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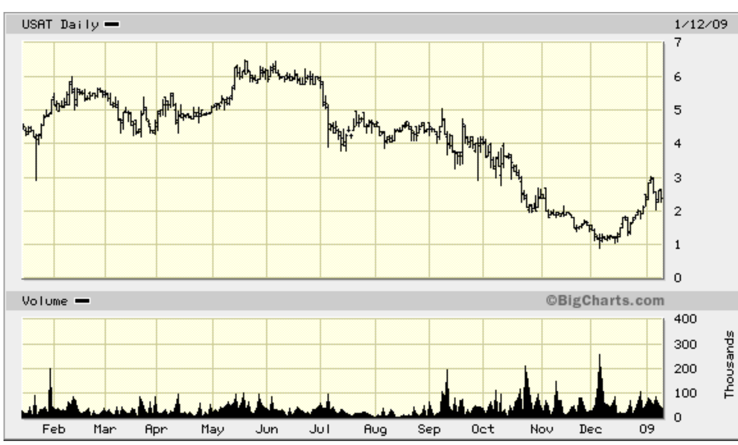
January 13, 2009
Analyst Report - www.WallStreet Research.org
CONTINUING COVERAGE - SPECULATIVE BUY

# USA Technologies, Inc. (NASDAQ: USAT)

USA Technologies, Inc., founded in 1992 and headquartered in Malvern, Pennsylvania, is a leading supplier of networked devices and associated wireless non-cash payments, including intelligent vending, as well as energy management products. Its networked products and associated services enable the owners and operators of distributed assets, such as vending machines, personal computers, copiers, faxes, kiosks, and laundry equipment the ability to offer their customers alternative cashless payment options. It also offers owners and operators remote monitoring, control and reporting on the results of these distributed assets. The Company's energy management products reduce the power consumption of various equipment, such as refrigerated vending machines and glass front coolers. USA Technologies markets its products through direct sales, distributors, channel sales and licensing. The Company has strategic relationships with MasterCard, Coca Cola Enterprises, AT&T, First Data, Blackboard, ViVOtech, and Sony. We believe the Company, supported by 69 patents (27 patents pending), is uniquely positioned to take advantage of the anticipated dramatic growth of the networked devices sector. It currently has 35,000 ePort® intelligent vending installations in a total domestic vending market of 8 million units. The Company has an estimated 6,000 laundry installations and about 1,000 other installations (business centers and kiosks). We believe the shares, trading on the NASDAQ under the symbol USAT, offer a rare opportunity to participate in a small company that has a dominant position, aided by key strategic relationships, in a rapidly growing and potentially large market. As the anticipated rapid growth in terminal placements leads to climbing recurring revenues and as manufacturing and overhead cost reductions lead to improving margins, the Company is expected to achieve profitability in fiscal 2010.




CURRENT PRICE: $2.37
52-WEEK RANGE: $0.90 - $6.49
AVG DAILY VOLUME (90-DAY): 61,900
OUTSTANDING SHARES: 15.3 million
FLOAT: 15.0 million
MARKET CAPITALIZATION: $36.2 million
TARGET PRICE: $7.50

## SELECTED INCOME STATEMENT DATA

REVENUE: $16.1 million
GROSS PROFIT: $3.4 million
EBITDA: ($13.9 million)
NET INCOME: ($15.8 million)
Basic & Diluted EPS: ($1.06)

All income statement figures twelve months trailing as of September 30, 2008

## SELECTED BALANCE SHEET DATA

CASH: $8.0 million
WORKING CAPITAL: $8.4 million
TOTAL ASSETS: $35.0 million
LONG TERM DEBT: $353.1 thousand
NET WORTH: $29.2 million

All balance sheet figures as of September 30, 2008

## HIGHLIGHTS

♦ Reported 42,000 terminals connected to USALive® network as of end of September 2008 quarter, up 75% from the approximately 24,000 a year earlier.

♦ Closed a 3-year exclusive ePort® agreement with one of the largest soft-drink bottlers in the U.S.

♦Launched the ePort® Generation Eight (G8) with new features and ePort® Edge™, a magnetic swipe only cashless solution.

♦ Announced co-marketing agreements with First Data Corporation regarding a prepaid vending solution utilizing the e-Port® and the GO-Tag contactless payment presentation device of First Data.

♦ Rapid growth in terminal placements and improving margins should enable the Company to become profitable in fiscal 2010.

## STOCK CHART

After stabilizing in the $3.50-4.50 range in the July-September period, the shares fell along with the overall market starting in October through early December, hitting a closing low of $1.14 on December 5. However, the stock has since rebounded sharply and has broken though its 50-day moving average, currently at about $1.90.

## HEADQUARTERS

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**PRODUCTS**


**ePort®** provides wireless, Internet networking technology that enables vending operators to accept cashless transactions such as credit and debit cards, RFID tags, employee/student IDs, and hotel room keys for payment. By networking vending machines, vending operators gain access to online auditing and monitoring capabilities that allow them to proactively maximize space-to-sales, minimize stops-per-asset, and limit machine down time. The unit is designed for a rapid retrofit in 10 minutes. Approximately 35,000 ePort® devices (including about 1,000 kiosks) have been networked nationwide.

ePort® enables both credit and debit cashless payments. ePort® is an attractive financial proposition for vending operators with the average increase in sales approximately 20%, with the average purchase up 32% versus cash locations. The operators hardware cost is $329 (a level that has been falling as USA's manufacturing costs decline). There is a $9.95 per month per unit networking services fee and a 5% credit card processing fee. The anticipated sales increase results in a less than one year payback to the vending machine owner. The Company's experience has been that once an ePort® installation is made it remains in place; discontinuances are rare, less than 1%. On October 6, 2008, USA Technologies announced the launch of the ePort® Generation Eight (G8). The Company's G8 is the third G series ePort device to offer a cashless transaction solution for unattended point of sale appliances that integrates a new quad-band radio, contactless card reader, with the traditional swipe card process. The ePort® G8 provides the same benefits of the ePort G7 plus important new features to their customers at a new lower price of $329. USA Technologies' new ePort G8 accepts both traditional magnetic stripe credit cards and credit cards with tap and go technology, known as MasterCard's PayPass, American Express' ExpressPay, Visa's Contactless, Chase Bank's Blink, Discover Network's Contactless, and now First Data's new GO-Tag RF sticker. Some of the G8's new features include: 1) a newly designed control unit that is 65% smaller than the previous ePort® G7 (this makes the G8 easier to install and compatible with wider variety on unattended point of sale devices); 2) improved design features, including universal mounting, preassembled cables and plug in antenna, which facilitate even faster installation and activation; and 3) over the air update capability.


Also on October 6, 2008, USA Technologies announced the launch of ePort® EDGE™, developed specifically for those in the vending industry who want to bring their customer a magnetic swipe only cashless system at the low cost of $199. USA Technologies' EDGE's™ "slimmed down" design is built on an entirely new hardware and software platform enabling some of the EDGE's™ new features that include: 1) one piece design (card reader and processor combined) that enable magnetic swipe card transactions; 2) faster transaction processing due to a more powerful processor; and 3) over the air update capability. Initial installations of the EDGE are scheduled for February 2009.

**EnergyMiser®** installs in cold-drink vending machines, snack vending machines, coolers and other electronic appliances and can reduce the electrical power supply consumption of the machines by an average of up to 40%. In the case of cold-drink vending machines and glass-front coolers, it is estimated that customers realize on average $120 in blended savings per placement, per year, resulting in a payback period of less than one year (the sales price is about $80). Energy products contributed almost 20% of fiscal 2008 revenues. The EnergyMiser® line includes the following products:

VendingMiser®: reduces the electrical energy used by vending machines.

CoolerMiser™: reduces the electrical energy used by sliding glass and pull open glass-front.

SnackMiser™: reduces the amount of energy used by non-refrigerated snack vending machines.

**PlugMiser™** reduces the amount of energy used by all types of plug loads including those found in personal or modular offices (printers, personal heaters, and radios), video arcade games and more.

**VM2iQ® and CM2iQ®** are the second generation of the VendingMiser® and Cooling Miser® devices that are installed directly inside the machines and have the capability to control the cooling system and the advertising lights separately.

**eSuds™** is an end-to-end solution for the commercial laundry industry. Operators use eSuds™ to offer a cashless payment option and web-based remote monitoring to its customers and consumers. eSuds™ is currently found primarily in the college and university market, enabling students to check online for washer and dryer availability in their laundry room, pay with their university one-card system, and be alerted via email or text message that their wash and dry cycles are complete. USA Technologies recently announced that nine more universities and colleges were installing eSuds services; this will bring the total number to 59, up from 40 a year ago., When the installations are completed USA Technologies will have nearly 7,000 connected washer and dryers. The Company charges an average fee of $2.50 per month per connected unit. Current installations include Carnegie Mellon, Case Western, Georgia State, Johns Hopkins, Louisiana State, Rutgers, and Temple. eSudsTM is also marketed to the multi-tenant housing market, and last year the Cmpany announced a distribution agreement with Coinmach Service Corp., a laundry equipment service company with approximately 80,000 locations.

**Business Express®** is an unattended, 24/7, self-service business center system. Locations can either purchase business center equipment already bundled with the Company's hardware, software and back-end services for a complete self-service business center solution, or purchase the TransAct® system, which enables existing business center devices to be retrofitted to accept credit and debit cards. Options are available to meet almost any need, space restraint and brand requirement. USA Technologies is the market leader in this fragmented niche market with over 400 hotels as customers. The Company estimates the average revenue at each location at $6,500 per year, of which it receives about 15%. Current installations include locations at Crowne Plaza, Four Seasons, Holiday Inn, Hyatt, Marriott, Radisson, Ramada, Ritz-Carlton, Sheraton, and Wyndham hotels.

## STRATEGIC RELATIONSHIPS

### MasterCard International

USA Technologies has had a growing relationship with MasterCard International (MasterCard) over the past two years. In June 2006, MasterCard and the Company signed an agreement to deploy 1,000 e-Port® devices that accept MasterCard "PayPass™" in Coca-Cola vending machines owned and operated by the Philadelphia Coca-Cola Bottling Company. From July 2006 through June 30, 2007, the Company had earned approximately $400,000 in equipment revenues from this agreement. In November 2006, MasterCard and the Company signed an agreement to deploy 5,000 e-Port® devices that accept MasterCard "PayPass™". From November 2006 through June 30, 2007, the Company had earned approximately $1,975,000 in equipment revenues from this agreement. In May 2007, MasterCard, the Company, and Coca-Cola Enterprises, Inc. entered into an agreement to deploy 7,500 e-Port® devices. From May 2007 through December 31, 2007, the Company had earned approximately $3,248,000 in equipment revenues from this agreement. In November 2007, MasterCard and the Company signed an agreement to deploy 4,051 e-Port® devices that accept MasterCard "PayPass™". From November 2007 through March 31, 2008, the Company had earned approximately $1,600,000 in equipment revenues from this agreement.

**AT&T Mobility (formerly Cingular Wireless**


**and AT&T Wireless)**

In July 2004, USA Technologies signed an agreement to use AT&T's digital wireless wide area network for transport of data, including credit card transactions and inventory management data. AT&T operates the largest digital wireless network in North America and the fastest nationwide wireless data network in the United States.

**Coca-Cola Enterprises, Inc.**

In May 2007, USA Technologies entered into a three-year supply and licensing agreement with Coca-Cola Enterprises, Inc. ("CCE"), the world's largest marketer, producer and distributor of Coca-Cola products. The agreement covers the purchase by CCE from USA Technologies of its G6 e-Port® and related e-Port Connect™ services for use in CCE's beverage vending machines, including the purchase of e-Ports® by CCE under the MasterCard agreement. The price of each e-Port® was $433. The Company receives 5% of the cashless revenues from the CCE vending machine as a processing fee and a monthly payment of $9.95 per unit. The agreement also included the MasterCard PayPass Participation Agreement entered into between USA Technologies, CCE, and MasterCard under which CCE had agreed to use commercially reasonable efforts to complete installation of up to 7,500 e-Ports® by August 31, 2007. By amendment executed by the parties to the Agreement, the installation completion date was changed to October 31, 2007. In addition to accepting credit and debit cards, these e-Ports® accept payment from credit cards utilizing MasterCard's PayPass contactless Technologies and were to be utilized in CCE beverage vending machines in multiple cities throughout the United States. For each e-Port® successfully installed by CCE, USA Technologies received an aggregate of $433 from CCE and MasterCard. The agreement provided that if all 7,500 e-Ports were not installed by August 31, 2007 (later extended to October 31, 2007), USA Technologies was required to refund to MasterCard a pro rata share of any payments received from MasterCard that related to any uninstalled units. CCE was required to pay $433 per unit whether or not they successfully install the e-Ports® by October 31, 2007. As of October 31, 2007, a total of approximately 7,000 units were installed by CCE, and as of December 31, 2007, all of the units had been installed by CCE.

**First Data (GO-Tag)**

GO-Tag form factors work like a premium gift card. They can be provided in various forms such as fobs, stickers or wristbands that have a prepaid amount loaded on them and are able to make contactless prepaid payments. The fob is a smaller version of a gift card that can be attached to a key chain. The sticker can be adhered to personal items like a cell phone, employee badge or MP3player. A customer buys the GO-Tag in a store that sells prepaid cards and uses it by simply waving or tapping it in front of a contactless reader at the point-of-sale, checking out quickly and conveniently without using cash.

The GO-Tag provides the customer with the same result as if a credit card was swiped and provides the vendor with a combination gift card/loyalty solution, real-time transaction processing using existing prepaid infrastructure, easy on-line program management, seamless integration with point-of-sale and contactless readers, easy online reload automation and account registration, and fraud protection using point-of-sale support, real time transaction processing and reporting.

On October 1, 2008, USA Technologies and First Data Merchant Services Corporation, a wholly-owned subsidiary of First Data Corporation, entered into a three

year joint marketing agreement. They agreed to jointly market and sell to vending operators and soft drink bottlers in the United States a prepaid vending solution which utilizes the Company's e-Port® and the GO-Tag contactless payment presentation device of First Data. The agreement contemplates the sale to customers of up to 100,000 e-Ports and up to 25 million GO-Tag devices over its three year term. The Company would sell the e-Ports to the customers at retail pricing. The e-Ports® would accept credit cards, debit cards, and contactless cards as well as the GO-Tag contactless devices of First Data.

At the time of entering into the agreement, the Company issued to First Data performance–based warrants to purchase up to 1,500,000 shares of Common Stock. First Data would have the right to purchase 500,000 of such shares within two years of issuance at $5.25 per share (the "A Warrants"), and 1,000,000 of such shares within three years of issuance at $6.00 per share (the "B Warrants"). The A Warrants are only exercisable by First Data if a minimum of 20,000 e-Ports® are sold to a customer prior to the expiration of the A Warrants. The B Warrants are only exercisable by First Data if the A Warrants become exercisable and if a minimum of 15,000 additional e-Ports® are sold to a customer following the date on which the A Warrants become exercisable and prior to the expiration of the B Warrants.

The agreement provides that First Data has the preemptive right for a period of three years to purchase that number of securities being offered for sale by the Company during the period in order to maintain its pro-rata portion of the Common Stock of the Company following the issuance of any securities to be sold by the Company in any such subsequent securities offering.

In addition, USA Technologies and First Data Prepaid Services, an affiliate of First Data Corporation, entered into a three year referral agreement pursuant to which First Data Prepaid Services would provide processing services for the GO-Tag devices sold to customers under the joint marketing agreement. The Company and the customer would enter into a separate processing agreement pursuant to which USA Technologies would process all transactions other than those related to the GO-Tag devices.


$199


## INDUSTRY

### Vending

Annual U.S. sales in the vending industry were estimated by the Vending Times Census of the Industry (2007 Edition) to be approximately $46.8 billion. There are 8 million vending locations in the U.S. and 30 million locations worldwide. The total vending market can be served by the Company's ePort, VendingMiser and SnackMiser technologies. The overall market growth is 5% to 6% annually, while the addressable market is growing more rapidly at 9% annually.

Networked devices can be used to monitor vending machines (and ATMs and cash/credit card machines) for breakdowns and stock levels and send alerts when a machine is need of servicing. The reduction in field maintenance costs, the reduction in theft due to the reduction of cash payments, and the previously discussed increase in sales make networked devices an appealing option for vending machine operators.

### Commercial Laundry

The domestic commercial laundry business is estimated to be $5 billion in annual sales by the Coin Laundry Association (2005). There approximately 3.5 million commercial washers and dryers in operation in the U.S., of which 700,000 are in universities. The average annual growth rate for the commercial laundry sector has been 10% to 12%. USAQ Technologies' addressable market is primarily the seven largest laundry operators but also includes several smaller operators. These operators own and manage the equipment that is installed in multi-housing units and college and university locations. The addressable market does not include single Laundromat operations.

Networked device transactions improves customer satisfaction through better maintenance and higher machine availability and specialized services such as email alerts to indicate that the laundry cycle is finished.

**Business Centers**

There are currently 52,000 hotels in the U.S. and 300,000 worldwide according to the American Hotel & Lodging Association. The demand for business center availability in hotels ranges from luxury to budget accommodations, with an increasing number of travelers needing and expecting the availability of computers, printers, fax machines, copiers and other business services. USA Technologies believes that there are 5,900 hotels in the primary addressable market – business oriented hotels with 150 rooms – and 13,900 hotels in a secondary market, hotels with 75 to 150 rooms. The growth rate for the overall market has been 5% annually, with the addressable market gaining 8% annually.

Staff availability can restrict hotel business center hours. Through device networking, self-service business centers can accept non-cash payment (including credit and room cards) and remain open at all times regardless of stall availability.

**Kiosks**

Kiosks represent a $500 million U.S. market according to Frost and Sullivan Consulting. They are increasingly being used as self-service specialty shops within larger retail environments. Value-added services such as photo enlargement and custom imaging located within major retailers including Kinko’s are an example of this retailing concept. Since pricing on these products and services is generally higher than one or two dollars, the cashless payment option is essential. Kiosk transactions are expected to grow to $1.3 trillion by 2011 according to Time Magazine (March 24, 2008 edition).

Device networking provides improved maintenance and management for kiosks as well as expanding the scope of products and services available at point-of–demand beyond what can be reasonably be purchased with change.

## SALES AND MARKETING

The Company's sales strategy includes both direct sales and channel development, depending on the particular dynamics of each of its markets. The marketing strategy is diversified and includes media relations, direct mail, conferences and client referrals. As of June 30, 2008, the Company was marketing and selling its products through its full time staff consisting of 7 people.

**Direct Sales**

USA Technologies sells directly to the major operators in each of its target markets. Each of its target markets is dominated by a handful of large companies, and these companies comprise its primary customer base. In the vending sector, approximately 10 large operators dominate the sector; in the commercial laundry sector, seven operators currently control the majority of the market. USA Technologies also works directly with hoteliers for our TransAct™ and Business Express® products. Within the vending industry, its customers include soft drink bottlers and independent vending operators throughout the United States and Canada. On the soft drink bottler side, heavy effort is being put into securing additional distribution agreements and servicing its existing customers growing demand for additional cashless locations and the related back-office services.

**Channel Sales**

USA Technologies currently engages in channel sales for its TransAct™ and Business Express® products. The Company also works with audio-visual companies that service major hotels.

**Marketing**

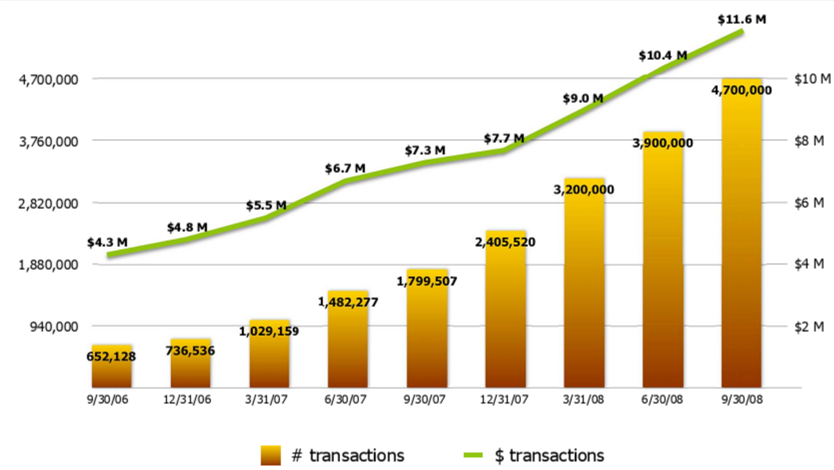
USA Technologies’ marketing strategy consists of building its brand by creating a company and product presence at industry conferences and events, in order to raise visibility within its industry, create opportunity to conduct product demonstrations and consult with potential customers one-on-one; sponsoring educational workshops with trade associations such as National Automated Merchandiser Association ("NAMA"), to educate the industry on the importance and benefits of its solution and establish its position as the industry leader; develop several one-sheet case studies to illustrate the value of its products; the use of direct mail campaigns; advertising in vertically-oriented trade publications such as Vending Times, Automatic Merchandiser and Energy User News; and cultivate a network of state governments and utility companies to provide incentives or underwriting for its energy management products.

## COMPETITION

USA Technologies has a dominant position in the market of providing cashless transactions, networked services and value-added services on a machine-to-machine basis. Few companies offer a breadth of products and services with end-to-end solutions similar to that USA Technologies. Moreover, there are no companies serving all the vertical markets that USA Technologies serves and no companies providing competition for the Company’s energy products.


In the ePort® for vending sector, the only competition that USA Technologies has identified is Transaction Network Services (NYSE: TNS). TNS is an international data communications company which

**USAT TRANSACTION VOLUME BY QUARTER**




provides networking, data communications and value added services to retailers, banks and payment processors. It is also a provider of secure data and voice network services to the global financial services industry. Although TNS offers wireless connectivity and transaction processing for point-of-sale devices, it does not provide the turnkey services provided by ePort®. The USA Technologies/ Transaction Network Services market shares are estimated at 90%/10%, respectively.

The eSuds™ product line competes with LaundryView by Mac-Gray and Laundry Alert by Laundrymate. Market shares are estimated at about one-third each.

Business Express'® major competitors are Business Automation and Alphanet. Market shares in this sector are also estimated at approximately one-third each.

## MANAGEMENT

**George R. Jensen, Chairman & CEO**

Mr. Jensen has been Chief Executive Officer and Director of USA Technologies since January 1992. He was founder, and was Chairman, Director and Chief Executive Officer of American Film Technologies Inc. (AFT) from 1985 to 1992. AFT was in the business of creating color image versions of black-and-white films. From 1979 to 1985, Mr. Jensen was President and Chief Executive Officer of International Film Productions, Inc. From 1971 to 1978, Mr. Jensen was a securities broker, primarily for the firm of Smith Barney, Harris Upham. He received a Bachelor of Science degree from the University of Tennessee and is a graduate of the Advanced Management program at the Wharton School at the University of Pennsylvania.

**Stephen P. Herbert, President & COO**

Mr. Herbert joined USA Technologies in April 1996 ast which time he was also elected Director. Prior to joining USA Technologies he had been at Pepsi-Cola since 1986. From 1994 to April 1996 at Pepsi-Cola he was a Manager of Market Strategy. In that position he was responsible for directing development of market strategy for the vending channel and subsequently for the supermarket channel for Pepsi-Cola in North America. Mr. Herbert graduated with a Bachelor of Science degree from Louisiana State University.

**David M. DeMedio, Chief Financial Officer**

Mr. DeMedio joined USA Technologies in March 1999. Prior to being named Chief Financial Officer in April 2005, he served as Controller and Director of Network and Financial Services. From 1996 to March 1999, Mr. DeMedio had been employed by Elko, Fischer, Cunnane and Associates, LLC as a supervisor in its accounting consulting and auditing practice. Prior to that, Mr. DeMedio held accounting positions at Intelligent Electronics Inc. He received a Bachelor of Science in Business Administration from Shippenberg University and is a Certified Public Accountant.

## FINANCIALS AND OUTLOOK

**Recent Results**

USA Technologies revenues in the year ended June 30, 2008 rose 76% to $16,103,546 from $9,158,012 in fiscal 2007. Equipment sales rose 66% to $12,384,870 from $7,454,076 while license and transaction fees surged 118% to $3,718,676 from $1,703,936.

The gain in equipment sales was attributed to increased sales of $4,643,000 for vending and $711,000 for energy equipment. There were modest declines in sales of $189,000 for business center and $165,000 for laundry equipment. The increase in vending equipment sales was primarily related to the CCE/MasterCard Agreement and the November 2007 MasterCard Agreement as well as first time volume purchases following the MasterCard seeding initiative. Cost of equipment for the fiscal 2008 was $9,703,474, compared to $6,442,627 for fiscal 2007. The increase of $3,260,847 was primarily due to the increase in vending equipment sales. The gross margin on equipment sales expanded to 21.7% from 13.6%.

Cost of services for the fiscal 2008 was $2,981,218, compared to $1,369,152 for the fiscal 2007. The increase of $1,612,066 was primarily due to the increase in the number of e-Ports connected to the network. The gross margin on services inched higher to 19.8% from 19.6%. In regards to transaction fees, during fiscal

2008, the Company processed approximately 11.3 million transactions totaling over $34.4 million as compared to approximately 3.9 million transactions totaling over $21.3 million during the year ended June 30, 2007, an increase of 190% in transaction volume and 62% in dollars processed.

Overall, gross profit for the fiscal 2008 was $3,418,854, representing 21.2% of revenues, compared to $1,346,233, representing 14.7% of revenues, for the fiscal 2007. The increase of $2,072,621 was primarily due to an increase in sales of vending products coupled with the Company's continued efforts to decrease the per unit costs to manufacture the e-Port. In fiscal 2007, the units were sold at or near cost. Additionally, the Company maintained the profit margins generated from sales of the energy saving Miser product line.

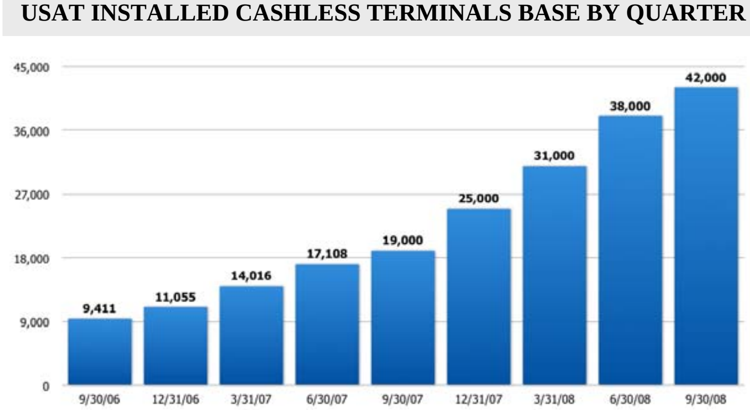
Selling, general and administrative (SG&A) expenses increased $3,937,059 or 27% in fiscal 2008 to $18,643,215 from $14,706,156 in fiscal 2007. The increase was primarily due to an increase in compensation expense of approximately $2,518,000, an increase in consulting expenses of approximately $479,000, primarily related to Sarbanes-Oxley implementation costs and network support services, recruiting expenses of approximately $311,000, and facilities expenses of approximately $294,000. The increase in compensation expense is due to non-cash stock bonuses awarded to executive officers through the Long-Term Equity Incentive Program ($880,000) and due to an increase in the number of full-time employees during the fiscal year ($1,638,000). While SG&A expenses continued to be above revenues, the percentage increase was little more than one-third the rate of sales growth. Importantly, the Company took action to constrain these expenses during the year and SG&A expenses decreased from approximately $4,753,000 during the second quarter of fiscal year 2008 to approximately $4,445,000 during the third quarter, and further decreased to approximately $4,000,000 during the fourth quarter. The net loss for fiscal 2008 improved to $17,198,481 from $18,563,909 (after about $781,000 in preferred dividends in each year).

In the first quarter of fiscal 2009, ended September 30, 2008, USA Technologies, revenues were $3,394,879, a modest increase over the $3,355,656 reported in the year-earlier period. Reflecting the growing installed base, license and transaction fees were $1,355, 964, an increase of $650,572 , 0r 92%, versus the first quarter of fiscal 2008. The increase in license and transaction fees was due to the increase in the number of ePort® units on the USALive® network, primarily as a result of the recurring revenues being generated by the ePort® units deployed in the prior fiscal year under the MasterCard PayPass Participation Agreement entered into by the Company, Coca-Cola Enterprises and MasterCard Worldwide, as well as first time volume purchases following the MasterCard seeding initiative. As of September 30, 2008, the Company had approximately 42,000 devices connected to our USALive® network as compared to approximately 24,000 devices as of September 30, 2007. During the September 2008 quarter, the Company processed approximately 4.7 million transactions totaling over $11.6 million as compared to approximately 1.8 million transactions totaling over $7.3 million during the year-earlier quarter, an increase of 161% in transaction volume and 59% in dollars processed. The gross profit margin for services rose to 22.00% from 20.05% a year earlier.

Equipment sales, which can reflect the timing of large orders, were $2,038,915, a decrease of $611,349, or 23%, from the year-earlier period. The decrease in equipment sales was due to a decrease in sales of approximately $517,000 in ePort® vending equipment sales, primarily related to the significant number of ePort® units installed in the prior period under the November 2007 agreement with MasterCard Worldwide as compared to sales during the current period, a decrease in sales of approximately $122,000 in energy conservation equipment, and a slight increase in other equipment sales of approximately $28,000. The gross profit margin for equipment sales rose sharply to 29.68% from 14.25% as a result of producing both the ePort® vending and energy equipment products at a lower cost as well as selling both of the products at higher average sales prices.

SG&A expense of $4,439,533 decreased by $952,501 or 18% primarily due to a decrease in compensation expense of approximately $980,000, and a decrease in professional and consulting services of approximately $44,000, offset by an increase in product development

**USAT INSTALLED CASHLESS TERMINALS BASE BY QUARTER**



costs of approximately $80,000. The overall decrease was due to focused cost reduction measures taken by the Company during the third and fourth quarters of fiscal year 2008.

USA Technologies reported a net loss of $3,853,895 (approximately $1.1 million of non-cash charges) for the September 2008 quarter compared to a net loss of $5,262,989 (approximately $2.1 million of non-cash charges) for the quarter ended September 30, 2007.

**Growth Drivers**

Numerous factors point to steadily improving financial results in coming quarters: 1) The Company finished the September 2008 quarter with 75% more connections to USALive than it had a year earlier – 42,000 versus 24,000; 2) The ePort® G8, with added features and reduced production costs, provides an all-in-one solution that installs quickly in vending machines to accept traditional magnetic stripe credit cards as well as contactless credit cards with tap-and-go technologies; 3) USA Technologies has a three-year ePort® agreement with one of the largest soft drink bottlers in America. Under the terms of an agreement reached earlier this year, the Bottler shall utilize USA Technologies as its sole and exclusive supplier of all credit-debit card vending systems, as well as, all card processing and data services; 4) As part of corporate wide sustainability programs, the nation's two largest vending and food service companies are distributing VendingMiser to their combined customer base of more than 300,000 vending machines across the country; 5) USA Technologies is working with major cellular phone companies to introduce Near Field Communications to vending, giving consumers the ability to make purchases from vending machines with cellular phones. The first pilot program is underway with Nokia at Gonzaga University in Washington State; 6) Kiosk installation growth should pick up following recent agreements: on November 10, 2008, with Merit Entertainment, the provider of industry-leading Megatouch countertop entertainment systems, for the installation in all of its new Megatouch touchscreen entertainment systems for the next three years; and on October 7, 2008, with AIR-Serv, the market leader in the coin-operated tire-inflation and vacuuming services space, for the installation of 10,000 terminals in the next two years; and 7) Energy utilities offering EnergyMiser devices free or with rebates have doubled over the past 12 months to nearly 60.

**Projections**

Aided by growing and new strategic relationships and by the market-opening prospect of an upgraded top-of-the-line model and a lower-priced alternative, we believe the Company has the potential to increase its installed base of ePorts® from 35,000 as of September 30, 2008 to about 50,000 by the end of fiscal 2009, increase the fiscal 2009 year end level by 150% to about 150,000 in fiscal 2010, and double the fiscal 2010 year end level to about 300,000 in fiscal 2011. Importantly, as the installed base grows there will be an increasing flow of steady monthly revenues creating greater visibility for revenues and earnings. We look for second fiscal quarter results to about match the first quarter's but, with the initial delivery of the EDGE® during the third quarter and the impact of recent kiosk agreements, as well as growing sales for the G8, revenues should show a marked acceleration beginning in the second half. Based on our projection of revenues of $5 million in the June 2009 quarter, we estimate full year fiscal 2009 revenues of $16 million. We believe new marketing agreements could accelerate revenue gains to $35 million in fiscal 2010, and $90 million in fiscal 2011. Aided by declining per unit manufacturing costs and the growing installed base, gross margins for this product are expected to expand to 34% in fiscal 2009, 42% in fiscal 2010, and 47% in fiscal 2011. We believe energy conservation product (Miser) sales could grow almost 20% in fiscal 2009 from 28,000 units to 33,000 units and show gradual improvement at a slower rate in the future. The eSuds™ and Business Express® product lines are believed to have the potential to grow at a 10% annual rate. While revenues are expanding, USA Technologies' efforts to keep SG&A expenses under control (on January 5, 2009 it reduced its number of employeesd by 22 individuals) and a significant reduction in research and development costs now that the Company has introduced two new products, should result in these costs falling from $18.6 million in fiscal 2008 to $14-$15 million in the current fiscal year. Importantly, the Company estimates that monthly cash operating expenses will fall to $800,000 in the June 2009 quarter which points to still lower SG&A level in fiscal 2010.

*If USA Technologies achieves these sales and expense targets, the Company could cut its loss from $17.2 million in fiscal 2007 to $12 million in fiscal 2009, achieve profitability in fiscal 2010, and, with the recurring income base continuing to expand and profit margins continuing to widen, achieve substantial profits in fiscal 2011 with net income potentially as high as $18 million.*

**Financial Position**

On October 17, 2007, USA Technologies sold a total of 2,142,871 shares of the Company's common stock at a price of $7.00 per share, for gross proceeds of approximately $15 million William Blair & Co., LLC, a broker-dealer, acted as the exclusive placement agent for the private placement. Despite this capital raise, USA Technologies finished the September 30, 2008 quarter with $9,392,980 in cash and cash equivalents and current available-for-sale securities, down from $10,293,241 a year earlier. This decline was caused by the need to classify illiquid auction-rate securities as non-current assets. However, USA Technologies sold its auction rate securities, at par, on January 2, 2009, receiving $4,850,000 in cash. Thus, as of January 2, 2009, the Company had approximately $11 million in cash. Assuming that USA Technologies' new monthly cash operating expenses would be $800,000, and that its average monthly gross profit of $306,000 earned during the first nine months of calendar year 2008 would continue, the Company believes its existing cash and cash equivalents would provide sufficient funds to meet its cash requirements, including capital expenditures and repayment of long-term debt, through at least June 30, 2010. Depending on market conditions, we believe the Company may seek to raise additional capital in calendar 2009.

We believe USA Technologies shares represent an attractive opportunity for long-term investors willing to accept the general high risks associated with emerging growth companies such as the lack of near-term profitability, unproven (if promising) markets, the potential for delays in program start-ups, and the likelihood of dilution from future offerings.

## SUMMARY

We believe USAT shares offer a rare opportunity to participate in a small company that has a dominant position, aided by key strategic relationships, in a rapidly growing and potentially large market. The intelligent vending market is displaying rapid growth. USA Technologies' product upgrades and improvements and growing strategic relationships have fortified the Company's already dominant position in this field and formed the basis for dramatic growth in coming years. The GO-Tag initiative is an example of the substantial untapped opportunities available in the networked device field. As the growth in terminal placements and improving margins bring the Company closer to achieve profitability, we believe USA Technologies shares will garner growing investor interest. Assuming achievement of the target of $18 million in net income in fiscal 2011, assigning a 15 multiple on that figure, an increase in shares outstanding by 20% to about 18 million, and a 25% annual discount rate, we generate a $7.50 price target for the shares.

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