INNO FOR SUC

BY JERRY SOVERINSKY

Top-decile performers continuously seek to differentiate themselves from their competitors — a winning strategy in 2011.

It was a hybrid George Clooney-Lady Gaga kind of year, commented Glenn Plumby, vice president of operations at Speedway LLC, at the NACS State of the Industry (SOI) Summit in April, in assessing what 2011 industry performance looked like.

From the more distinguished Clooney perspective, industry highs were set for sales, fuel margins, pre-tax profit, foodservice growth and top quartile performance. From the more erratic Gaga perspective, however, fuel consumption and cigarette sales were soft, fuel prices jumped, credit card fees continued to increase and breakeven cents per gallon were on the rise — kind of weird, in light of such strong performance numbers:

VATE

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TOTAL SALES: $681.9 BILLION

CHANGE FROM 2010 (+18.5%)

FUEL MARGIN: 18.4 CENTS

CHANGE FROM 2010 (+16.5%)

PRETAX PROFIT: $7.0 BILLION

CHANGE FROM 2010 (+7.7%)

FOODSERVICE SALES: $23,431 PER STORE PER MONTH

CHANGE FROM 2010 (+10.8%)

Far removed from the eye of the worst economic downturn in recent history, the convenience store industry proved it was more than just recession-resistant, it indeed fuels the economy, with c-store sales contributing $1 out of every $22 to the U.S. gross domestic product (GDP).

But as previous SOI Summits revealed, the success is far from uniform among operators. Historically, top-quartile performers have far outpaced their peers in nearly every performance category. And as this year's event showed, top-decile performers — the top 10% of operators — fared even better, well ahead of both the industry averages as well as those in the top quartile.

While the numbers are indeed compelling, more important, as NACS Vice President of Research Dae Kim explained, are the specific factors that contribute to operational excellence. What are top-decile companies doing to generate such strong numbers?

Fueling Sales

By all accounts, 2011 was a Gaga year for fuel, one that could easily turn (Simon) Cowell-esque in 2012 (meaning evil, for non-reality show viewers).

Same-firm fuel sales on a monthly basis made huge gains — 27.1% over 2010 to reach $427,097 — but this was hardly surprising, given that the average selling price increased by a nearly identical value: 27.6%, from $2.71 to $3.45 per gallon. The increased sales also led to a stronger bottom line, with same-firm gross profits for fuel on a monthly basis up 11.2%, to $22,759.

More significantly, fuel consumption across the industry dropped 1.6%, from 9.13 million barrels per day in 2010 to 8.99 million barrels per day last year, with same-firm sales on a monthly basis down 0.4%, to 123,710 gallons — a trend Plumby pegged as a crucial "watch out" for 2012. (See "The Top 5 Watch Outs" on page 30 for more information.)

"Consumption was down in 2011 about 1.6%," Plumby 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."

While the industry recorded an average per-store drop in volume, top-quartile performers overcame rising prices and actually *increased* the volume of fuel sold by 5.9%, from 171,127 gallons per month in 2010 to 181,240 gallons per month in 2011.

But most impressive, top-decile performers far outpaced their top-quartile peers, selling 215,870 gallons per month, a 19.1% volume lift. How are they doing it?

It comes down to breakeven cents per gallon (CPG), explained Kim, expanding on another Plumby "watch out," one that saw breakeven CPG rise more than 10% to 11.8 cents last year. However, top decile operators were far more efficient, with a 6.91 cents breakeven CPG, a 41% improvement over the industry average and nearly 60% lower than ninth decile performers, who stood at 18.29 cents.

In bottom-line numbers, the results are striking: When a top-decile firm competes against a ninth decile store on the same street corner, given the same fuel prices, that top-decile firm generates $181,000 more gross profit dollars over the course of the year, Kim said, working in monthly sales volumes figures.

"That's how they hold you underwater, because of the breakeven effect" he said.

Up in Smoke

Cigarette sales moved beyond Gaga-like and settled at (Lindsay) Lohan-esque (i.e., troubling) last year, with same-store sales down a worrisome 1% and gross profits off 2.6%, a fall off that Plumby characterized as concerning.

"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. ...We have to work really hard to...try to correct [that]."

As they did with fuel volume sales, top performers stood far above their peers with cigarette sales, with quartile leaders generating an 9.1% lift from 2010 Summit numbers to $74,535, while top-decile leaders fared even better at $96,338, 29.3% higher than top-quartile operators.

Overall, cigarette unit volume was down 0.3% last year, while OTP was on the rise: Total OTP sales were up 3.6% last year, representing a 3.1% rise in units sold. Leading the category was smokeless tobacco, with sales up 7.6% and a 4.7% lift in units sold.

As contributing to in-store sales, cigarettes dipped 1.4 points to 38.09%, while OTP was up 0.1 points to 4.04%. Significantly, among key categories, OTP is registering strong sales and margin growth, with sales up 2.1% and gross margin now at 31.1%.

Kitchen Confidential

Foodservice continued its rapid expansion last year, with in-store sales up 0.9 points and now representing 16.86% of total in-store sales. The high-margin category — 39.4%, trailing only candy (48.5%) and packaged ice cream (46.5%) — carried the bulk of in-store gross profit dollars, up 0.9 points to 29.37%.

For top performers, those numbers were even stronger: Top-quartile operators generated $36,067 in foodservice sales last year, a staggering 56.4% jump over the $23,064 industry average. But top-decile performers went even further, recording $46,625 in sales, a 29.3% jump over top-quartile operators and a 102.2% lift from the industry average.

Breaking down the category into line item leaders, both prepared foods and cold dispensed beverage sales (CDB) were up sharply, 13% and 12.3%, respectively. It's a strong showing for prepared foods, whose 2010 sales had recorded a very modest 1.6% growth (CDB was already strong).

Consumer preference is favoring fresh — or at least differentiation, as packaged sandwiches sales were off 9.5%.

And across all food categories, top-quartile performers are generating far more in annual sales than the bottom quartile: three times the amount in prepared foods ($28,293 vs. $10,055), 4.5 times the amount in hot dispensed beverages ($9,327 vs. $2,063) and three times the amount in cold dispensed beverages ($4,741 vs. $1,637).

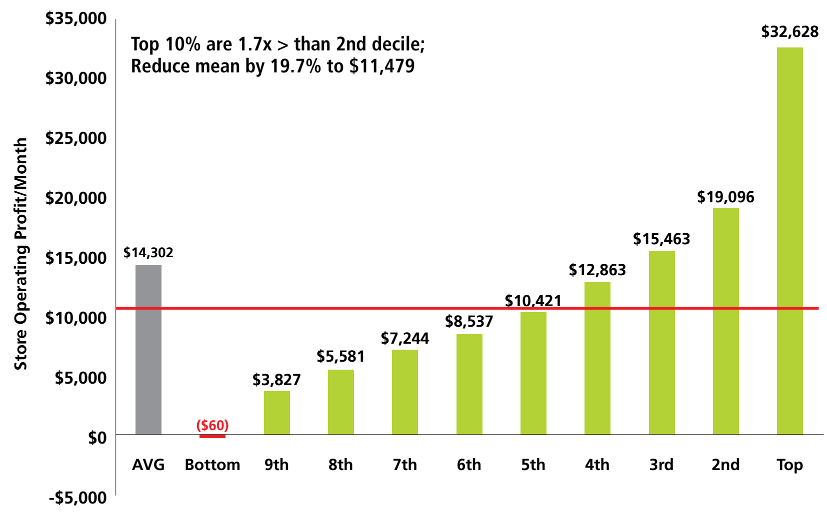
"Most top-quartile retailers are famous for something," said John Zikias, senior vice president of category management and supply chain for Thorntons Inc., "and they use that to drive performance. ...That's what separates them from the others."

According to Zikias, foodservice presents sizable sales opportunities for retailers, representing a "really optimistic trend in our business. ...If you're not focusing on food...you're missing a really big opportunity," he said.

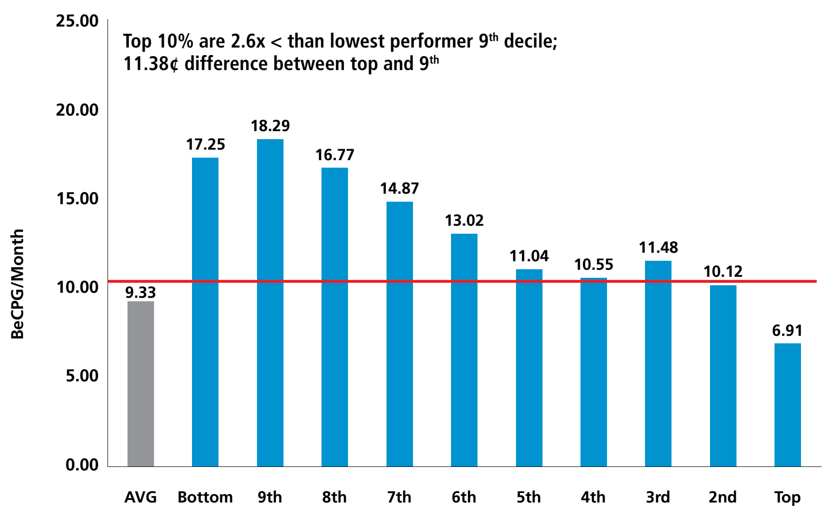
But whereas foodservice was on the rise, grocery sales were down sharply last year, with perishables off 13.2%, edible grocery down 1.8% and non-edible grocery 16.8% lower. As such, Zikias said top performers need to understand the downsized returns and assess store space allocation.

"Are you making a strategic decision with your grocery business," Zikias asked, "adding space for foodservice?"

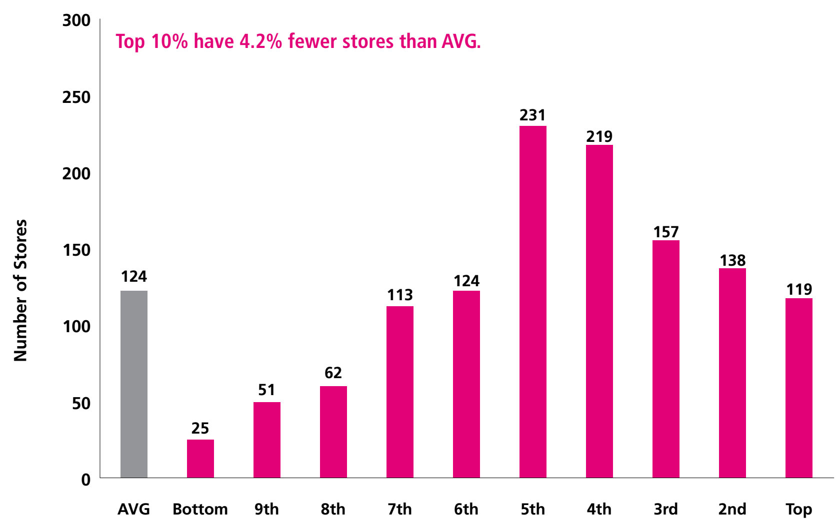
Store Operating Profit

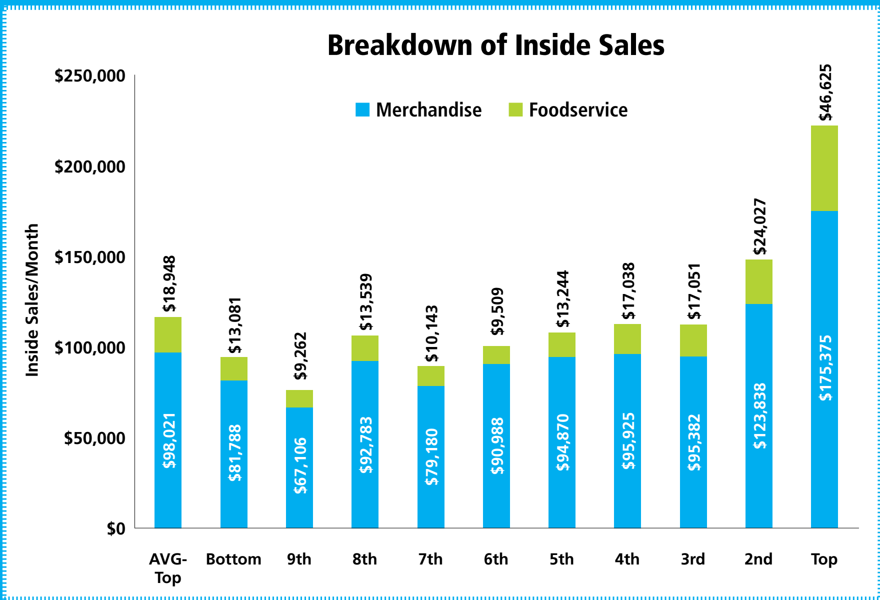


Breakeven CPG

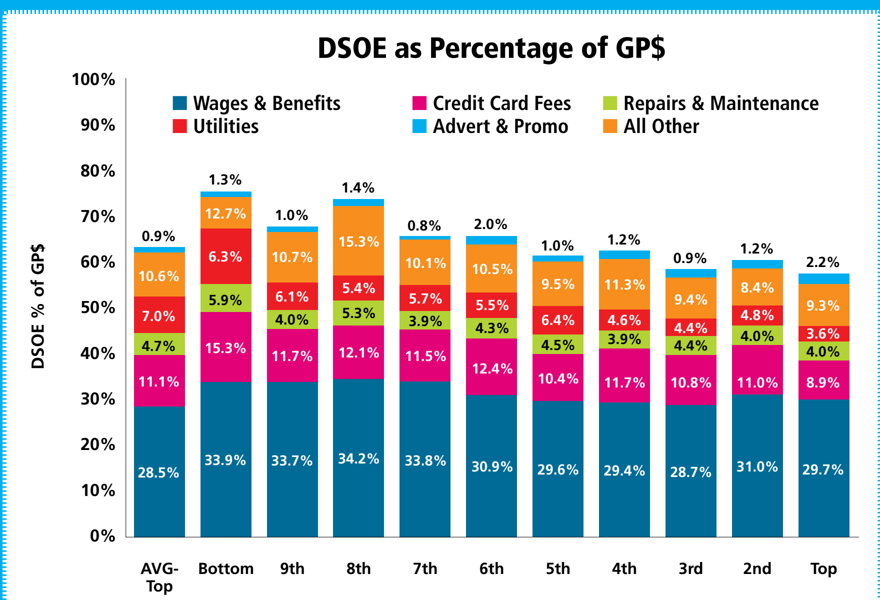


Store Count





Category Sales					
2011	TOP 10%	TOP 25%	2ND QUARTILE	3RD QUARTILE	BOTTOM QUARTILE
CIGARETTES	$96,338	$74,535	$33,533	$41,770	$28,608
PACKAGED BEVERAGES	$29,608	$25,738	$16,230	$15,361	$11,781
BEER	($18,113)	$16,665	$13,360	$14,671	$10,518
OTHER TOBACCO PRODUCTS	$8,483	$6,902	$5,224	$6,610	$3,697
CANDY	$5,272	$4,591	$3,775	$3,797	$2,976
SALTY SNACKS	$8,725	$6,769	$4,182	$2,792	$2,606
PREPARED FOOD	$30,585	$28,293	$8,214	$9,328	$10,055
HOT DISPENSED BEVERAGES	$12,847	$9,327	$2,438	$2,665	$2,063
COLD DISPENSED BEVERAGES	$5,140	$4,741	$3,883	$2,836	$1,637



Making the proper adjustments can help elevate sales and profits.

Lean, Mean Fighting Machine

While Plumby and Zikias provided detailed breakdowns of industry and category performances, it was Kim who offered the Summit's most insightful — and perhaps aspirational — data, with his focus on top-quartile and -decile performers, especially among store productivity categories.

Some of the key metrics included:

- The industry average for monthly store operating profit was $14,302, while top-quartile performers generated $25,611 (a 79.1% increase) and top-decile operators realized $32,628 (128.1% above the average and 27.4% higher than top-quartile performers).
- Monthly pre-tax profit was $9,149 industry-wide, while top-quartile performers generated $17,452 (90.8% above the industry average) and top-decile performers tallied $22,600 (147.0% above the average).
- Top performers are finding ways to lower credit card fees on a cents per gallon basis, with incentives (cash discounts, loyalty club payment alternatives, etc.) that are making a difference. While the industry average stood at 6.56 cents, top-quartile performers paid 5.51 cents and top-decile performers just 4.88 cents. The bottom line savings were significant: With 215,870 gallons sold per top-decile store per month, the 1.68-cent credit card savings translated to $3,626.62.
- Industry leaders are spending money to make money. Under direct store operating expenses (DSOE), the top-decile stores spent $61,927 per month last year, 1.4 times more than the second decile ($43,074) and 2.4 times the ninth decile ($36,453). The added expenses, according to Kim, were not just for wages, utilities and rent; top performers spent the most on advertising and promotions.

Credit card fees remain the bane of

the industry, with per-store monthly charges up 23.0% to $6,666 (or nearly $80,000 in annual fees), which represents 10.3% of gross profit dollars, a 1.3-point increase over 2010. Compare that to rent ($5,463), utilities ($4,022), repairs and maintenance ($2,950), and it's no wonder Plumby pegged this expense as yet another 2012 "watch out."

However, some favorable news was offered: Plumby noted that the Durbin Amendment saved retailers $90 million in 2011 on interchange fees since its enactment on October 1, a savings that is projected to reach $500 million in 2012.

When it comes to labor, top-decile performers are paying $15.13 per hour in labor costs, compared to an industry average of $12.48, which dips to $11.85 when excluding data from the top decile. And the increased outlay led to more stability, with manager turnover at 12.1% for top-decile stores, compared to 15.8% for top-quartile stores and 19.9% for the entire industry.

The investment paid off, as top-decile stores generated $34.54 of in-store gross profit dollars per labor hour, a 39.4% increase from the $24.78 industry average, and 11.1% higher than the top-quartile performers.

The numbers came at a dizzying pace, and the top-decile numbers were indeed impressive, leading to speculation that the largest footprints were leaving — well — the largest footprints.

But not so, said Kim. Per-company store count for the top-decile companies was in fact 4.2% lower than the industry average (119 compared to the industry average of 124), though their square footage was substantially larger — 3,171 versus 2,660 for the industry as a whole, or 19.2% greater.

Putting It All Together

With undifferentiated product lines, diverse customer needs, modest supplier leverage, increasing regulations and a large number of operators willing to accept low returns, the challenges for all operators remain considerable, Kim said. How best to succeed?

Kim said top-decile firms are following either low-cost leadership or high differentiation models, each of which taps into unique customer needs.

While divergent strategies, their similarity lies in innovation, as top performers distinguish themselves while constantly testing the marketplace — testing assumptions, thinking of alternatives and plotting choices. "Innovators try things constantly, they are set up to do it," Kim said. "Have you earned 10 years of experience or have you repeated the same year 10 times?"

"We all sell the same things at commodities pricing," Kim said. "Trying to be a differentiator is how you compete." NACS

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

Data from this article were taken from this year's NACS State of the Industry (SOI) Summit from April 3 to 5. Final SOI data is available in the *NACS State of the Industry Report of 2011 Data*. To order, go to nacsonline.com/products.

Benchmarking Resources

Top-decile and top-quartile retailers didn't reach their lofty status by accident. They invested time and thought into setting realistic, achievable goals and developing benchmarks to guide them on their path to success.

And while using same-store data to establish an internal benchmark is highly valuable, decision makers can never know their true performance until they look outside of their company and at the industry as a whole.

NACS offers two invaluable tools to convenience and fuel retailers to assist them in taking their benchmarking activities to the next level: the *NACS State of the Industry Report* and the CSX LLC database.

The annual *NACS State of the Industry Report* is the industry's premier benchmarking tool and most comprehensive collection of firm-level, store-level and category data and trends based on the convenience and fuel marketing industry's prior year performance. Taking time to review the report, setting goals based on the benchmarks and devising strategies to reach them is a guaranteed way to learn more about the industry and help your organization improve.

The CSX LLC database allows retailers to have their finger on the pulse of the industry all year long. Users can view financial and operational benchmarks, determine opportunity gaps by comparing their own data and track their progress, all in one user-friendly web based application. The subscription-based service offers limitless opportunities to benchmark against key industry metrics by providing specific reports that apply to all segments of the industry. The application also allows users to refine the sample and rank the data by quartile or drill down into the regions or states they operate in and view operational metrics that are, on average, just 45 days behind real time.

For more information on the *NACS State of the Industry Report*, contact Bob Swanson at NACS at (703) 518-4219 or rswanson@nacsonline.com. For more information on the CSX benchmarking database, contact Chris Rapanick at (703) 518-4253 or crapanick@csxllc.com.