battle zones

Are major oil sell-offs 'last stand' for jobbers, retailers?

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Think Waterloo or Gettysburg or the Tet Offensive. Battles that decided the destiny of nations sometimes define themselves in real time; others display monumental significance months or even years later.

For everyone from the big roll-up companies to jobbers and mid-sized convenience-store chains, the release of thousands of major-oil retail properties over a mere two to three years—"a withdrawal of a magnitude we have never seen," says one industry veteran—may prove pivotal, deciding whether a chain moves to greater vitality or dies on the vine.

"We're seeing one-time opportunities for someone to grow their business," says Tom Kelso, a managing partner with Baltimore-based Matrix Capital Group. "If you marketed in Ohio and BP sells in Ohio, you needed to compete aggressively. Because once they've announced the sale and have [those properties] sold, the opportunity is gone and gone forever."

What does "forever" mean? Francis Bologna, an industry consultant and head of F. Bologna and Associates, New Orleans, gives an example of a jobber who has 25 to 30 stores.

"Let's say he's looking to buy eight to 10 stores adjacent to him," Bologna says. "If they're really nice stores, maybe someone with stronger financing may beat him out of the deal. There's only so many locations in a market. What happens is the jobber doesn't grow nearly as fast [as the competition]. Pretty soon, where [the jobber] was once a buyer, he is now becoming a seller."

Letting Go

The phenomenon of major oil companies relinquishing control of corporate-run stores stretches across the mainland, from one coast to the other. Consider:

- Last year ExxonMobil converted upstate New York, following other markets, from a direct-served market to a variety of distributors. Sources say ExxonMobil may be considering trans-

ferring control in additional markets.

› Shell has moved many locations run by MSOs, or multisite operators, in key markets such as Indianapolis and Denver to consolidators or other large operators. Recently, the company sold more than 250 West Coast stores to refiner-marketer Tesoro Corp.; the stores will retain the Shell brand for the long term.

› In December 2006, ConocoPhillips announced intentions to divest all of its 830 direct-owned gas stations as part of an "asset rationalization program." As CSP went to press, the company divulged additional details, saying it would shave 8.5% of its total branded network by pulling out of Minnesota, North Carolina, South Carolina and certain portions of Arizona, Nevada, Wisconsin, and the Dakotas.

› BP continues to move corporate locations in key markets "east and west of the Rockies" to individual entrepreneurs. The company has also announced it would discontinue growing the BP Connect brand and instead pursue a nationwide program with its ampm store. The growth, BP officials say, will largely come through franchisees, not direct operations.

› Chevron appears to be a holdout, apparently committed to its current infrastructure.

The situation is clear: In some markets, the battle is over. In others, it's a frenzy of closed-door meetings, multiple calculations and cell-phone alerts.

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>
> **TOM KLOZA** *OPIS*

And yet in other markets, key players are gearing up to fight.

A casual count of reported sell-offs in the past year or so shows that 1,178 stores have shifted from the hands of majors to other parties—jobbers, c-store chains or small, independent business owners. Counting the pending sale of ConocoPhillips' company-operated assets, the number will shoot to well above the 2,000-store mark.

Market Indicators

A number of factors will determine where oil companies will divest and how appealing those properties will be to would-be buyers:

MARGINS

Margin changes for the first six months of 2006 vs. 2005:

Midwest: –1.6%

Northeast: 12.9%

South Central: 20.5%

Southeast: 4.5%

West: –0.5%

National: 3.5%

POPULATION

West: Expected to grow at twice the national rate, with California playing a standout role.

Midwest, Northeast: Expected to grow at half the national rate.

South: Will continue to have the highest population numbers.

Southeast: Florida set to outpace New York in terms of population.

WEATHER

Severe: Midwest, Northeast.

Mild: West Coast, South, Southeast.

Seasonal Concerns: Hurricanes and tropical storms put a question mark on Florida and Gulf states.

Sources: CSX LLC, fall 2006; U.S. Census Bureau; CSP

"The trend [of oil companies selling company-owned stores] will continue," says Bill Trefethen, managing director of Trefethen & Co. LLC, Scottsdale, Ariz. "But as for where and when, who knows? It's like saying it's going to snow in Alaska because you know it's going to happen, but you just don't know when and where."

Though growth-minded jobbers and local retail chains are poised to win in many of these smaller, regional markets, the big consolidators can roll through like acquisition tanks, using Wall Street valuations to sweeten pots and stymie the locals. But don't discount the dealers. Lenders can create a "band of brothers" amid the fractional masses, pulling together irresistible "even the dogs" packages to dangle before sophisticated, holistic-minded majors [CSP—May '06, p. 26].

Why are the majors selling? It's a matter of simple arithmetic, say many industry observers.

"A big part of this is responsible accounting on the majors' part," says one consultant who spoke on condition of anonymity because of his close ties to Big Oil. "Stock analysts look at them sitting on tens of billions in real estate and getting a poor return. Other people do a better job of running stores. Why not just sell them the product and let them take the risk with the environmental and the people? In the meantime, you free up capital."

Hot Markets

So which markets are the hottest? Houston-based ConocoPhillips' announcement of its asset sale—836 stores, with about 500 dealer-operated and the rest company ops mainly in the Rockies and the West Coast—has created much buzz of late. Many of its best, company-operated properties are in Denver, with what one retailer estimates to be 60 to 70 of the chain's prime sites.

Add to that the most recent acquisitions by San Antonio-based Tesoro, which purchased 250 Shell properties in California and an additional 145 stores on the West Coast from Thousand Oaks, Calif.-based USA Petroleum, and the result is a lot of attention shifting to that half of the country.

"It's definitely a mixed bag in that there's a lot of action," says Evan Gladstone, executive managing director of NRC Realty Advisors, Chicago. "But it's all over the place."

If one were to cast a sell-off divin-

Sources: BP/ConocoPhillips/ CSP Information Group/ExxonMobil/Shell

ing rod over a map of the United States, Bologna would guess areas of moderate climate would be the favorite. "Any area that is not seasonally challenged is preferable," he says. "People have to get in and out of their cars [at gasoline stations] and they're a lot more comfortable when it's not blistering cold."

Then there's topography and the distance between cities and towns. "A company has to think, 'What's it going to take to supply these stores, and do I want to build a network in a 500-mile radius that's full of hills?' " Bologna says. Population centers would be yet another predictor of a hot market, he says.

In forecasting prime markets, another strategy may be eliminating what's stone cold. Put another way, the lack of luster and profit may be driving Big Oil to divest in certain markets.

"There are always markets you circle and say, 'These are the elephants' graveyard,' and nobody wants to operate there," says Tom Kloza, chief oil analyst for Oil Price Information Service, Wall, N.J. "It used to be the

Hot Markets

Across the United States, major oil companies are remaking the competitive landscape by selling off company-operated, franchised and dealer locations to players who design the most appealing packages. Laval, Quebec-based Alimentation Couche-Tard has been a big winner, but others have been participating—and winning. Here's a map of markets that have come into play in the past year.

WESTERN CENTRAL

Denver: Couche-Tard takes 71 from Shell; 60–70 ConocoPhillips company ops go on the block

MIDWEST

Chicago: Couche-Tard picks up 31 leases from Shell

Columbus, Ohio: True North buys 29 sites from Shell

Hammond, Ind.

Indianapolis, Ind.: Couche-Tard buys 40 Shell sites; BP puts up 29 sites

Kansas City

Twin Cities, Minn.

EAST

Albany, N.Y.

Atlanta

Baltimore/Washington, D.C.: BP sells 70 sites to various parties

Buffalo, N.Y.

New York City

Orlando, Fla.: Couche-Tard picks up 28 sites from Shell

Rochester, N.Y.

Pittsburgh

Syracuse, N.Y.

SOUTH

Baton Rouge, La.: Couche-Tard picks up 22 sites from Shell

Dallas: Shell plans sell-off in 2007

Houston: Shell plans sell-off in 2007

New Orleans: Shell plans sell-off in 2007

EASTERN CENTRAL

Memphis, Tenn.

Nashville, Tenn.: Delek buys 25 sites from BP in late 2005

Front Line Reports

SACRAMENTO/ SAN DIEGO

STATUS: *Mainly dealer units for sale; Tesoro's big buy*

Chris Moore is concerned about Tesoro's purchase of almost 400 stores in two separate deals with Shell and USA Petroleum. That's because, in his view, the San Antonio-based refiner-marketer knows less about selling in-store merchandise and more about bringing cheap gasoline to the street.

"I'm worried that they'll be like ARCO," he says, referring to how that West Coast chain made its name by discounting its gasoline.

Moore, vice president of retail for New West Petroleum, Sacramento, Calif., says the West Coast presents an interesting dilemma for distributorships such as his. While the opportunities to take on major-oil sell-offs exist, not all properties are desirable.

"For us, it's not about the size [of our chain]," says Moore, whose company operates stores in Sacramento and San Diego. "We're looking to grow with bigger lots and bigger stations."

DENVER

STATUS: *Shell divested; ConocoPhillips on the block*

Denver may prove a hot market, with as many as 60 to 70 of ConocoPhillips' direct ops in the area. The market also has seen Shell's MSO (multisite operator) locations join the Couche-Tard family.

Brian Haldorson, president of A-B Petroleum Co., which operates 13 Denver stores, the majority of which fly the Conoco flag, is hopeful. He believes his company could grow as a result of recent and future M&A activity.

"Companies like ConocoPhillips say they want to use existing marketers to expand their business because it's a more efficient model to survive," he says. "That's what they said early on; whether they do that, we'll wait and see."

Phoenix market and Southern California. … Now you can put a big circle around Ohio and Indiana and maybe some corners of western Pennsylvania. They're just too ugly—they're markets *non grata*. If you look at Indiana and Ohio, people are not clamoring to retire there."

In addition, other "ugly" pockets exist in parts of Georgia, New Jersey and Virginia, where product is abundant and "ultracompetitive marketers" such as QuikTrip and RaceTrac have driven their tent stakes firmly into the ground. In such areas, many oil companies prefer to shift the physical operations to someone else while maintaining—if not building—volume.

"There's no disputing that, with the exception of [Sunoco], Amerada Hess and maybe a few others, the traditional oil companies are probably not going to want to own any dirt," Kloza says. "They'll just sell it through superjobbers or jobbers that are large enough to operate without a huge credit risk."

The Forecast

Where will the next markets open up? Some say that crystal ball is too cloudy at the moment.

"We can't predict what's going to happen in the future," says Valerie Corr, spokeswoman for BP Products North America. "We continually review the network of branded sites, and that's the most accurate way to put it. As you know, things change, so it's hard to say next year what things will look like."

Corporate locations in Pittsburgh, South Florida and Atlanta, as well as throughout Arizona, California, Illinois and Indiana, have shifted to individual entrepreneurs through sealed-bid sales in the past two years; in that time, NRC has helped BP transition more than 130 stores into the hands of new owners. A review of current sales on the NRC Web site showed a breadth of available BP- and ARCO-branded sites from Washington and Oregon to New Jersey and Pennsylvania.

Paula P. Chen, U.S. field public affairs adviser for Exxon Mobil Corp., Fairfax, Va., says ExxonMobil will continue to grow through three key classes of trade—company-operated stores, direct-served dealers and branded distributors—though she couldn't disclose the company's plans

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FRANCIS BOLOGNA *F. Bologna and Associates*

CHICAGO/ INDIANAPOLIS

STATUS: *More sell-off potential; tight gas margins*

In 2001, Bob Juckniess was the Indianapolis "guinea pig" for Shell's then-fledgling MSO program, through which seasoned operators gained control over clusters of stores once leased to dealers. At one point, he oversaw as many as 50 stores in Indiana and Ohio under his Indianapolis-based firm RWJ Management Cos. Inc.

All that changed in mid-2006, when Shell sold 40 Indy stores—including 35 operated by Juckniess—and some supply contracts to Alimentation Couche-Tard. Juckniess' Cincinnati stores went to a local jobber, leaving him with a blank slate.

So Juckniess started over. This time, he looked for the promise of growth with a different brand in a different market: BP in Chicago.

"We went into the bidding process and got six high-volume locations," says Juckniess, who took over the sites in November 2006. "BP wanted to make sure they partnered with operators who could execute the franchise program in a superior manner. … With our experience running 50 Shell-branded locations, we had a lot to bring to the table. At first blush, we're doing very well."

or strategies for specific markets.

By the end of 2006, ExxonMobil had converted approximately 160 sites in the upstate New York markets of Albany, Buffalo, Syracuse and Rochester markets to distributor sites, just as it has done previously in the Detroit and Milwaukee markets.

And ConocoPhillips ended the month of January by announcing it would pull out altogether in three states and in portions of five other states, furthering opportunities for growth-minded parties.

Winning Deals

So who will win as more markets open up? Successful bidders will create packages that are not only economically appealing but also offer incentives to the oil company. Two of the more valued incentives: added gallons and getting problem sites off the books.

Bidders promising to rebrand additional stores in the same market can find their offers more appealing to the majors. "[The majors] don't just want money; they want gallons," says Bob Bassman, an industry attorney with Bassman, Mitchell & Alfano, Washington, D.C. "They want to grow. They have formulas crediting you with dollars for each gallon. It's almost too bad if you're a single-branded Shell jobber, because you don't have any [new] gallons to bring to the table."

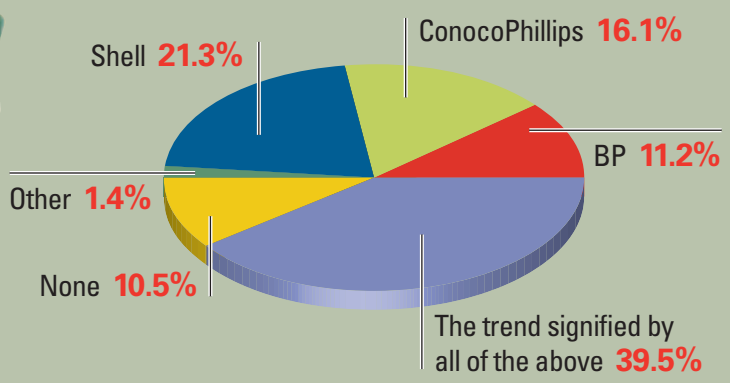
Problem or "dog" sites represent another wrinkle. Companies such Couche-Tard and The Pantry, while having a reputation for cherry-picking the best locations, can also pick up low-volume sites to become a more attractive bidder to the major oil company.

"They're going to negotiate to buy as few properties that don't meet their profile, but they're going to get some they don't want," Bologna says. "[But] there's a selling arm within those companies that is disposing as quickly as they acquire. Again, they don't want to spend any time or money on a property that doesn't fit their profile."

Although many of the known bidders—jobbers, mini-majors and larger chains—can formulate proposals, dealers can also become players, mainly through working with investment groups. Suncor Capital, one such firm

SELL DIVISION

Which Big Oil company's retail sell-off is of most interest to you?



Source: Kraft/CSP Daily News Poll. Based on 286 respondents.

Front Line Reports

NEW YORK

STATUS: *Retailers finding opportunities as majors' direct-dealer class fades*

Major urban centers such as New York and Chicago remain watershed markets for major oil, according to Harry Singh, president of Bolla Management Corp., Brooklyn, N.Y., a distributor and marketer of ExxonMobil, Sunoco and BP fuels.

"When you go into urban areas like New York City, the growth is tremendous," he says. "In New York, the city is still a profitable market for most oil companies. If you go out in Long Island … there are more distributors there, so the oil companies are getting out of direct-served. Their dealers can't survive there."

He has grown most aggressively with ExxonMobil, through which he has more than 20 sites, followed by Sunoco and, most recently, BP. By the end of the year, he expects to have more than 40 sites split between the three brands.

TAMPA, FLA.

STATUS: *Majors out, except ExxonMobil with about a dozen sites*

The battle in Tampa, Fla., may be largely over, with Shell having hooked up with Couche-Tard yet again last year, and BP and Chevron already having sold to area marketer Risser Oil, Clearwater, Fla.

Kerry Katchuk, president of Risser, says all that's left in his area are a dozen or so ExxonMobil sites—locations he describes as "decent."

Katchuk views Couche-Tard as a good competitor, but believes the change from major-oil dealers is a welcome one.

"In the old days, oil companies used to give dealers lower rents and low dealer tankwagon prices—we would be fighting a very competitive location," he says. "These days [those sites] are not cutthroat. It's the unbranded and the hypermarkets who are our enemy now."

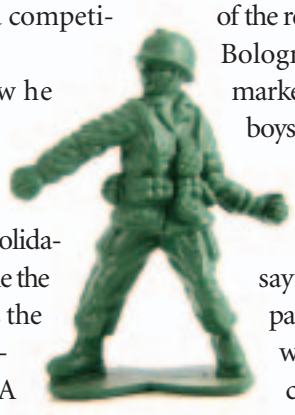
based in Los Angeles, formulates these types of packages, working with dealers and dealer representatives to create larger proposals.

A Suncor official, who spoke on condition he not be named, says establishing relationships with dealers and formulating a package that includes lower-volume and closed sites leads to an appetizing proposal for the majors.

"If [a major] wants to sell … then what about the dealer sites, the raw land or stations that have been closed for five years?" the source says. "When you buy as a package, you solve [the major's problems] and everyone can get their fair share of [the deal.]"

Little Fish, Big Fish

No one can dispute that opportunities abound. But as the majors chum the waters, the little fish still have to fight the sharks. To that end, the consolidators are an undeniable force. They have Wall Street muscle and the economic formulas to trump area competitors on price.



Bologna recalls how he worked with a midsize jobber on a deal for eight to 10 stores that eventually went to a consolidator. He explained that while the jobber was able to assess the prospective buy at a multiple of 6 times EBITDA (earnings before interest, tax, depreciation and amortization), the consolidator could easily pay 6.5 or 7 times EBITDA due to the chain's stock value.

"Because their stock is trading at 7.5 or 8 [times EBITA], they automatically have accretive value by buying that revenue stream," Bologna says. For retailers trying to wrap their heads around the economics, the success of the formula lies in the consolidator growing the number of dollars it generates without losing money on transition costs or the stores falling short of projected revenue. If a company can minimize the losses, then the new revenues can have a positive effect on the company's trading price and its overall value.

Jobbers will still have their fair share of wins in the sell-off frenzy, but Bologna believes these will be in markets where consolidators can't make the numbers work.

"The frustration is that [jobbers] can't effectively compete in the marketplace on acquisitions of quality stores because of the reality [of the consolidators]," Bologna says. "There are smaller markets or [places where] the big boys have not come in yet … but it won't be long before the bigger houses start to stretch out. [Or they may say] now this particular company is large enough that if we went out and bought it, we could do strategic tuck-ins."

> "The trend [of oil companies selling company-owned stores] will continue. … But as for where and when, who knows? It's like saying it's going to snow in Alaska because you know it's going to happen, but you just don't know when and where."
>
> **BILL TREFETHEN** *Trefethen & Co. LLC*

In War's Wake

As the sell-offs and acquisitions proceed market by market, clear winners and losers will emerge. "People who are well capitalized and hungry for growth … are going to have an opportunity to get access to terrific sites," says a petroleum- and convenience-focused attorney who asked not to be identified.

But there will be plenty of retailers bearing the scars of battle, according to Kelso. Multisite operators in markets where majors have changed their strategies have seen sites pulled out from under them. And hundreds of oil-company employees who used to oversee these locations could either be reassigned or let go.

Even those victorious in assuming new assets may discover that victory is a double-edged sword. Image upgrades and unforeseen environmental requirements will now fall not on the majors but the jobbers and independent dealers, Bassman says.

"If the laws change to require $2,500 temperature-control pumps," he says, "the majors won't care."

Dealers who assume control over lower-volume properties may also be vulnerable, says Bologna. This class of trade won't have the capital necessary to reinvest in stores and, depending on the site, may stumble sooner than later.

"It's sheer dirt," he says. "Even though a station may be run-down, if the location is good, the site will harvest for a long time. Other dirt is marginal. As stores go, it will lose value when a new store opens right around it. … Everything in that marketplace automatically starts to get dinged by virtue of a [consolidator's] across-the-board upgrade."

The real scenario developing lies in the adage of one man's treasure. And if any one of these growth-minded players can formulate the numbers, then many of these properties will be of value as time goes on.

According to Kelso, many victors will emerge. "Oil companies are winners; they're getting premium prices for assets," he says. "Jobbers are winners [by growing gallons] and because many of these jobbers will want to operate through dealer models, they'll create opportunities for [smaller independents]." ■