

# VALUE FOCUS

# Convenience Stores



**SEGMENT FOCUS**  
**Foodservices**

**2015**

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Q1: Motor Fuels

Q2: Grocery Stores

Q3: Alternative Fuels  
& Transportation

Q4: Foodservices

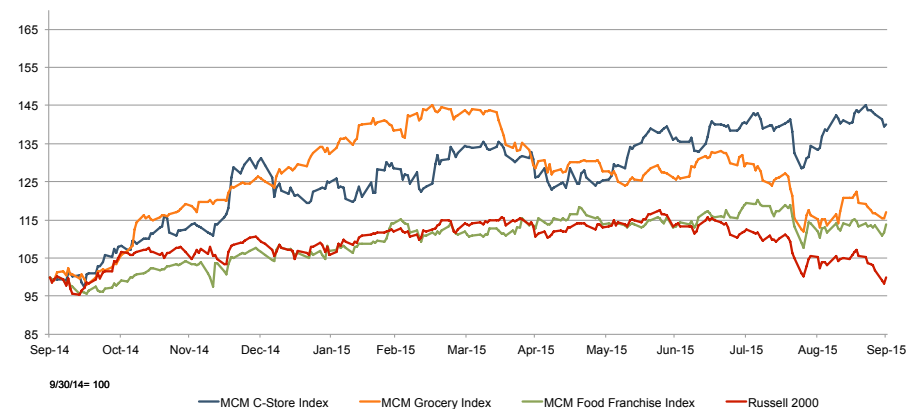
# Value Focus

## Convenience Stores

## Fourth Quarter 2015

**Equity Market Overview.** During the three months ending September 2015, equity market pricing for the convenience store index posted a 2.5% increase, outpacing the performance of the Russell 2000 index which declined 12.2% during the quarter. However, performance among individual index participants was mixed. TA and CST continued to face steep stock price declines (-30.4% and -13.7%, respectively). MUSA and RUT's prices were also down for the quarter. ANCUF and CASY's prices increased by 5.8% and 7.7%, respectively. Due to the large amount of weight ANCUF carries in our index based on its market cap, its performance overshadowed some of the downturns faced within the group. The grocery store index posted a decrease of 6.9% during the quarter, largely led by Whole Foods (WFM) which posted a 19.4% decrease. WFM has the second largest market capitalization in our grocery index. The fast food index posted a modest quarterly increase (0.6%).

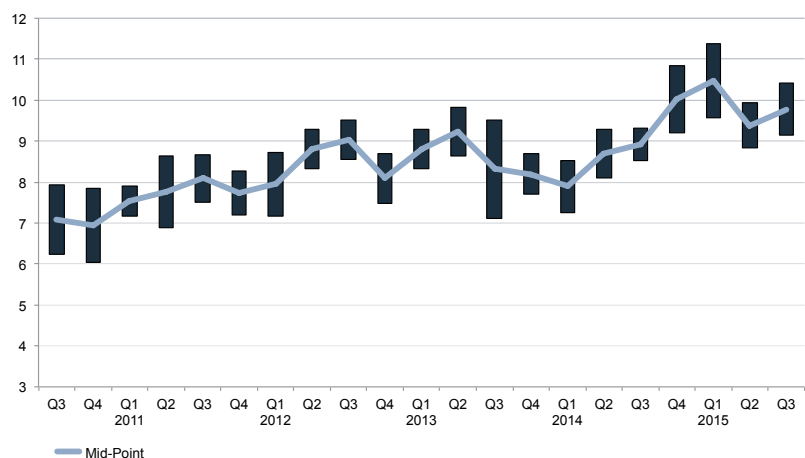
### C-Store, Grocery Store, & QSR Stock Indices



Data Source: Capital IQ / Bloomberg

**Valuations Up, Ranges Widen for C-stores.** EBITDA multiples were up modestly for convenience stores and somewhat down for fast food operators. Grocery store multiples were down a full turn. Multiples for public C-store operators rose from 9.4x EBITDA at the end of the second quarter of 2015 to 9.8x at the end of the third quarter of 2015.<sup>1</sup> C-store multiples remained above their five-year average (8.5x). The favorable trend in multiples is expected to continue to fuel M&A activity in the near term, although margin compression is anticipated beyond 2015. Despite the currently rich multiples, some business owners are hesitant to sell given current fuel margins and the attractiveness of their prevailing cash flows.

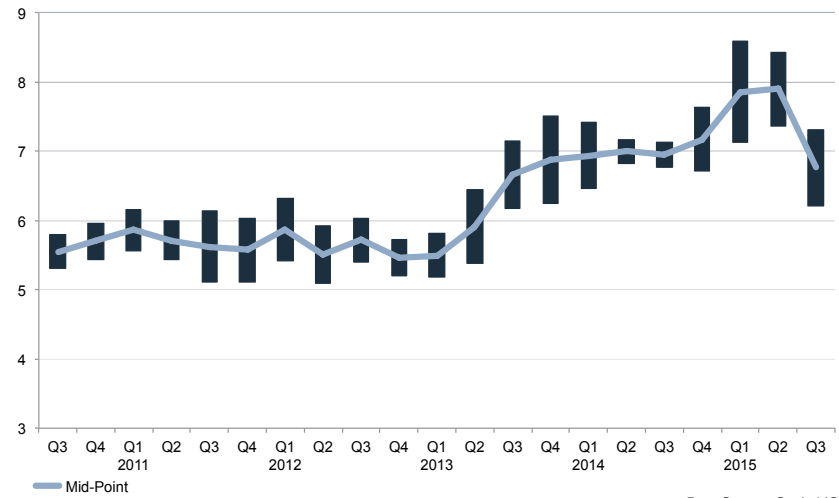
**C-Store EBITDA Valuations // Quarterly Range of Mean Highs & Lows**



Data Source: Capital IQ

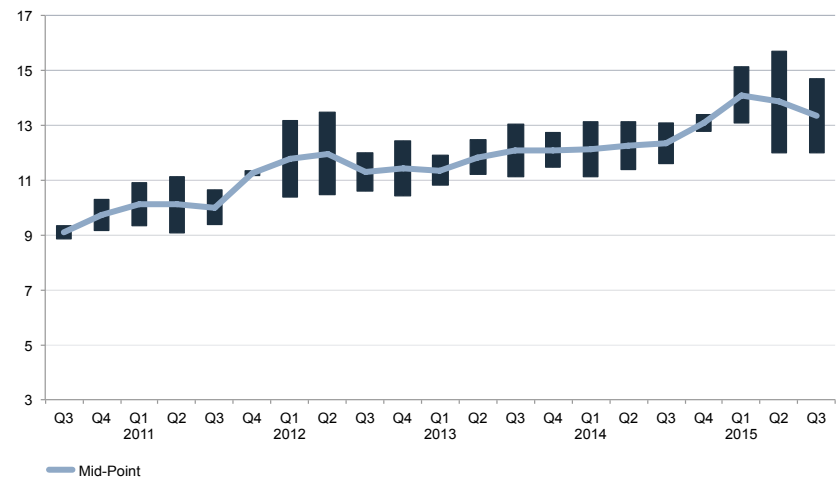
<sup>1</sup> As measured by the average of : (1) the median of the highest EBITDA measure of all the companies in the Mercer Capital index over the entire quarter and (2) the median of the lowest EBITDA measures of all the companies in the Mercer Capital index over the entire quarter. Pantry was eliminated from the Mercer Capital index this quarter due to its recent merger. Beginning with this quarter's newsletter, current and historical multiple data was obtained from Capital IQ. In prior newsletters, data was sourced from Bloomberg.

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



Data Source: Capital IQ

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



Data Source: Capital IQ

Publicly Traded Companies

Company	Ticker	Stock Price at 9/30/15	LTM Price Range		Equity Market Cap	Enterprise Value	Revenue			EBITDA			EBITDA Margins		
			High	Low			LTM	2015 Est.	2016 Est.	LTM	2015 Est.	2016 Est.	LTM	2015 Est.	2016 Est.
<b>Convenience Stores</b>															
Alimentation Couche Tard Inc	ANCUF	\$45.25	\$47.33	\$29.61	\$25,675	\$28,647	\$34,315	\$34,734	\$36,979	\$1,826	\$1,909	\$2,113	5.32%	5.49%	5.71%
Casey's General Stores Inc	CASY	\$102.92	\$114.90	\$70.43	\$4,013	\$4,866	\$7,525	\$7,754	\$7,723	\$500	\$470	\$510	6.65%	6.06%	6.60%
TravelCenters of America LLC	TA	\$10.33	\$18.10	\$8.37	\$397	\$1,036	\$6,726	\$6,377	\$7,303	\$205	\$158	\$163	3.05%	2.48%	2.23%
CST Brands Inc	CST	\$33.66	\$45.03	\$32.55	\$2,575	\$3,862	\$12,319	\$10,290	\$11,876	\$501	\$348	\$362	4.07%	3.38%	3.05%
Murphy USA Inc	MUSA	\$54.95	\$73.97	\$47.73	\$2,570	\$3,059	\$14,767	\$13,852	\$16,085	\$433	\$335	\$360	2.93%	2.42%	2.24%
<b>Average C-Stores</b>					<b>\$7,046</b>	<b>\$8,294</b>	<b>\$15,130</b>	<b>\$14,601</b>	<b>\$15,993</b>	<b>\$693</b>	<b>\$644</b>	<b>\$701</b>	<b>4.40%</b>	<b>3.97%</b>	<b>3.97%</b>
<b>Median C-Stores</b>					<b>\$2,575</b>	<b>\$3,862</b>	<b>\$12,319</b>	<b>\$10,290</b>	<b>\$11,876</b>	<b>\$500</b>	<b>\$348</b>	<b>\$362</b>	<b>4.07%</b>	<b>3.38%</b>	<b>3.05%</b>
<b>Grocery Stores</b>															
Fresh Market Inc/The	TFM	\$22.59	\$42.12	\$18.70	\$1,096	\$1,129	\$1,804	\$1,755	\$1,869	\$175	\$188	\$198	9.72%	10.73%	10.60%
Village Super Market Inc	VLGEA	\$23.61	\$33.97	\$21.43	\$335	\$380	\$1,584	na	na	\$67	na	na	4.22%	na	nm
SpartanNash Co	SPTN	\$25.85	\$33.72	\$18.80	\$970	\$1,507	\$7,881	\$7,757	\$7,841	\$202	\$228	\$243	2.56%	2.94%	3.10%
Weis Markets Inc	WMK	\$41.75	\$51.21	\$37.20	\$1,123	\$1,123	\$2,828	na	na	\$156	na	na	5.50%	na	nm
Ingles Markets Inc	IMKTA	\$47.67	\$55.76	\$22.75	\$966	\$1,884	\$3,791	\$3,810	\$3,871	\$240	\$241	\$254	6.33%	6.33%	6.56%
Roundy's Inc	RNDY	\$2.32	\$6.12	\$2.03	\$115	\$761	\$4,030	\$3,977	\$4,172	-\$158	\$117	\$131	-3.92%	2.95%	3.14%
Whole Foods Market Inc	WFM	\$31.65	\$57.00	\$30.05	\$11,350	\$11,413	\$15,206	\$15,430	\$16,618	\$1,400	\$1,412	\$1,499	9.21%	9.15%	9.02%
SUPERVALU Inc	SVU	\$7.18	\$12.00	\$6.95	\$1,888	\$4,600	\$17,993	\$17,826	\$18,066	\$726	\$774	\$814	4.03%	4.34%	4.50%
Kroger Co/The	KR	\$36.07	\$39.43	\$25.14	\$34,808	\$46,079	\$108,784	\$108,541	\$110,147	\$5,459	\$5,096	\$5,594	5.02%	4.69%	5.08%
<b>Average Grocery Stores</b>					<b>\$5,850</b>	<b>\$7,653</b>	<b>\$18,211</b>	<b>\$22,728</b>	<b>\$23,226</b>	<b>\$919</b>	<b>\$1,151</b>	<b>\$1,248</b>	<b>4.74%</b>	<b>5.88%</b>	<b>6.00%</b>
<b>Median Grocery Stores</b>					<b>\$1,096</b>	<b>\$1,507</b>	<b>\$4,030</b>	<b>\$7,757</b>	<b>\$7,841</b>	<b>\$202</b>	<b>\$241</b>	<b>\$254</b>	<b>5.02%</b>	<b>4.69%</b>	<b>5.08%</b>

Source: Bloomberg

Publicly Traded Companies (cont.)

Ticker	Stock Price at 9/30/15	LTM Price Range		Equity Market Cap	Enterprise Value	Revenue			EBITDA			EBITDA Margins			
		High	Low			LTM	2015 Est.	2016 Est.	LTM	2015 Est.	2016 Est.	LTM	2015 Est.	2016 Est.	
<b>Fast Foods</b>															
McDonald's Corp	MCD	\$98.53	\$100.99	\$85.36	\$92,796	\$110,697	\$26,016	\$25,061	\$24,181	\$8,658	\$8,628	\$9,076	33.28%	34.43%	37.54%
Wendy's Co/The	WEN	\$8.65	\$11.64	\$7.44	\$3,149	\$5,547	\$1,970	\$1,801	\$1,243	\$372	\$398	\$387	18.88%	22.07%	31.08%
Yum! Brands Inc	YUM	\$79.42	\$94.85	\$64.38	\$34,232	\$37,449	\$13,151	\$13,272	\$14,055	\$2,180	\$2,793	\$3,138	16.58%	21.05%	22.33%
Dunkin' Brands Group Inc	DNKN	\$49.00	\$56.50	\$40.89	\$4,656	\$7,159	\$783	\$804	\$851	\$404	\$411	\$441	51.57%	51.16%	51.78%
Krispy Kreme Doughnuts Inc	KKD	\$14.63	\$22.32	\$14.50	\$930	\$941	\$508	\$494	\$527	\$65	\$67	\$75	12.82%	13.52%	14.16%
Panera Bread Co	PNRA	\$193.41	\$208.00	\$153.00	\$5,036	\$5,135	\$2,618	\$2,688	\$2,796	\$386	\$395	\$415	14.73%	14.68%	14.84%
Chipotle Mexican Grill Inc	CMG	\$720.25	\$758.61	\$597.33	\$22,439	\$22,439	\$4,441	\$4,718	\$5,404	\$941	\$1,019	\$1,198	21.20%	21.60%	22.17%
Jack in the Box Inc	JACK	\$77.04	\$99.28	\$63.08	\$2,816	\$3,475	\$1,531	\$1,543	\$1,636	\$274	\$291	\$320	17.88%	18.88%	19.57%
Restaurant Brands International Inc.	QSR	\$35.92	\$45.45	\$32.72	\$7,270	\$19,596	\$1,197	\$4,094	\$4,361	\$473	\$1,594	\$1,752	39.54%	38.93%	40.17%
Sonic Corp	SONC	\$22.95	\$36.51	\$21.74	\$1,195	\$1,662	\$595	\$605	\$632	\$158	\$164	\$175	26.56%	27.05%	27.70%
<b>Average Fast Foods</b>					<b>\$17,452</b>	<b>\$21,410</b>	<b>\$5,281</b>	<b>\$5,508</b>	<b>\$5,569</b>	<b>\$1,391</b>	<b>\$1,576</b>	<b>\$1,698</b>	<b>25.30%</b>	<b>26.34%</b>	<b>28.14%</b>
<b>Median Fast Foods</b>					<b>\$4,846</b>	<b>\$6,353</b>	<b>\$1,751</b>	<b>\$2,245</b>	<b>\$2,216</b>	<b>\$395</b>	<b>\$404</b>	<b>\$428</b>	<b>20.04%</b>	<b>21.83%</b>	<b>25.02%</b>

Source: Bloomberg

## Margins

According to OPIS, nationwide retail gasoline margins ended the third quarter of 2015 at 19.1 cents per gallon, up from 17.8 cents per gallon twelve weeks earlier and slightly above the historical five-year average of 18.9 cents.<sup>2</sup> Between the end of the third quarter and the time of this publication, retail fuel margins expanded again (20 to 30 cents per gallon) as a result of falling gasoline prices. According to OPIS, bulk prices have dropped faster than retail prices in the past few weeks, which has been generally beneficial to fuel marketers. Retail fuel prices during late 2014 reached their lowest levels in five years, and fuel margins during December reached 38 cents per gallon, nearing the best margins of the past decade. As a result, U.S. retailers have enjoyed favorable margins for the better part of a year. Diesel margins ended the third quarter at 32.4 cents per gallon, down from a 51.7 cent margin level twelve weeks ago. Although fuel prices are inherently volatile, consensus outlooks do not anticipate significant increases in pricing in the near future, especially after taking into account the near-term shift to winter-grade fuel (a generally more cost-effective blend of fuel).

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 18.9 cents per gallon for 2010 through 2014. 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 18.9 cents, this translates to a typical three to five cents per gallon of bottom line profit.

<sup>2</sup> National Association of Convenience Stores 2015 Retail Fuels Report.

## Government and Regulatory

**EMV Cards.** In October, the House Small Business Committee held its second hearing on the EMV deadline and what it means for small businesses. NACS estimates that the total cost of implementation is \$26,000 per store, as each pump requires updated payment hardware. This translates to roughly \$3.9 billion in expense for the C-store industry in the U.S. Many retailers maintain that the chip-and-signature cards represent an enormous cost burden without the additional security that chip-and-PIN cards would offer. On a related note, a nationwide survey conducted in late August found that 56% of consumers do not understand what an EMV or chip card is. Many retailers claim that they have been offered little, if any, training on the new systems from either the banks or networks, and some retailers are finding that the chip card readers are significantly backordered. It is unclear at this point what effect the hearing will have on the EMV implementation.

**Gas Taxes.** The Highway Trust Fund is set to expire (once again) on October 29th. The House of Representatives Transportation and Infrastructure Committee approved the Surface Transportation Reauthorization and Reform Act of 2015, a six-year, \$325 billion surface transportation bill. An additional short-term extension of the Highway Trust Fund is anticipated until the House and the Senate can agree on a long-term solution.

**EPA Air Quality Standards.** In early October, the EPA issued more stringent air quality standards for ground-level ozone. NACS is concerned that the new standards will necessitate reformulated gasoline in what are now conventional gasoline areas, more states will impose lower RVP requirements, and certain states will face costly vapor recovery requirements. All of these measures would likely lead to higher fuel prices for consumers.



# Recent M&A Activity

In addition to the major transactions listed below, there were several transactions involving 50 or fewer units during the third quarter. According to insiders, many private entities whose owners have never considered a sale are now exploring their options. Many owners fear this is their best opportunity to exit the market and have become frustrated at their inability to grow strategically through store unit acquisitions due to competition from larger players who are able to offer higher multiples. These larger players face a lower cost of capital and have opportunities for operational efficiencies that most of the smaller players do not. A large number of transactions have taken place in 2014 and 2015 by the larger market participants. It is questionable if recent multiples are sustainable, particularly if bigger players are preoccupied with integrating recent acquisitions. Eventually, the cycle of recent acquisitions will subside and multiples should drop. A near-term Federal Reserve rate hike could also serve to bleed off some of the steam from heated markets.

The fourth quarter is traditionally one of the busiest quarters in terms of M&A activity. In the meantime fuel marketers have been enjoying the benefits of low fuel pricing and the corresponding margin that accompanies soft oil prices. Owners are likely torn between the draw of high multiples and the status quo of favorable profits.

- » In August, **7-Eleven** finalized its purchase of **Tedeschi Food Shops**, representing a net acquisition of approximately 180 C-stores.
- » **Circle K** entered into an agreement with **CCK** to rebrand more than 700 Mexican-based Extra brand C-stores to Circle K stations within the next two years. Circle K is also expected to rebrand the **Kangaroo Express** stores purchased from **Pantry** earlier this year to Circle K stores. The cumulative effect of the rebranding will be approximately 3,500 stores rebranded to Circle K.
- » **GPM Investments** is purchasing **approximately 175 c-stations and tobacco stores** in the Midwestern United States. The seller has not yet been disclosed.
- » **Albertsons** combined with **Safeway** earlier in the year. Now, the combined entity has filed for an IPO in which it hopes to raise nearly \$2 billion.
- » **Anheuser-Busch InBev** is expected to purchase its major rival, **SABMiller** for \$104 billion, which would create the world's largest beer manufacturer. The deal is subject to regulatory approval.
- » **Walgreens** announced in late October its intention to acquire all the outstanding shares of **RiteAid** at a total enterprise value of approximately \$17.2 billion.
- » **CST Brands** began the process to enter into a definitive agreement to acquire **Flash Foods, Inc.** Flash Foods operates 164 C-stores in Georgia and Florida as well as 21 quick service restaurants, 15 real estate sites, a merchandise distribution company, and a fuel supply company. The deal is expected to close in the first quarter of 2016.

## SEGMENT FOCUS

# Foodservices

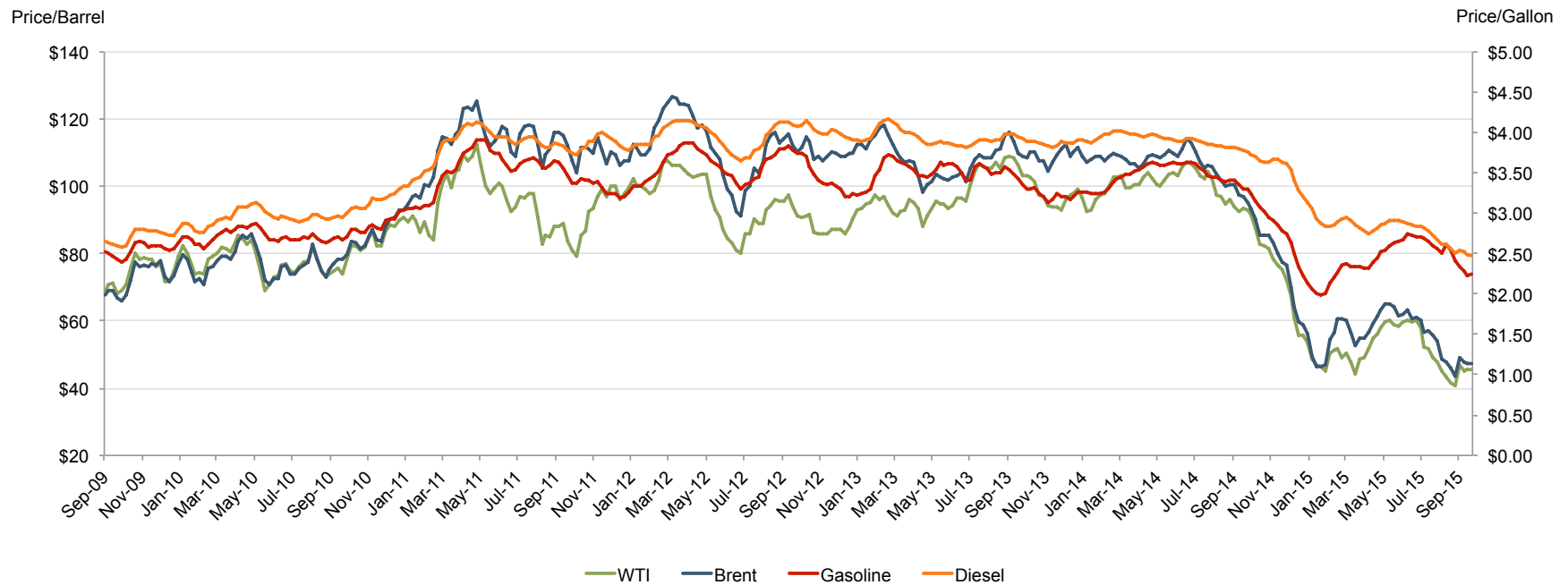
According to the National Restaurant Association, the foodservice industry is expected to reach a record high of \$709 billion in revenue for 2015, which would represent a 3.8% increase from 2014. For comparison, C-stores saw a 9.7% increase in foodservice sales in 2014. Given the high profit potential for in-store food offerings, it is paramount for many retailers to maximize their food offerings. Foodservice represented just 18% of C-store revenue but represents the highest contributor to gross profit on a percentage basis at 29%.<sup>3</sup> Trends to watch in the near-term include:

- » **Technology** is a rising trend with more individuals demanding online, app-based or kiosk-based ordering and payment options. According to the National Restaurant Association's *2015 Restaurant Industry Forecast*, approximately one fourth of customers say technology factors into their dining decision, up from 20% a year ago. The implementation costs of such technology could be a major cost facing operators in the near-term, as restaurant operators – including C-store chains – will be faced with responding to increasing demand for technological services.
- » There is a push for **fresh, healthy, and locally sourced options**, especially among millennial consumers. 49% of millennials believe C-stores have the same capability as restaurants for offering fresh dining options. It is important for these options to be easily portable for consumers, who often consume purchases in their cars or on foot.
- » There seems to be a **battle-for-breakfast** taking place. C-stores have traditionally sold a higher volume of breakfast offerings as compared to lunch and dinner options. In fact, 94% of stores surveyed for the *2015 CSP.net Foodservice Handbook* offer breakfast, and 35% of respondents believe that the breakfast category has the highest potential for revenue growth. During 2015, McDonalds began offering all-day breakfast in an attempt to revamp company revenues.
- » Restaurant **menu options** appear to be shrinking. The average U.S. menu size is the smallest it has been in eight years. Fewer offerings lead to a higher rate of ingredient turnover, and therefore, fresher ingredients. It also leads to easier choices for guests, allowing for faster service and potentially higher revenues.
- » There seems to be a push toward **delivery options** – for both food and other convenience items. Sales from online grocery stores are expected to increase 16% in 2015. During the year 7-Eleven and Walgreens partnered with Postmates (in certain markets) to deliver products chosen via an app. UberEATS is a relatively new service that utilizes Uber's existing technology platform by delivering local restaurant food in certain markets. Additionally, some 7-Eleven stores in Canada are expected to test a program to act as pickup locations for online Walmart orders.

<sup>3</sup> CSP.net, "Data: Where is Foodservice Traffic Growing the Fastest", January 30, 2015

# Fuel Pricing and Supply Charts

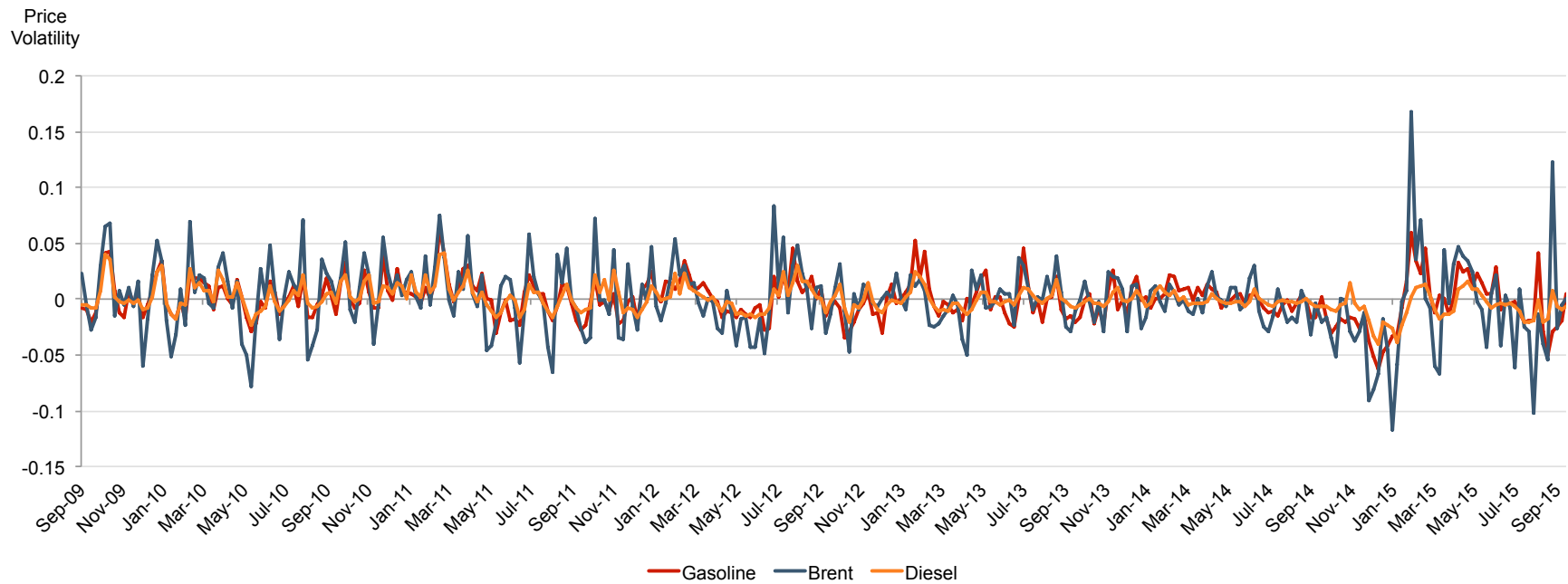
## Fuel Prices & Supply



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

# Fuel Pricing and Supply Charts

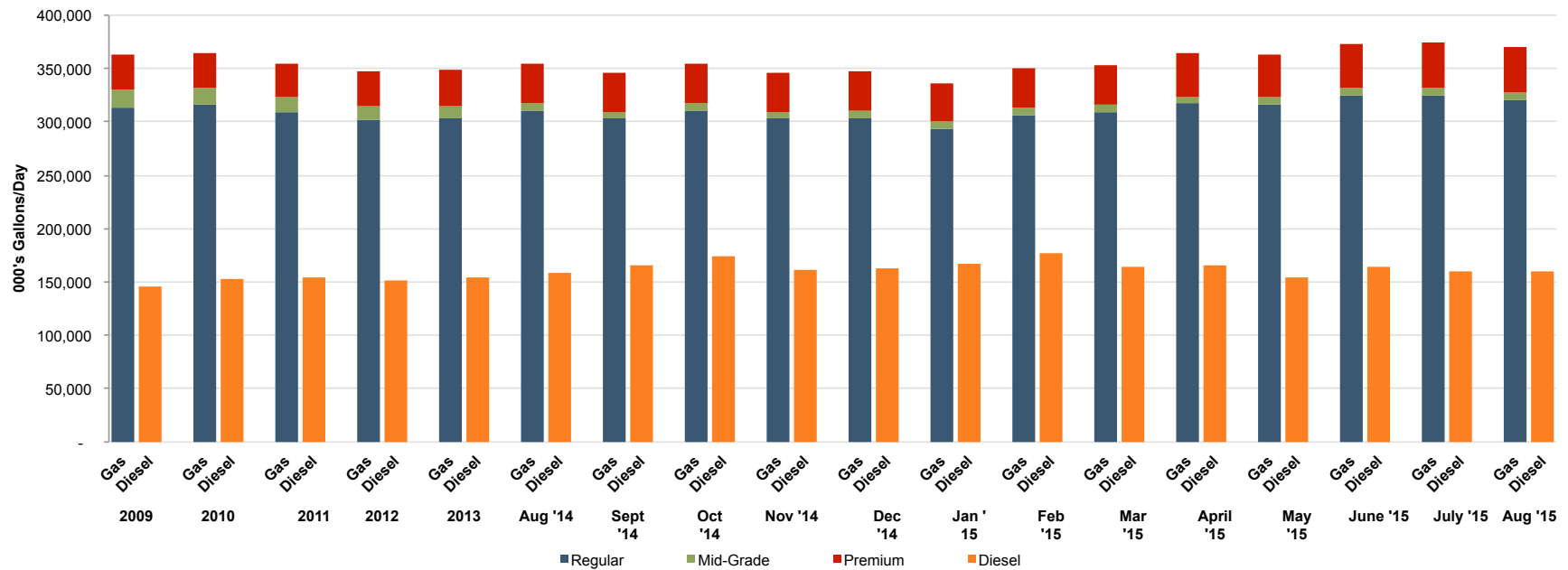
Motor Fuel and Brent Crude Price Fluctuation



Data Source: Calculated by Mercer Capital from 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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