June 2018

FEATURE

Traffic Jam

Despite a record-breaking year of inside sales, convenience store traffic is trending down.

BY JERRY SOVERINSKY

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NACS State of the Industry Summit

"Like a lot of you, we pay particular attention to one metric at Sheetz: customer counts," said Joe Sheetz, president and CEO of Sheetz and NACS Board Chairman, in opening this year's NACS State of the Industry (SOI) Summit, held April 10-12 in Chicago. "After all, you can't upset someone not coming to your store in the first place."

It was the dominant theme of this year's event, a growing concern among retailers and one that crept into many of the event's presentations.

"Why didn't our customers show up?" asked Andy Jones, president and CEO of Sprint Food Stores, and a member of the NACS Research Committee in his numbers presentations. "It was like we had a party and everyone RSVP'd, but only a few came through our front doors."

Over the past four years, total consumer shopping trips to all retail outlets per household have declined steadily, down by nearly three trips on average in the holiday quarters alone. "This trend is heavily driven by younger consumers, particularly millennials who are fundamentally shopping differently than previous generations," Jones explained.

And so began this year's numbers analysis.

LOW-INCOME SHOPPERS AND AMAZON

Over the past three years, the number of convenience trips per week has fallen 27.8%, or a full trip less. "That's tough to overcome," Jones conceded. "Even if we increase the market basket spend, we cannot make up the entire spend from this trip loss."

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There were other factors contributing to a decrease in store traffic, Jones said, but the reasons were not obvious. Looking back less than a decade when the economy had faltered, struggles were understandable. But today, with low unemployment, low gas prices and low interest rates, "We should be killing it, right?" Jones asked rhetorically. "With all of these tailwinds, we should have crushed 2017."

Alas, while overall numbers were strong, growth was not as robust as one would expect, Jones said, a shortcoming that he attributed to several factors, including:

- **Higher fuel prices:** Fuel prices increased 12.8% from 2016, which equals roughly $3 more on a 10-gallon fill-up. "That is a lot of money that the customer now does not have to buy things inside our stores," said Jones.
- **Struggling low-income households:** "The low-income customer is tremendously important to us and they are struggling," Jones said, revealing the average low-income household's income grew just $3,227 from 2007-2016, while they spent 22% more for basic necessities during the same period.
- **E-commerce growth:** While brick-and-mortar sales have increased roughly 4% per year over the past decade, online sales are growing four times that rate, tallying more than 18% in 2017. "And let's talk about Amazon," Jones said. "It has grown to $692 billion (market cap) in the past 11 months. ... Don't be fooled, Amazon is into our space also ... its Amazon private brand battery is now the number one-selling battery in the U.S."
- **Unstable political climate for Hispanics:** "The current political climate is definitely affecting [Hispanics]," Jones said. Whereas 25% of Hispanics were frequent food buyers (more than three times per week) at convenience stores in 2015, that percentage plunged to just 15% in 2017. It's a drop that's not being felt solely at convenience stores. "Target and Food Locker are reporting declining sales in border states due to the loss of Hispanic customer trips," he said. "And in our industry, beer manufacturers are reporting the same issue."

At the same time, low-income shoppers are frequenting value grocery and dollar stores, diverting sales from convenience stores. "A lot of us are all chasing the same customer and the space is getting really crowded," Jones said. "[As a result], this customer has less money to spend."

CONSOLIDATIONS

Industry performance in 2017 was also impacted by ongoing consolidations, Jones said, citing the following:

- Store count reached 154,958 in 2016, relatively unchanged from 2016 (154,535).
- Company count dropped to 1,597 in 2017 (from 1,679 in 2016, and more than 2,000 in 2008). "The number of companies operating in our channel is declining," Jones announced.
- Average store count is on the rise, up from 27 in 2008 to 36 in 2017. "As you can see, the big are getting bigger," Jones said, "with the top three biggest chains—7-Eleven, Alimentation Couche-Tard and Speedway—making up two-thirds of the top-20 overall store count."

> "Even if we increase the market basket spend, we cannot make up the entire spend from this trip loss.

HELP WANTED

"Everyone knows it is getting harder and harder to find good people," Jones said, introducing another prominent issue that impacted retailers' bottom lines. It takes retailers 31 days to fill a vacant job, Jones said—a 30.3% increase from 2006 when it took just 23 days.

For industries that are contracting, this expanded hiring timeframe has resulted in minimal disruption, but "since our industry is one that is growing, we need people," Jones said. "And not only do we need people, we need *good* people."

When the industry finds those people, its per-hour labor costs are on the rise. For the first time in history, convenience store associates are earning more than $10 per hour ($10.19), up more than 28% from a decade ago, when the average hourly wage was $7.95.

While the higher wage slowed store associate turnover (115% in 2017, down from 133% in 2016), it still lags far behind 2010 (73%) and 2012 (75%). "Our industry high turnover rate issue has not been solved," Jones said—a costly shortcoming that on average costs a retailer roughly $1,300 to hire, train and equip a new hourly store associate. At the same time, the turnover rate for store managers fell by one-third in 2017 to 18%, a meaningful reduction as the average cost to replace a manager tops $3,500. But still, Jones admonished, there's work to be done, balancing the need to reduce costs while meeting evolving employee needs.

Citing a recent survey conducted by Snagajob, Jones said hourly workers want more training and a clear path for career development, a long-term concern that retailers should acknowledge when onboarding new talent.

The pool of available talent is substantial, despite an unemployment rate that has dropped precipitously from 2010 (down to 4.1%, from a high of 10.0%). "The labor force participation rate is [actually] 63%," Jones said. "That means that there are 37% of eligible workers 16 years and older who are choosing not to get a job. This is an opportunity for us, but we are going to have to compete with welfare-equivalent wages to get them to work in our stores."

To understand what that might entail, Jones presented a "heat map" that showed labor force participation by state, followed by a map that displayed the value of welfare by state, which indicated that some states distribute more than $15 per hour in total welfare benefits.

The figures were striking and underscored the challenges that retailers face when trying to recruit workers. "I have stores in Georgia and South Carolina," Jones said. "I would need to pay these people $12 and $13.50, respectively, so that they earn the same as when they were on welfare. And if you have stores in California and New York, you are having to pay in excess of $15 dollars per hour to attract them."

KEY INDUSTRY METRICS

SNAPSHOT	2016	2017	% CHANGE
Store Count	154,535	154,958	Flat
Inside Sales	$233.0 B	$237.0 B	1.7%
Fuel Sales	$316.8 B	$364.1 B	14.9%
Total Sales	$549.9 B	$601.1 B	9.3%
Pretax Profit	$10.2 B	$10.4 B	1.6%
Credit Card Fees	$9.5 B	$10.1 B	5.8%
Employees	2.50 M	$2.48 M	(0.8)%
Fuel Margin (cents/gallon)	20.09 c	22.02 c	9.6%
Fuel Margin (net of cc fees)	14.93 c	16.57 c	11.0%

THE BOTTOM LINES

After detailing these prominent industry concerns, Jones reached the most anticipated portion of any numbers presentation: performance benchmarks, the time when retailers can measure themselves against competitors and evaluate their efficiencies.

Among the highlights, Jones stated that "While total sales were up 9.3% to $601 billion. The concern is that it was led by fuel, [which increased] due to commodity price increases." As a result, while fuel sales jumped nearly 15%, inside sales trickled up modestly by 1.7%. (See Key Industry Metrics table.)

SALES

PER STORE/ PER MONTH	2016	2017	DIFFERENCE
Total All Sales	**$366,619**	**$409,163**	**11.6%**
Fuel Sales	$298,510	$342,846	14.9%
Fuel Gallons	141,169	143,800	1.9%
Average Selling Price	$2.11	$2.38	12.8%
In-Store	$159,751	$162,435	1.7%
Foodservice	$35,613	$36,749	3.2%
Merchandise	$124,423	$126,220	1.4%
Mdse Less Cigarettes	$78,700	$79,045	0.4%
Cigarettes	$45,454	$46,555	2.4%

Also, while fuel prices increased in 2017, fuel margins rose commensurately, "at 22 cents-per-gallon, the highest since 2014," Jones said.

A recurring concern was the industry nemesis—credit card fees—which rose nearly 6%, following two years of declines. "It is crazy that an industry that makes $10.4 billion in profits has to pay one line in fees just to process our payment transactions. This issue must be addressed," Jones said.

SAME FIRMS

Meanwhile, same-store performance recorded sizable increases in total sales (+11.6%) and in fuel sales (+14.9%). (See Sales table.)

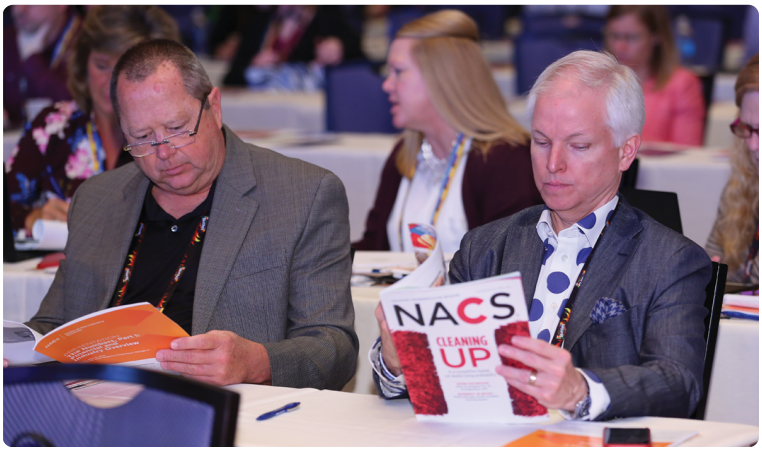
Rising pool margins led to a substantial fuel gross profit dollar lift of 6.1% to $83,231 in 2017 (per store, per month), with foodservice providing nearly 20% of total gross profit dollars ($19,084), up 4.5%.

Tempering those positive returns was news that key expenses are on the rise. "We really need to pay attention to expenses," Jones said. "While our industry's gross profits increased 6.1% last year... expenses increased 7.7%. We must reverse this if [we're] going to survive and thrive in the future."

GROSS PROFITS

PER STORE/ PER MONTH	2016	2017	% CHANGE
Total Gross Profit	**$78,421**	**$83,231**	**6.1%**
Fuel	$28,361	$31,670	11.7%
Pool Margin	$20.09	$22.02	9.6%
Margin - CC Fees	$14.93	$16.57	11.0%
In-Store	$54,600	$55,985	2.5%
Foodservice	$18,263	$19,084	4.5%
Merchandise	$36,482	$37,179	1.9%
Mdse Less Cigarettes	$29,490	$30,077	2.0%
Cigarettes	$7,031	$6,980	(.07)%

Core direct store operating expenses rose in every key category, led by card fees (+12.0%, to $5,652) and wages and benefits (up 8.1% to $20,401). Within wages and benefits, health insurance costs surged 9.3% to $1,495, while workers compensation fell 3.8%. (See Core Direct Operating Expenses table.)



PRODUCTIVITY

Jones concluded his presentation with overall productivity broken down by quartiles, a segmentation of all stores according to their performance.

For overall store operating profit, the top quartile more than doubled the second quartile ($38,267 vs. $18,399) and earned more than nine times the bottom quartile ($4,225).

"If we compare the top to the bottom quartile, these are two really different businesses that are being run," Jones said, "with the top quartile having almost a 12-cents-per-gallon breakeven advantage. And they put in the bank almost five times what the bottom does on an EBITDARL basis."

CORE DIRECT STORE OPERATING EXPENSES

PER STORE/ PER MONTH	2016	2017	DIFFERENCE
Wages & Benefits	$18,872	$20,401	8.1%
Card Fees	$5,047	$5,652	12.0%
Utilities	$3,033	$3,183	4.9%
Repairs & Maintenance	$2,910	$3,042	4.5%
Supplies	$1,713	$1,733	1.2%
Total DSOE	$47,325	$50,767	7.3%
Facility Expense	$11,875	$13,003	9.5%
Total DSOE & Facility Expense	$59,200	$63,771	7.7%

Jones framed this disparity in stark terms: "The bottom quartile store across the street from a top quartile store simply cannot compete."

WHAT IT ALL MEANS

"Keep in mind, the big are getting bigger and the best are getting better," Jones said, in summarizing industry performance numbers. "But after four consecutive years of record profit, our competition has taken notice and they are not standing still.

"So we can't either."

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ABOUT JERRY SOVERINSKY

Jerry Soverinsky is a Chicago-based freelance writer and a *NACS Daily* and *NACS Magazine* contributing writer. Visit his work at www.jerrysoverinsky.com. (www.jerrysoverinsky.com)

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BY CHRIS BLASINSKY

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