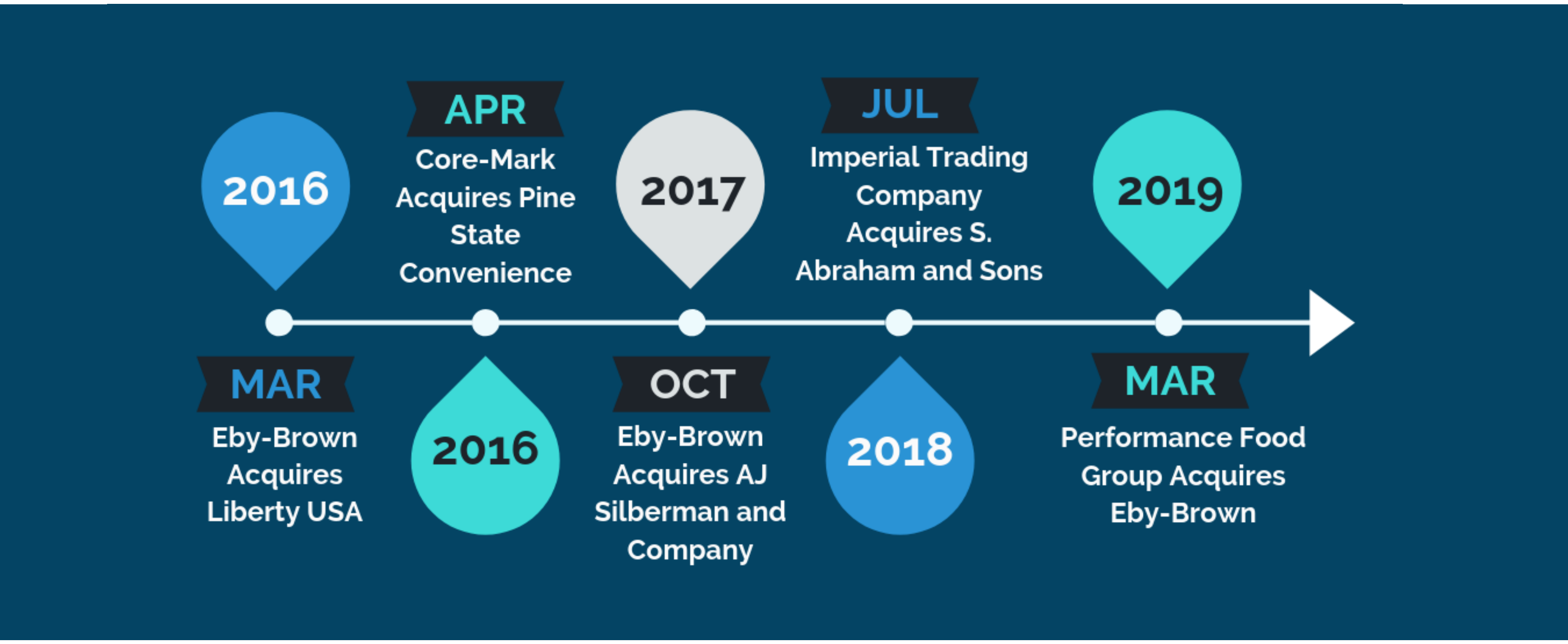

# C-STORE DISTRIBUTION AND RETAIL

## How to Stay Relevant in an Evolving Landscape

## COMPETITION HEATS UP AND CONSOLIDATION CONTINUES

In recent years, the convenience store ("c-store") wholesale distribution and retail industries have experienced a meaningful shift in the competitive landscape, which is causing companies in the sector to reevaluate their growth strategies (beyond just organically fighting for market share). In a highly fragmented sector that consists of many local, privately-owned businesses and a smaller population of large, full-service wholesale distributors serving multiple geographies, companies big and small are fighting to remain viable. As the marketplace becomes more competitive, companies have shifted their focus to mergers and acquisitions ("M&A") to help quickly drive growth and survive in an industry that is constantly evolving. This has led to a flurry of acquisition activity in recent years by large regional and national players that are aggressively looking for competitive advantages such as a broader geographic presence, differentiated service offerings, an enhanced customer base and more buying power.




Many of the smaller distribution companies remain very attractive targets to regional and national companies that are looking to expand their presence within certain markets. Large players are interested in distributors that service independently owned stores, chain locations or both. A large distributor with scale can provide category management solutions, optimized delivery routes and improved technology to independently owned c-stores. Additionally, they can also drive additional volume, absorb fixed cost infrastructure and lower working capital requirements for large chains. This was the case with the recent acquisition of S. Abraham & Sons ("SAS") by Imperial Trading in mid-2018. As a result of this transaction, the combined entity has become the fifth largest convenience store distributor in the U.S., with service capabilities from the U.S. and Canadian border to the Gulf of Mexico. Together, they are now able to supply more than 5,000 retail locations and have achieved annual sales volume totaling $2.5 billion. The synergies realized from this transaction should result in a significant increase to the company's bottom line and has allowed for two strong companies in the sector to become even more dominant while providing a better customer experience.

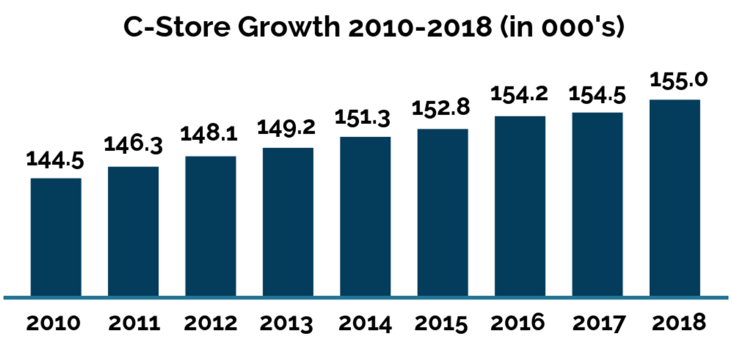
Another recently announced notable transaction in the industry is the acquisition of Eby-Brown by Performance Food Group ("PFG"). PFG is a foodservice distribution company with a nationwide network of 75 distribution centers and over 5,000 suppliers. Eby-Brown is a leading U.S. distributor to the c-store industry with over $5 billion in revenue. PFG's c-store distribution segment, Vistar, is a national wholesale distributor with 20 distribution centers strategically placed in every region of the country. This acquisition will allow for Vistar to strategically expand in the c-store distribution channel where there is significant overlap with suppliers and product categories in the Midwest and Southeastern parts of the U.S. This transaction will also create opportunities to use PFG's brands for unique offerings in the prepared and made-to-order foodservice market, which can drive incremental growth to Eby-Brown's existing customer base of over 15,000 locations. This transaction is expected to close in the second quarter of 2019 and the combined entity will service over 75,000 locations across the U.S.

## CONSOLIDATION'S IMPACT ON C-STORE RETAILERS

Consolidation is not only happening amongst distributors, but with c-store operators as well. As large c-store chains like Marathon and 7-Eleven continue to gain market share, it has become increasingly difficult for the rest of the market to compete. Midsize operators (less than 100 locations) are being forced to make significant investments in people, time and technology to stay competitive. In many cases, they simply cannot justify or afford the investment given their lack of scale. Small operators are constantly facing the decision whether they want to be a buyer or a seller in order to remain viable. As buyers, they can benefit from additional scale which can bolster margins, but a sizable upfront investment is required. As sellers, they can exit in a strong M&A environment rather than continue to invest time and money. Most of the large c-store chains have already experienced a significant amount of consolidation, with the focus now shifting to the remaining midsize chains, and smaller operators with between 10 and 100 stores. This is expected to drive a higher volume of deals with smaller store counts in the foreseeable future.

# C-STORES CONTINUE TO BE RELEVANT IN AN EVOLVING RETAIL LANDSCAPE

The flood of M&A activity in the c-store distribution sector is being driven by the favorable outlook for the industry overall. According to the National Association of Convenience Stores ("NACS"), the U.S. c-store segment experienced the 16th straight year of record in-store sales in 2018. While the growing concern of the "Amazon effect" or digital retailing has threatened other retail industries, consumer's demand for convenience and instant gratification has heavily shielded the c-store category from these threats. Approximately 83% of in-store products are consumed immediately or within one hour of purchase, which reinforces the significance and strength of the c-store channel in the overall retail landscape. However, other variables such as changing consumer preferences, declining profit margins and an increasingly competitive landscape have presented clear challenges that are driving companies to aggressively pursue various expansion strategies. These expansion strategies have included M&A, new product offerings, partnerships and other initiatives.

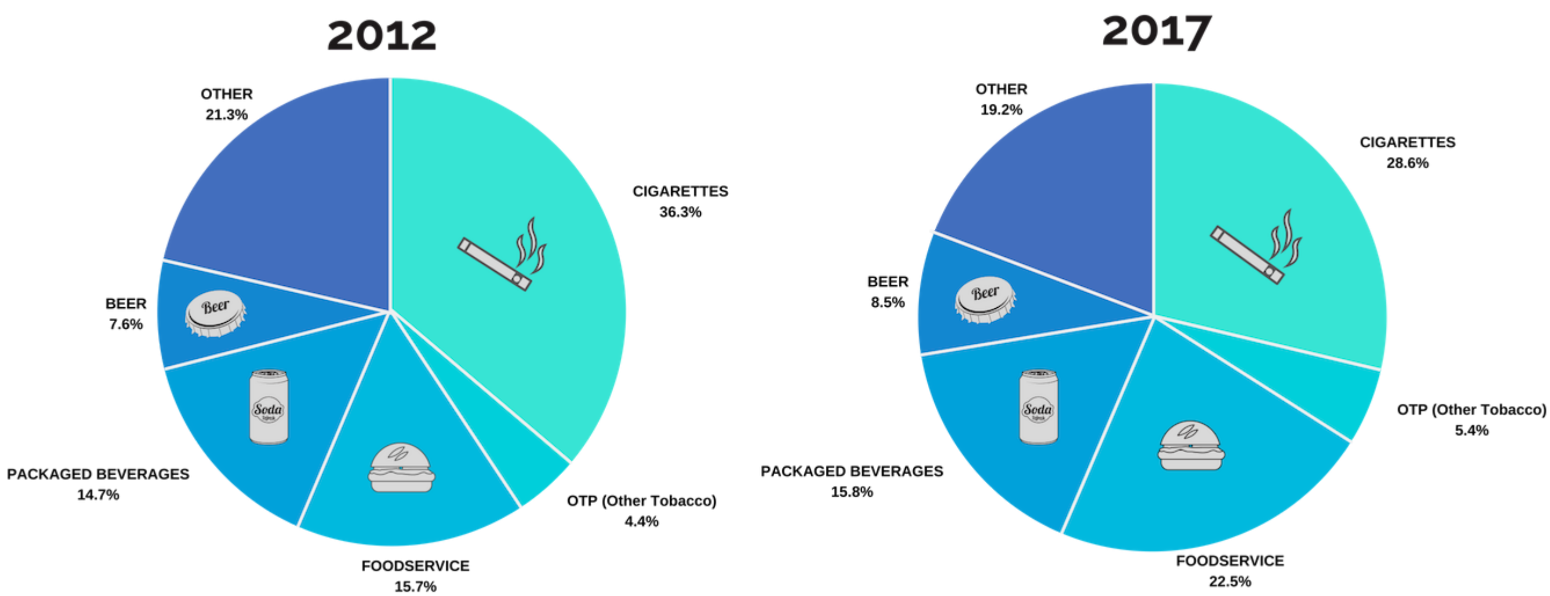



# SHIFTING CONSUMER PREFERENCES DRIVING THE NEED FOR OPERATIONAL EFFICIENCIES

One noteworthy shift in the industry is the changing consumer preferences away from cigarette and tobacco products in c-store outlets. Based on NACS data, cigarette product sales in the c-store industry have decreased nearly 8% from 2012 to 2017. This creates a major challenge for retailers and distributors as the industry has historically been characterized by a high volume of cigarette and tobacco sales, which already have slim margins.

Consequently, companies have shifted their focus to offsetting these volume declines with higher sales of foodservice products, which are more profitable and cater to the demands of an evolving consumer preference for fresh, high-quality products.

**C-Store Sales by Product**




**In 2012, over 36% of all c-store products sold were cigarettes compared to less than 16% of sales being foodservice products. In 2017, cigarette sales dropped to less than 29% of c-store sales, while foodservice products surged to nearly 23%.**

Core-Mark International, Inc. ("Core-Mark"), the second largest c-store distributor in the U.S., is one of the industry leaders that has successfully adapted to the decreasing demand for tobacco products and now prides itself as the leader in providing fresh foods to the c-store industry. In the Company's latest quarterly report (Q1-2019), cigarette sales dropped by 2%, but the company was able to partially offset this decline through strong foodservice sales and alternative nicotine products.

Core-Mark's fresh food sales have experienced double digit (%) year-over-year growth since 2014 and the segment remains a focus for the company going into 2019.

In an industry that has become increasingly competitive, simply changing focus towards a more relevant product mix may not be enough to drive sustainable growth. Large c-store distributors have created multi-pronged strategies in order to remain competitive. To drive growth that outpaces the industry, best-in-class distributors have shifted their focus to utilizing their scale to leverage existing warehouse capacity and fixed SG&A expenses, increasing productivity and throughput throughout their supply chain, and investing in technology to improve overall efficiency. This has made it increasingly challenging for local and regional distributors to remain viable as they are unable to make the significant investment required to compete with large distributors.

## STATUS QUO NOT AN OPTION MOVING FORWARD

Overall, as c-store distributors and retailers look towards the future, their focus will be on diversifying their offerings away from traditional tobacco and nicotine products, opportunistically identifying M&A targets and offering a broader array of fresh products. There has been a profound shift in the industry over the past few years and it will continue to evolve for the foreseeable future. This shift has sparked a trend that is expected to continue alongside consumer preferences that are constantly changing. Consumers are redefining what convenience means and retailers and distributors are being forced to adapt. The largest wholesalers remain acquisitive and the smaller players will continue to face the decision of being a buyer or seller. Those that choose to stay on the sidelines, may face the risk of slowly watching their business diminish with no real exit opportunity in the future, as competitors with stronger balance sheets, better technology and more diverse offerings gradually steal their market share and make them less relevant.

# FOOD & BEVERAGE EXPERTISE

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The range of segments that GCG has worked in extends from snack foods to dairy products, private label, manufacturing, retail and distribution, among many other segments. Our Food & Beverage professionals have deep roots in the industry and can provide clients with the guidance and support needed to expand their businesses, allow them to run more effectively and venture into new markets both domestically and globally. Our experience, community of networks and relationships have positioned us as industry leaders surrounding M&A, private placements and financial advisory in the Food & Beverage Sector.


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