THE BUSINESS OF CONVENIENCE RETAIL
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# CSP


## 2019 Outlook Survey

With a presidential election looming, retailers face troubles and opportunities both familiar and new P. 24


2019 OUTLOOK SURVEY

# A VOTE FOR GROWTH

## As economic worries rise and a presidential election looms, convenience-store retailers seek certainty

BY CSP STAFF | ILLUSTRATIONS BY DOUG CHAYKA

Business in the c-store industry is good—again. In CSP's latest Outlook Survey, nearly 80% of retailers describe current business conditions as "good" or "excellent," about the same amount as the previous two years of the annual survey. And about half of operators expect even greater improvement in 2020. There's a lot to cheer about.

"The c-store industry is doing very well with margins and volumes on motor fuels strong, and inside sales and foodservice sales increases outpacing inflation," says David Nelson, founder and CEO of Study Groups and professor of economics at Western Washington University, Bellingham, Wash. Meanwhile, the national economy is "in record economic expansion territory," thanks to strong consumer spending and job growth, near record-low unemployment and low interest rates and inflation.

Given those economic tailwinds, there seems nowhere to go in 2020 but up. But more than 50% of Outlook Survey respondents expect business conditions next year to stay the same or even decline. This compares to 30% in 2018 who had the same sentiment for the coming year.

The unconventional presidency of Donald Trump, recent drone attacks on Saudi oil facilities, regulatory moves against vaping and disruptive technology are just some of the forces that shook up the markets—and growth forecasts—in 2019. Adding to the uncertainty is the upcoming U.S. presidential election, which could lock in another four years of norm-shattering under Trump or usher in an entirely new political—and regulatory—mindset. (See p. 29 for retailers' take on the election.)

And there is a sense that this seemingly unstoppable, multiyear economic boom must end.

"The economy is rocking right now, but at an unsustainable pace, and a downturn is coming sooner [rather] than later," one Outlook Survey retailer says.

U.S. economic growth, which began moderating in 2018, should continue to do so through 2020, Nelson says. Economic slowdowns in Europe and Asia, Brexit and the trade dispute with China are beginning to affect consumer confidence and raise uncertainty for business investment, he says.

Kevin Smartt, president and CEO of Kwik Chek Food Stores, Spicewood, Texas, has an astute metaphor for the country's current balancing act.

"We have a strong economy but we're fragile," Smartt says. "It's almost like [how] a piece of glass is strong. It supports walls and weight, but if it cracks, it shatters."

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# A SMART GROWTH GAME

By most indicators, the U.S. economy is stable and growing, said Nik Modi, managing director of RBC Capital Markets, New York, during a recent CSP Tobacco Update webinar. Gross domestic product has been growing at a respectable rate of 3%. Wage inflation is up, although it also means more money in people's pockets. Borrowing continues to be cheap; in September, the Federal Reserve lowered interest rates by another quarter of a percent, while Trump has been pushing for a zero or even negative rate.

But some retailers question how long the good times will last.

"I don't think Brexit or trade with China is really going to affect this industry much," says Robert Forsyth, president of Moto Inc., a subsidiary of FKG Oil Co., Belleville, Ill. "But what will affect this industry is the coming recession."

Forsyth believes the United States is long overdue for a downturn and will be poorly equipped to deal with it when it happens.

"Interest rates are already so low, we can't lower them much more to the stimulate the economy in recession," he says. The federal budget deficit, which moved past $1 trillion in 2019, would restrict significant stimulus spending.

"If the next recession is long and hard, my fear is we don't have ordinary measures to help pull ourselves out of that," he says.

However, Forsyth expects Moto Inc., which has 79 MotoMart stores in six states, to survive any downturn, just as it has in past decades.

"We've been in business over 60 years. You never know what kind of year you're going to have, because you never know what margin you're going to make on fuel," he says. "We're always playing a very conservative game. Come what may, we can weather it." Forsyth describes Moto's play-it-safe strategy as "low growth, low debt," with an emphasis on buying property instead of leasing.

Kwik Chek has a focus on growing smartly—not quickly. This means carefully picking new store locations that meet its long-term foodservice goals. "We're focused on fresh food," Smartt says. "We want to find locations that give us a food-centric market and feel."

With this moderating economic picture, more than half of Outlook Survey respondents plan to change their store count in 2020, with about 6 in 10 planning to grow by acquisition and new-to-industry sites. About one-quarter expect to sell stores, with most opting for small, strategic pruning.

Dee Dhaliwal, president of Dhaliwal & Associates, Pleasanton, Calif., plans to add to his store count of three sites in 2020 with one acquired location and one new build. He has also taken advantage of the past few years' strong fuel margins to reinvest in his current locations, including replacing a car wash and making decorative updates. In his Silicon Valley markets, the local economy is strong. That said, when Dhaliwal looks at the global and national economy, he is a bit less certain.

"I am a little nervous about the trade war, in terms of the cost of goods going up, inflation," he says. "Unfortunately, the knee-jerk reaction to that is, 'Let's raise the minimum wage.' It's a downward spiral." (Starting in 2017, California began raising its state minimum wage in steps to reach $15 per hour by 2023.)

Smartt is also uneasy about the tariffs the United States has placed on China and other trading partners, and the volatility news of these moves add to the stock market.

"Any piece of negative bad news we hear sends stock down [for] a few days," he says. "That uncertainty of fear, if a business person is planning on investments, is always challenging."

A sense of unease is growing at a time when c-store industry foot traffic has been stagnating. According to the 2019 Outlook Survey, 62% of retailers saw flat or lower foot traffic in 2019 vs. 2018. Most respondents blame the erosion on consumers' changing shopping habits and competition.

But shoppers' economic conditions also appear to be flagging. Nearly one-fifth of convenience consumers say their personal financial situation has declined in the past six months, up 8 points from 2015, according to Technomic Inc.'s *Q2 C-Store Consumer MarketBrief.*

For c-store retailers attempting to boost sales in this environment, the big opportunities are in the store. Nearly 40% of Outlook Survey respondents cited cannabidiol (CBD) products for their growth potential, and 30% cited foodservice.

Independent retailer 36 Lyn in Minneapolis has dedicated a 2-by-5-foot fixture for CBD products, says Director of Operations Lonnie McQuirter. But the assortment is far from final. "It's a new industry, and it will take some time to play out what will be premium, discount and a healthy balance in the middle," he says. Also still playing out: the federal regulatory approach to CBD.

Meanwhile, e-cigarettes are being run through the regulatory gauntlet. As of press time, the U.S. Food & Drug Administration was finalizing its policy on flavored e-cigarettes, which would require any flavors other than tobacco to be taken off the market and then resubmitted for authorization.

"If they are only making vaping products [that are] cigarette-flavored … that is going to be a big problem," Forsyth says, pointing out that adults enjoy flavors too.

While the short-term picture for e-cigarettes looks negative, the controversy could eventually subside, as it has for other popular products, Modi said. For example, in 2012, Monster energy drinks came under intense public scrutiny over possible ill effects. However, when data emerged that a can of Monster contained the caffeine equivalent of a 12-ounce serving of Starbucks coffee, the negative publicity began to wane, he said.

## STUCK IN NEUTRAL

**About half of retailers surveyed by CSP expect business conditions to improve in 2020, while the other half expects them to remain the same—or decline. Meanwhile, 62% have seen c-store traffic flatten or fall from 2018, with most blaming changing consumer shopping habits.**

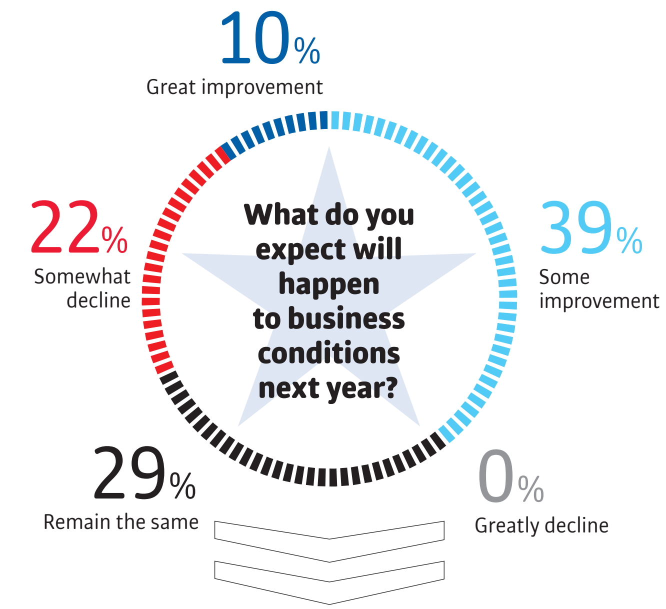
### How has your store foot traffic performed in 2019 vs. 2018?

| | |
|---|---|
| Up significantly | 8% |
| Up slightly | 30% |
| Flat | 38% |
| Down slightly | 22% |
| Down significantly | 2% |

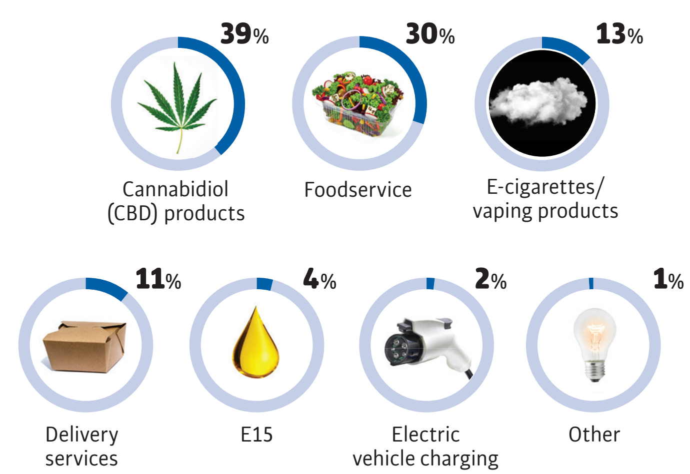
### In your opinion, what is the main reason for the industry's traffic decline?

| | |
|---|---|
| Consumers' changing shopping habits | 32% |
| Competition from other channels (dollar, restaurants, mass merchandisers) | 19% |
| Competition from other c-store retailers | 14% |
| Competition from online retailers (e.g., Amazon) | 12% |
| Consumers' changing driving habits | 11% |
| I don't know | 8% |
| Other | 4% |

**Source:** CSP 2019 Outlook Survey




### Which new product or service offers the greatest potential for c-stores?




CSP's Outlook Survey consists of 83 operator respondents in a survey conducted in August and September 2019.

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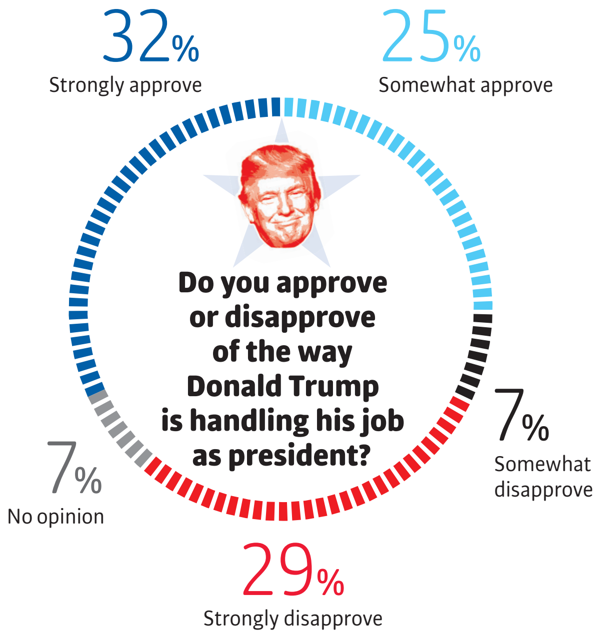
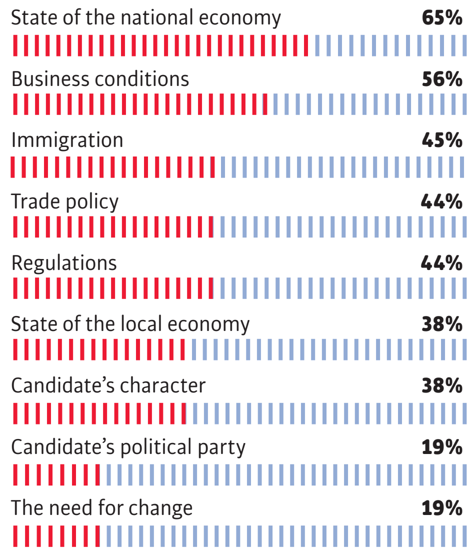
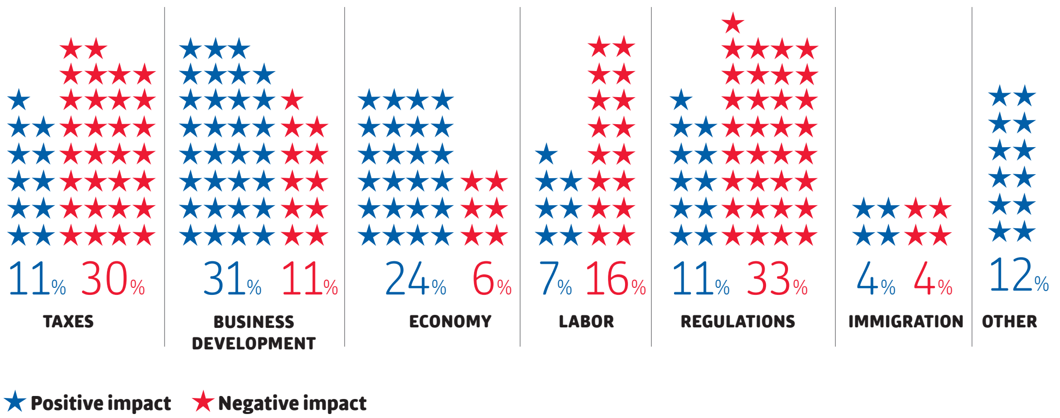
# A VOTE FOR GROWTH




## Which issue(s) will determine how you vote for president in 2020?




## In what areas has local government had the most impact on business?




Let's talk politics.

Fifty-seven percent of Outlook Survey respondents approve of Trump's performance, with nearly one-third strongly approving of the job he is doing. Another 36% are unhappy with Trump's performance, with 29% strongly disapproving. (The rough party breakdown of participants for this survey: 45% Republican, 33% independent and 14% Democrat.)

"The c-store industry has generally fared well under policies of the Trump administration as taxes have been cut and the regulatory burden reduced," Nelson of Study Groups says.

In terms of what will influence their vote in 2020, nearly two-thirds of respondents cited the national economy, followed by business conditions.

"The politics of convenience stores generally are based on what's best for the communities they serve and their employees," McQuirter of 36 Lyn says. "If our customers are good, we make more money; if our staff is good, we are more productive."

But state and local government has a more immediate effect on a business' growth plans. In fact, 80% of Outlook Survey respondents said state government has the greatest effect on their business. After Illinois doubled its gas tax to 38 cents per gallon and its cigarette tax by $1 per pack in July, Moto Inc. saw "a large decrease" in store sales at its more than two dozen sites along the Missouri and Indiana borders, Forsyth says. The tax increases—and the perilous financial condition of the state—have encouraged Moto to reverse course on development projects slated for Illinois and pursue growth in Missouri, which has lower taxes and less regulation.

"The southern part of Illinois is a weak economy," Forsyth says. "It's partially a result of poor political decisions, which negatively affected the working-class population, which is our bread and butter."

Government can be a positive influence in areas such as support for business development. This could include anything from tax incentives to legalizing a formerly illegal business, such as video gaming. In Illinois, which legalized video gaming in 2009 and expanded it in 2019, Moto has found growth opportunity with dedicated video-gaming rooms. And in Pennsylvania, Rutter's opened its fourth gaming location after that state followed Illinois' lead. The York, Pa.-based chain is only a couple of months into the business and trying to understand its effect on in-store and fuel sales, says Scott Hartman, president and CEO.

"It's a little early to be able to pin those trends down," Hartman says. "But we like gaming. Our rooms are busy."

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# LABOR PAINS

With national unemployment hovering around 3.7%, labor is proving a greater throttle on convenience retailers' store growth than any other factor, ahead of building costs, economic conditions or regulatory issues. Nearly two-thirds of Outlook Survey retailers cited it as their main business challenge.

"It's not a convenience store problem—it's an overall economic problem," says Bill Conerly, principal with Lake Oswego, Ore.-based Conerly Consulting LLC. "I hear about it in agriculture, in manufacturing, in construction. C-store people are not just competing with other convenience stores—they're competing with everybody for labor."

While some regions typically have higher unemployment rates than others, Conerly is seeing them begin to tighten. And with the working population expected to decline from 2020 to 2030, "What employers are experiencing now, it's just going to get worse," he says.

Conerly advises focusing on hiring quality first-level managers, who can have a huge influence on overall employee retention. At FKG, the turnover rate for store managers is only 6%, compared to the industry average of 22%, according to NACS figures.

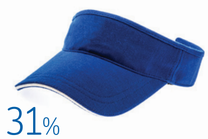
"Having long-term, knowledgeable, committed store managers running our stores—that's our secret sauce," Forsyth says. The key is for corporate to involve store managers in decision-making. "We don't know how to run stores. We have to be humble enough to identify and respect-fully glean from you the best practices and share them among other managers. The ideas and expertise are in the field."

That said, "the point of pain" for FKG remains cashier turnover. "You try to employ people and you simply can't," Forsyth says. "It not only is our industry's biggest problem but also the entire economy's biggest problem." This is despite what Forsyth describes as "incredible benefits" and above-average pay that outpaces Illinois' minimum wage requirements, which are rising to $15 per hour by 2025.

Dhaliwal & Associates is paying its employees more than $15 per hour, ahead of California's minimum-wage increase timeline. "But we expect more out of them," Dhaliwal says. "We do have to adjust pricing on everything accordingly." He emphasizes the link between higher wages and prices to employees during training. "People are paying more money, so they expect excellent service for what they're getting, so you still try to create value."

**3.6 million** Amount of private-sector workers who quit their jobs in July 2019, pushing the quit rate to an 18-year high, according to data from the Federal Reserve Bank of St. Louis

## What long-term issue or trend will most impact the c-store channel of the future?



31% Labor costs

14% Marijuana legalization

13% Alternative fuels (electric, hydrogen, ethanol, etc.)

13% On-demand delivery

12% Tobacco regulations

11% Shifting demographics

2% Sin taxes

1% Autonomous vehicles

1% Automation/robots

2% Other

## What are the biggest roadblocks to expanding your store count?

| | |
|---|---|
| Finding enough workers to staff new locations | 30% |
| Land prices and availability for new builds | 27% |
| Uncertain economic conditions | 25% |
| Increasing building costs | 24% |
| Regulatory burdens | 21% |
| Unrealistic multiples for potential acquisitions | 19% |
| Lack of access to capital | 12% |
| Other | 6% |

## What are the three biggest business challenges you face today?

| | |
|---|---|
| Tight labor market | 65% |
| Employee turnover | 36% |
| Regulatory pressures | 35% |
| Increased competition from c-stores | 32% |
| Local economic conditions | 30% |
| Declining store foot traffic | 29% |
| Increased competition from nontraditional retailers (food, drug, mass, dollar) | 20% |
| Fuel margin volatility | 19% |
| Increased competition from e-commerce | 15% |
| Interchange fees | 13% |

**Source:** CSP 2019 Outlook Survey

2019 OUTLOOK SURVEY

# FUEL'S UNCERTAIN FUTURE

Providing more than 62% of total sales in 2018, according to NACS, fuel continues to define the c-store industry. This is even as retailers attempt to grow in-store categories such as foodservice, aware that the dominance of fuel—much like the economic growth run—cannot last forever.

Forty-six percent of Outlook Survey respondents expect fuel demand to flatten or decline in the long term; most cite changing consumer preferences for the trend, ahead of regulations or the rise of electric vehicles. More than half, meanwhile, expect an increase.

The past three years of the Trump administration have given fuel retailers reason to be optimistic, whether because of loosening regulations that can raise costs or a move to freeze fuel economy standards that depress demand.

In general, the Trump administration "has been trying to remove barriers to production, make sure the energy we need can be delivered in a way that is economically advantageous for the consumer," says John Eichberger, executive director of the Fuels Institute, Alexandria, Va. He points to the Trump administration's Safer Affordable Fuel-Efficient Vehicles Rule, which would freeze fuel-economy improvements around the 2025 vehicle model year, and opening offshore oil production.

Another Trump push—to enable year-round sales of E15—is a victory for some fuel retailers. But the devil has been in the details, says Tim Columbus, a lawyer with Steptoe & Johnson LLP, Washington, D.C. For example, to sell E15, retailers must demonstrate their underground storage tanks and dispensing systems are compatible with E15 or they will face a violation.

"Now the administration says, 'Don't worry—we're going to get rid of that impediment.' They will need a rulemaking," Columbus says. "That leaves people betwixt and between."

The administration's unconventional approach has also created uncertainty around the Renewable Fuel Standard (RFS); while supporting biofuel use with the E15 waiver, the U.S. Environmental Protection Agency has also been granting dozens of biofuel blending waivers to refiners over the past two years, which ethanol supporters argue is undermining the intent of the RFS.

"The program is 12 years old," Columbus says. "There's been more hoopla about the RFS in the last 2.5 years than in all of the previous years combined."

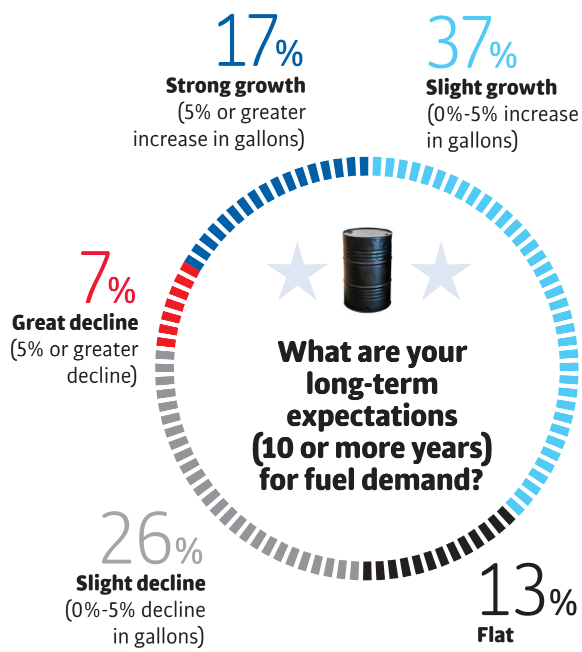
Meanwhile, the September drone attack on Saudi Arabia and Iran's possible role has ratcheted up tension in the oil market and revealed the vulnerability of supply. "All those thing create uncertainty in the oil market," Eichberger says. For retailers, how prepared they are to ride the market jitteriness is key—in particular, have they invested the past year's record fuel margins to make their businesses more resilient?

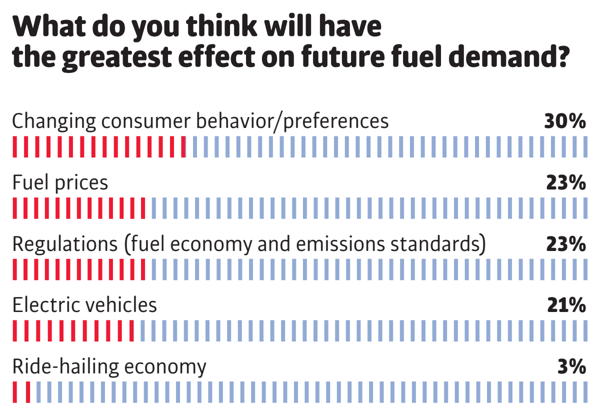
"If we go into a volatile market, that's going to have a massive impact on how you go to market," Eichberger says. It will also influence the mergers and acquisitions market in the year ahead.

He says, "If you're going from 25- to 13-CPG fuel pool margins—[some retailers may say] 'Now I need out.' That could be the biggest hit."

## FUEL GAUGE

**More than half of Outlook Survey respondents expect fuel demand to grow, with most expecting slight increases. The biggest factor in that decline: changing consumer behavior, according to 30% of respondents.**




**Source:** CSP 2019 Outlook Survey


CPG

National average retail fuel margins this past summer, according to Oil Price Information Service