NACS State of the Industry Summit

A WINNING YEAR

According to data released at the recent NACS State of the Industry Summit, 2014 was a year like no other.

BY JERRY SOVERINSKY

46.5% That's the impressive increase in pre-tax profit achieved by convenience and fuel retailers in 2014 (following a year that had already established an industry record for in-store sales), according to data released at this year's NACS State of the Industry (SOI) Summit, held April 14-16 in Chicago.

They are historic returns that validate the industry's collective commitment and efforts, a progression of growth over the past several years. Recall previous year SOI Summit summations: depressed (Running Out of Gas, 2008), stagnant (Flat is the New Up, 2009), sustainable (Keep Your Business in Great Shape, 2010), cautious (Top Five Watch Outs, 2011), mixed (Tale of Two Halves, 2012) and last year's weird (Twilight Zone, 2013).

But alas, after achieving a 46.5% lift in profits in 2014, following an otherwise healthy 2013, the restraint gave way to — gasp! — self-congratulations and even a little swagger. "If we were a country, [based on industry sales], we would stand somewhere between Saudi Arabia and Switzerland," said Billy Milam, president of RaceTrac Petroleum Inc. and member of the NACS Research Council, during an opening day presentation.

Virtually every category, quartile and region recorded gains — strong gains — that positioned the convenience store industry as a model of success. And to learn firsthand of the achievements was a standing-room-only crowd of industry leaders — a 15% increase in attendance from last year — eager for news and insights.

"We've outgrown this hotel," announced Steve Loehr, NACS chairman and vice president of operations support for Kwik Trip Inc., moments after the event began. "That shows a positive story about the SOI and a positive story about the value of NACS. Despite challenges to the economy, ours is an industry that is growing."

And so began this year's Summit.

ECONOMIC OUTLOOK

"We did it," proclaimed David Nelson, professor of economics at Western Washington University and president of Study Groups, upon taking the stage for the event's opening presentation. "In June of last year, we fully recovered the number of jobs lost in the recession."

After six-and-a-half years, the economy and opportunities for convenience stores look strong:

1. Employment: The U.S. economy has added an average of 269,000 new jobs per month over the past year, "the best since the mid-1990s. We've gone 61 months with positive job creation every month," Nelson said.

2. Oil: "We're now at a 28-year low in oil imports; [there's] a real price war going on" with the United States as the largest oil producer in the world.

3. Economic outlook: "Our current expansion is 70 months old," nearly a year longer than the average expansion (60 months), Nelson said. Things are so strong, he quipped, "Millennials may be moving out of their parents' basement."

Despite those auspicious trends and returns, Nelson cautioned retailers against complacency. "Uber, the world's largest taxi company, owns no vehicles; Facebook, the world's most popular media owner, creates no content; Alibaba, the most valuable retailer, has no inventory; and Airbnb, the world's largest accommodations provider, owns no real estate. Makes me wonder: Are we doing something wrong here with bricks and mortar and the goods that we sell?"

NEW DRIVERS OF FUEL DEMAND

"Every forecast [about fuel demand] will probably be outdated tomorrow," began John Eichberger, vice president of government relations for NACS and executive director of the Fuels Institute. "They're instructive, but it's much more important to think about what the fundamental drivers are."

While gasoline consumption is trending down ("By 2030, we'll have another 22% destruction in gasoline demand,"

Dr. James Johnson, distinguished professor at the University of North Carolina at Chapel Hill, led a rousing discussion of disruptive demographics.

Eichberger said.), the result of increasing fuel efficiency, less certain for retailers is the impact of alternative fuels such as natural gas, biofuels, hydrogen, electric and biodiesel. Are they passing fads or technology that will be widely embraced? For that, Eichberger said it's important to look at the pace of change.

It's been more than a century since the gas-fueled Model T was introduced, and today, 98.1% of vehicles still run on gasoline. "How long does it take for the transportation industry to adopt new technologies?" Eichberger asked rhetorically. "It takes a long time."

Regardless of the fuel used, consumer habits are also changing. With Millennials moving back to urban centers and ride-sharing services on the rise, "We're seeing a sea change in the way the next generation behaves and relates to their vehicle," Eichberger said. And with smartphone adoption nearly ubiquitous, interconnectivity between cars and mobile devices will be key, creating opportunities for convenience store retailers. "Figure out what type of strategies we can use to communicate with customers while they're driving."

Finally, Eichberger addressed alternative fuels and considered their likely impact, both short and long term. For that, he was bullish on the potential for hydrogen fuel cells, a grid-independent electric vehicle with zero emissions. "Infrastructure is being built in select cities," he said, "and while we need to pay attention to this, there's no need to begin putting in hydrogen refueling stations yet."

HEALTH AND WELLNESS

"It's all about the execution and the quality," said Sherry Frey, senior vice president of the Nielsen Perishables Group for Nielsen, in addressing strategy for convenience store retailers looking to capitalize on good-for-you foods, including fresh food. "You don't get credit for brown bananas," she said.

"Pursuing health and wellness has caught the attention of the American public," Frey continued. "It is a mainstream conversation." To succeed, retailers must understand four key principles about consumers:

- **Knowledge is king:** Consumers are becoming proactive, taking ownership of health and nutrition.
- **Healthy aspirations:** The desire for a healthy lifestyle does not always match behavior.
- **Food as medicine:** Vitamins and fortified foods are on the rise.
- **Not one size fits all:** Population diversity corresponds to differences in purchasing behaviors.

AND STILL MORE...

Other speakers offered additional insights, both on the main stage as well as during breakout sessions:

- **Jeff Lenard**, vice president, strategic industry initiatives for NACS, looked at strategies for succeeding with fresh, health and good-for-you foods in "A Refreshing Look at the Industry."
- **Tom Kloza**, global head of energy analysis for OPIS, analyzed fuel prices in "Energy Pricing in a Changed World," cautioning retailers to reject the predictions of pundits, who promised $5/gallon pricing earlier in the year. "Beware of what you see in the news," Kloza said. "Very much it's an agenda that gets pursued."
- Select suppliers hosted **Retailer Hot Topic Sessions** during breakfast on the themes of millennials, channel blurring, maximizing dayparts and spending with relevance.

Finally, networking receptions and supplier-hosted dinners — as well as the NACSPAC Lounge — brought together attendees for some quality relationship-building.

Frey sees health and nutrition as an increasing priority for Americans, one that retailers must acknowledge and commit to to achieve sustainable returns. "Health and wellness is more than just carrying a few products on your shelves; it's about living and breathing it every day," she said. "It's not just how you engage with your shoppers but how you engage with your employees and what health and wellness programs you're supporting.

"That we can be part of something to foster a healthier America is very exciting," Frey concluded. "The reality is healthier shoppers really contribute to a healthier bottom line."

DISRUPTIVE DEMOGRAPHICS

"Our country, every region, is in the midst of an unprecedented demographic transformation," announced Dr. James Johnson, William Rand Kenan Jr. Distinguished Professor at the University of North Carolina at Chapel Hill.

The changes have dramatically altered the social, economic and political fabric of our country, he said, which present profound implications for convenience stores. Key changes include:

- **The South rises:** "[Since 1970], the South has captured about half of the net population growth in this country," Johnson said, with the largest increases occurring in Florida, Texas, Georgia and North Carolina.
- **Increasing diversity:** From 2000 to 2010, 91.7% of population growth was among non-whites.
- **Intermarriage:** "Marriage patterns are changing, with the largest, non-Hispanic growth group identifying themselves as two or more races ... That has enormous implications on your advertising."
- **Aging population:** "Everything has to change as a function of an aging population," Johnson said. Retailers must tweak their product mix, labeling, packaging and portability accordingly. "Things need to be senior-friendly," he said, including the accessibility of stores.

Sanjay Khosla, of the Kellogg School of Management at Northwestern University, told attendees how to find sustainable growth by doing a few things bigger and bolder.

Sherry Frey, senior vice president of the Nielsen Perishables Group for Nielsen , discussed healthy trends.

- **The rise of women:** Women will soon surpass men as the majority of the workforce. "This is one of the most challenging issues we're going to face," Johnson said, as it could impact the people who visit convenience stores.
- **Multi-generational families:** There is a big increase in grandparents taking care of their grandchildren, which affects what is bought for the home.

The changing demographics are creating opportunities, Johnson said, such as among immigrants and ethnic minorities. "You can win at this game, but you have to have your eyes open and your eyes on diversity. The companies that understand and cater to the [changes] will win."

FEWER, BIGGER BOLDER

"How do you get sustainable growth by doing just a few things bigger and bolder?" asked Sanjay Khosla, senior fellow at the Kellogg School of Management at Northwestern University. The rhetorical question prompted retailers to take another look at today's do-everything mentality.

"Many companies around the world are spreading themselves thin with more food, more items, more markets," Khosla said. "We call this the seduction of more. How do you go from the seduction of more to the wisdom of less?" To succeed, retailers must keep things focused, concentrating on areas where they can win. "Don't be everything to everybody ... The most difficult thing is to say 'no.'"

Khosla recommends focusing on just five key areas where you have a competitive advantage, backing those with resources and teams of people. And then empower those people to take charge. "When you liberate people and give them freedom, you unleash the potential of teams."

Attendee interest was enthusiastic and sustained throughout the Summit, with nearly all presentations and breakout sessions generously attended. The overwhelming majority celebrated a job well done, albeit one where all external influences aligned to help contribute to extraordinary results. NACS

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Billy Milam, president of RaceTrac Petroleum Inc. and member of the NACS Research Committee, shared industry performance numbers with attendees.

NACS State of the Industry Summit

UP, UP AND AWAY

Industry numbers hit an all-time high in 2014,with nearly every category, quartile and region recording gains.

BY JERRY SOVERINSKY

"Last year, if you didn't make money, you've got to go," said Tom Kloza, global head of energy analysis for OPIS, commenting on 2014 industry performance at this year's NACS State of the Industry (SOI) Summit, held April 14-16 in Chicago. "You're not going to see a year like 2014 often."

He didn't have to say much more to convince the standing-room-only crowd of that sentiment. For several years, it's been fair to gauge industry performance based on attendance at the SOI Summit. Since 2009, in fact, following a year characterized by the nasty "D" word — Depression — attendance at the event has steadily swelled, a correlation to overall industry sales and profits.

However, even this year's 476 SOI Summit attendees — 15% more than last year — failed to top last year's achievements. Pretax profit surged 46.5% to $10.4 billion in 2014, following an already robust 2013 that established its own industry record for in-store sales.

Granted, most Summit presenters acknowledged that unique, external circumstances, which led to unusually high fuel margins, drove the overall profit increase, but performance was still impressive in nearly all other key categories and metrics.

Indeed, one had to look hard to find weak spots in any of the numbers, and Billy Milam, president of RaceTrac Petroleum Inc., conceded as much during his opening day presentation. "This might be a tired argument," he went on, "but [the card companies] took $11.4 billion, $1 billion more than our profits."

Quite simply, things are looking good for the convenience store industry, whose collective (just a smidge under) $700 billion in sales exceeds the GDP of Switzerland, and whose inside sales of $213.5 billion equal the total industry sales — inside and out — from 1998. Indeed, were the convenience store industry a country, it would rank in the top 20 globally in terms of production.

Regular Unleaded Margins

2013: **19.0%**

2014: **22.3%**

A 17.4% difference

(Source: CSX, LLC)

A palpable, pervasive excitement was felt among the Summit crowd, an overwhelming enthusiasm that has resolutely replaced nervousness (2012 and 2013) and despair (2008 through 2011). Attendees were anxiously awaiting their collective progress report, which did not disappoint.

But first, came the caveats.

WHAT'S ON THE HORIZON

"The [convenience store customer] has changed," said Milam, member of the NACS Research Committee, who stressed a long-term perspective for growth. "Our customer is different and the expectation is different." Income bifurcation — the difference between the top 20% versus 80% of income earners — continues to grow. "How does this impact us?" he asked rhetorically. "The people in the bottom 80% have less income to make purchases."

Meanwhile, the numbers of miles driven in the United States are stagnant; combined with rising fuel efficiency, gas volume sales steadily declined from 2007-2012 (it rose slightly in 2014). But clearly, with overall vehicle fuel efficiency up more than 25% over recent years, the convenience-petroleum paradigm is shifting. ("By 2030, we'll have another 22% destruction in gasoline demand," John Eichberger, vice president of government relations for NACS, said later that morning. "It's going to change the nature of the market.") And while gas consumption may be down, it's not slowing the expansion of the convenience format.

Numbers Race

"One in three brick-and-mortar retail establishments in this country are a convenience store," Milam said. "We dominate the landscape with [more than] 150,000 stores."

In fact, the U.S. convenience industry store count of 152,794 stores is a 1% climb from 2013 and 28% increase from 2000. But growth is not restricted to the convenience store industry. Over the past two years, the dollar store leaders have experienced even greater store count growth (Dollar Tree is up 6.9% and Dollar General 6.0%), while drugstore chain CVS is up 2.6% and Walmart has grown 4.9%. "So how do we stifle that [growth]?" Milam asked. It's a concern that merits attention.

Over the past year, a number of retail-restaurant deals have been consummated, generating staggering valuations — Walgreens/Alliance Boots ($15.3 billion), Burger King/Tim Hortons ($13.4 billion) and Dollar Tree/Family Dollar ($8.5 billion) — consolidations that pose increasing competition to convenience stores. And while Amazon's drone delivery may have run into a snag with the federal government, Milam said the mega-online retailer is looking at an innovative brick-and-mortar format that eschews checkout lines and cash registers.

"You don't have to talk with anyone. It's that kind of forward thinking that we need to think about." Throw in roaming convenience trucks that venture to the customer (even a Starbucks version that includes mobile payments) and a corner store concept of on-demand delivery brought to you by Uber, and retail may look quite different in the coming years, Milam warned. "These guys are thinking about how to turn retail on its head."

THE NUMBERS

But still, no matter these tectonic shifts in consumer preferences and retailing dynamics, the convenience store industry is currently getting things right. Nearly two hours into this year's SOI Summit, it was time for some bottom-line results (% change from 2013):

Industry

- **Inside sales:** $213.5 billion (+4.6%)
- **Fuel sales:** $482.6 billion (-1.8%)
- **Card fees:** ($11.4 billion (+2.3%)
- **Employees:** 2.43 million (+10.6%)
- **Fuel margin** (cents/gallon): 22.2 cents (+18.8%)
- **Fuel margin** (net card fees): 16.9 cents (+26.4%)

While motor fuels prices were down nine cents per gallon ($3.45 to $3.36) in 2014, this created a six-cents-per-gallon lift in margin (18.7 cents to 25.0 cents).

Same Firms

Meanwhile, same store performance recorded sizable increases in in-store sales and an uptick in fuel gallons sold (% change from 2013):

- **Total sales:** $596,004 (-0.2%)
- **Fuel sales:** $477,390 (-1.8%)
- **Fuel gallons:** 143,780 (+2.3%)
- **In-store sales:** $146,049 (+4.6%)
- **Foodservice sales:** $28,170 (+9.7%)
- **Merchandise sales:** $118,403 (+3.4%)
- **Merchandise sales (less cigarettes):** $70,936 (+5.5%)
- **Cigarette sales:** $48,479 (+0.1%)

"I'll take the 0.1% [increase] in cigarettes sales, given the declines we've seen over the past few years," Milam said.

Same-store sales for convenience store competitors were mixed, with Walgreens recording the strongest gain (+9.3%), followed by Dollar General (+3.1%) and Rite Aid (+1.3%). While CVS saw just a 0.5% increase in sales, the rise is notable considering the company no longer sells cigarettes. "We need to pay attention to major chains," Milam warned again.

Part of that effort — to fend off competitors — will require a boost in efficiencies and gross profit dollars, something the convenience channel accomplished convincingly in 2014, with monthly totals as follows (% change from 2013):

- **Total gross profit:** $81,833 (+11.8%)
- **Fuel:** $32,314 (+22.8%)
- **Fuel pool margin:** 22.47 (+20.1%)
- **Fuel margin (less card fees):** 17.19 (+28.2%)
- **In-store:** $47,382 (+6.2%)
- **Foodservice:** $15,892 (+9.8%)
- **Merchandise:** $31,786 (+4.3%)
- **Merchandise (less cigarettes):** $25,514 (+6.4%)
- **Cigarettes:** $6,562 (-2.6%)

"Gross profit is up," Milam proclaimed, a nearly across-the-board (less cigarettes) rise that is outpacing expenses two-to-one.

At the same time, key expenses are growing, "driven by supplies, repairs and maintenance and wages ... with utilities and card fees [mitigating] those numbers," Milam said. Expect expenses to continue to rise, he warned, with 29 states adopting a minimum wage increase in 2015 that is greater than the federal level.

Among wages and benefits, health insurance costs jumped 11.7% in 2014 to $1,750 per store per month, in part because of growth in part- and full-time employee numbers.

Speaking of employees, Milam pointed to employee turnover, which has grown considerably in just the past four years:

- **Non-manager:** 68.0% to 80.7%
- **Manager:** 14.1% to 14.4%

Core Direct Store Operating Expenses

Per Store/Per Month	2013	2014	△
Wages & Benefits	$22,391	$23,899	6.7%
Credit Card Charges	$7,045	$7,189	2.0%
Utilities	$3,052	$3,262	6.9%
Repairs & Maintenance	$3,016	$3,203	6.2%
Supplies	$1,397	$1,542	10.4%
Total DSOE	$43,429	$45,693	5.2%
Facility Expense	$9,537	$9,981	4.7%
Total DSOE & Facility Expense	$52,966	$55,673	5.1%

(Source: CSX, LLC)

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Sales

Same Firms

Per Store/Per Month	2013	2014	Δ
Total All Sales	$597,069	$596,004	(0.2)%
Fuel Sales	$486,314	$477,390	(1.8)%
Fuel Gallons	140,586	143,780	2.3%
Average Selling Price	$3.46	$3.32	(4.0)%
In-Store Sales	$139,680	$146,049	4.6%
Foodservice Sales	$25,675	$28,170	9.7%
Merchandise Sales	$114,534	$118,403	3.4%
Mdse-Cigarettes	$67,243	$70,936	5.5%
Cigarettes	$48,411	$48,479	0.1%

(Source: CSX, LLC)

Gross Profit $

Same Firms

Per Store/Per Month	2013	2014	Δ
Total Gross Profit	$73,179	$81,833	11.8%
Fuel	$26,304	$32,314	22.8%
Pool Margin	18.71	22.47	20.1%
Margin-CC Fees	13.41	17.19	28.2%
In-Store Sales	$44,636	$47,382	6.2%
Foodservice	$14,472	$15,892	9.8%
Merchandise	$30,462	$31,786	4.3%
Mdse-Cigarettes	$23,986	$25,514	6.4%
Cigarettes	$6,739	$6,562	(2.6)%

(Source: CSX, LLC)

PRODUCTIVITY

Milam also presented a detailed analysis of quartile performance, breakouts that will also be available in the soon-to-be-released *NACS State of the Industry Report of 2014* Data. As a benchmark, keep in mind the following top-quartile productivity numbers, he said (per store, per month):

- **Motor fuels gallons sold:** $199,307
- **Breakout cents-per-gallon:** 8.71 cents
- **Merchandise sales:** $147,995
- **Foodservice sales:** $40,150
- **Store operating profit:** $39,605
- **EBITDA:** $37,565
- **Net profit margin (pretax/sales):** 3.63%

The top numbers point out significant disparities in performance among top and bottom performers — and even those somewhere in the middle — though collectively, the nearly sweeping increases in key categories among all segments emphasize an extremely healthy state of the industry, one where retailers are capitalizing on opportunities.

"We are starting to get it when it comes to foodservice," Milam concluded. With strong fuel gross profits, a 46% increase in pre-tax earnings, and higher productivity, the convenience store industry is growing — but there is still work to be done, he said, referencing his opening remark caveats.

The callback was timely, leading in to the second half numbers presentation by Kevin Smartt, CEO of Kwik Check Food Stores, who covered category detail and regional performance.

While 2014 was indeed a superior year of performance, there is little in the sense of security when it comes to the convenience channel and an expanding roster of competitors.

Gasoline and tobacco are down, Smartt said, while "everything else" is on the rise — particularly foodservice. To continue to succeed, retailers must Create an appealing environment for shoppers, offer appealing Choices, Customize offerings, including Craft or small batch versions, while continually focusing on Convenience (the five C's).

"Take those five Cs back, take them to your team," Smartt said, fresh insights to help grow sales and profits.

2014 was a monumental year of achievement, Smartt observed, a once-in-a-generation spike in performance where an industry pounced on opportunities for maximum results.

Yes, elements outside of retailers' control (fuel margins) were favorable, but it still took a collective, strategic effort to generate such substantial returns. That's a testament to NACS members and their relentless quest to innovate and improve, to set an ever-higher bar for achievement. And while 2015 may not bring such favorable returns, it's a challenge Summit attendees seemed ready to face. NACS

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