Value Focus

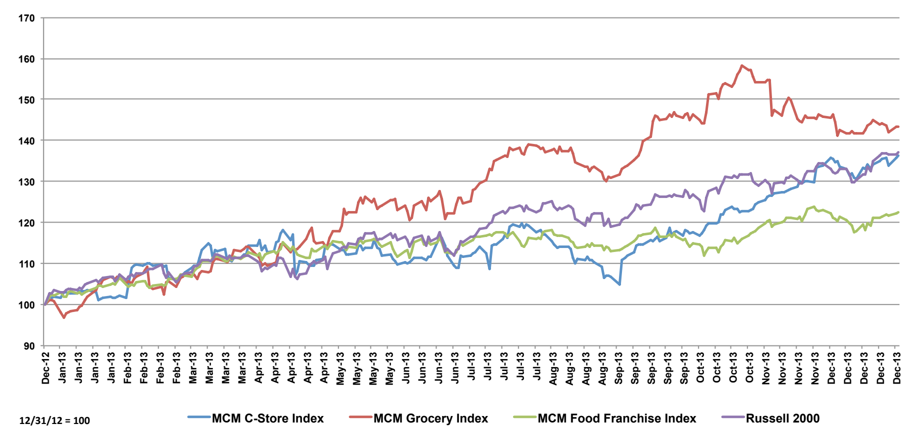
Convenience Store Industry

Convenience Stores | Grocery Stores | QSR (Fast Food)

First Quarter 2014

Equity Market Overview. Over the last three months, median stock market pricing for the convenience store and fast food indexes was up 16.7% and 5.9%, respectively, outperforming the Russell 2000 index's increase of 8.4%. The Mercer Capital grocery retail index posted a 1.4% decline in the fourth quarter.

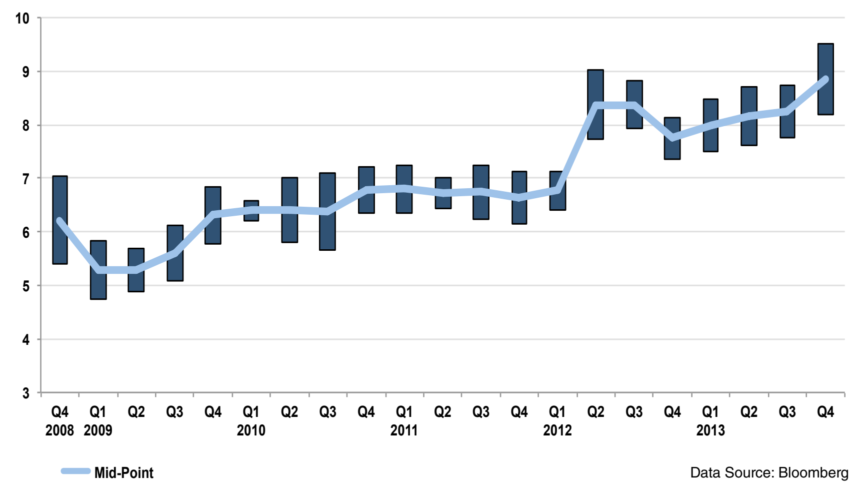
2013 C-Store, Grocery Store, & QSR Stock Indices



Data Source: Yahoo.com

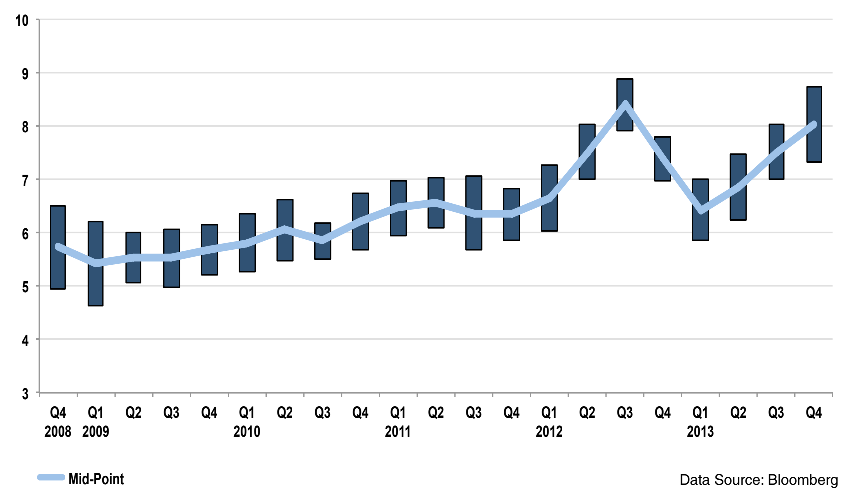
Valuations Drift Higher. End of quarter total capital-to-EBITDA ratios were up across the board. Multiples for public c-store operators increased from 8.2x EBITDA at the end of the third quarter to 8.8x at the end of the fourth quarter. Grocery store and fast food publics posted smaller increases, as shown in the charts. During 2013, the median end-of-quarter multiples for our c-store index ranged from 7.2x EBITDA to 8.8x EBITDA. At year-end 2012, the median c-store multiple was 6.1x EBITDA.

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



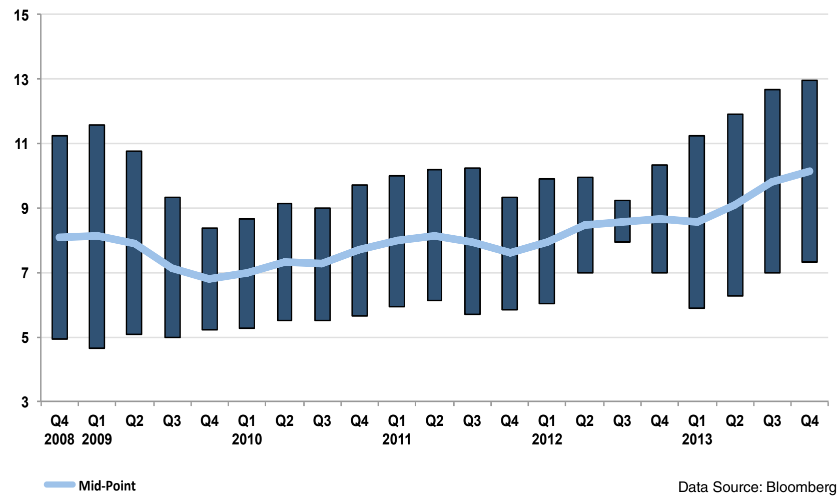
Data Source: Bloomberg

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



Data Source: Bloomberg

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



Data Source: Bloomberg

Margins. Nationwide retail gasoline margins took a hit during the fourth quarter ending at 11.2 cents per gallon, down from 23.6 cents per gallon in the first week of the fourth quarter. OPIS attributes the margin plummet to a broad spike in gasoline prices throughout the nation, most of which took place during December. Gasoline prices are currently supported by a stronger-than-expected increase in oil demand. Diesel margins have also slumped, but they remain roughly 30% higher than gasoline margins.

Generally, over 70% of a c-store's sales are motor fuels, but contribute roughly only one-third of total convenience store gross margin dollars. Fuel margins have been very consistent on an annual basis, averaging 16.9 cents per gallon for 2008 through 2012. Retailers tend to reduce their markup when prices go up by leaving prices the same for as long as possible. Therefore there is typically a delay between the time that crude prices rise and the time that pump prices rise. This lag also occurs when wholesale prices drop. That is, retailers may tend to leave the pump prices elevated – leading to increased margins – until local competition forces the prices downward. On average, it costs a retailer approximately 12 to 16 cents to sell a gallon of gasoline. Given that the average five-year markup on gasoline was 16.9 cents, this translates to a typical 2 to 3 cents per gallon of profit.

Swipe Fees. Credit card swipe fees, also known as interchange fees, have been a significant issue for petroleum retailers. Retailers have argued that they have had little power to negotiate the fees which range from 2% to 5% of purchases.

In December, a federal judge approved a $5.7 billion settlement between certain retail groups and Visa and Mastercard. However, the National Association of Convenience Stores (NACS) and other retail groups were unhappy with this settlement because it did not prevent Visa and Mastercard from increasing fees in the future and the method of retailer surcharging is burdensomely complex.

The NACS and other retailers will continue to appeal the settlement, despite the December decision. Regardless of the decision, it does not seem likely that retailers will see much relief in the form of credit card swipe fees in the near term.

Spin-off Activity. The trend in 2013 was for petroleum producers to divest or separate the retail side of operations. Valero spun off its retail side with the IPO of CST Brands in May. Murphy Oil followed suit in September as its retail operations began trading as Murphy USA Inc.

Data shows that spinoffs have outperformed the S&P 500 Index by an average of 30% to 45% during the first three years of trading, implying strong valuations in the near term. For larger closely held multi-unit operators, this could translate to near-term increases in valuations.

Recent M&A Activity

Given that terms were not disclosed relating to these transactions, we are unable to derive valuation multiples. However, industry insiders noted a trend of improving multiples and increased activity. This is expected to continue into 2014.

- **Sunoco** completed its acquisition of **Mid-Atlantic Convenience Stores** (MACS), increasing its store count by approximately 300, and altering the expectation that Sunoco would begin to exit the retail fuel business. Due in part to continued industry consolidation, the increasing role of financial players within the industry, and the master limited partnership trend, many refiners are divesting or spinning off the retail side of operations. For now, Sunoco is bucking the trend. Terms of the deal were not disclosed.
- **Western Refining, Inc.** entered into a definitive agreement to purchase 38.7% of **Northern Tier Energy LP** from ACON Investments and TPG, two private equity firms. While this transaction was primarily a refining play, it includes the SuperAmerica retail chain consisting of 163 company operated c-stores and 74 franchised locations.
- **Susser Holdings Corporation** acquired substantially all of the assets of **Sac-N-Pac Stores, Inc.** and **3W Warren Fuels, Ltd.**
- The master limited partnership momentum continues with **Western Refining Logistics LP's IPO** on October 10th. This follows the **Phillips 66 Partners IPO** in the second quarter.
- **Hess Retail Corp.** gained approval for a spinoff in early 2014. At the time of this publication, it remains unclear whether Hess will exit the downstream business by selling it off to a third party of just spinning it off.

Segment Focus

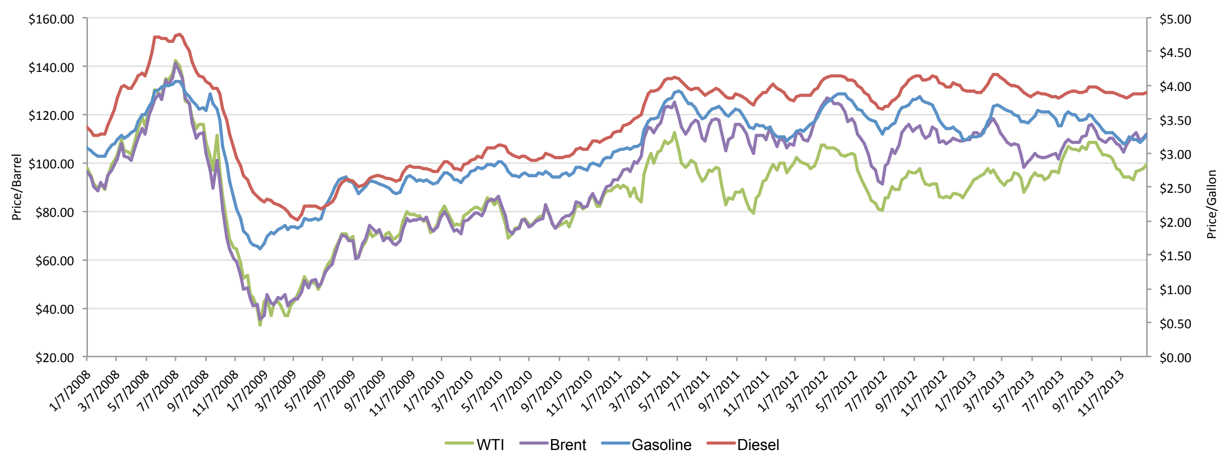
Motor Fuels

Gasoline sales represent more than 3% of the country's overall GDP. According to the Short Term Energy Outlook (STEO) issued in January by the U.S. Department of Energy's Energy Information Administration (EIA) the global benchmark Brent crude is expected to drop roughly 5.5% from now until the end of 2015.

West Texas Intermediate is expected to drop 8% over this same time period, and implies a widening of the Brent to WTI spread. These drops could imply a reduction in gasoline prices by more than 20 cents per gallon.

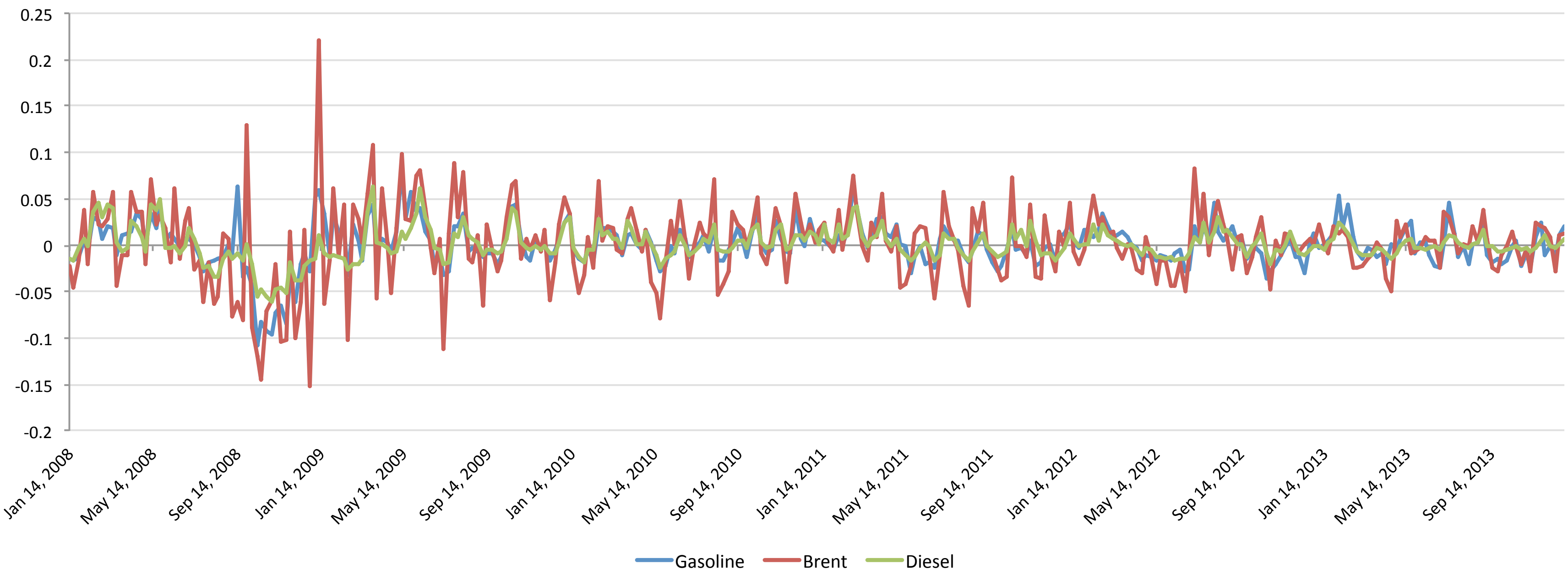
Production from countries outside of OPEC is expected to increase by a record high of 1.9 million barrels per day in 2014, led by the United States and Canada. OPEC production is expected to decline by 0.5 million barrels per day in 2014.

LTM Retail & Wholesale Motor Fuel Prices



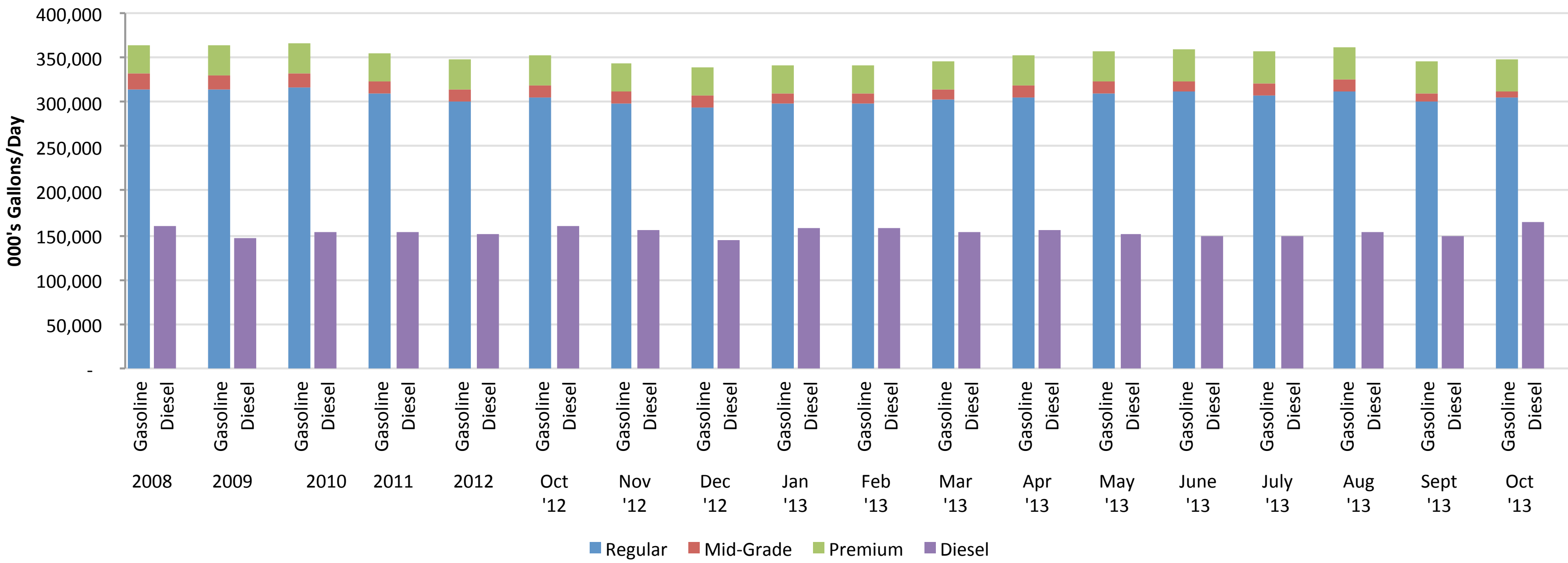
Data Source: US Energy Information Administration (EIA.gov)

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)

Prime Supplier Sales Volumes

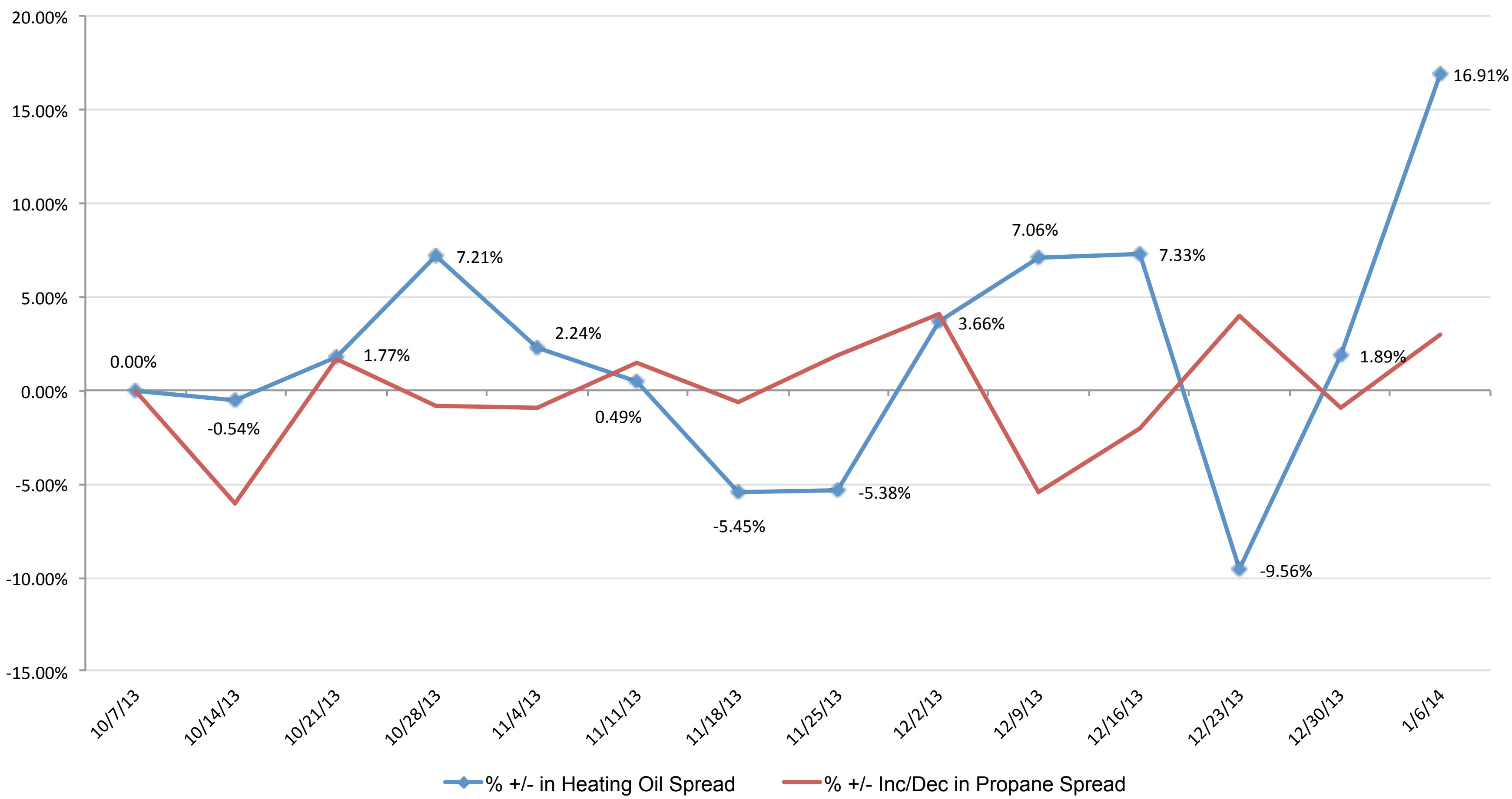


Data Source: US Energy Information Administration (EIA.gov)

Non-Motor Fuel Prices

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

Percentage Change in Non-Motor Fuel Spread by Month



Data Source: Calculated by Mercer Capital based on raw data obtained from the 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:

- Convenience stores
- Grocery stores
- Fast food (QSR)
- Travel Centers

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

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