With Fewer Chains to Acquire, C-store M&A Market Is Changing

Small to mid-sized companies expected to get increased attention.

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NATIONAL REPORT — In 2014, it was GPM Investments LLC and its 120-percent store count increase, mostly driven by its acquisition of VPS Convenience Store Group's Southeast division. In 2015, it was Speedway LLC and its 86-percent growth spurt on the heels of purchasing Hess Corp.'s retail network. In 2016, it was Alimentation Couche-Tard Inc. with a 39.4-percent boost to its U.S. footprint following its takeover of The Pantry Inc., parent of the Kangaroo Express chain.

This year, Western Refining Inc. joins the ranks atop the *Convenience Store News* Top 20 Growth Chains list. Between January 2016 and January 2017, the El Paso, Texas-based company saw its convenience store portfolio jump 119.4 percent, adding 295 net new stores for a total store count of 542. This accomplishment was largely driven by the company's acquisition of Northern Tier Energy LP. The deal, which closed in June, added to Western Refining's footprint 170 Midwest c-stores — primarily carrying the SuperAmerica banner — and another 114 franchised locations supported by Northern Tier under the SuperAmerica trademark.

Nearly two months after the closing, Western Refining CEO Jeff Stevens reported that the newly merged company was excited to grow its retail operations on the heels of a tremendous second quarter in the division. But then, in a turn of events, Western Refining found itself an acquisition target. In November, Tesoro Corp. finalized a definitive agreement to acquire Western Refining for $4.1 billion. The move will create a leading multi-brand marketing and convenience store portfolio in growing geographies with more than 3,000 combined branded retail sites.

Western Refining declined to speak to *CSNews* about its 2016 growth or its future under Tesoro, citing the pending deal. The transaction is on pace to close in the first half of this year.

The quick turnaround of Western Refining from buyer to seller did not really take convenience channel merger and acquisition (M&A) experts by surprise. As Dennis Ruben, executive managing director of NRC Realty & Capital Advisors LLC, explained, Tesoro has been on an acquisition course since buying the retail assets of BP — a deal that closed in 2013.

"Tesoro has been the exception to the rule. Most of the oil companies have been on a divesture kick over the past several years, but Tesoro has been one of the exceptions that has been acquisitive," Ruben said.

Terry Monroe, founder and president of American Business Brokers & Advisors, added that "in the world of mergers and acquisitions, especially when dealing with publicly traded companies, their main focus is increasing shareholder value for their stockholders."

He pointed to the pending sale of CST Brands Inc. to Couche-Tard, and Marathon Petroleum Corp. launching a strategic review of Speedway. "Whenever you have a publicly traded company and the focus is on quarterly results, it is hard to keep raising sales to meet the earnings call," Monroe said. "But if you can do an acquisition, there is an immediate boost to the stock price and then the company will spend the next year or two growing their new acquisition."

INCHING UP THE RANKS

While Western Refining's jump to Top Growth Chain was sealed when it more than doubled its size thanks to Northern Tier, the other convenience store chains on this year's Top 20 Growth Chains ranking practically inched their way onto the list, when comparing this year's numbers to the growth tracked by *CSNews* in prior years.

The annual ranking, now in its sixth year, is based on store count figures provided by TDLinx, a service of Nielsen. The period analyzed was January 2016 to January 2017. TDLinx defines a convenience store as a store that includes a broad merchandising mix, extended hours of operation and a minimum of 500 SKUs. Fueling stations with small kiosk stores do not meet the official definition and thus are not reflected in TDLinx's store count figures.

Behind Western Refining, in the No. 2 spot, is GPM Investments with 177 net new stores added for a 26.3-percent increase. Sunoco LP's addition of 123 stores (a 4.3-percent increase) was good enough to snag third, while CST Brands Inc.'s 118-unit jump (an 11.2-percent increase) places it fourth. Rounding out the top five is Kwik Trip Inc., which added 66 stores to see a 13.6-percent lift.

Now, consider that Couche-Tard, 2016's Top Growth Chain, added 1,510 stores just on its own — more than all of this year's growth chains combined. Overall, the 2017 *CSNews* Top 20 Growth Chains added a net 1,396 stores to their portfolios between January 2016 and January 2017, equating to a 5.9-percent increase for the year. That's 1,763 stores less than what last year's Top 20 Growth Chains added (3,159 stores for a 12.3-percent increase).

This may be the new normal, according to Monroe. The Top 100 convenience store chains in the United States feature a few big retailers, like 7-Eleven Inc. and Couche-Tard, but then it falls off into the 500 or below number as far as store count goes.

"Look at Yesway. They came into the marketplace saying they were going to have 1,000 stores in no time and be a big player. They are having a hard time getting to first base because there are not that many chains of stores to acquire," said Monroe.

Ruben echoed this insight, pointing out "there are fewer deals, fewer big companies out there." From his perspective, there are two factors at play: People are still making pretty good money in their stores and not looking to sell; and continued M&A activity is shrinking the pool of potential buyers in the market.

"Take the Couche-Tard acquisition of CST; they will also wind up owning the general partner of CrossAmerica Partners. That really takes a potential large buyer out of the game. You had CST and CrossAmerica bidding on these deals and, all of a sudden with Couche-Tard, it's going to be one company," Ruben explained.

> "What we believe is where you are going to see more acquisitions is in the small to mid-sized companies. There is going to be increasing pressure on the guys who have 25 to 75 stores," he continued. "It's going to be more difficult for them to compete with these very large players."

So, the question then becomes how can a mid-sized operator grow — unless they can negotiate a deal with someone who is in their backyard? And even then, "if there is a deal on the street for sale, it's going to be hard for a small or mid-sized company to compete with larger operators," Ruben added. "Larger operators have a cheaper cost of capital; they don't need financing. It's going to become more challenging for those smaller guys to grow through acquisition."

NRC has been involved in several deals where multiple companies have been interested, but "at the end of the day, when you get down to the final round, it's the same five or six or 10 big players who can write the biggest checks, and they don't have financial contingencies in their offers," according to Ruben.

Cheap money has fueled a lot of the recent acquisition activity, Monroe said, cautioning that "we will never see money this cheap." He also noted it's a great time to be a seller because that cheap money has increased the value of convenience stores.

Similarly, cheap money has made it a great time to be a buyer because they can get more for their money and not have a huge debt service, allowing a buyer to pocket the interest savings and reduce its debt before interest rates rise again, explained Monroe.

As the industry started to see over this past year, opportunities are more plentiful in the smaller ponds. Monroe agrees that more acquisitions are going to be of smaller chains. "The chains that are family owned or have family involved, and generally have professional management, will not sell," he said. "They have everything in place and will continue to grow their companies."

SUCH A THING AS TOO BIG?

The challenge for all these growth chains making acquisitions is ultimately realizing that not all the stores work or make sense for their business, Ruben responded when asked if there is any danger in the convenience store industry of a chain getting too large.

"We are doing a 100-store sale for Sunoco. That's a perfect case. We think a lot of the larger companies that have done big acquisitions need to prune their portfolios of stores that don't make sense — some stores are too small; they don't work; they end up doing an acquisition across the street from another store they already have," he reasoned.

NRC likewise handled five separate sales for 7-Eleven. The stores sold were too far from its distribution center, too small, didn’t fit their model or, "quite frankly, didn't make sense for 7-Eleven but would make a great deal of sense for some smaller operator," Ruben said.

With roughly 154,000 c-stores in the United States, too big in the convenience channel is hardly possible, Monroe pointed out. "The biggest chain is less than 10,000 stores. We don't have a McDonald's and a Burger King and a Wendy's yet — meaning we don't have a national convenience store chain that is dominating all of the markets," he said. "The convenience store industry is still a very fractured industry and very regional."

METHODOLOGY

The *Convenience Store News* Top 20 Growth Chains report is based on store count figures provided by TDLinx, a service of Nielsen. This is the sixth year that *CSNews* has partnered with TDLinx to identify the c-store retailers that added the most convenience stores in the past year. Wherever possible, the TDLinx numbers were confirmed by the companies. TDLinx defines a convenience store as a store that includes a broad merchandising mix, extended hours of operation and a minimum of 500 SKUs. Fueling stations with small kiosk stores do not meet the official definition and thus are not reflected in TDLinx's store count figures.

For our full report on this year's Top 20 Growth Chains, look in the March issue of Convenience Store News [2].

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