Summer vender utilization: may be beneficial to move venders for summer months

Conclusions: School milk vending represents a significant sales and marketing opportunity for processors

Regarding school milk vending, the question for a dairy processor should not be “Do I do it” but “How do I do it?”

- Milk vending is an open playing field in which processors can generate profits on incremental volume
- Processors need only determine how to leverage existing systems to make vending work for them considering:
 - Processor capabilities
 - Propensity for risk/innovation
 - Access to capital
 - Access to effective vend partners, i.e. vend operators
 - School environment in processor market
- With a more passive approach, processors may wait to be approached by vend operators
 - Simply sell required milk to third-party at wholesale price
- Aggressive processors can actively partner with vend operators or establish their own vending infrastructure
 - Allows the processor more control over products and programs
 - Helps to build strong long-term relationships with school districts
 - Helps build strong brands with key market consumers