THE TOP 5 WATCH OUTS FOR 2012

BY JERRY SOVERINSKY

The NACS State of the Industry Summit revealed record industry performance numbers — but not all signs are favorable for 2012 as five big "watch outs" loom large.

Summit attendees not only gained valuable insight from 2011 performance metrics but also discussed strategic direction for future planning.

No depression. No recession. No deflation. No inflation. As a result, just a ho-hum year of steady growth for fuel and inside sales — especially foodservice — that totaled more than two-thirds-of-a-*trillion* dollars.

By nearly any industry's standards (pick one, any one: housing, hospitality, manufacturing and so on), 2011 was a great year for convenience stores, one that far surpassed performance numbers from 2010: a 18.5% increase to $682 billion in gross sales (a record); a 15.2% boost in fuel operating margin; and a 19% lift in same-store monthly sales.

How then, to explain, attendees' poker-faced restraint dominating this year's NACS State of the Industry (SOI) Summit — one whose underlying theme was one of foreboding (with five big trends to watch out for in 2012 and beyond) whose data revealed overwhelming success. Rather than dwelling on the record-high performance numbers, equal emphasis was given to a drop in fuel gallons, still higher credit card fees and decreasing tobacco sales.

The answer for the seeming austere mood lies in the nature of what the SOI Summit has come to represent for attendees. It's never been a rah-rah, cheerleading recap. Rather, as emcee and Chronister Oil CEO Wendy Chronister said in her opening address, "This is a forum providing you [with information to] make strategic decisions and take action."

There were familiar presenters (David Nelson, John Zikias, Todd Hale, Tom Kloza) and a few new ones (Glenn Plumby, Phil Flynn, Jim Ellis), each offering complementary insights targeting the economy, fuel, consumer and shopper insights and even politics.

The data was comprehensive and even more targeted than in previous years, breaking down results into deciles as well as quartiles, with voluminous analyses that promised to help make 2012 yet another successful year.

SOI veteran presenter David Nelson talks about the economic landscape; attendees made connections during networking receptions; NACS Chairman Tom Robinson reflects on top-decile performance.

Update on the U.S. Economy

Frequent SOI Summit presenter David Nelson, professor of economics at Western Washington University and president of Study Groups, took the stage early on day one, pointing out that while the recession was declared over in mid-2009, the general population has yet to feel reassured.

"The reason many don't think the recession is over is because unemployment is high," he said as he updated attendees on the U.S. economy. And the statistic bears direct impact on convenience stores. According to Nelson, for every 1% drop in the unemployment rate, inside sales (excluding tobacco), grow by roughly 2%. But the news in this area, despite flat to modest improvement last year, is looking up. "There is some good news on the employment area," he said. "For each of the last three months...we have seen an excess of 200,000 jobs created a month."

Looking forward, Nelson predicts unemployment rates to drop to 8.2% in June 2012, 8% by December 2012 and 6.8% by December 2014. Favorable economic signs include a rise in consumer spending, a decrease in the household debt to income ratio and an uptick in construction — especially important for retailers as "construction workers are among the best c-store customers" who visit two or three times per week on average.

But lest SOI Summit attendees get too optimistic, Nelson offered a number of elements that could lead to — yes — another recession:

- If oil prices reach $138 a barrel (currently, 79% of analysts say the price of oil is not a significant drag on economic growth)
- Fiscal tightening: an expiration of the Bush tax cuts and temporary payroll cut, as well as mandatory spending cuts of $1.2 trillion over 10 years begin, which alone comprise 3.5% of GDP
- Election year uncertainty
- Global slowdown

Nelson said fiscal tightening presents the gravest economic risks, as taxes will mostly likely need to be raised. "Congress will have to deal with this massive problem," he said, which could lead to higher gas taxes, sin taxes and even a national value-added tax.

Watch Out!

Next up was Glenn Plumby, vice president of operations at Speedway LLC, and member of the NACS Research Council, who presented what continues to be a favorite topic for Summit attendees: The Numbers. And for 2011, many of those numbers were industry highs:

- In-store sales grew 2.4% to $195 billion (record high), with total sales (fuel and inside sales) reaching nearly $682 billion (record high), which translates into 4.5% of the overall $15.04 trillion U.S. gross domestic product
- Pre-tax profit was up 7.3% to $7.0 billion (record high)
- Same firm sales rose 19.0% to $464,558 per month

Rather than dwell too much on convenience store successes, though, Plumby highlighted areas that require immediate industry attention, a number of "watch outs" that present immediate challenges for retailers.

1 Gasoline consumption trends are dropping.

"Consumption was down in 2011 about 1.6%," he said, "not a very good number for our business. ...It's very concerning that you have to go all the way back to December 2003" to reach the same level of consumption.

For 2012, the consumption decrease is continuing, down 7.1% from 2007 and 4.8% from 2011. "Right now, these gallons are difficult to find."

2 Retail price trends are not in our favor.

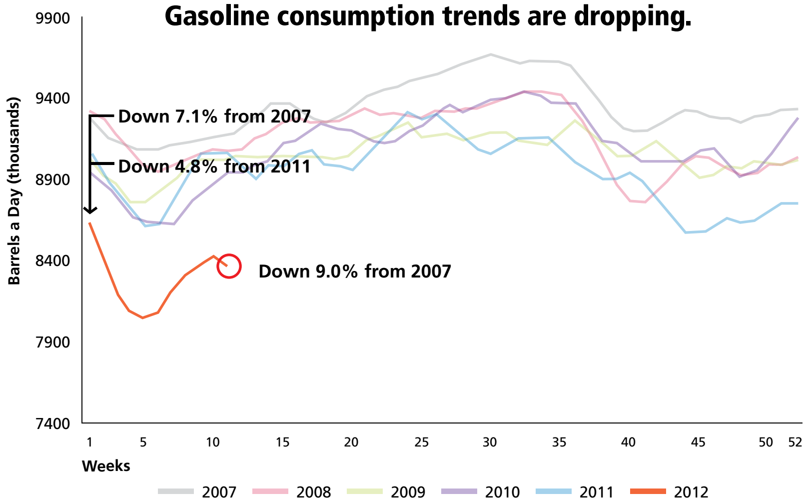
Fuel prices are also on the rise, which last year averaged $3.52 a gallon. And as gas prices rise, so, too, do fuel surcharges and other retail product prices, a trend that presents challenges to consumers and retailers.

3A Cigarette volume is soft.

Cigarette sales were down 1% last year to $52,045 per store/per month last year, a drop that Plumby characterized as a concern. "I have a difficult time remembering when that occurred," he said. "In our world, that's not good from the standpoint that we look for that basket that's around the cigarette transaction; that's a very profitable basket."

Watch Out 1

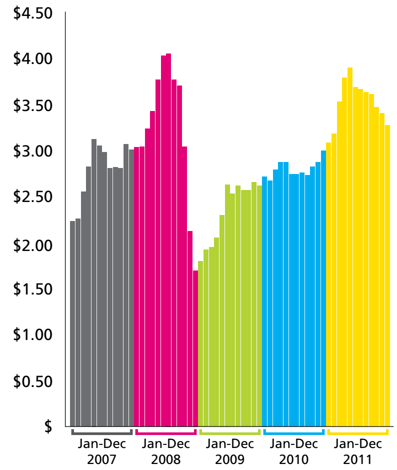
Gasoline consumption trends are dropping.

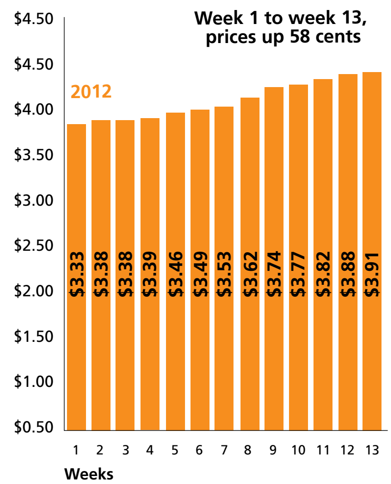


(Source: Energy Information Agency, Department of Energy)

Watch Out 2

Retail price trends are not in our favor.

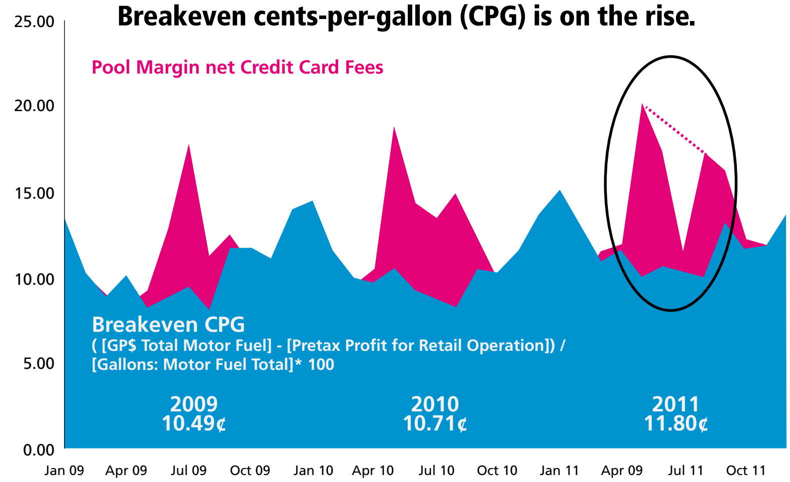




(Source: OPIS)

Watch Out 4

Breakeven cents-per-gallon (CPG) is on the rise.



(Source: NACS State of the Industry Survey of 2011 Data, CSX LLC)

Watch Out 3A

Cigarette volume is soft.

PER STORE PER MONTH	2010	2011	% CHANGE
IN-STORE SALES	$125,116	$129,208	3.3%
FOODSERVICE SALES	$21,155	$23,431	10.8%
MERCHANDISE SALES	$104,979	$107,135	2.1%
MDSE LESS CIGARETTES	$62,400	$63,804	2.3%
CIGARETTES	$52,546	$52,045	(1.0)%

Watch Out 3B

Cigarette margin is down.

PER STORE PER MONTH	2010	2011	% CHANGE
IN-STORE	$38,317	$39,880	4.1%
FOODSERVICE	$11,030	$11,854	7.5%
MERCHANDISE	$27,885	$28,660	2.8%
MDSE LESS CIGARETTES	$21,228	$22,158	4.4%
CIGARETTES	$7,774	$7,571	(2.6)%

(Source: NACS State of the Industry Survey of 2011 Data, CSX LLC)

Watch Out 5

Direct Store Operating Expenses (DSOE) are increasing.

PER STORE PER MONTH	2010	2011	% CHANGE
WAGES & BENEFITS	$18,381	$18,478	0.5%
CREDIT CARD CHARGES	$5,418	$6,666	23.0%
RENT/OCCUPANCY	$5,162	$5,463	5.8%
UTILITIES	$3,938	$4,022	2.1%
REPAIRS & MAINTENANCE	$2,920	$2,950	1.0%
SUPPLIES	$1,055	$1,080	2.4%
TOTAL DSOE	$45,851	$47,928	4.5%
TOTAL DSOE LESS CARD CHARGES	$40,433	$41,262	2.0%

(Source: NACS State of the Industry Survey of 2011 Data, CSX LLC)

NACS Vice President of Research Dae Kim shares top-decile performance; Jim Ellis emphasized uncertainty as the 2012 election approaches; Glenn Plumby delivered the industry numbers and warned of five big "watch outs."

3B Cigarette margin is down.

Commensurate with soft cigarette volume is a falling cigarette gross profit, which dropped 2.6%. "I can tell you in our world, that's a big watch out," Plumby said. "We have to work really hard to...try to correct [that]."

4 Breakeven cents-per-gallon (CPG) is on the rise.

Plumby next presented a graph that charted when selling gas was profitable, citing a formula that derived breakeven cents per gallon. For 2011, that figure rose more than 10% to 11.8 cents, an increase "that makes operating the business *that* much more difficult," he said.

5 Direct Store Operating Expenses are increasing.

Core operating expenses jumped 4.5% last year, led by credit card fees, which rose a staggering 23.0% per store per month. (Excluding credit card charges, DSOE were still up 2.0%.)

How best to counter these mounting challenges? According to Plumby, it's about retailing fundamentals. "At the end of the day, it's about execution...getting the right people in the stores...driving customer satisfaction and keeping the customer coming [back] to our store. That's our way to combat these issues."

John Zikias, senior vice president of category management and supply chain for Thorntons Inc., followed Plumby by highlighting in-store category performance. While his presentation was packed with margin and profit detail, he focused on several key points that would "help you understand how you can be a top quartile performer in 2012 and beyond":

- The top 10 categories contributed 92.4% of sales and 89.1% of gross profits, a sharp concentration of category performance.
- Packaged beverages are now the number two gross profit contribution category.
- Food and cold beverages drive food category sales, whereas previously driven by only beverages.

Picking up on Plumby's "watch out" theme, Zikias highlighted a number of concerns that he stressed must be addressed, among them:

- Cigarette sales were down 1% from 2010, with gross profits off 2.6%.
- Grocery sales and gross profit are down significantly, with non-edible grocery sales off 16.8% and gross profit dollars down 21.8%. Zikias said it's perhaps time to look for other opportunities in this space, especially as beverages and snacks are strong, with sales that increased 7.6% (packaged beverages) and 9.3% (packaged sweet snacks).
- Premium beer sales were down 1.2%, but it's not a matter of simply shifting to the increasingly popular crafts, whose sales rose 13.9%. "You need the premiums; it's the biggest demand," Zikias said, as premium beer sales represented 53.7% of overall beer sales.
- Candy units declined, but for some retailers, the effect here can be misleading. Thorntons, for instance, focuses on king-sized and seasonal candies, Zikias said.
- Foodservice growth is being fueled by prepared food, with sales up 13% last year — a sharp improvement over packaged sandwiches, with sales declining 9.5%. For many operators, a robust foodservice program sharply distinguishes them from other operators. Indeed, for top-quartile performers, prepared food profits were three times that for bottom quartile performers, while hot dispensed beverages were seven times greater and cold dispensed beverages four times greater.

Innovate to Win

"We're going in the right direction," proclaimed Todd Hale, senior vice president of consumer and shopping insights for The Nielsen Company, who told SOI Summit attendees that consumers are finally beginning to demonstrate positive economic signals.

Urging retailers to seek innovation in order to distinguish themselves and grab market share, Hale cited pop-up stores, product ordering from billboards and campus stores as ways retailers are trying to engage customers. "People are in a hurry, there is a need for convenience," he said. "You need to be flexible as to how you reach them."

Understanding the Shopper

The NACS Coca-Cola Retailing Research Council (CCRRC) seeks to grow

NACS Director of Industry Analytics Leroy Kelsey shared Convenience Tracking Program data; attendees soaked up shopper insights during general and educational sessions; VideoMining founder Rajeev Sharma talked customer behavior in the stores; many a-ha moments were experienced during presentations.

industry sales through a better understanding of the shopper, explained Fran Duskiewicz, senior executive vice president for Nice N Easy Grocery Shoppes and CCRRC member. The "consumer" is a person with a need who makes a purchasing decision. This individual later becomes a "customer" when they actually buy and use the product. Between the consumer and the customer lies the "shopper" — and understanding this person and how he or she makes critical purchase decisions is crucial.

TNS Landis Executive Vice President John Essegian offered more details on the Council's research, which identifies five compelling platforms for retailers to explore and the reasons why people make purchases at convenience stores:

- **My time:** People want an unrushed atmosphere.
- **Fresh value fast:** Customers are seeking a QSR alternative, one that is clean and offers good food, good value and made-to-order offerings.
- **Female friendly:** The female demographic is a significant growth opportunity. Women seek safe, comfortable and modern surroundings — a coffee shop alternative.
- **Family time:** With ice cream shop prices escalating, family-friendly convenience stores offer tremendous opportunities, as long as they are affordable, clean and safe.
- **My place:** The "my place" store is less like the traditional convenience store and more like a corner store, the place where you can start your day and are greeted by name by a friendly staff.

Retailers must draw from new occasions, Essegian said, thinking beyond the current occasion for incremental growth while defending the convenience store turf from other channels.

Shopper Insights

Research from the NACS Convenience Tracking Program (CTP) and VideoMining provided actionable shopper insights. The programs help retailers grow brand equity and customer loyalty, while building sales.

CTP, explained Leroy Kelsey, director of industry analytics at NACS, is a consumer insight research program launched in 2009 that interviews convenience store visitors both before and after a store visit. The program tallied 10,000 interviews in 33 states last year and is on track for 13,000 interviews this year. (For more information visit nacsonline.com/ctp.)

The program measures several metrics, including:

- **What customers are spending:** Last year, the average intended spend (determined via pre-store interviews) was $5.32, while actual spend was $5.70. The gender gap here was notable: Females spent 56 cents more than they intended, versus 36 cents for males.
- **Promotional effectiveness:** Internal signage dominates customer engagement.
- **Impulse purchases:** Candy was the number one impulse buy last year.
- **Missed purchases:** Packed beverages topped the list of intended buys that were missed, with the primary reason attributed to the item being out of stock.
- **Fuel purchases:** 23% of customers didn't follow up a fuel purchase with an in-store purchase because they didn't have enough time.

The second program shared at the Summit incorporates sophisticated video observation software developed by VideoMining that analyzes actual convenience store shopping transactions, deconstructing performance from the time the shopper enters the store until purchase (or lost sale). VideoMining founder Rajeev Sharma revealed total in-store time averaged 121 seconds last year, down 20 seconds from 2010. Considering checkout takes about 30 seconds, "Basically, you have 90 seconds to close a sale," he said.

Sharma said the program helps retailers improve in-store sales conversions, quantifying areas where leakage occurred in the path-to-purchase and identifying purchase barriers.

Top Ten

Whereas previous SOI Summits focused on quartile performers, Dae Kim, NACS vice president of research, broke down performance figures into deciles this year, revealing that, like top-quartile performers, top-decile performers are pulling away from the industry.

Whereas top-quartile performers generated $25,611 per month in store

Jim Essegian dissects shopper insights from NACS Coca-Cola Retailing Research Council research; a packed room during Summit general sessions; participants expect insights and are not disappointed.

operating profit, top-decile performers recorded $32,628, a 27.3% lift. Additionally, versus top-quartile performers, top-decile performers sold 19.1% more fuel, 18.4% more merchandise and 29.3% in foodservice. (For more on top-decile performance, read "Innovate for Success" on page 38.)

The performance jump was noticeable among nearly all categories and Kim said this played out irrespective of store count and store size (square footage). While the top performers generally had a larger square footage footprint, Kim said this reflected the breadth of offers, and was not by itself a driver of success.

Kim called out winning strategies for the top performers, revealing that top-decile retailers are following either a low-cost leadership or high differentiation model, with middle firms losing out.

"We all sell the same things at commodities pricing," Kim said, echoing the innovation theme presented by Hale. "Trying to be a differentiator is how you compete."

In Closing

"I definitely learned a lot," Chronister said as she summed up the Summit's presentations. "I'm going to take action and make my plan...and the top-decile [information] is very relevant to that plan."

Of course, even the best laid plans, she conceded, need to be tweaked, alluding to outside factors — economic and otherwise — that one can never fully anticipate. "Everyone has a plan until they're punched in the mouth," Chronister said, a quote she attributed to Mike Tyson. But even then, hard work can often help prepare one for the unexpected.

"I will continue to advocate and stay active at home and tell people about our industry," she said. "To make sure I know the changes before anyone else does."

Jerry Soverinsky is a NACS Magazine *and a* NACS Daily *contributing writer.*

Not to be Forgotten

Phil Flynn, FOX Business News contributor and senior energy analyst and general market analyst for PFGBEST, delivered a technical analysis. Flynn's passionate address in defense of speculators ("Speculators are good for the economy.") was the lone presentation that fell flat for attendees, an analysis for which subsequent presenters expressed sharp disagreement.

Tom Kloza, "It is entirely possible to pick up a turd by the clean end," remarked Tom Kloza, chief analyst at OPIS (Oil Price Information Service), in his characteristic humorous fashion, which is especially notable because it usually accompanies a data-dense motor fuels presentation. "This market doesn't need extra liquidity," he said, dismissing Flynn's support of speculators. "Holding massive positions for a few nanoseconds does not help our economy."

Kloza suggested that global fuel demand will increase, with diesel the "hot fuel" of this decade, especially in the southern hemisphere. Indeed, what do Costa Rica, Turkey and El Salvador have in common, he asked attendees? They are all countries where the United States exported diesel last year in significant amounts, a trend that will continue.

Jim Ellis, A consultant at PRIsm, Jim Ellis laid out a detailed analysis of the upcoming November election, running through the presidential and key congressional races. "Romney is the probable Republican nominee," he said, a proclamation that seems certain at press time as nearly all remaining challengers (except Ron Paul) have dropped out of the race.

Ellis predicted Obama to retain the presidency with Republicans gaining seats in the Senate — possibly a majority — and holding on to the House.