Is The Party Over?

After four years of record profits, the convenience store industry's remarkable run may be running out of gas By Angela Hanson & Don Longo

THE REMARKABLE FINANCIAL SUCCESS OF THE CONVENIENCE STORE INDUSTRY hit a snag last year as in-store sales rose only 2.1 percent after two years of solid gains of close to 4 percent and even 5 percent. Perhaps more surprisingly, though, foodservice sales increased at about half the growth rate of two years ago.

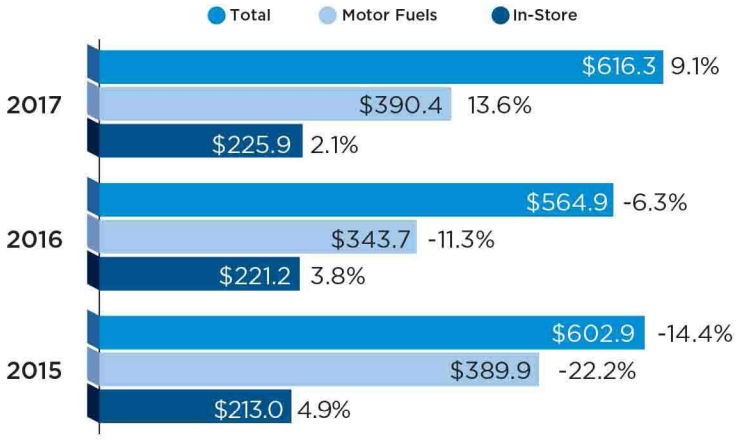
Total convenience store industry sales did rise 9.1 percent last year to $616.3 billion, but that dollar growth was mainly driven by a 12.4-percent increase in the average price of gas in the United States, according to the 43rd annual *Convenience Store News Industry Report*, the longest-running, continuously published annual report on the health and performance of the convenience retail channel.

Last year's in-store sales gain paled in comparison to the 3.8-percent and 4.9-percent increases registered in 2016 and 2015, respectively.

In terms of store count, the industry added 423 stores year over year, while the proportion of single stores to chains remained at 37 percent for chains and 63 percent for single stores, according to Nielsen/TDLinx.

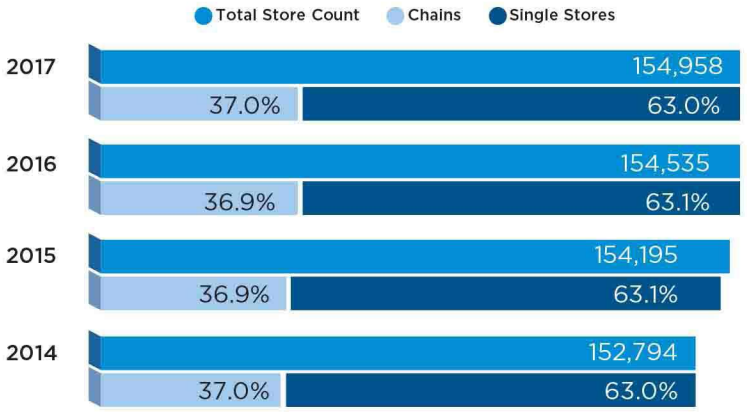
Motor fuel volume stalled last year at about 154 billion gallons consumed by U.S. drivers, but dollar sales grew 13.6 percent due to rising gas prices. Gross margin cents per gallon increased

Total Convenience Store Sales (in billions)



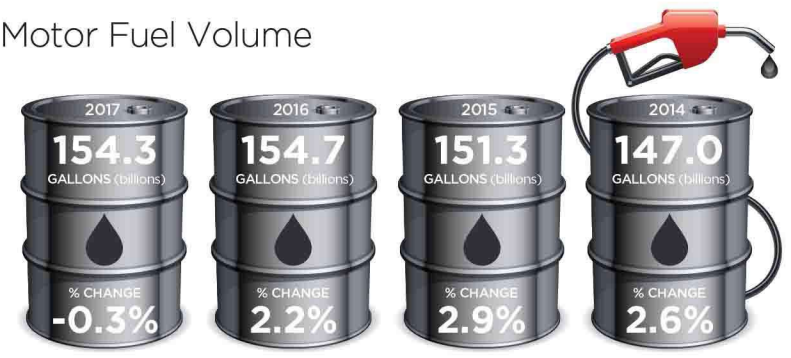
Source: *Convenience Store News* Market Research, 2018

Store Growth Analysis



Source: Nielsen TDLinx; *Convenience Store News* Market Research, 2018

Motor Fuel Volume



Source: *Convenience Store News* Market Research, 2018

3.5 percent to 23.7 cents per gallon.

The increase in the retail price of gasoline from $2.25 per gallon in 2016 to an average of $2.53 per gallon in 2017 had a number of impacts. The higher gas prices probably suppressed driving mileage somewhat and reduced trips to the store. Once in the store, consumers also had less disposable dollars to spend on merchandise, food and drink.

Industry gross profits were up 5.8 percent last year to $101.73 billion, while pretax profits were up 1.8 percent to $9.26 billion.

In-store sales per unit were a record high of $1,473,386 per store, but the 1.5-percent increase was less than half of that achieved in each of the previous two years.

Fuel volume was flat last year as prices rose and consumers drove less.

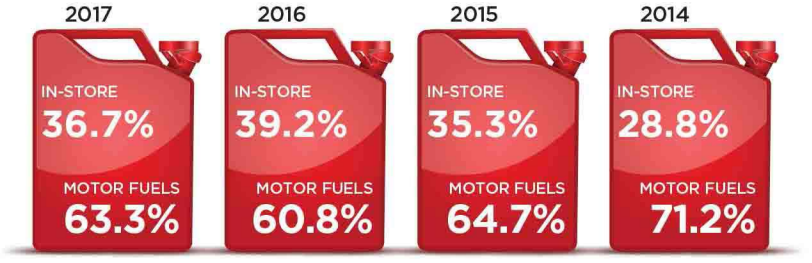
Foodservice sales (including prepared food and hot, cold and frozen dispensed beverages) increased only 3.6 percent — the lowest increase in many years. Foodservice sales had grown by 6.6 percent in 2016 and 7.1 percent in 2015. Prior to that, there were several years of double-digit percentage sales growth for the foodservice category at convenience stores.

Despite the slowdown in growth, foodservice still gained as a percentage of total in-store sales. Foodservice comprised 16.38 percent of in-store sales last year, up from 16.14 percent in 2016.

The highest percentage of in-store sales still comes from the cigarettes category. Cigarettes represented 29.82 percent of U.S. c-store sales last year, down slightly from 30.11 percent. However, rising taxes and manufacturer price increases combined to hide the annual 2-3 percent drop in volume the category has experienced for the past decade.

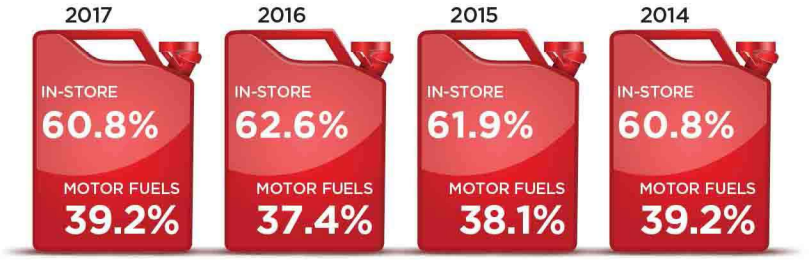
Packaged beverages, the third-highest grossing in-store category (after cigarettes and foodservice), also had a relatively difficult year in 2017. This category — dominated for years in size by carbonated soft drinks and driven by growth in the energy drinks segment — saw its share of in-store sales dip from 12.74 percent in

Industry Sales Mix



Source: *Convenience Store News* Market Research, 2018

Gross Profit Dollar Mix



Source: *Convenience Store News* Market Research, 2018

Industry Gross Profit

	2017 $ BILLIONS	2016 $ BILLIONS	% CHANGE
In-Store	$61.85	$60.18	2.8%
Motor Fuels	$39.88	$35.93	11.0%
TOTAL	**$101.73**	**$96.11**	**5.8%**

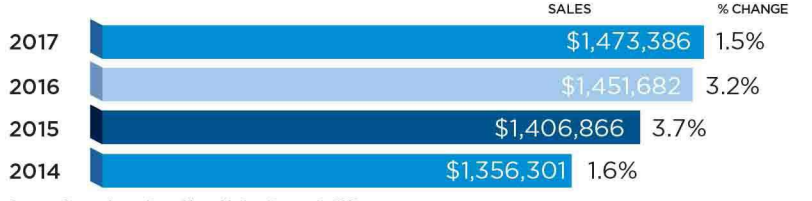
Source: *Convenience Store News* Market Research, 2018

Pretax Profits

	TOTAL INDUSTRY PRETAX PROFIT (in billions)	% CHANGE	PRETAX PROFIT PER STORE	% CHANGE
2017	$9.26	1.8%	$60,410	2.6%
2016	$9.10	-1.9%	$58,886	-3.9%
2015	$9.28	3.5%	$61,277	2.3%

Source: *Convenience Store News* Market Research, 2018

In-Store Sales per Store



Source: *Convenience Store News* Market Research, 2018

2016 to 12.5 percent last year.

In terms of percentage sales gains, the fastest-growing categories last year were other tobacco products (up 10.8 percent per store), wine and liquor (up 5.4 percent per store), and prepared food (up 4 percent per store). Categories that had the biggest percentage declines were ice cream (down 3.1 percent), publications (down 2.8 percent), and non-edible grocery (down 1.4 percent).

WHAT HAPPENED?

"Yes, convenience did not grow as fast as the prior year," said Carl Elliott III, director of the Nielsen Convenience Channel. "Considering food deflation, less gallons consumed, and that ecommerce is taking automobiles off the road, thus reducing trips, the year was still good for convenience, compared with other [brick-and-mortar] retail channels."

Wells Fargo Securities convenience channel analyst Bonnie Herzog now views the c-store industry's outlook more cautiously due to declining c-store trips/traffic, labor shortages/staffing needs and rising wages, a struggling low-income consumer, aggressive tactics from quick-service restaurants (QSRs), the emergence of delivery/eat-in alternatives, and ecommerce.

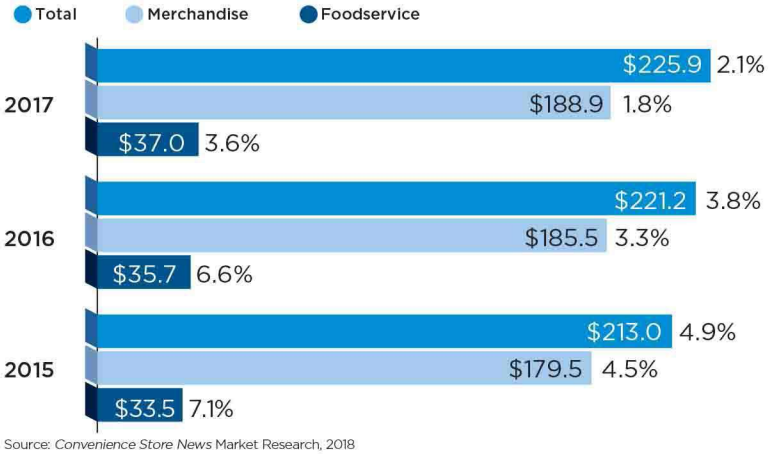
"Overall, while we continue to view c-stores' participation in the broader fuel-supply chain as an advantage, we came away from the [NACS State of the Industry Summit] event incrementally more concerned about the growing threats facing the industry and its ability to navigate a rapidly evolving consumer landscape," Herzog wrote in a recent report.

Convenience channel growth in 2018 is still expected to exceed all other channels Nielsen tracks, except for the value channel (dollar stores) and only by slightly, noted Elliott.

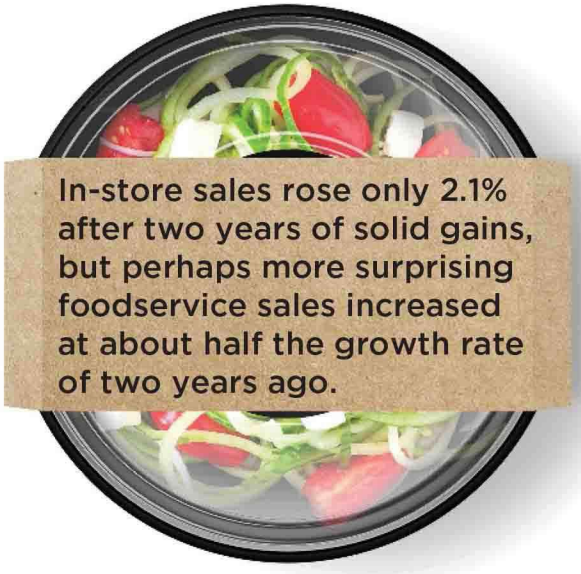
"The future for convenience is very bright for those who differentiate themselves from the old model of gas-sodas-smokes," said the Nielsen analyst.

Convenience will be impacted by millennial and Generation Z cohorts who are digital natives. Elliott believes convenience retailers will need to invest in technology — loyalty, apps, mobile order and pay, tech-enabled delivery, etc. — to attract

Total Merchandise & Foodservice Sales (in billions)



Source: *Convenience Store News* Market Research, 2018



In-store sales rose only 2.1% after two years of solid gains, but perhaps more surprising foodservice sales increased at about half the growth rate of two years ago.

In-Store Sales by Category

	PERCENT OF IN-STORE SALES 2017	PERCENT OF IN-STORE SALES 2016	SALES PER STORE 2017	SALES PER STORE % CHANGE	TOTAL INDUSTRY SALES (in millions) 2017	TOTAL INDUSTRY SALES (in millions) % CHANGE
MERCHANDISE						
Cigarettes	29.82%	30.11%	$439,340	0.5%	$67,345	1.1%
Packaged beverages	12.50	12.74	184,212	-0.4	28,237	0.2
Beer/malt beverages	9.41	9.56	138,615	-0.1	21,248	0.5
Other tobacco products	5.62	5.16	82,866	10.8	12,702	11.4
Edible grocery	4.85	4.98	71,482	-1.2	10,957	-0.6
General merchandise	3.62	3.53	53,279	4.0	8,167	4.6
Candy	3.17	3.19	46,756	1.0	7,167	1.6
Salty snacks	2.81	2.74	41,361	3.8	6,341	4.5
Non-edible grocery	1.66	1.71	24,461	-1.4	3,750	-0.8
Fluid milk products	1.58	1.58	23,277	1.5	3,568	2.1
Wine & liquor	1.40	1.35	20,683	5.4	3,170	6.1
Alternative snacks	1.10	1.11	16,218	0.8	2,486	1.4
Ice cream & frozen novelties	0.91	0.95	13,339	-3.1	2,045	-2.5
Health & beauty care	0.70	0.71	10,386	1.0	1,592	1.6
Ice	0.49	0.50	7,176	-0.8	1,100	-0.2
Publications	0.46	0.48	6,781	-2.8	1,039	-2.2
Packaged sweet snacks	0.30	0.30	4,449	2.7	682	3.3
All other merchandise	3.22	3.17	47,470	3.2	7,276	3.8
Merchandise subtotal	**83.62%**	**83.86%**	**$1,232,151**	**1.2%**	**$188,872**	**1.8%**
FOODSERVICE						
Prepared food (prepared on- or off-site)	11.15%	10.87%	$164,131	4.0%	$25,159	4.6%
Hot dispensed beverages	3.37	3.38	49,652	1.1	7,611	1.7
Cold dispensed beverages	1.33	1.35	19,663	0.5	3,014	1.1
Frozen dispensed beverages	0.53	0.54	7,789	-0.7	1,194	-0.1
Foodservice subtotal	**16.38%**	**16.14%**	**$241,235**	**3.0%**	**$36,978**	**3.6%**
TOTAL IN-STORE	**100.00%**	**100.00%**	**$1,473,386**	**1.5%**	**$225,850**	**2.1%**

Source: *Convenience Store News* Market Research, 2018

these up-and-coming generations.

"Foodservice is also a differentiator for those who embrace it. Quality foodservice will drive loyalty with shoppers," he said.

OPERATIONS

A lot of retailer concern today is centered on the decline in store trips. This is a phenomenon that has affected brick-and-mortar retailers in virtually all trade channels. According to Nielsen Homescan, trips per shopper declined 1 percent at drugstores, 2.4 percent in conventional grocery, 1.6 percent in premier fresh grocery, and 1.4 percent at warehouse clubs. Trips were flat in the dollar store channel.

According to the *2018 CSNews Industry Report*, in-store transactions per week declined 1.2 percent at convenience retailers last year. Meanwhile, the average in-store transaction (excluding fuel) rose 1.7 percent to $8.60.

Direct-Store Operating Expenses

	DOLLARS PER STORE 2017	2016	% CHANGE
Wages	$311,284	$285,320	9.1%
Payroll taxes	16,664	16,163	3.1
Workers compensation	12,653	12,320	2.7
Health insurance	29,331	27,058	8.4
Other benefits	5,457	5,361	1.8
Labor subtotal	**$375,389**	**$356,222**	**5.4%**
Credit card fees	76,150	71,704	6.2
All other direct-store operating expenses	162,285	155,000	4.7
TOTAL	**$613,824**	**$582,926**	**5.3%**

Source: *Convenience Store News* Market Research, 2018

Most retailers attribute the slowdown in in-store sales growth to a decline in store traffic.

Industry experts pointed to factors such as higher fuel prices, growth in ecommerce, low-income households being left behind, the political climate for Hispanics, and aggressive tactics from QSRs as influencing the overall trip count. Generational change was also an issue.

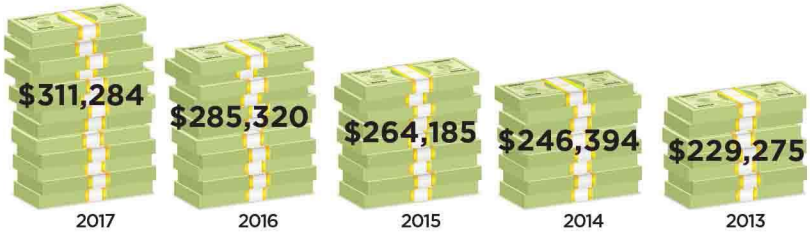
Andy Jones, president and CEO of Sprint Food Stores, reflected on the decline in trips at the 2018 NACS State of the Industry (SOI) Summit. "Why did trips decline? The reality is the total number of household trips are declining; they are down three trips on average," Jones said. "Millennials are fundamentally shopping differently."

In 2017, millennials made five fewer trips than they did in 2014, according to Jones.

"While traffic to the overall convenience and gas channel may be declining, we know than the retail footprint for conventional convenience stores has grown," Nielsen wrote in its *Total Consumer Report*, released in March 2018. "In addition to this, consumer behavior highlights areas of opportunity within this grab-and-go channel. Shoppers are spending 2 percent more per trip on FMCG (food, mass, convenience, grocery) categories within the convenience and gas channel than they were a year ago."

Another major area of concern for retailers is how rising costs are adversely affecting their bottom lines. Total direct-store operating expenses rose 5.3 percent last year to $613,824 per store. The biggest increases were in wages (up 9.1 percent) and health insurance costs (up 8.4 percent).

Five-Year Trend: Wages (dollars per store)



Source: *Convenience Store News* Market Research, 2018

Transactions

	2017	% CHANGE
In-store transactions per week	3,290	-1.2%
Motor fuel transactions per week	2,350	-0.8%
Average in-store transaction	$8.60	1.7%
Average motor fuel transaction	$26.35	10.4%
Average gallons per transaction	8.9	-4.0%

Source: *Convenience Store News* Market Research, 2018

C-Store Square Footage

	2017	2016	% CHANGE
Sales area	2,340	2,420	-3.3%
Non-sales area	810	825	-1.8%
Total store size	3,150	3,245	-2.9%
Total property size	27,600	27,750	-0.5%

Source: *Convenience Store News* Market Research, 2018

Motor Fuels Sales & Margins

	2017	2016	% CHANGE
Dollar sales (in billions)	$390.4	$343.7	13.6%
Gallons sold (in billions)	154.3	154.7	-0.3%
Gross margin cents per gallon	23.7	22.9	3.5%
Average sales price per gallon*	$2.53	$2.25	12.4%

*Weighted average, all grades and diesel
Source: *Convenience Store News* Market Research, 2018

Retail Gasoline Prices (per gallon)

Prices include dollars per gallon for all grades, all formulations
Source: U.S. Department of Energy/Energy Information Administration

Salary costs are being driven upwards by myriad higher minimum wage laws across states and municipalities around the country, as well as the current low unemployment rate.

Credit card transaction fees, a longtime burr for convenience retailers, were up 6.2 percent last year — a figure considered unacceptably high by most companies in the retailing industry, who feel further legislative reform is needed to curb the fees charged by banks and card companies.

Despite some c-store chains debuting prototype stores with larger square footage, the sales area, non-sales area and total store size of convenience stores declined in 2017. The total average property size also saw a very slight drop of 0.5 percent.

MOTOR FUELS

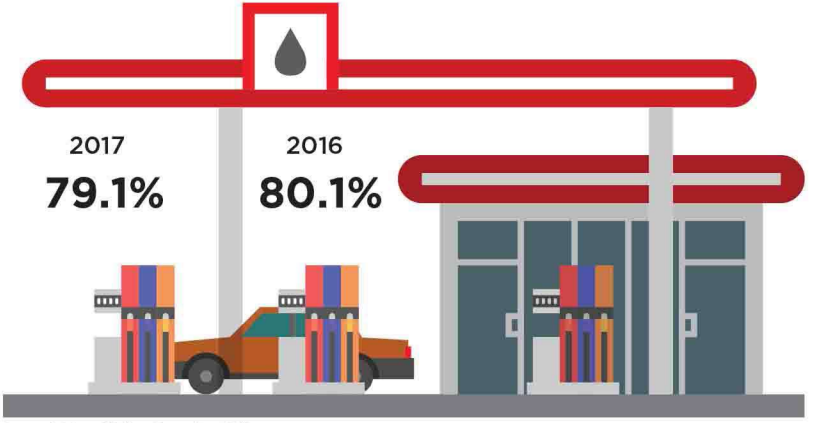
The average price of a gallon of gas rose by 28 cents, but volume was flat. The nearly 14-percent increase in motor fuel

Five-Year Trend: Motor Fuels

	2017	2016	2015	2014	2013
Dollar sales (in billions)	$390.4	343.7	389.9	501.4	509.6
Gallons sold (in billions)	154.3	154.7	151.3	147.0	143.3

Source: *Convenience Store News* Market Research, 2018

Stores Selling Motor Fuels (Percent of stores that sell motor fuel)



Source: Nielsen TDLinx, December 2017

revenue came after declines of almost 12 percent and more than 22 percent the previous two years. Gross profits from motor fuels rose 11 percent.

Numerous factors contributed to the decline in gallons consumed last year, including the spike in gas prices, vehicles with better gas mileage, and younger consumers, particularly in urban areas, driving less than previous generations.

Although the average price for a gallon of gas rose in 2017, fuel prices were still far below the wallet-draining prices seen in 2014 and 2013. In fact, 2017 was the third year in a row that the average price per gallon fell below the $3 benchmark. It also remained below the average of $2.57 seen in 2015, the first year in the last five that the average was beneath the benchmark. Additionally, it was more than a dollar less than the five-year high of $3.57, seen in 2013.

The percentage of U.S. convenience

Category Analysis: Cigarettes

	AVERAGE SALES PER STORE 2017	% CHANGE	INDUSTRY TOTAL (IN MILLIONS) 2017	% CHANGE
Premium	$355,597	0.9%	$54,509	1.5%
Branded discount	69,029	-2.8	10,581	-2.2
Subgeneric/private label	13,137	9	2,014	9.6
Fourth tier	1,561	-10.9	239	-10.3
Imports	16	20.4	2	21.0
TOTAL	**$439,340**	**0.5%**	**$67,345**	**1.1%**

Source: *Convenience Store News* Market Research, 2018

Five-Year Trend: Cigarettes

	2017	2016	2015	2014	2013
Percent change in total sales	1.1%	1.4%	3.9%	0.1%	-0.3%
Margin percentage	14.82%	15.20%	13.36%	13.60%	13.80%
Share of in-store sales	29.82%	30.11%	30.84%	31.10%	32.10%

Source: *Convenience Store News* Market Research, 2018

Category Analysis: Other Tobacco Products

	AVERAGE SALES PER STORE 2017	% CHANGE	INDUSTRY TOTAL (IN MILLIONS) 2017	% CHANGE
Smokeless	$47,291	4.4%	$7,249	5.0%
Cigars	23,810	13.9	3,650	14.6
Electronic cigarettes	9,539	50.9	1,462	51.8
Papers	1,592	-2.9	244	-2.4
Pipe/cigarette tobacco	634	-6.4	97	-5.8
TOTAL	**$82,866**	**10.8%**	**$12,702**	**11.4%**

Source: *Convenience Store News* Market Research, 2018

Five-Year Trend: Other Tobacco Products

	2017	2016	2015	2014	2013
Percent change in total sales	11.4%	9.0%	5.4%	4.3%	8.4%
Margin percentage	27.65%	28.06%	24.34%	24.20%	24.71%
Share of in-store sales	5.62%	5.16%	4.91%	4.89%	4.83%

Source: *Convenience Store News* Market Research, 2018

stores selling motor fuels has remained steady, at close to 80 percent, for the past several years.

TOBACCO

Cigarette sales were flat in 2017, posting sales gains of 0.5 percent in average sales per store and 1.1 percent for the total industry.

Premium cigarettes, though flat at 0.9-percent growth in average sales per store, was the highest-grossing segment by far. No. 2, branded discount, saw average per-store sales drop 2.8 percent. Subgeneric/private label had a more impressive 9-percent increase in sales per store, making it the third-largest class of cigarettes. Fourth tier, coincidentally in the No. 4 spot, fell 10.9 percent in sales per store — the largest percentage decline in the category. Dollar sales for imports were the lowest within cigarettes, but imports also saw the greatest percentage increase at 20.4 percent in average sales per store due to the small size of the segment.

Over the last five years, total cigarette sales have trended flat and the category as a percentage of in-store sales has fallen from 32.1 percent in 2013 to 29.82 percent in 2017. Still, cigarettes are the single highest-grossing category for convenience stores.

What is having the biggest impact on cigarette sales? State tax changes, according to Alan Beach, former senior vice president of merchandising at 7-Eleven Inc., who spoke at the NACS SOI Summit. He predicted retailers that haven't experienced a tax change in the last 10 years are likely to see one soon. Additional factors impacting cigarettes are heat-not-burn tobacco products, the Food and Drug Administration's shift in favor of less harmful tobacco products, and consumers switching to the other tobacco products (OTP) category.

Beach cautioned retailers not to turn their attention away from the cigarette category. "You can't ignore this. We need to protect this; it is what got us here," he said.

Consumers choosing OTP over cigarettes contributed to a 10.8-percent increase in average OTP sales per store in 2017. Electronic cigarettes led the way in growth, increasing 50.9 percent in sales per store. Cigar sales also rose, increasing 13.9 percent in sales per store. Smokeless increased 4.4 percent per store, but generates the most revenue in OTP.

Vapor is the main driver of the "off-the-charts" growth of e-cigarettes, according to Beach.

Over a five-year period, OTP's share of in-store sales has increased by nearly 1 percentage point, while sales growth has consistently risen since 2014.

FOODSERVICE

Foodservice sales increased 3.6 percent across the industry in 2017, continuing a five-year trend of growth. While that rate of growth was a slowdown from the 6.6-percent growth seen in 2016, foodservice as a percentage of in-store sales continues to rise steadily, reaching 16.38 percent last year.

The category is benefitting from a narrowing gap between those who eat out and those who stay at home, as well as consumers' increased embrace of value-focused quick-service restaurants, which many c-stores already compete with.

Category Analysis: Foodservice

	AVERAGE SALES PER STORE 2017	% CHANGE	INDUSTRY TOTAL (IN MILLIONS) 2017	% CHANGE
Prepared food (prepared on- or off-site)	$164,131	4.0%	$25,159	4.6%
Hot dispensed beverages	49,652	11	7,611	17
Cold dispensed beverages	19,663	0.5	3,014	11
Frozen dispensed beverages	7,789	-0.7	1,194	-0.1
TOTAL	$241,235	3.0%	$36,978	3.6%

Source: *Convenience Store News* Market Research, 2018

Five-Year Trend: Foodservice

	2017	2016	2015	2014	2013
Percent change in total sales	3.6%	6.6%	7.1%	6.3%	6.5%
Margin percentage	43.85%	•43.70%	43.72%	44.13%	44.64%
Share of in-store sales	16.38%	16.14%	15.71%	15.38%	14.93%

Source: *Convenience Store News* Market Research, 2018

Category Analysis: Packaged Beverages

	AVERAGE SALES PER STORE 2017	% CHANGE	INDUSTRY TOTAL (IN MILLIONS) 2017	% CHANGE
Carbonated soft drinks	$54,381	-4.0%	$8,336	-3.4%
Energy/alternative drinks	49,548	3.6	7,595	4.2
Bottled water	21,224	2.3	3,253	2.9
Sports drinks	17,838	-4.4	2,734	-3.8
Juice/juice drinks	14,338	-4.7	2,198	-4.1
Iced tea (ready-to-drink)	10,840	5.4	1,662	
Enhanced water	4,704	4.5	721	5.1
All other packaged beverages	11,339	2.9	1,738	3.5
TOTAL	$184,212	-0.4%	$28,237	0.2%

Source: *Convenience Store News* Market Research, 2018

Five-Year Trend: Packaged Beverages

	2017	2016	2015	2014	2013
Percent change in total sales	0.2%	4.2%	7.3%	5.1%	4.0%
Margin percentage	41.45%	41.40%	32.80%	32.67%	32.91%
Share of in-store sales	12.50%	12.74%	12.69%	12.41%	12.18%

Source: *Convenience Store News* Market Research, 2018

"Foodservice is our biggest opportunity to drive the business and differentiate," said Beach. "We can own food and immediate beverage consumption."

Prepared food remains the primary driver of the convenience foodservice category. The segment's average sales per store increased 4 percent last year to $164,131.

As regular snacking overtakes regular meals, and food on the go becomes increasingly popular, c-stores are in a good position to leverage their prepared food offerings.

"We are already good at immediate beverage consumption. We can add this on," Beach said.

The beverage side of foodservice, however, struggled in 2017. Only hot dispensed beverages grew sales by more than 1 percent for both the industry total and the per-store average: the industry tota increased 1.7 percent, while sales per store increased 1.1 percent.

Despite being an obvious paired item for prepared food, cold dispensed beverages only rose 0.5 percent in average sales per store. Frozen dispensed beverages dipped slightly, declining by 0.7 percent per store — something Beach noted "should not have happened."

As a category, foodservice continues to do well, but that is not enough to allow retailers to rest assured of its success, rather than actively seek out success.

"We need to be more relevant and faster to implement change in offer, flavors and packaging," Beach said. "We don't need to be first. We don't need to set the trend. However, we better be a fast second."

COLD VAULT

Packaged beverages held steady at 12.5 percent of in-store sales in 2017, the third-highest grossing category. However, significant sales declines in multiple segments resulted in flat growth of just 0.2 percent for the total industry and a decline of 0.4 percent in sales per store.

Carbonated soft drinks, which make up the largest percentage of packaged beverage sales, had another challenging year, falling 4 percent in sales per store. Other segments that saw per-store negative growth were sports drinks, down 4.4 percent, and juice/juice drinks, down 4.7 percent.

Total convenience store industry sales rose 9.1% last year to $616.3 billion. However, the dollar growth was driven by higher fuel prices, not in-store sales.