Zacks Small-Cap Research

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AVT, Inc. (AVTC-OTC)

AVTC: *Automated Retail Presents Solid Opportunities*

Current Recommendation	**Neutral**
Prior Recommendation	Buy
Date of Last Change	03/25/2014
Current Price (03/25/14)	$3.72
Six- Month Target Price	$2.60

UPDATE

In this report, we update our projections for 2013 and 2014. We are lowering our revenue and EPS forecasts for the fourth quarter of 2013 and for full year 2014.

We remain positive on the automated retail sector and believe that AVT has solid opportunities to leverage the growth that automated retail is enjoying. We also believe that at this early stage, the company's results are likely to remain lumpy. We are also lowering our rating to Neutral from Buy.

SUMMARY DATA

52-Week High	**$8.00**
52-Week Low	**$1.13**
One-Year Return (%)	**-2.3**
Beta	**N/A**
Average Daily Volume (sh)	**214,780**
Ord. Shares Outstanding (mil)	**16.5**
Market Capitalization ($mil)	**$61**
Short Interest Ratio (days)	**1.1**
Institutional Ownership (%)	**N/A**
Insider Ownership (%)	**5.7%**
Annual Cash Dividend	**$0.00**
Dividend Yield (%)	**0.00**
5-Yr. Historical Growth Rates	
Sales (%)	**46%**
Earnings Per Share (%)	**N/A**
Dividend (%)	**N/A**
P/E using TTM EPS	**N/A**
P/E using 2013 Estimate	**N/A**
P/E using 2014 Estimate	**14.1**
Zacks Rank	**N/A**

Risk Level	**Above Average**
Type of Stock	**Small Growth**
Industry	**Mach-Electrical**
Zacks Rank in Industry	**N/A**

ZACKS ESTIMATES

Revenue
(in millions of $)

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2011					10.3A
2012	3.4A	3.6A	3.8A	4.3A	15.3A
2013	1.4A	1.9A	1.0A	3.1E	7.5E
2014	1.4E	2.0E	1.2E	3.5E	8.1E

Earnings per Share
(EPS is operating earnings before non recurring items)

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2011					$0.01A
2012	$0.01A	$0.01A	$0.01A	$0.00A	$0.03A
2013	-$0.03A	-$0.02A	-$0.03A	-$0.05E	-$0.14E
2014					$0.14E

Disclosures on page 9

Zacks Projected EPS Growth Rate - Next 5 Years % **N/A**

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KEY POINTS

- AVT is a **technology company serving the automated retail industry**. It is the exclusive domestic distributor of Marley Coffee branded kiosks and automated coffee stores. The company intends to install about 2,000 company-owned Marley units within the next two years.
- AVT recently announced the launch of Automated Retail Income Development (ARID), an **investment fund** that hopes to raise $4.9 million to finance the anticipated roll-out of about 300 Marley kiosks.
- Overall, **secular trends for automated retail are favorable, in our view**. The self-service automated retail market in the U.S. is expected to grow from $740 billion in 2010 to more than $1.1 trillion in 2015, according to the IHL Group.
- For the first nine months of 2013, AVT reported total revenues of $4.4 million, down from $10.8 million in the first nine months of 2012. The company reported a net loss of ($1.2) million over this period versus positive net income generated in the first nine months of 2012.
- **We are lowering our projections.** Our 2013 full year revenue projection goes to $7.5 million from $12.7 million earlier. Our 2014 full year revenue projection goes to $8.1 million from $29.8 million earlier. Our full year LPS projections for 2013 and 2014 are now ($0.14) for each year, from our earlier projections of ($0.02) and $0.10 for 2013 and 2014 respectively.
- We are also **lowering our rating to Neutral** from Buy.
- **Risks** include that AVT is in the early stages of a transition, competition could increase, two large customers have driven revenue for the last few quarters, recurring revenue might take longer than expected to ramp or might not occur at all, AVT is essentially a controlled company and convertible preferred shares that convert into six AVT ordinary shares could be highly dilutive to public shareholders.

OVERVIEW

AVT (Automated Vending Technologies) is a **technology company focused on the automated retail industry**. Over the past roughly five years, management has developed new technologies and built self-service kiosks for automated vending. This is a market that has expanded dramatically. Today, automated retail machines sell a wide range of products including clothing, foods, high end electronics and even jewelry. Among the niches where AVT currently provides automated retail solutions, we believe premium coffee and medical marijuana are two with substantial potential.

Marley Coffee

AVT is the exclusive domestic distributor of Marley Coffee branded kiosks and automated coffee stores. The company intends to install about 2,000 company-owned units within the next two years. Management expects the Marley machines or *Marley Cafes* to reach a more than $24 million annual revenue run rate by year-end 2014. Marley Cafes can brew a cup of freshly ground coffee for less than it costs bricks and mortar high-end coffee chains that employ baristas and pay store rent. Moreover, some Marley Cafes have nearby seating areas so that people can sit just as they do in the bricks and mortar locations.

Earlier this year, AVT announced the launch of Automated Retail Income Development (ARID), an investment fund that hopes to raise $4.9 million to finance the anticipated installation of about 300 Marley Coffee machines. According to management, ARID intends to negotiate installations with retailers including Krogers (KR-not rated), Safeway (SWY-not rated) and others. Among the locations that ARID has earmarked for placement are several sites that formerly had a Rubi vending machine, as Outerwall (OUTR-not rated) recently announced its decision to discontinue its Rubi coffee unit. The location will be

a key driver of per unit sales, in our view. The machines cost about $8,500 to purchase and the company estimates that units can generate monthly net revenue of $1,500 to $2,000 and achieve payback on the initial investment within the first year of operation.

Overall consumption of gourmet coffee also continues to grow, advancing from 37% of all cups of coffee consumed in the U.S. in 2011 to 46% in 2012. However, hot beverage vending has not participated in the general growth in coffee consumption that Starbucks (SBUX-not rated) and other premium bricks and mortar venues have helped fuel. We believe coffee vending has lagged in part because of the changing nature of the domestic economy. Specifically, hot beverage vending machines were generally concentrated in industrial, blue collar work areas like factories or construction sites. Vending operators have removed many hot beverage machines over the past few years, as the industrial manufacturing base has contracted. In addition, we believe sales have also been impacted by negative perceptions consumers have from the days when they could only purchase poor quality coffee through vending.

Over time, as the quality of the coffee available through kiosks improves, we would expect consumer perceptions to change. Domestic coffee consumption continues to rise, as noted. In 2012, daily coffee consumption increased by 5%, according to the National Coffee Association (NCA)[1]. The gain in coffee consumption is most significant in the 18 to 39 demo. This is key, we believe, as AVT intends to place several Marley Coffee machines on college campuses. AVT has already begun installing Marley Cafes on campuses, including at the Student Bookstore at South Carolina University, through its agreement with Neebo, one of the largest suppliers of textbooks in the country with more than 250 campus bookstores nationwide.

Moreover, with other companies targeting the automated retail gourmet coffee niche, we believe consumers are becoming accustomed to purchasing gourmet coffee through this channel. AVT has early mover advantage, in our view, and along with other early entrants, can help change consumers perception of coffee purchased through vending machines. As upscale coffee brands such as Marley's expand in this channel, we believe that consumers will respond positively.

Negative perceptions are also likely to change, in our opinion, as the venues themselves change. In the past, prime locations for vending food and coffee have often been large factories, hospitals, college dormitories and other places where people could not leave easily and generally needed to purchase food and coffee quickly. Vending was a good solution because it was always available and could be placed near workstations, study desks, hospital waiting rooms, etc… so that people could grab something quickly on the go. Often this also meant that the quality of the food and coffee the machine dispensed was inferior.

Moreover, AVT's Marley Coffee micro-stores and self-service centers feature a variety of premium gourmet blends. With improvements in the coffee itself and better placement to capture a broader range of patrons, we believe this is a likely growth channel.

Addressable Market

We believe the addressable market for Marley Cafes could be large. According to *Vending Times* magazine, an estimated 1.4 million vending sites are located nationwide in manufacturing plants, factories, offices, government buildings, schools, colleges, hospitals and other public locations. They are served by approximately 9,000 vending operators. In addition, there are approximately 52,000 hotels nationwide, according to the American Hotel & Lodging Association, including roughly 6,000 business-oriented hotels with more than 150 rooms, and approximately 14,000 hotels with 75 to 150 rooms. Many

[1] NCA's National Coffee Drinking Trends study engaged a nationally representative sample of 2,955 people 18 and older, which NCA believes ensures that the data is accurate plus or minus 1.9% 19 times out of 20.

of these smaller hotels cannot afford to provide 24-7 room service or gift shops that operate around the clock. Automated retail provides a solution that is available at any time.

For Marley Cafes, AVT targets college campuses, traditional retail locations, high- traffic venues such as theaters and hotels and traditional foodservice vendors. In May 2013, the company announced an agreement with Cupful, Inc. for 300 Marley units that Cupful will place in the Las Vegas market. The company expects the deal to generate $2.5 million is sales revenue. AVT also recently announced that it had awarded an exclusive distributorship of Marley Coffee Automated Stores in the Tri-County area of South Florida. The company estimates that this franchise can generate more than $3.5 million in revenues for AVT. Miami-Dade, Broward and Palm Beach are Florida's three most populous counties. With over 5.5 million people[2], the Miami metropolitan area is Florida's most densely populated city. The company also announced last week that it had installed a Marley Café in the Westwood Pavilion in Las Angeles.

Pharmaceutical Kiosks

AVT builds systems for publically traded Medbox (MDBX-not rated), as well as for other companies in the medical and pharmaceutical industries. AVT worked with MedBox to integrate biometric fingerprint recognition technology into an automated prescription medicine dispensing machine[3]. AVT programs the machine, manufactures and installs the software and monitors the network. AVT can also place and merchandise the automated shop, as well as ship and replenish inventory. The global pharmacy kiosk market is expected to reach $7.8 billion per annum by 2018, according to *Pharmacy Times* magazine, up from $4.7 billion in 2011.[4] That metric does not reflect the legal marijuana channel.

SECULAR TAILWINDS

Secular trends are favorable, in our view. The self-service automated retail market in the U.S. is expected to grow from $740 billion in 2010 to more than $1.1 trillion in 2015, according to the IHL Group. Following World War II, the vending industry grew at roughly twice the pace of GNP. This growth was driven primarily by three things: 1) rising labor costs made machines an attractive alternative to hiring workers; 2) technological advances in food preservation and dispensing equipment enabled machines to dispense hot meals, sandwiches, coffee, and soft drinks; and 3) technological advances in money-changing equipment allowed machines to dispense products at various price points. Vendors targeted locations where people had limited time for lunch breaks such as factories, offices, schools, hospitals and other institutions. By 1960, the vending industry had reached $2.5 billion in annual sales.

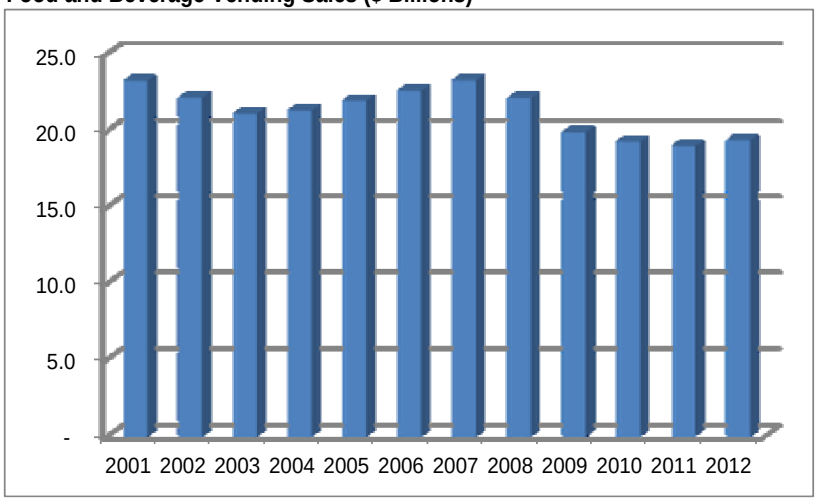
Vending sales of food and beverages (F&B) reached $22.05 billion in 2008. However, vending is not immune to economic cycles, in our opinion. In 2009, sales of food and beverages from vending machines fell 10% to $19.85 billion from 2008's above noted $22.05 billion, according to *Automatic Merchandiser* magazine. This decline is primarily attributed to high unemployment levels and general consumer belt tightening, we believe. Overall, the F&B vending industry remained under pressure for four years.

Finally in fiscal 2012, a recovering economy and rising consumer confidence combined to produce a 1.9% year-over-year increase to $19.31 billion. This metric was up from $18.96 billion in 2011, but it was still below the 10-year high of $23.21 billion the industry recorded in 2007 and it fell short of the 4.5% growth registered by bricks and mortar restaurants and bars.[5] Moreover, the 2012 growth stemmed partially from overall price increases, as 83% of vending operators raised prices to offset rising product

[2] As of the 2010 Census.
[3] Vending Times, December 2011, *AVT Expands Medbox Biometrics To High-End Venders*
[4] *Pharmacy Times*
[5] According to food research firm Technomic.

and operating costs. Nevertheless, this uptick may indicate that the F&B segment of the automated retail industry has turned the corner, in our view.

Food and Beverage Vending Sales ($ Billions)



Source: Automatic Merchandiser

Technology was another factor contributing to growth in 2012, as well. We believe this bodes well for AVT. Specifically, vending operators installed a broader range of payment options in 2012, including cashless. Research suggests that cashless machines fuel higher vending sales. Remote machine monitoring (RMM) or wireless technology also increased 8% in 2012, another positive trend for AVT, in our view.

At the same time, operators are using vending machines to sell a broader range of products and more sophisticated items than the snack foods, beverages and cigarettes that were once the mainstay of the vending industry.

Moreover, technology to enable cashless transactions has made it easier and more convenient for consumers to use vending machines and kiosks. Studies indicate that cashless technology has had a positive impact on sales, as noted.

Marley Coffee Kiosk



Source: Company reports

2013 RESULTS TO-DATE

For the first nine months of 2013, AVT reported total revenues of $4.4 million down 59% from $10.8 million registered in the first nine months of 2012. The company attributed the year-over-year decline to delays in the shipment of custom built kiosks. AVT is in early stages with many of its retail concepts.

On the lower revenue base, the company reported a net loss of ($1.2) million for the first nine months of 2013 versus positive net income generated in the first nine months of 2012. Reflecting the fairly long build cycle on custom built kiosks, management expects AVT's revenue stream may be lumpy for the next several quarters.

If recurring revenue from Marley Cafes and other initiatives grows, we believe that will help smooth out the quarterly variances in manufacturing revenue. However, conservatively, we are lowering our projections for the fourth quarter of 2013 and for 2014. Our full year revenue projection for 2013 goes to $7.5 million from $12.7 million earlier. Our full year revenue projection for 2014 goes to $8.1 million from $29.8 million earlier. On the lower expected revenue, our full year LPS projections for 2013 and 2014 are now ($0.14) for each year, from our earlier projections of ($0.02) and $0.10 for 2013 and 2014 respectively.[6]

We are also lowering our rating to Neutral from Buy. Although we believe there are substantial opportunities in the automated retail sector, we believe AVTC shares may have gotten ahead of fundamentals at this early stage.

RISKS

- AVT is still in the early stages of a transition from a vending service company to a technology company focused on automated retail. The company's need to reinvest in its business could translate into negative cash flow for the foreseeable future.
- Competition could increase and AVT could lose market share.
- Two large customers have driven AVT's revenue for the last few quarters. Management has indicated that this early stage in the company's transition, many initiatives are still in the pilot stage.
- Management expects recurring revenue from initiatives such as Marley Coffee to ramp but this process might take longer than expected or might not occur at all.
- AVT essentially has a controlling shareholder in Worth, Inc., a company that is owned by the father of AVT's founder and Chairman.
- AVT has convertible preferred shares outstanding that have been issued to Worth, Inc., among others. These shares are each convertible into six AVT ordinary shares. It could be highly dilutive to public shareholders, as these are converted. According to company filings, 125,000 convertible preferred shares were converted in the quarter ended September 30, 2013.
- We believe a risk for automated vending, as it is for retail in general, is that location is a critical determinant of success.

[6] AVT has 16.5 million ordinary shares outstanding. If all 2.6 million preferred convertible shares were converted, AVT's fully diluted average share count would be 31.9 million shares.

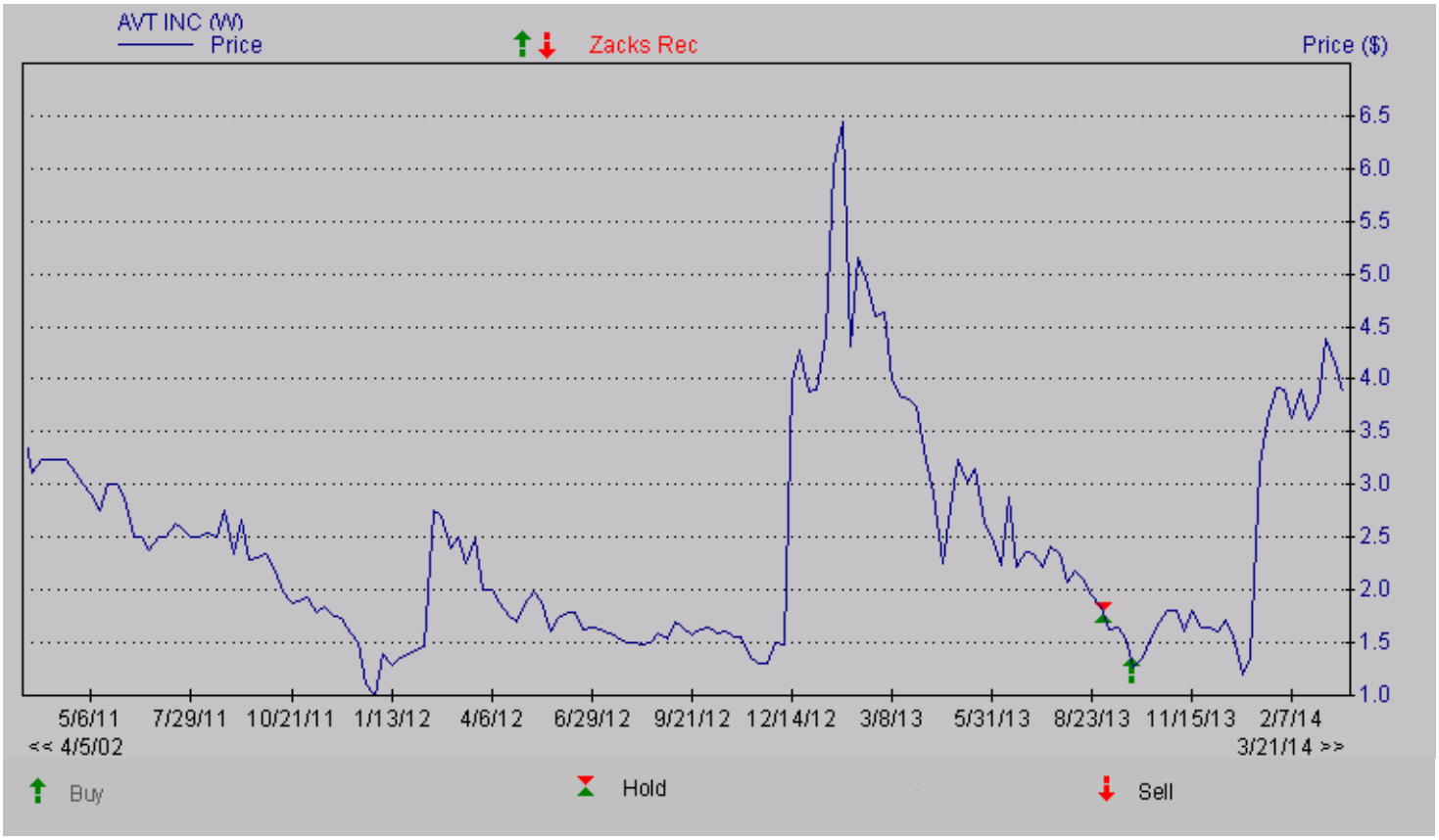
PROJECTED INCOME STATEMENT

AVT, Inc. Income Statement & Projections ($)

	1Q13A	2Q13A	3Q13A	4Q13E	2013E	1Q14E	2Q14E	3Q14E	4Q14E	2014E
Revenues:										
Vending Route	$244,467	$270,347	$288,398	$151,014	$954,226	$246,912	$273,050	$291,282	$152,524	$963,768
Manufacturing Machine Sales	1,150,840	1,670,796	785,912	2,944,843	6,552,391	1,162,348	1,754,336	880,221	3,386,569	7,183,475
Non-vending	-	-	-	-	-	-	-	-	-	-
Total revenues	1,395,307	1,941,143	1,074,310	3,095,857	7,506,617	1,409,260	2,027,386	1,171,503	3,539,093	8,147,243
Cost of Vending Products	71,404	90,458	84,032	43,794	289,688	71,604	79,185	84,472	44,232	279,493
Cost of Manufacturing	667,890	672,342	358,329	1,649,112	3,347,673	650,915	982,428	492,924	1,896,479	4,022,746
Cost of Non-vending	-	-	-	-	-	-	-	-	-	-
Total Cost of Sales	739,294	762,800	442,361	1,692,906	3,637,361	722,519	1,061,613	577,396	1,940,711	4,302,239
Gross Profit	$656,013	$1,178,343	$631,949	$1,402,951	$3,869,256	$686,741	$965,774	$594,108	$1,598,382	$3,845,004
Gross Profit Margin	47.0%	60.7%	58.8%	45.3%	51.5%	48.7%	47.6%	50.7%	45.2%	192.2%
Operating Expenses:										
General and Administrative	969,760	1,147,193	1,067,924	2,175,909	5,360,786	979,458	1,158,665	1,099,962	2,284,704	5,522,788
Depreciation and Amortization	74,416	216,739	71,162	74,008	436,325	75,160	218,906	73,297	77,709	445,072
Total Operating Expenses	1,044,176	1,363,932	1,139,086	2,249,917	5,797,111	1,054,618	1,377,571	1,173,259	2,362,413	5,967,861
Operating income	(388,163)	(185,589)	(507,137)	(846,967)	(1,927,856)	(367,877)	(411,798)	(579,151)	(764,031)	(2,122,857)
Interest Expense	29,081	50,668	51,609	51,609	182,967	51,000	51,000	51,000	51,000	204,000
Loss on Sale of Restaurant										
Other	-	-	-	-	-	-	-	-	-	-
Total Other Income (Expense)	29,081	50,668	51,609	51,609	182,967	51,000	51,000	51,000	51,000	204,000
Net Income	($417,244)	(236,257)	(558,746)	(898,576)	(2,110,823)	(418,877)	(462,798)	(630,151)	(815,031)	(2,326,857)
EPS or LPS (FD)	($0.03)	($0.02)	($0.03)	($0.05)	($0.14)	($0.03)	($0.03)	($0.04)	($0.05)	($0.14)
Weighted avg shares out (Mns)	13.6	14.3	16.5	16.5	15.2	16.5	16.5	16.5	16.5	16.5

*Quarterly results do not include divested restaurant business
Source: Company reports, Zacks SCR estimates

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Sell/Underperform: The analyst expects the company will underperform the broader U.S. Equity market over the next one to two quarters.

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