The Daily Check-In with Goldman Sachs

Hosted by Liz Bowyer, Global Head of Brand and Content Strategy
With Bonnie Herzog, Senior Analyst, Goldman Sachs Research
Recorded January 11, 2021

Liz: Hi, Bonnie.

Bonnie Herzog: Hi, how are you?

Liz: Thank you. You're a consumer staples analyst in Goldman Sachs Research. Convenient stores are among the sectors that you cover. And convenience stores have actually become a surprising bright spot in the retail landscape even before the pandemic. What's the story there?

Bonnie Herzog: You've seen a sector evolve over the years. It's become so much more sophisticated. There's a vast number of C stores in the US. There's about 153,000 convenience stores, and the bulk of them do sell gas. And you've seen them evolve in terms of sophistication, in terms of the offerings inside their store. Also location is a key driver. So they've really been quite resilient over a number of years.

I mean, if we look back to 2000, we've seen inside sales grow on average about 5%. And I really think that has a lot to do with their evolution in terms of offering a greater mix of fresh food, possibly, you know, other food service items, as well as just improving their mix of the beverage category, for instance, or the beer case for consumers. Driving in great traffic. So that's been a lot of what's driven their success over the years.

Liz: And how have convenient stores fared during the pandemic?

Bonnie Herzog: You know, there have been some positives and some negatives. If I think through the period of time since, you know, COVID really impacted all of us, which was mid March of last year, one of the biggest positives for the convenience store sector is they've really enjoyed in outsized fuel margins. And that's had a lot to do with the volatility that we've seen in crude oil. And keep in mind the C store operators, they are able to adjust their price at the pump for you and me as consumers, but in fact they're not necessarily lowering the prices as quickly. So thereby they're able to capture these really large fuel margins. So I would say that that's been one of the biggest opportunities.

But an offset to that during COVID because a lot of us of course have been stuck at home and not really being as mobile as we would have been otherwise, they're not getting the traffic that they normally would. So you're seeing traffic negatively impacted. But another offset other than just the fuel margins is when the consumers go into stores, what we're seeing is that they are spending more money. The basket sizes are larger. And what the C stores have done is they've been somewhat nimble to address this, and they've been offering, you know, larger pack sizes for the consumers, kind of trying to draw them into the stores as well as, you know, selling more PPE for consumers. So that's been some of the pluses and the positives.

And I would say, in general, the positives have probably outweighed the negatives, which is again slower foot traffic. But we're seeing that slowly pick up as, you know, some of the reopenings occur.

Liz: But how important is the revenue from fuel to these convince stores' bottom line?

Bonnie Herzog: So fuel really is the largest component. It represents about 60% of total sales for the convenience stores, but it really is such a low-margin business, it only represents about 40% of their gross profit. So this is one of the areas where the industry certainly is dependent on fuel, but that's going to evolve over time. And that's why you're seeing a lot of the smarter or more sophisticated operators pivot their business and offering so much more inside the stores to offset that, especially as we as consumers possibly are driving less in the future or less mobile, you know, post pandemic world. I mean, that's something that we're really trying to think through, consumer behavior, even once we all have the vaccine and there's more freedom. But realistically a lot of us may be working from home more often than we would have pre COVID. So that's a consideration. And so that's where the convenience store industry really needs to adapt. And they are as best as they can.

Liz: And what about the rise in electric vehicles? That will surely have an impact as well.

Bonnie Herzog: It's interesting because right now, you know, electronic, you know, or electric vehicles are very low as a percentage. I mean, it's only about 2% of the population. And it's really on the coasts, the West Coast and East Coast. And over time it certainly will increase, but it's going to take decades before we see that penetration get close to even 20%. I think the the predictions are, you know, just under 20% in the next decade-plus. So the industry is adapting, again, you know, a couple of companies, Couche-Tard and Casey's, have been investing in this.

Couche-Tard, for instance, has a pilot program in Norway where they actually have charging stations. So what they have found is that the consumers with electric cars are coming in, charging their cars, and the good news is they're going into the stores, they have more time, and they're spending a lot more money. So there's a lot of learnings. It's so early, but this industry, given that there are so many convenience stores throughout the US, 153,000, I think 90-plus percent of us live within 10 minutes of a convenience store. They're going to use that to their advantage. You know, as electric cars increase, there are things that they can do to adapt and encourage those consumers to charge, you know, as they implement charging stations as well as come into their store and buy more product, which is usually higher margins certainly than fuel.

Liz: So Bonnie, you mentioned that one of the differentiators for some of these store operators has been food. Can you talk about how they've evolved their food offerings and what sort of impact that's had on their businesses?

Bonnie Herzog: Yeah, it's interesting because we've really seen the retail lines blurring between convenience stores, QSRs, or fast food restaurants, as well as some of the small grocers. So you think about us as consumers and where we're shopping and eating. It's evolving. And we're going to many different places, whether it's our coffee in the morning or our lunch in the afternoon. So what the C stores have done is really improved their offerings, making it a lot, you know, a lot more fresh food offerings or just really, you know, creating an environment or a food service that can compete with a lot of the QSRs.

So one, for instance, is Casey's General Stores. They are the fifth largest pizza company, which is pretty impressive given they're a convenience store. So they've done a tremendous job driving not only traffic but higher basket sizes, bringing in consumers, but they also do delivery. And now during COVID, of course, there's pick up. So this is where the convenience stores where it's still a pretty low percentage of their inside sales, maybe 20%, but the margins on this food service is as high as 60%. It's the highest margin inside the store. So it makes sense that more of them are pivoting to the food service item.

Murphy USA, for instance, has smaller store box sizes, and they have some limitations. But they just most recently made an acquisition and purchased QuickChek. And part of that has to do with some learnings that they're going to get to move faster into the food and beverage sector. So I see this continuing across the broader landscape. And this is really what's setting apart the larger chains with some of the smaller mom-and-pop stores that simply can't compete. They're not as sophisticated, and it's much more challenging.

Liz: And how does the composition of the industry break down between the large chains and the small mom-and-pop stores?

Bonnie Herzog: In terms of, you know, right now there's again 153,000 stores. It's interesting because it's still a very fragmented industry, and about 60% of those are small mom-and-pop, you know, store operators. And then when you look inside their box, you know, it's a smaller percentage that, you know, is driven from some of these food service offerings, from some of these independent, you know, convenience store operators. So that's the opportunity for them, but also it's a continued consolidation story here for this sector.

Liz: So finally, Bonnie, what's your outlook for convenience stores in 2021 and beyond?

Bonnie Herzog: I mean, I still see a tremendous roll-up or consolidation story, especially given, you know, 60% of these stores are still mom-and-pop owned and single-store operators. So I see the larger stores continuing to make acquisitions as well as, you know, building new boxes and becoming so much more sophisticated. So I think about a lot of what these convenience stores are doing. It's, you know, they're implementing frictionless payments. There's opportunities for them to be drop locations. I think about partnering possibly with Amazon in the future because think about, you know, by definition, convenience. Their real estate, their locations, given that they're so close to so many of us, it makes sense for them to kind of think outside the box and think what other convenience they can bring to us. And that's where the stronger operators will, you know, flourish and continue to take share.

The other thing is certainly offering more by way of, you know, fresh food, food service, beverage offerings. Just trying to bring more consumers into their stores, driving traffic, top line, and importantly the bottom line because the margins on these products are that much greater.

Liz: Thanks, Bonnie.