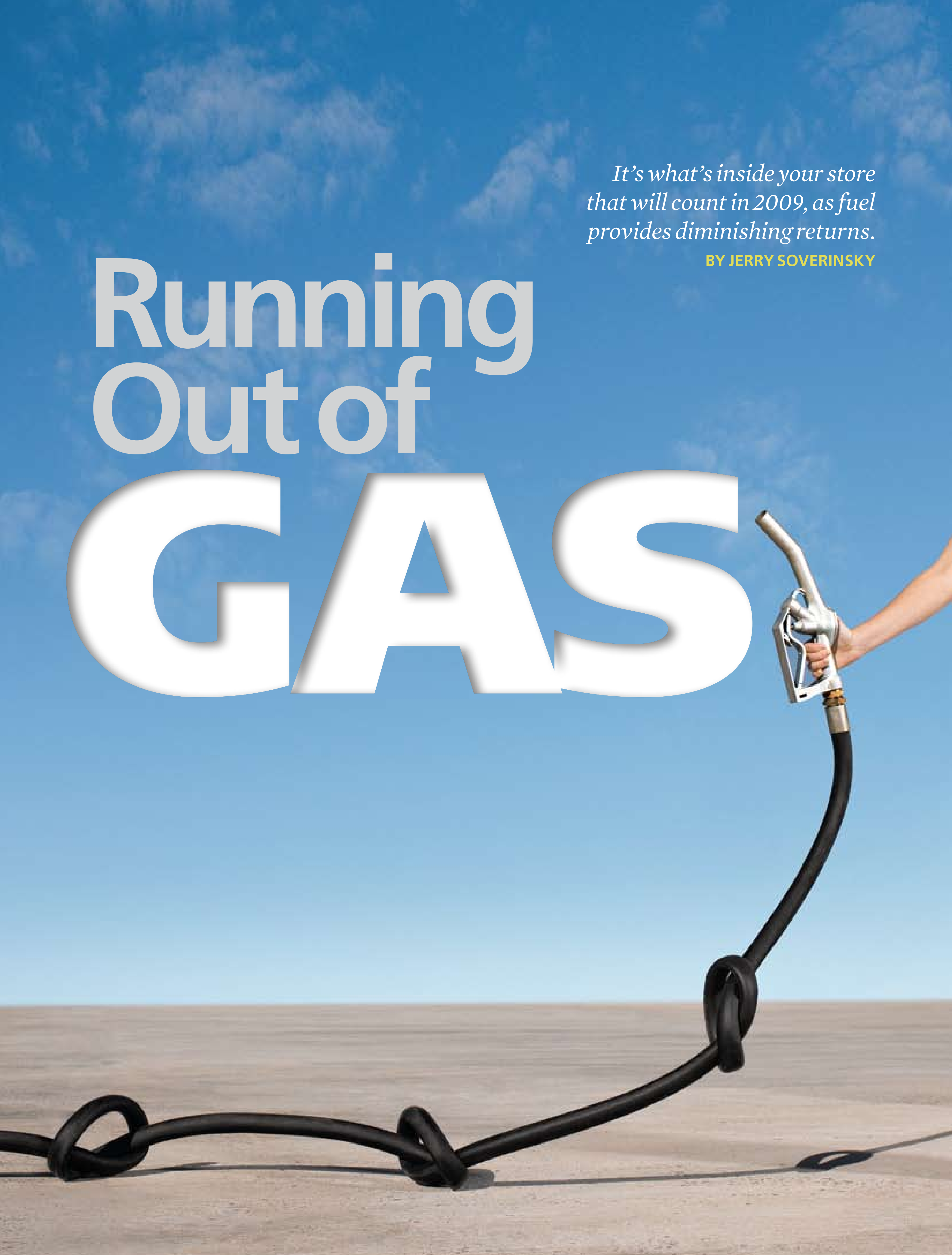
Running Out of GAS

It's what's inside your store that will count in 2009, as fuel provides diminishing returns.

BY JERRY SOVERINSKY



It never takes long. Last year at the NACS State of the Industry Summit in partnership with CSP, it came less than two hours into the opening session, and its utterance was greeted with a sustained murmur that echoed through the conference hall. It was the "R" word. Recession.

Looking back, the 2008 State of the Industry opening session offered a sobering analysis for retailers, one peppered with talk of inflation, deflation and economic downturn.

And this year?

In the spirit of downturns, most of the analyses at the 2009 general sessions were even *more* sobering than those in 2008. And just as it did during last year's Summit, the harshest assessment came quickly, not long after the opening session. But this year, the "R" word was replaced by a "D" word: Depression.

Like an agile boxer dancing about the ring, tossing about a continuous volley of jabs that score convincingly with the judges, Walter Zimmermann, chief technical analyst at United Energy, presented strong evidence that the market is signaling an imminent depression.

He said that a credit bubble burst precipitated the Great Depression, before noting that the credit bubble that burst recently *dwarfs* the size of the Great Depression credit bubble. "There's a lot of bad news to come," he warned, and went on to predict commodities to bottom in 2011, stocks to crash in 2012, and real estate to hit its low point in 2014.

And then it was time for lunch.

Yes, the Summit presented ominous predictions for the economy as a whole, but it also was replete with practical data for store operators — "Protect your pennies," as State of the Industry Summit Chairman Fran Duskiewicz, senior executive vice president at Nice N Easy Grocery Shoppes, advised during one presentation — a micro-way to manage the macro-outlook, if you will.

Collectively, the Summit provided meaningful context for the industry's role within a larger economic framework, with take-home advice aimed at maximizing the industry's collective performance — one store at a time.

Don't Overlook the Opportunities

NACS Chairman of the Board Sonja Hubbard, CEO of E-Z Mart Stores Inc., opened the general session by establishing an optimistic, ambitious tone.

"We have learned to operate lean, mean and survive the tough times," she began, noting that today's economic climate is "in a time of crisis." But despite the tough economic outlook, there are several key points she urged attendees to remember.

"Our industry isn't recession-proof, but maybe we're recession-resistant," Hubbard said, a recognition that fuel and food are staples aren't easily placed on hold. As such, she issued a directive that was repeated several times during the course of the conference: "Don't overlook the opportunities...Adversity is a great teacher, we have opportunities to grow ourselves."

Hubbard pointed to two areas that bear consideration and generate positive returns, no matter the economic conditions. "We need to show our supplier partners that we are their greatest opportunities for growth, and we need to expand our advocacy efforts," she added, reminding attendees of the ongoing battle against credit card fees.

It was an enthusiastic opening, one that established a measured and confident tone for the remainder of the Summit.

Economies of Scale

The transition from generalities to specifics came quickly, though not without an affectionate beginning. David Nelson, professor of economics at Western Washington University and president of Study Groups, opened his presentation with a question.

"How will the economy be LUVD?" Nelson asked. (Not rhetorically, either. He wanted a show of hands.)

His question posed an assessment of the current recession and its eventual (!) recovery. Would the economic graphs charting the progress be:

- L-shaped (several years or more of little growth)?
- U-shaped (a one- to two-year contraction followed by growth)?
- V-shaped (contraction immediately followed by growth)?
- Or D-shaped (prolonged contraction followed by further contraction that could last up to three years — i.e., the Great Depression)?

While Nelson didn't offer a definitive prediction, he provided details that illuminated the industry's position in the current economy. (The most show of hands went up for U-shaped.)

For example, monthly employment data shows a severe increase in the unemployment rate (UR). Since the fourth quarter of 2007, the UR has increased from 4.9 percent to just under 9 percent.

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This is not an innocuous figure without direct economic impact to the industry, and Nelson was quick to translate the numbers to retailers' bottom lines: A rise in the unemployment rate from 5 to 9 percent equals a decline of $4,842 per month in inside sales for the average retailer — or roughly 5.24 percent of sales.

Collectively, the spike in the UR is part of a much larger consumption dip. Combined with an increased UR, there has been a net loss since mid-2007 of $13 trillion to the U.S. economy, primarily a result of residential real-estate losses and a decline in stock market and asset values.

Among the signs that will indicate a recovery, Nelson cited companies hiring more temporary workers, an increase in per-worker weekly hours, the beginning of a clearing of unsold homes, and a rebound in the stock market and leads by four months or more.

Nelson also offered some advice for dealing with current economic realities:

1. **Watch your cash**. "Don't spend cash unnecessarily — that's part of your cushion to survive right now."
2. **Review your trade credit**. "Segment your customers by risk because customers are going to want to use you for financing when their own capital is impaired."
3. **Manage your working capital**. "There's a lot of cash to be found in how you manage your receivables, your inventories and your payables."
4. **Be conservative with debt**. "Banks are looking for ways to find you out of compliance with your covenant and to raise your rates."
5. **Stress test your business**. "What's your plan for survival if sales drop another 5 percent, 10 percent or 20 percent? Do you have the means to survive?"
6. **Become as efficient as possible**. "In this time when your employees are worried about their jobs, they're worried about your business — they'll be much more responsive to measures that may help you not only survive the current economic downturn, but make a lot more money when things get better."
7. **Adapt merchandise to changing consumer purchasing behavior**. "Today's customer is not the same as the customer was a year ago. They're thinking quite different things about the economy."
8. **Get rid of nonperforming, non-core assets and to look for opportunities to acquire new core assets**. "I think the upturn will come, and I think that investments made today could pay big dividends in the years ahead."

Nelson closed with a final recommendation that seemed to embody the collective spirit of the attendees: "[W]hen times are down, there's always people that are hurting a lot worse than we are. And I would just ask you to consider the needs of others who are hurting in the communities that you serve."

Running Out of Gas

Greg Parker, president and CEO of The Parker Companies, pointed to industry trends while urging dealers to (re)adjust their focus.

"We've got to learn to be less reliant on gasoline as an industry," Parker said, pointing to industry data that showed that from 2006 to 2008 only six months out of 36 produced profitable fuel margins. This is all the more troubling, considering that gasoline accounts for 75 percent of total industry sales. But as for assistance, he warned not to look toward cigarettes.

"With the new [federal] cigarette price increase, we're going to have diminishing profits in the cigarette category," Parker continued, noting that the industry cannot rely on the profits this coming year "that we had on gas in the past. But we can learn how to better

SOI attendees learned that the more they understand the numbers, the more successful they will be in 2009 and beyond.

Attendees and speakers at the SOI Summit showed high spirits in spite of some somber economic news.

manage our businesses."

Among Parker's recommendations, he urged retailers to renegotiate with suppliers to lower expenses. "Now is a great time to go back to our suppliers and talk to them about reducing those expenses," he said, noting how credit card fees have escalated and cut into retailers' bottom lines. In fact, the convenience and petroleum retailing industry paid an unbelievable $8.4 billion in credit card fees in 2008, an increase of 10.5 percent from last year.

"This is where I start getting mad — $800 million more that we paid for credit card expenses [in 2008]," said Parker. "And if you will look at the past four years between 2004 and 2008, credit card expenses have more than doubled...[T]his credit card thing is just totally out of control."

A Non-Fuel Focus

With an eye toward generating revenue and maximizing profitability, Fran Duskiewicz focused on inside sales.

"The fun thing about this business is selling stuff," he began, before launching into a point-by-point analysis of product categories.

Cigarettes "now are becoming a higher risk inventory department than ever before because the cost of it is so expensive," Duskiewicz said. At the same time, while he believes that higher cigarette taxes will drive down sales, retailers should focus on the other tobacco products category. "Last year I called it the little department that could — I think it still is — I think we own this department and it's only going to keep growing," he said.

And while newspapers and periodicals are failing, there are other opportunities in the general merchandise category. It just takes careful — and sometimes swift — action.

"After [the University of] Syracuse [men's basketball team] won a six-overtime game, we sold Syracuse t-shirts," Duskiewicz said, noting that the high-margin shirts turned over quickly. Many Nice N Easy stores also sell the cult-favorite blanket of couch potatoes — Snuggies and Snuglettes (for children). "Our general merchandise sales spiked like you wouldn't believe because we were selling Snuggies," he said.

Sometimes, Duskiewicz said, it takes a different perspective when viewing sales data. For instance, while coffee sales dipped at his stores, many customers migrated toward energy shots. He views that shift not as a lost sale — just a converted one.

Finally, repeating a common Summit theme, Duskiewicz said that the industry requires a collaborative effort between retailers and suppliers, and he praised Kraft for removing pre-priced numbers from their salty snack packages and Frito-Lay for taking their 99-cent bags to $1.29.

"Carbonated soft drinks have a significant take-home component," he said. "I urge our trade partners to work with us more on take-home packages. We can sell more consumption products for beverage companies."

Shut Up and Listen

Regardless of the state of the economy, for David Portalatin, director of industry analysis for NPD Group, the focus for retailers should always be on consumers. Understanding their needs and responding accordingly is the key to growing a business in this — or any other — economy.

"Consumers are *telling* you what they need," Portalatin emphasized, "and those businesses who respond to those needs will do extremely well."

For retailers to leverage opportunities with consumers, it's important to recognize the challenges. First, it's no secret that consumers are cutting back on their purchases. According to NPD research, more than half of consumers polled said they will spend less over the next three months, and more than half of those are doing so because they have less money to spend.

For retailers, this presents practical

Speaker David Nelson injected a little humor into his presentation.

challenges, but ones they should meet head on. "Giving people a deal will resonate," Portalatin said, pointing to Walmart's recent uptick in sales, coinciding with its "Save money. Live better." marketing message.

However, just cutting prices won't necessarily do the trick. "Everyone is discounting," Portalatin said, "Think creatively about how you can stand out."

Portalatin recommended differentiating quality, value and convenience. "Differentiated chains will gain share and rebound in traffic faster than their counterparts," he said. But as for value — don't focus on the lowest price. "You might pay more for a national brand that's more expensive, but if there's a value proposition, it's a good choice."

Additionally, Portalatin pointed to foodservice as a key area where retailers can differentiate themselves. "The top performers are different — they're more developed in food prepared onsite, offering coffee, hot drinks and packaged sandwiches," Portalatin said.

"But don't give away the farm, consumers want a good deal but [they'll pay for] a fair deal," noting that competing on price alone will be a losing proposition, since QSRs are able to provide increasing pressure in this regard.

Oil: No Peaking

Joe Petrowski, CEO of Gulf Oil/Cumberland Farms, examined the petroleum industry with a political bend. While the challenges facing petroleum retailing are real, "Shaping legislation affecting fuel retailing is extremely important," Petrowski said, who went on to discuss federal taxes, cap and trade, and alternative fuels.

However, while many of the industry's challenges are external, Petrowski said that there is much retailers can control. "[First], you need to get net operating costs under 10 cents (per gallon)," Petrowski urged.

Second, "structure yourself for alternative fuels and be proactive in understanding trends," he said.

Third, find a way to breed customer loyalty that doesn't depend only on price. "Loyalty can be many things," Petrowski said, indicating that gestures as simple as smiling or welcoming customers can go a long way in establishing your brand.

And finally, find ways to buy fuel better through either hedging or supply-chain management.

The Glass Is Half Full

Combined with a line-up of industry experts who shed insights on real estate, oil and commodity and CPG, to name just a few, the underlying Summit tone was one of unfinished business, with a message imploring retailers to understand the challenges ahead and fully leverage every opportunity and resource.

I couldn't help but perceive a very subtle skepticism among the attendees, not one of defeatism, but rather, an acknowledgment that economic realities will override much of the control that they wield over their business operations.

It was a sentiment that at least one of the speakers also recognized, who, while conceding the realities all around them, reminded them of the industry's context within that larger picture.

"You're growing faster than McDonald's," cried Don Ratajczak, an economist at Morgan Keegan & Company who opened the Summit's second day general session, a "for heaven's sake" reproach that tried to shake the despair from the attendees. He seemed unimpressed by the dour news that seemed to permeate the previous day's session.

"For what's going on, the average fourth quarter operating profit at other industries dropped 40 percent last year, whereas for c-stores, they increased," Ratajczak reminded the attendees.

"So don't hang your heads...I think your industry is going to have a good year." NACS

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