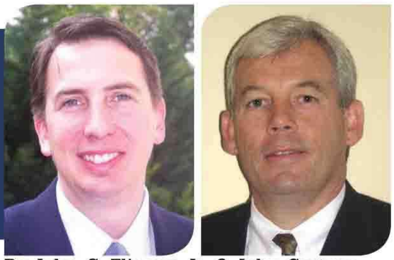
A Peek Into the M&A Marketplace of 2016

Growth in multiples are under pressure and may have peaked

As 2015 comes to a close, the mergers and acquisitions (M&A) market in the convenience and gas station (C&G) industry is showing no real signs of slowing down any time soon. While the C&G industry has experienced a tremendous amount of M&A activity over the past several years, it is still extremely fragmented and ripe for further consolidation.



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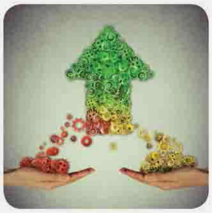
In addition, for the most active companies in the M&A marketplace, acquiring a major competitor can be the easiest and most cost-effective option to fuel their future growth plans in existing trade areas, or to expand their current marketing footprint.

However, as 2016 quickly approaches, there are certainly signs that the growth in multiples that the most active consolidators have been willing to pay for C&G retail assets are under pressure and may have peaked in 2015. Before we discuss the outlook for 2016 in more detail, let's briefly review some of the largest transactions that were announced or have closed in 2015, and some of the common themes in all of these acquisitions.

- Global Partners LP acquired 97 retail gas stations and seven dealer supply-only agreements located in New York and Maryland from the Capitol Petroleum Group for $156 million. This acquisition quickly followed the master limited partnership's (MLP) earlier acquisition of petroleum marketer Warren Equities Inc. for approximately $387 million. The Warren Equities acquisition included 147 company-operated sites, 53 commission agent locations and more than 300 dealer supply-only agreements.
- TravelCenters of America (TA) continued its expansion into the convenience store space by completing or announcing six separate transactions that included 124 retail sites. These acquisitions reportedly cost TA approximately $230 million.
- CrossAmerica Partners LP acquired the West Virginia-based One Stop convenience store network. The MLP paid all cash for the assets and the funds were secured from its corporate credit facility.
- United Pacific, formerly known as United Oil, purchased 251 gas stations and convenience stores from Pacific Convenience & Fuels. The locations are in the states of California, Nevada, Oregon, Washington and Colorado. United Pacific is a portfolio company of the Fortress Investment Group LLC, a diversified global investment management firm.
- 7-Eleven Inc. acquired the Tedeschi Food Shops retail network that included approximately 180 sites in the Northeast section of the United States.
- Cumberland Farms Inc. announced the sale of its Gulf Oil LP fuel business to the Boston-based private equity firm ArcLight Capital Partners. It has been reported that the transaction will exceed $1 billion.

The public announcements and post-closing industry analysis concerning all of these acquisitions clearly indicates MLPs, the publicly traded convenience store companies and buyers backed or controlled by private equity firms are firmly entrenched as the leading M&A players or consolidators in the C&G industry. A motivated seller with attractive C&G assets will continue to seek out these strategic buyers because of the financial resources of the companies and their proven ability to close almost any transaction.

In addition, the ability of the larger consolidators to access the historically inexpensive capital markets should continue in 2016 since the Federal Open Market Committee (FOMC) — and Federal Reserve Chairwoman Janet Yellen in particular — are still hesitant to raise market interest rates to a range that would be commensurate with the actual level of economic activity in the economy. The Fed seems to agree with former U.S. Treasury Secretary Larry Summers that the problem of "secular stagnation" in the major industrial economies such as the United States and the decline in the growth of emerging market economies have created too big of a risk to end the Fed's accommodative monetary policy any time soon.



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Therefore, while the bullish U.S. employment report for October may finally nudge the Fed to increase short-term interest rates by 25 basis points during its December FOMC meeting, no one expects rates to rise to a level that will significantly dampen M&A activity throughout the economy.

UNDER PRESSURE

While all the current market incentives that have been fueling the merger mania in the C&G industry over the past several years are still in place, we would like to use the remaining portion of this article to briefly highlight several external macroeconomic issues that should inhibit the future growth in purchase multiples and the overall site-level prices that have been recently paid for C&G retail assets. These forces will put pressure on the future profitability of the C&G industry and the aggregate amount of capital available to chase these assets.

- **Retail Margin Expansion**: The massive decline in crude oil prices that has had a positive impact on retail margins seems to have come to an end. While it is always difficult to predict the movement in worldwide crude oil prices, it seems unlikely a major consolidator is preparing a five-year pro-forma business plan assuming retail margins will continue to expand at a pace equal to the past two years.
- **Increased Labor Expenses**: The recent announcement by Wal-Mart Stores Inc. and several other major retail chains that the growth in store labor expenses will have a major negative impact on future profitability was certainly a wakeup call for all investors and retail operators. New York Governor Andrew Cuomo's push for the Empire State to become the first state in the country to adopt a $15-per-hour minimum wage for all industries cannot be ignored or considered an isolated event.

The progressive forces in the United States certainly seem to be winning the national discussion over what is an appropriate "living wage" and as a result, even conservative states such as Arkansas, Nebraska and West Virginia have enacted fairly robust minimum wage increases for 2016 and/or beyond. In addition, President Obama has announced plans to greatly expand the number and categories of employees that are entitled to overtime compensation through revisions to various national labor rules and regulations, and several large class-action lawsuits have been filed in the U.S. alleging that C&G operators failed to properly pay overtime wages to employees.

As the overall level of retail wages continues to rise throughout the United States in the near future, C&G operators are going to have to pay higher wages to compete for the most talented employees, and these increased labor costs will also directly lead to higher payroll taxes, unemployment insurance and workers compensation expenses. All of these issues will have a negative impact on store-level profitability and the ultimate price or multiple that buyers will be willing to pay for a network of C&G sites.

- **The Weaker IPO Market:** The initial public offering (IPO) market in the United States has suddenly slowed down as the sharp stock-market swings or volatility in the late summer and early fall have trimmed investor appetite for risk and, as a result, numerous companies have delayed or put off plans to go public. The change in the IPO market seems to have impacted several large privately held C&G companies that had been planning to go public by forming new MLPs.

  If the IPO market environment does not rebound in 2016, the growth in new capital and the expanding number of publicly held companies that have helped to fuel the C&G merger mania over the past several years will start to subside.

- **Threat of an Interest Rate Increase:** Although no one can know with certainty how quickly interest rates may rise in 2016, it is clear that the discussion of an increase in interest rates by the Fed and the general economic downturn in the exploration and production portion of the petroleum industry has had a negative impact on the unit prices (the MLP equivalent of stock shares) of MLPs. The general reduction in MLP unit prices will eventually result in a market increase in the cost of capital for the industry, place additional pressure on lender credit terms, and create a more challenging environment for raising capital. Any increase in the cost and availability of capital typically has a direct and negative impact on purchase multiples.

Although all these factors are most likely going to impede future profitability in the C&G industry, the M&A activity within the sector remains strong and we expect this will continue into 2016, albeit at slightly less robust multiples. CSN

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