

# VALUE FOCUS

## Convenience Stores



**SEGMENT FOCUS**  
**Foodservices**

**2014**

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& Transportation

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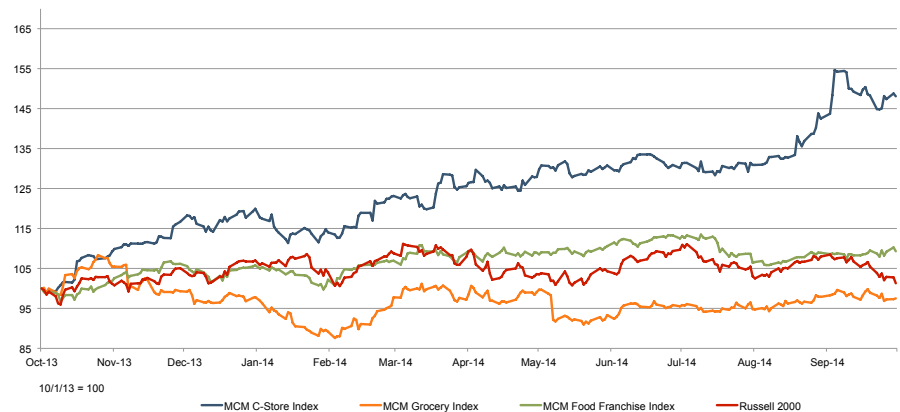
# Value Focus

## Convenience Stores

## Fourth Quarter 2014

**Equity Market Overview.** During the three months ending September 2014, median stock market pricing for the convenience store and grocery indexes increased 12.7% and 1.8%, respectively, outperforming the Russell 2000 index's, which declined 8.6%. A portion of the increase in the c-store index was attributable to the 16.6% rise in ANCUF's stock. Market analysts appear impressed with the company's growth and expect it to make a large acquisition in the near future. Pantry was up by 19.7% driven by the combination of investor activism and better-than-expected operating results in its latest fiscal quarter. Mercer Capital's fast food index was down 3.4% in the third quarter.

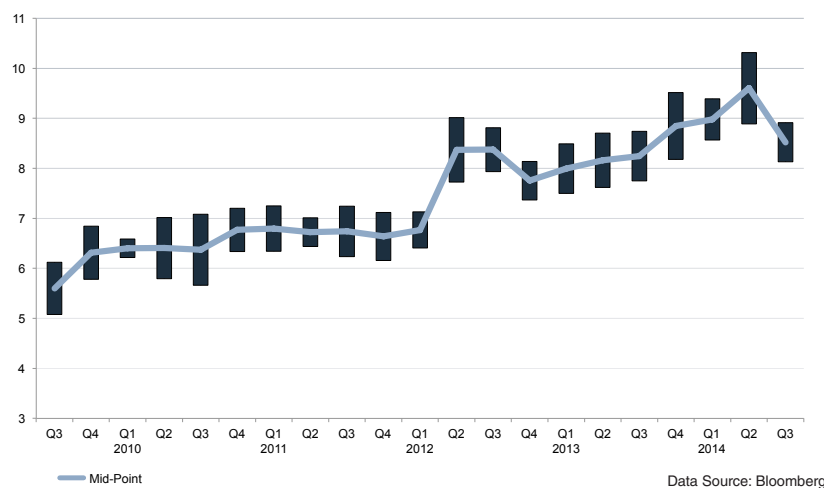
### C-Store, Grocery Store, & QSR Stock Indices



Data Source: Capital IQ / Bloomberg

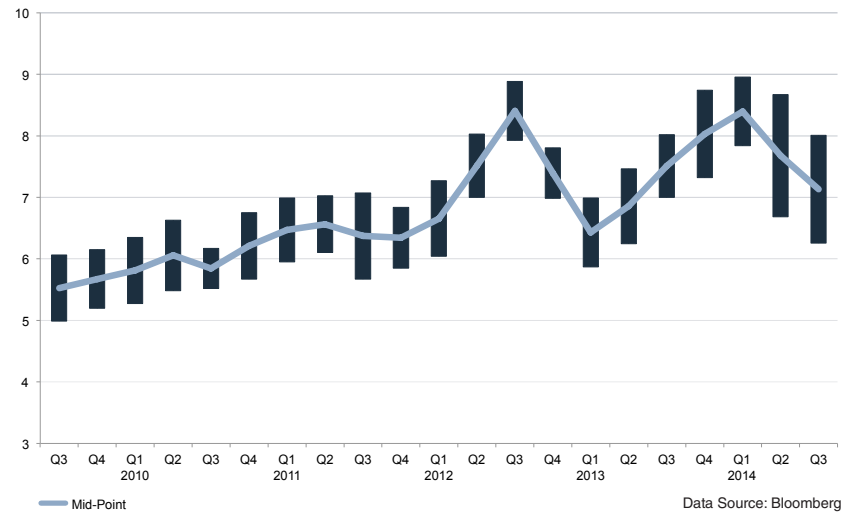
**Valuations Down, Ranges Tighten for C-Stores, Widen for Grocery and Fast Food.** EBITDA multiples were down for convenience stores and to a lesser degree for grocery stores and fast food operators. Multiples for public c-store operators fell a full turn from 9.6x EBITDA at the end of the second quarter of 2014 to 8.5x at the end of the third quarter of 2014.<sup>1</sup> The drop in EBITDA multiples could be somewhat misleading considering that Susser was recently eliminated from our group given its recent acquisition by ETP. Susser had boasted some of the largest multiples to EBITDA in the last few quarters. Excluding the Susser measures in the previous quarter, c-store multiples would have been up slightly in the third quarter. Despite the decrease, c-store multiples remained above their five-year average (7.4x). Valuations for grocery store publics retreated a half turn on EBITDA and fast food publics were down just slightly, as shown in the following charts. During 2013, comparable EBITDA multiples for the c-store index ranged from 8.0x to 8.8x EBITDA. At year-end 2012, the median c-store multiple was 7.8.

**C-Store EBITDA Valuations // Quarterly Range of Mean Highs & Lows**

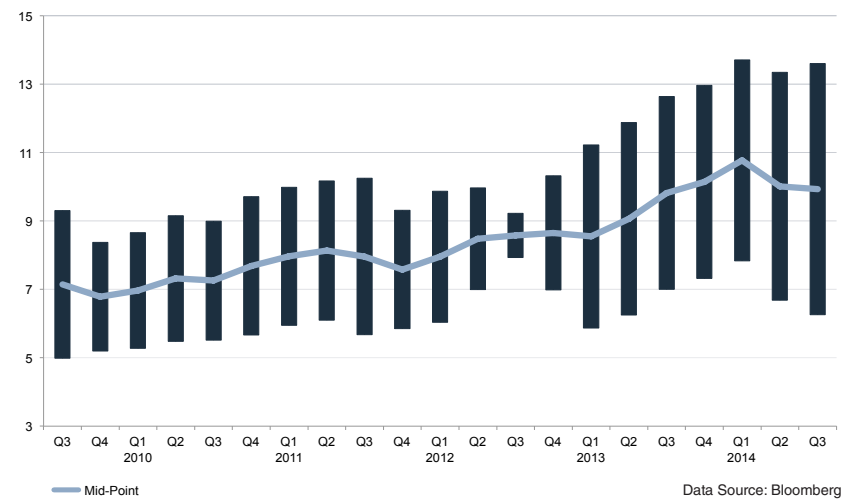


<sup>1</sup> As measured by the average of : (1) end-of-quarter high EBITDA measures of all the companies in the Mercer Capital index and (2) the end-of-quarter low EBITDA measures of all the companies in the Mercer Capital index. Travel Centers of America is currently excluded due to underperformance. Harris Teeter was eliminated from the Mercer Capital grocery index during the second quarter due to its recent acquisition. Susser was eliminated during the third quarter due to its acquisition by ETP during the quarter.

**Grocery Store EBITDA Valuations // Quarterly Range of Mean Highs & Lows**



**Fast Food (QSR) EBITDA Valuations // Quarterly Range of Mean Highs & Lows**



Publicly Traded Companies

Ticker	Price for 9/30/14	High Price for LTM	Low Price for LTM	Equity Market Cap	Enterprise Value	Revenue			EBITDA			EBITDA Margins			
						LTM	2014 Est.	2015 Est.	LTM	2014 Est.	2015 Est.	LTM	2014 Est.	2015 Est.	
<b>Convenience Stores</b>															
Alimentation Couche Tard Inc	ANCUF	\$31.82	\$33.82	\$20.85	\$18,001	\$20,470	\$38,245	\$37,769	\$36,041	\$1,626	\$1,613	\$1,819	4.25%	4.27%	5.05%
Casey's General Stores Inc	CASY	\$70.93	\$76.94	\$63.93	\$2,741	\$3,595	\$8,017	\$7,829	\$8,652	\$377	\$377	\$411	4.71%	4.81%	4.75%
Pantry Inc/The	PTRY	\$21.00	\$21.90	\$11.00	\$492	\$1,429	\$7,612	\$7,589	\$7,653	\$199	\$215	\$225	2.61%	2.84%	2.94%
TravelCenters of America LLC	TA	\$11.39	\$11.85	\$7.01	\$429	\$910	\$7,955	\$8,136	\$8,214	\$96	\$141	\$157	1.21%	1.73%	1.91%
CST Brands Inc	CST	\$36.13	\$38.59	\$28.70	\$2,726	\$3,755	\$12,640	\$12,738	\$13,294	\$329	\$342	\$382	2.60%	2.68%	2.88%
Murphy USA Inc	MUSA	\$55.03	\$56.38	\$37.09	\$2,573	\$3,066	\$17,903	\$18,304	\$19,685	na	\$348	\$323	nm	1.90%	1.64%
Murphy USA Inc	MUSA	\$48.89	\$52.73	\$36.12	\$2,285.3	\$2,846.9	\$18,083.3	\$18,383.5	\$19,675.3	\$339.6	\$334.5	\$321.0	5.4%	1.8%	1.6%
<b>Average C-Stores</b>					<b>\$4,494</b>	<b>\$5,538</b>	<b>\$15,395</b>	<b>\$15,394</b>	<b>\$15,590</b>	<b>\$526</b>	<b>\$506</b>	<b>\$553</b>	<b>3.08%</b>	<b>3.04%</b>	<b>3.19%</b>
<b>Median C-Stores</b>					<b>\$2,650</b>	<b>\$3,330</b>	<b>\$10,328</b>	<b>\$10,437</b>	<b>\$10,973</b>	<b>\$329</b>	<b>\$345</b>	<b>\$353</b>	<b>2.61%</b>	<b>2.76%</b>	<b>2.91%</b>
<b>Grocery Stores</b>															
Fresh Market Inc/The	TFM	\$35.62	\$53.76	\$28.60	\$1,720	\$1,756	\$1,643	\$1,514	\$1,747	\$129	\$168	\$189	7.84%	11.13%	10.84%
Village Super Market Inc	VLGEA	\$23.70	\$37.46	\$19.01	\$333	\$376	\$1,498	na	na	\$51	na	na	3.40%	na	nm
SpartanNash Co	SPTN	\$20.51	\$25.32	\$19.33	\$774	\$1,357	\$5,527	\$7,954	\$8,019	\$169	\$221	\$234	3.06%	2.78%	2.92%
Weis Markets Inc	WMK	\$41.75	\$53.04	\$39.00	\$1,123	\$1,123	\$2,727	na	na	\$148	na	na	5.42%	na	nm
Ingles Markets Inc	IMKTA	\$25.09	\$28.18	\$21.65	\$571	\$1,480	\$3,820	\$3,829	\$3,867	\$215	\$215	\$217	5.64%	5.62%	5.61%
Roundy's Inc	RNDY	\$3.41	\$10.96	\$2.95	\$169	\$879	\$3,960	\$3,907	\$4,013	\$132	\$118	\$132	3.33%	3.02%	3.29%
Whole Foods Market Inc	WFM	\$39.38	\$64.88	\$35.97	\$14,281	\$14,343	\$13,914	\$14,191	\$15,838	\$1,289	\$1,304	\$1,422	9.26%	9.19%	8.98%
SUPERVALU Inc	SVU	\$9.63	\$9.78	\$5.38	\$2,475	\$5,237	\$17,147	\$17,050	\$17,580	\$764	\$780	\$769	4.46%	4.57%	4.37%
Safeway Inc	SWY	\$34.38	\$35.36	\$26.20	\$7,921	\$11,735	\$36,496	\$36,513	\$36,505	\$1,451	\$1,445	\$1,446	3.97%	3.96%	3.96%
Kroger Co/The	KR	\$52.30	\$52.96	\$34.74	\$25,571	\$36,771	\$103,998	\$98,365	\$108,532	\$4,648	\$4,410	\$4,991	4.47%	4.48%	4.60%
<b>Average Grocery Stores</b>					<b>\$5,494</b>	<b>\$7,506</b>	<b>\$19,073</b>	<b>\$22,915</b>	<b>\$24,513</b>	<b>\$900</b>	<b>\$1,083</b>	<b>\$1,175</b>	<b>5.09%</b>	<b>5.59%</b>	<b>5.57%</b>
<b>Median Grocery Stores</b>					<b>\$1,422</b>	<b>\$1,618</b>	<b>\$4,743</b>	<b>\$11,073</b>	<b>\$11,928</b>	<b>\$192</b>	<b>\$500</b>	<b>\$501</b>	<b>4.46%</b>	<b>4.53%</b>	<b>4.49%</b>

Source: Bloomberg

Publicly Traded Companies (cont.)

	Ticker	Price for 9/30/14	High Price for LTM	Low Price for LTM	Equity Market Cap	Enterprise Value	Revenue			EBITDA			EBITDA Margins		
							LTM	2014 Est.	2015 Est.	LTM	2014 Est.	2015 Est.	LTM	2014 Est.	2015 Est.
<b>Fast Foods</b>															
McDonald's Corp	MCD	\$93.53	\$102.07	\$89.93	\$91,837	\$107,268	\$28,299	\$28,145	\$28,727	\$10,369	\$10,063	\$10,521	36.64%	35.76%	36.62%
Wendy's Co/The	WEN	\$8.18	\$10.10	\$7.67	\$3,002	\$4,456	\$2,280	\$2,071	\$1,976	\$425	\$406	\$416	18.64%	19.61%	21.07%
Burger King Worldwide Inc	BKW	\$31.20	\$34.20	\$18.64	\$10,980	\$14,015	\$1,042	\$1,062	\$1,134	\$635	\$711	\$782	60.90%	66.92%	68.92%
Yum! Brands Inc	YUM	\$72.42	\$83.58	\$63.16	\$31,865	\$35,030	\$13,573	\$13,715	\$15,096	\$2,712	\$2,945	\$3,308	19.98%	21.47%	21.91%
Dunkin' Brands Group Inc	DNKN	\$46.78	\$52.50	\$40.29	\$4,940	\$6,756	\$732	\$755	\$808	\$369	\$383	\$422	50.40%	50.71%	52.16%
Krispy Kreme Doughnuts Inc	KKD	\$17.46	\$26.63	\$14.82	\$1,124	\$1,130	\$469	\$466	\$493	\$60	\$61	\$67	12.75%	12.98%	13.57%
Panera Bread Co	PNRA	\$158.94	\$193.18	\$142.41	\$4,305	\$4,405	\$2,471	\$2,529	\$2,776	\$407	\$406	\$440	16.49%	16.07%	15.86%
Chipotle Mexican Grill Inc	CMG	\$653.24	\$697.93	\$420.20	\$20,263	\$20,263	\$3,625	\$4,066	\$4,775	\$684	\$811	\$1,008	18.87%	19.95%	21.11%
Jack in the Box Inc	JACK	\$62.74	\$68.85	\$38.27	\$2,449	\$2,984	\$1,477	\$1,479	\$1,508	\$269	\$268	\$287	18.19%	18.13%	19.05%
Sonic Corp	SONC	\$21.61	\$23.74	\$16.75	\$1,172	\$1,639	\$547	\$549	\$578	\$133	\$140	\$154	24.38%	25.56%	26.67%
<b>Average Grocery Stores</b>					<b>\$17,194</b>	<b>\$19,794</b>	<b>\$5,452</b>	<b>\$5,484</b>	<b>\$5,787</b>	<b>\$1,606</b>	<b>\$1,619</b>	<b>\$1,740</b>	<b>27.72%</b>	<b>28.72%</b>	<b>29.69%</b>
<b>Median Grocery Stores</b>					<b>\$4,623</b>	<b>\$5,606</b>	<b>\$1,879</b>	<b>\$1,775</b>	<b>\$1,742</b>	<b>\$416</b>	<b>\$406</b>	<b>\$431</b>	<b>19.42%</b>	<b>20.71%</b>	<b>21.51%</b>

Source: Bloomberg

## Margins

Nationwide retail gasoline margins ended the quarter at 21.4 cents per gallon, up from 19.5 cents per gallon in the last week of the first quarter, and above the historical five-year average. Between the end of the third quarter and the time of this publication, retail fuel margins have continued to rise as prices for gasoline and diesel dip near their lowest levels in four years. Margins at the end of October were 37 cents per gallon, their highest level of 2014 and near some of the best margins of the past decade. Retail diesel prices are also quite low, and diesel margins have continued to rally, ending the quarter at 39.8 cents per gallon.

Generally, over 70% of a c-store's sales are motor fuels; however, fuel typically contributes only one-third of total convenience store gross margin dollars. Fuel margins were relatively consistent on an annual basis, averaging 17.1 cents per gallon for 2009 through 2013. There is a relatively modest delay between the time crude prices increase and the time that pump prices rise. Conversely, retail price reductions typically lag when wholesale prices drop. Retailers tend to reduce their markups when costs are escalating. Conversely, when costs are declining, retailers tend to leave their pump prices elevated – leading to increased fuel margins – until competition forces pump pricing downward. The time lag between cost changes and retail price adjustments as well as the duration of cost trends is a significant influencer of operator margin. On average, it costs retailers approximately 12 to 16 cents to dispense a gallon of fuel. Given that the average five-year markup on gasoline was 17.1 cents, this translates to a typical two to three cents per gallon of bottom line profit.

## Transaction and Security Issues

**Cybersecurity.** 2014 has been plagued by data breaches and security issues. Some of the company's largest retailers and internet sites were attacked including Target, AOL, eBay, Michael's Stores, and Home Depot. Between May 2013 and May 2014, the data of nearly half the U.S. population was compromised through cybercrime and security breaches. Some industry insiders warn these attacks may escalate during the holiday shopping season. Retailers are responding as best they can to the threat. The International Franchise Association (IFA) has partnered with the National Cyber Security Alliance to make security a priority within franchisees' businesses, and other retailers appear to be forming coalitions as well. Businesses are advised to use tools to monitor their network traffic as well as utilizing more traditional anti-virus software. According to specialists, businesses should be aggressive in managing cybersecurity by analyzing risk at both headquarters and the point-of-sale. Employees should receive adequate training in assessing risk and companies should consider outsourcing security.

## Transaction and Security Issues (cont.)

**Chip-and-Pin (EMV) Technology.** The vast majority of retailers continue to use magnetic strip credit cards for their in-store credit cards. Such cards are generally less secure than the alternative chip-and-pin models which are growing in popularity. The EMV cards have an embedded chip, as opposed to a magnetic strip, and require a consumer to enter a PIN number. It was announced in the third quarter that Wal-Mart will be reissuing their in-store cards as EMV. President Obama issued an executive order during October which mandates the newer chip-and-pin technology on all government-issued debit and credit cards. The EMV cards are roughly ten times more expensive to produce than the magnetic strip cards, and the major credit card companies are against the switch as these types of transactions are less profitable for them. It is estimated that the c-store industry lost at least \$250 million to credit and debit card fraud in 2013.

**Mobile Payments & Beacon Technology.** Apple released its new iPhone 6 during the third quarter along with its highly anticipated Apple Pay service. This new service allows consumers to make purchases with their phones by utilizing the iPhone's built-in fingerprint security system and the owner's personal credit card information. Although a system where customers could make payments easily without accessing their wallets would seem desirable for merchants, the system uses near-field communication (NFC), which the *Wall Street Journal* estimates that fewer than 10% of merchants currently support. Another factor contributing to merchants' reluctance to accept Apple Pay is the development of their own competing mobile payment methodology. The Merchant Consumer Exchange (MCX) is implementing its own system called CurrentC for processing mobile payments. This service will have the dual benefit of allowing retailers to bypass swipe fees while retaining retailers' capability to collect purchase history and habits on its customers and retain loyalty programs. It remains to be seen how the battle between the two services will play out in the marketplace. According to NACS, Apple currently boasts 220,000 stores in its network while CurrentC can claim about half of that.

Related to the mobile payment phenomenon, is the acceleration of beacon technology. Small gadgets placed at strategic locations throughout a store communicate with customer mobile devices through Bluetooth. Opportunities for beacon technology include real-time messaging of promotions to customers, in-store behavior tracking, self-checkout, and reducing customer wait time in lines. For c-stores, an in-store product or food coupon sent to a customer who is fueling at the pumps via credit card could entice him to enter the store to make a more profitable, in-store purchase.

**Swipe Fees.** The NACS is hopeful that the United States Supreme Court will hear the case related to swipe fees in January. Although a consortium of retailers lost their battle at the appellate level, many believe the cap set on swipe fees by the Fed is far too high and allows for exorbitant profits for the banks while ultimately passing costs onto retailers and consumers. Swipe fees increased 23.3% in 2011 and are the second-largest expense for most operators.



## Fuel Prices and Consumer Optimism

According to NACS, 46% of consumers feel optimistic about the economy in October. A large portion of those surveyed cited lower gas prices as a contributing factor towards their optimism.

## Tobacco

Drug Retailer CVS is now tobacco free, ahead of schedule. The company through its pharmacy benefits management segment (Caremark) announced its intentions to require some customers to pay an extra \$15 co-pay on prescriptions filled at pharmacies that still sell tobacco products.

Big tobacco is making headlines for fighting back against restrictive and graphic packaging requirements in certain foreign countries, notably Uruguay, Australia, Thailand, and India.

The FDA has raised its maximum fine by 10% for sales of tobacco products to minors.

## Elections

The November mid-term elections gave control of Congress to the Republican Party. It remains to be seen how this will impact the industry. NACS is hopeful that the issues of menu labeling, energy, and the internet lottery will receive some attention from the 114th Congress.

# Recent M&A Activity

- » In late May 2014, **Hess** announced its intention to sell its recently spun-off retail operations to **Marathon Petroleum** for \$2.6 billion. This transaction was completed during the third quarter.
- » **ETP** announced in April its plans to acquire **Susser Holdings Corp.** in a unit and cash transaction valued at a total consideration of approximately \$1.8 billion. This transaction took place in the third quarter. In late September, **ETP** announced its intentions to acquire **Aloha Petroleum, Ltd.** of Hawaii for approximately \$240 million.
- » In early August, **CST** announced its intention to acquire the general partner of **Lehigh Gas Partners**. The \$85 million transaction is expected to increase CST's annual fuel volume by over one billion gallons. CST will benefit from its new corporate structure which gives the company the benefit of making acquisitions within the structure of a master limited partnership. **CST** also announced in early August its intention to acquire all of the assets of **Nice N Easy Grocery Shoppes, Inc.** in central New York.
- » **Alimentation Couche-Tard, Inc.** announced its intention to acquire **55 Super Pantry** c-stores. The stores will be rebranded as Circle K stores subsequent to the acquisition.
- » **United Oil Company** was acquired by an investment management firm during the third quarter. It was rumored that the price was near \$500 million, although it was not disclosed.
- » **Petroleum Marketing Group, Inc.** acquired **13 East Coast c-stores** during the quarter.
- » **RaceTrac Petroleum** announced plans to sell off gas stations and convenience stores that did not fit the companies' current business models. **Black Oil Company** decided to divest its c-store operations in order to focus on its core operations. Industry analysts expect the trend of divestitures to continue if the pace of acquisitions remains steady.
- » **Dollar Tree, Inc.** announced in late July its intention to acquire **Family Dollar Stores, Inc.** in a deal valued at approximately \$8.5 billion. Since then, Dollar General has had competing offers for the retailer rejected and launched a hostile takeover bid. The state attorney general of North Carolina is now investigating the Dollar General offer and other state attorneys general are investigating the Dollar Tree takeover.
- » Industry insiders continue to emphasize **the trend of improving multiples and increased activity**. This is expected to continue for the remainder of 2014. Factors contributing to higher multiples include the increase of willing lenders to finance transactions at relatively low rates, the increase of tax-advantaged MLPs and spinoffs, and higher demand for properties in urban centers and smaller format stores. Experts indicate that while multiples a few years ago were in the 5x to 6x EBITDA range, recent deals have been in the 7x to 8x range, and recently some deals have occurred in the low double digits. As typical of transactions, valuations are driven by target size and post-merger efficiencies and synergies.
- » **Master Limited Partnerships, or MLPs, have become popular in recent years due to their tax-advantaged structure.** We reported last quarter that the IRS began an internal review of MLPs and temporarily suspended its guidance to companies interested in forming an MLP. While the MLP structure is beneficial from an operating and acquisition standpoint, there is concern in the marketplace that the IRS may shut down or reduce the ability of companies to employ this structure. Some industry analysts speculate that this may be one driver behind the recent abnormally high pace of acquisitions in this industry. Companies may see the end in sight and are trying to take advantage of the benefits while they can.

## SEGMENT FOCUS

# Foodservices

According to the National Restaurant Association, the foodservice industry is expected to reach a record high of \$683 billion in revenue for 2014, which would represent a 3.6% increase from 2013.

The "retail-host restaurant" segment, to which c-stores belong, is expected to experience even higher growth rates (on the order of 5.1%) than traditional restaurant operators (2.6% for table-service restaurants and 4.4% for limited-service restaurants). Given the high profit potential for in-store food offerings, it is paramount for many retailers to maximize their food offerings.

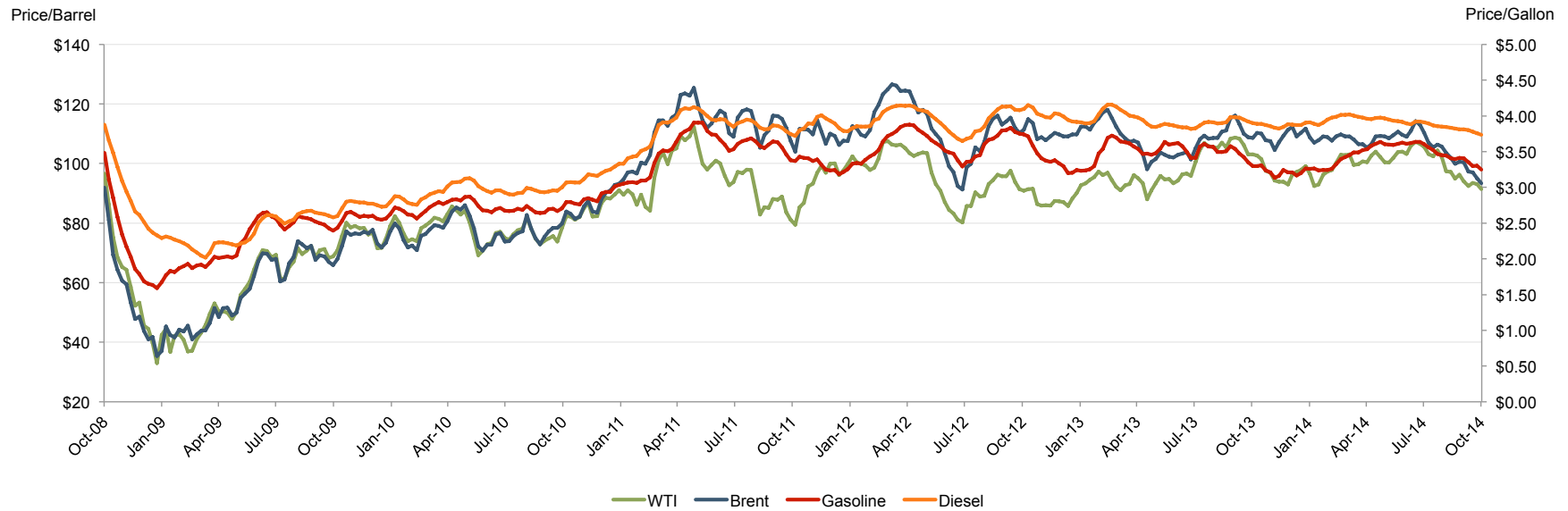
Foodservice represented just 18% of c-store revenue while representing the highest contributor to gross profit on a percentage basis at 29.1%. Year-over-year gross margin dollars were up 2.5% in the foodservice segment, approximately equal to the increase in year-over-year revenue.

The most profitable segment of foodservice appears to be food prepared on site, a category which boasted gross margins of nearly 60% in 2013.

According to a report in *Marketing Daily*, a growing number of consumers are looking for healthier and fresher food offerings, which presents an opportunity for c-stores whose customers may be tiring of traditional fast food options while still needing a quick alternative. In fact, more consumers are purchasing prepared foods, and the c-store chains that were voted most popular in a recent survey have concentrations in fresh food offerings and made-to-order food and drinks.

# Fuel Pricing and Supply Charts

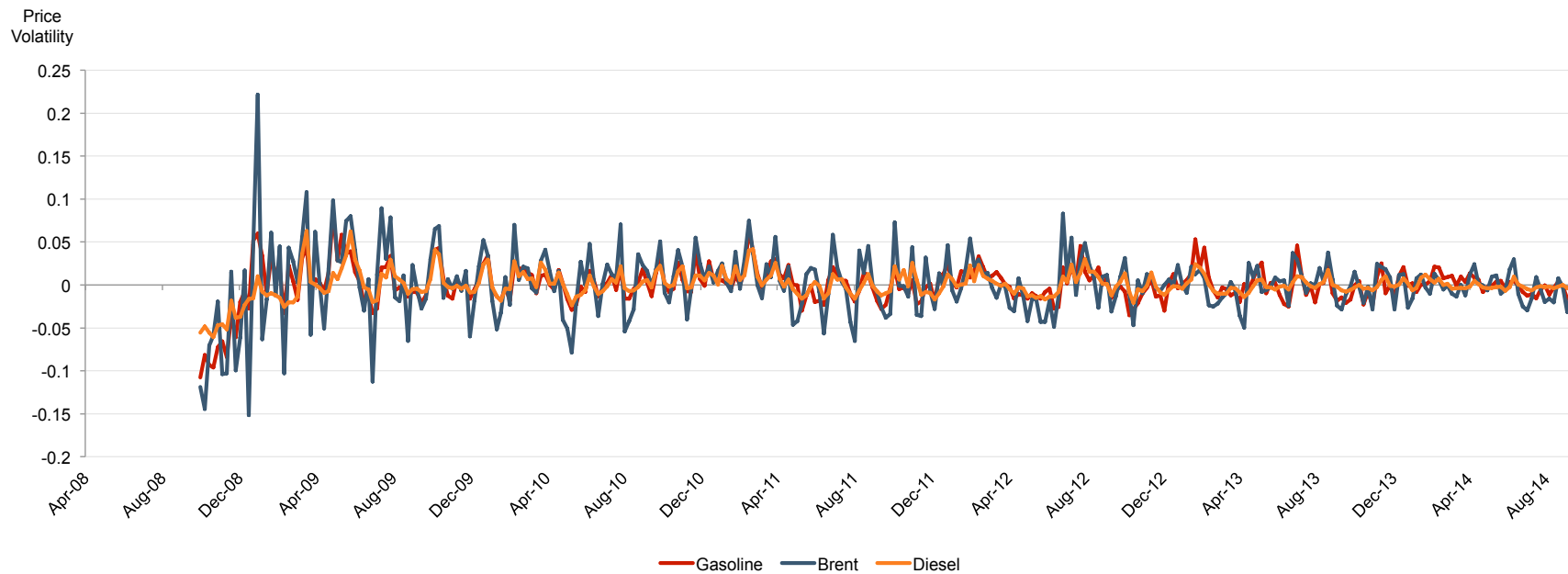
## Fuel Prices & Supply



Data Source: Calculated by Mercer Capital based on raw data obtained from the US Energy Information Administration (EIA.gov)

# Fuel Pricing and Supply Charts

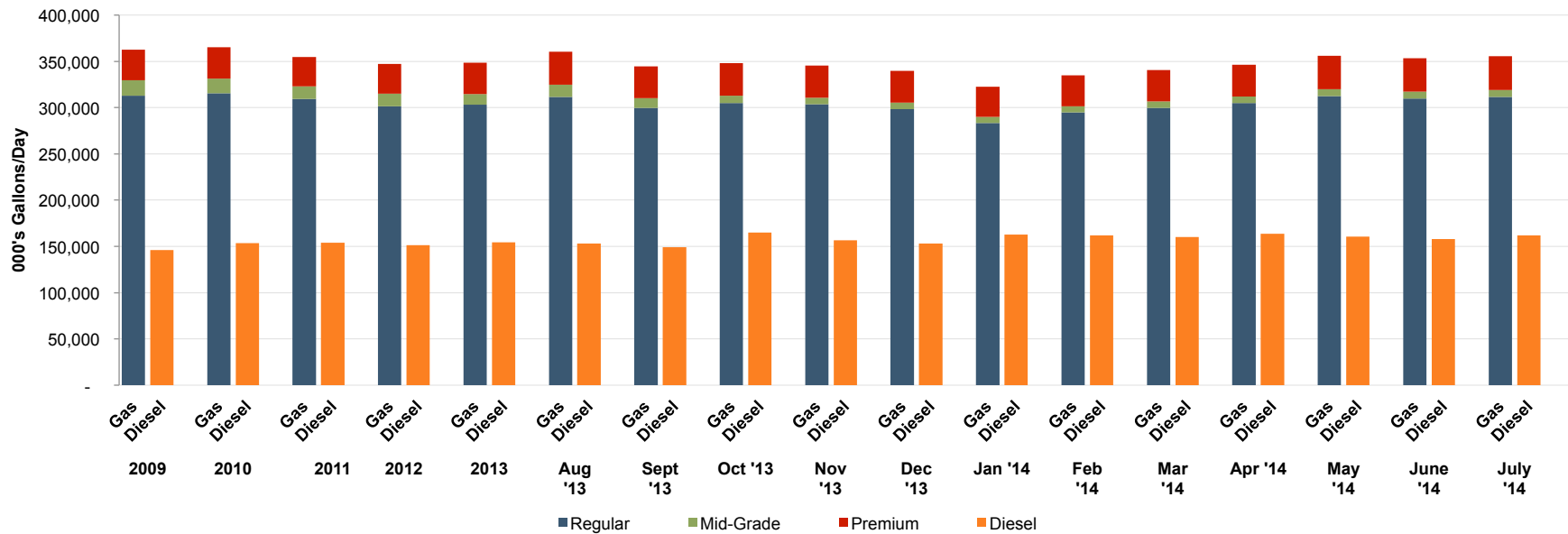
## Motor Fuel and Brent Crude Price Fluctuation



Data Source: Calculated by Mercer Capital based on raw data obtained from the US Energy Information Administration (EIA.gov)

# Fuel Pricing and Supply Charts

## Prime Supplier Sales Volumes



Data Source: US Energy Information Administration (EIA.gov)

# Mercer Capital

Convenience Store  
Industry Services

Mercer Capital provides the multi-unit retailing and QSR industries with corporate valuation, financial reporting, transaction advisory, and related services.

## Industry Segments

Mercer Capital serves the following industry segments:

- Motor Fuels
- Grocery Stores
- Alternative Fuels & Consumer Transportation
- Foodservices

## Mercer Capital Experience

- Family and management succession planning
- Buy-side and sell-side transaction advisory assistance
- Conflict resolution and litigation support
- Trust and estate planning
- Buy-sell agreement valuation, design, and funding advisory

Contact a Mercer Capital professional to discuss your needs in confidence.

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