With incremental or no growth in many categories, the industry experiences its fourth most profitable year — in the midst of the country's worst economic setback in decades.

BY JERRY SOVERINSKY

Flat Is the

Attendees at previous NACS State of the Industry Summits understand that Walter Zimmermann, chief technical analyst at United Energy, has a way of muting the most favorable economic data of the speakers who precede him. And this year was no different.

Following several speakers who collectively reported that the convenience and petroleum retailing industry escaped relatively unscathed in 2009, during an otherwise brutal year for other industries, Zimmermann sobered the mood by warning operators that things were about to get worse. Maybe.

Rifling through a dizzying collection of data-dense charts, Zimmermann offered convincing evidence — much like a district attorney trying to persuade a captivated jury — that the talking heads on CNBC and the like ("Where it can be difficult to cut through the cheerleading.") are filling consumers with false optimism.

"This is another gruesome gem," he said at one point, referencing a sharp, downward graph. "The annualized pace of U.S. home sales hit record lows [last year], going back to 1980. This is your triple black diamond ski slope." He paused for effect, allowing the audience to absorb the news.

Next, he related unemployment figures to real estate foreclosure rates, assessing that the latter are not increasing simply because the former have mounted. Rather, he characterized the 30-percent foreclosure rate as strategic, relating to consumers being able to rent a house for less than they can pay a mortgage.

"If banks today have to write down the value of all their mortgages to current home values," Zimmermann said, "they would have to write off $900 billion. And banks do not have that as a net worth."

I glanced around, and noticed dozens of attendees squirming in their seats and lowering their heads — not out of boredom, mind you, but out of discomfort at such dispiriting news. When pressed to offer an economic forecast, Zimmermann said that the real estate market still had four years — until 2014! — before it bottomed out.

He continued, stopping to emphasize a

New Up

slide that he referred to as the "*most* worrisome" (*quadruple* black diamond ski slope?): "Consumer credit is in a nosedive," he said, adding that people are overextended and need to save money. But as lending is tight, it's difficult to obtain a loan. All of this pointed to a "terrible risk" of deflation, Zimmermann noted, which he said is "punishing" for people who have debt. "Deflation can grind the economy to a halt."

Finally, summing up the global economic problem for the next several years, Zimmermann pointed to a revenue shortage. "There is not enough revenue to support the debt that exists...We believe that there is caution, if not alarm [on the horizon], for the economy."

Well.

Zimmermann spoke for less than an hour, and while he exited the stage to enthusiastic applause, the collective expression among attendees was one of impressed indifference, a sincere appreciation for his financial insights, but tempered with a liberal dose of confidence — a realization that their industry had already withstood the most severe economic downturn in decades.

The distinction highlighted the duality of this year's State of the Industry (SOI) Summit, one emphasizing the state of the industry, and the other detailing the state of the overall economy. They were not the same, at least in 2009. NACS Chairman Jay Ricker alluded to such as he opened the Summit earlier that morning, "We're going to look well beyond trends within our industry."

Zimmermann had indeed delivered on such a promise, and the audience seemed to firmly grasp the distinction. Yes, things *might* take a turn for the worse for the overall economy. But dedicated and committed convenience store and petroleum retailers, having made it through 2009 in one piece, seemed confident that they could endure anything that 2010 and beyond might bring.

The NACS State of the Industry Summit presented much to reassure such an outlook.

Resisting the Downturn

"In spite of the worst economic year on record, we're still where America shops," proclaimed Greg Parker, president and CEO of The Parker Companies and vice chairman of the NACS Research Committee, second to take the stage. He spoke of the recession not as a harbinger of belt tightening but of opportunities.

"The nimble retailers...will come out ahead with less competition than they did in the past," Parker said, imploring retailers to focus on the backcourt, as gasoline consumption has waned and will continue to decline. "Better quality employees are available to all of us. Other opportunities are available from our government; it's a great time to be investing in your business. A recession is a terrible thing to waste."

On the Upswing

Next up was David Nelson, professor of economics at Western Washington University and president of Study Groups, who sustained the elevated mood of attendees by relaying promising news.

"The financial system has stabilized, panic has subsided, and the economy is growing again," Nelson declared. "Unemployment has started to decline and we avoided another depression."

According to Nelson, real GDP growth turned positive in the second half of 2009, fueling 1.9 percentage points of growth, which he predicted would grow to 3.3 percent this year. And fuel volume was up one percent for the year, a modest increase from 2008, though still lower than what was sold in 2007.

The total is significant, as Nelson quantified the relationship between fuel volume and inside sales: Every one percent increase in volume is associated with a growth in real inside sales of up to 0.57 percent.

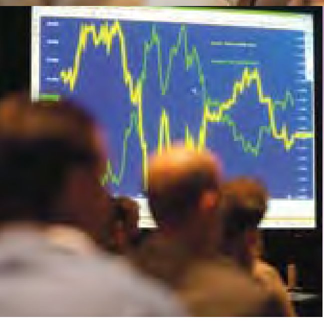
Nelson summed up the state of the economy, noting the following:

- Convenience store and petroleum retailers are in a recovery, and retailers should position themselves to leverage the turnaround.
- Economic growth will be steady but slow, rising up to 3.5 percent in 2010 and 4.5 percent in 2011.
- Unemployment is high and shows little sign of recovering over the short term.
- There is little inflationary pressure on the horizon. As such, retailers should seek good value and a measured approach to risk.

Winding down his presentation, Nel-








son said that the fiscal and monetary stimuli are winding down, and the ball is being passed to the private sector. "Are you ready?" he asked rhetorically, tossing an actual tennis ball into the crowd.

I'm pretty sure it bounced off of a chair, for whatever that portends. (Though to be fair, it was only 9:15 am.)

"Clearly Recession-Resistant"

Parker revisited the stage after Nelson and expanded on his earlier remarks, noting that the industry experienced its fourth best year, which is all the more remarkable, as it came during the height of the recession. "Our industry is clearly recession-resistant," he said, noting that in-store sales were up 5 percent, while total retail sales elsewhere dropped 7 percent.

Parker cited unemployment as a "mixed bag" for retailers: On the one hand, it has prevented the industry from realizing its full potential, with the current rate costing stores roughly $7,500 per month in lost sales; but on the other hand, there's a deeper pool of potential hires, along with HIRE (Hiring Incentives from Restore Employment) tax credits available to employers.

He detailed the emerging opportunities for retailers, stressing the low cost of capital for qualifying companies and lower land costs as particularly suitable for expansion. And to position finances most favorably, he recommended the following:

- Monitor working capital, reduce receivables, manage inventories and increase cash flow. Cash is crucial for current operations and future investment.
- Reduce debt and liabilities and secure access to capital for financial optimization.
- Sell underperforming stores.
- Decrease margins and expenses.

Focus on What You Can Control

"Flat is the new up," began Fran Duskiewicz, senior executive vice president of Nice N Easy Grocery Shoppes Inc. and member of the NACS Research Committee, who argued for a relative economic assessment — a gap analysis — to assess true industry performance.

"If you are up modestly up but everyone else is down, the gap analysis is the key," he said, imploring retailers to continue to search for opportunities and value across all categories.

While foodservice continues to generate hefty numbers — Duskiewicz said it accounts for 29.7 percent of in-store gross margin dollars — he said that much of that gets eaten up in costs, including labor, utilities and maintenance. Similarly, a large cooler is a "time-consuming monster" to stock and maintain, with a huge utility component. Recognizing that, he emphasized that tobacco holds a lot of added potential as a relatively labor-free category: "I'm not adding any labor to sell cigarettes, and I don't have to heat or cool them. So for productivity, I love cigarettes."

For similar reasons, he also offered an enthusiastic endorsement of OTP, another labor-free category, and one whose prices are proving more favorable than cigarettes. "I love OTP, it's a big department and we'll continue to develop this as much as we can," he said.

Duskiewicz said that there's a lot of untapped potential in coffee, arguing that the industry didn't fully seize the labor-free margins that it offers. "It's a scary proposition to see such a large potential margin like hot dispensed beverages down," he said, pegging the drop at 15.2 percent, while conceding that McDonald's "out-flanked" the industry with its McCafé concept.

Finally, he offered the most optimistic view of the industry's near-term prospects when he told the audience, "I have a sense that people are looking to bust out, the mood in the country has been down, and I think we're off to the races."

Fueling Sales

Despite the absence in 2009 of a fourth-quarter fuel save, which was what occurred in 2008, speaker Tom Kloza, chief analyst at OPIS, offered modest econom-






ic optimism for petroleum retailers.

"It's been a quiet first quarter of 2010," he began, "with relatively small day-to-day [oil] price changes...But I don't expect that to continue. If volatility is your friend, it's coming back. And he's like the guy who empties the chemical toilet in National Lampoon. He's coming back and he's annoying."

Addressing refining prospects through 2012, he predicted aggressive pricing, with refiners offering "a lot of deals" as they try to protect their market share, especially with an expected burst of output in 2012.

In the short term, he said that he is 95 percent certain that the EPA will approve a higher percentage for ethanol, and he implored retailers to consider how to accommodate vehicles that are ill-equipped to handle anything higher than E10. And he offered a bright outlook for diesel, saying that it would be the first product to realize a strong global recovery, though he was uncertain as to its timing.

Kloza closed by echoing a theme begun by Zimmermann in reference to the cable network talking heads: "There is news and there is propaganda."

Focused and Moving Forward

To be sure, credit card interchange rates were mentioned prominently at the Summit, but not in the same doomsday characterization as it was during last year's event.

While overall credit card fees dropped 11.9 percent to $7.4 billion, the drop was significantly less than what would be expected with the drop in the industry's revenue dollars. As a percentage of overall sales, credit card actually fees increased, from 1.35 percent to 1.45 percent of total industry sales dollars, factoring in all forms of payment, including cash and check. Total credit card fees also surpassed overall convenience store industry profits for the fourth consecutive year.

As interchange fees continue seemingly unabated, there's the full confidence that the industry will continue to move forward, relying on NACS data, Study Groups and other industry tools to help retailers interpret their collective metrics while laying the groundwork for best practices and success.

That is the true value of the NACS State of the Industry Summit and its data, an invaluable resource for an industry that fully appreciates and recognizes its collective strength and efforts, one that illuminates both where success began as well as where it is heading. NACS

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This year's NACS State of the Industry Summit attendees received an insider's look at 2009 category data as well as expert insights from industry leaders.

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