Chapter 1: Overview of Industry

A macro overview of a company's industry and the economy are critical starting points for any valuation analysis. In many cases, the industry trends are better indications of the future than a review of the company's historical operations. The gasoline service station industry is entering into a new generation of co-branding franchises, high volume retailers, and streamlined self-service operations. Gas stations are transforming from traditional full-service gas stations to becoming one-stop-shops complete with food service, simple staple groceries and contents previously unassociated with gas stations.

History

Gas Stations or “Filling Stations” as they were called, began appearing early on in 20th century America. With the introduction of Henry Ford’s Model T in 1908, and the subsequent need for refined petroleum to power the mass produced vehicle, the gas station was born. Ford’s automobile manufacturing company started mass producing the cars through the help of his assembly line production method. By 1927, over 15 million Model T’s had been produced, and many other car manufacturers had entered the market. Due to the increase in demand to fuel the automobile industry, oil production in the U.S. skyrocketed to over a million barrels per day in 1920.

As automobiles became a more integral part of American’s lives, the gas station became their sole destination for fuel and maintenance. Up until the 1970’s, all gasoline stations were full-service. Attendants would pump gas, clean windshields, check tire pressure, and perform most of the maintenance duties on the customer’s vehicle. However, when the oil embargo of 1973 took place, prices increased despite attempts to enforce price controls. This laid the ground work for self-service stations as consumers became more price conscious. As the industry began to commercialize, the traditional full-service became inefficient. Also consumers, in effect, made the decision that cheaper fuel was more crucial than having the benefits of full service.

By 1990 there were only 111,657 traditional gas stations in the U.S., a major decline from the nearly 231,000 stations in the 1940’s. The self-service trend, and increasing gallonage per station had shoved many independent stations out. In recent times, the Convenience Store (C-Stores) and HyperMart dealers (ie: CostCo, Kroger, K-Mart) have begun to take over the market.

Industry Snapshot

According to the “Gasoline Service Stations” section of the *Encyclopedia of American Industries*, the U.S. market for consumer gasoline had four major competing categories in the 1980’s, 1990’s, and early 2000’s:

- Service stations, which offer service through at least one bay and have a volume greater than a set limit (typically 20,000 gallons per month);
- Pumpers, which have more than six nozzles and have a volume exceeding a set limit (typically 50,000 gallons per month) and possibly having additional services such as a Convenience Store (C-store), car wash, or remote bays;
- Convenience stores, with a minimum of 600 square feet of retail space, the primary business of which was the sale of food items, typically with one or two islands and fewer than six nozzles;
- And others, facilities with gasoline volume below minimum volume for pumpers or service stations that may also include additional services such as a C-store, car wash, or bays.

In 2002, 78 percent of all oil refineries in the United States were integrated refiners. Integrated refiners are companies that are integrated vertically by taking part in the production of gasoline (refining), in the marketing, and the retailing of gasoline products. The small number of integrated refiners that control the gasoline service stations is reflective of the current direction of the industry. In 2011, 4 oil refineries in the U.S. were shut down. From 1994 to 2004, the number of gasoline service stations in the United States declined by over 35,000. Since then the number of gasoline stations continued to decline by over 11,000, from 167,346 in 2004 to 156,065 in 2012. The large integrated refiners such as Shell, Exxon Mobil, and ConocoPhilips have moved towards increasing efficiency in their production and distribution chains. Current gasoline service stations are increasing their gallonage, and reducing labor costs through automation. Small independent, un-branded stations have been driven out of the market as they have had difficulty keeping pace with the large branded chains.[1]

Industry Makeup

According to Standard & Poor’s Industry Survey, the petroleum business is segmented into three major parts:

1. the exploration and production of oil (considered the “upstream”);
2. the transportation, storage, and trading of crude oil and refined products (the “midstream”);
3. and the refining and marketing of crude oil (the “downstream”).

1. Andrew N. Kleit, “The Economics of Gasoline Retailing,” Pennsylvania State University, 2003

Today, the so-called "supermajors" have a strangle hold on the petroleum industry. These companies are vertically integrated, meaning that they participate at every level of production and distribution. The "supermajors" consist of the large publicly traded companies, BP PLC, Chevron Corporation, ConocoPhillips, Exxon Mobil Corporation, Royal Dutch Shell PLC, and Total SA.

The following is taken from the Standard & Poor's Industry Survey on Oil & Gas: *Production & Marketing*. "According to NPN, US retail gasoline locations, both branded and unbranded, are owned and operated in four different ways:

- lessee/dealer operated (company-owned, and leased to an independent dealer);
- open dealer (branded station owned by dealer);
- salary operated (company-owned and -operated);
- and, commission operated (company-owned stores run by an independent operator on a commission basis, usually based on gasoline volumes)."

"Jobbers"

The most dominant type of owner in the retail gasoline industry is the "jobber." Jobbers are a person or a firm that obtains a contractual agreement to franchise a particular gasoline brand in a given region. According to Andrew Kleit of Pennsylvania State University, jobbers make up 44 percent of retail gasoline market sales. Major branded oil companies find jobbers attractive, because they are responsible for purchasing locations, building the sites, and the promotion of the brand. Lessee and open dealers control approximately 27 percent of the retail gasoline market, and company owned stations operate another 12 percent. The remaining market is controlled by independent gas stations that are unbranded. These independent stations partake in what is known as the hypermarket.

Hypermarket

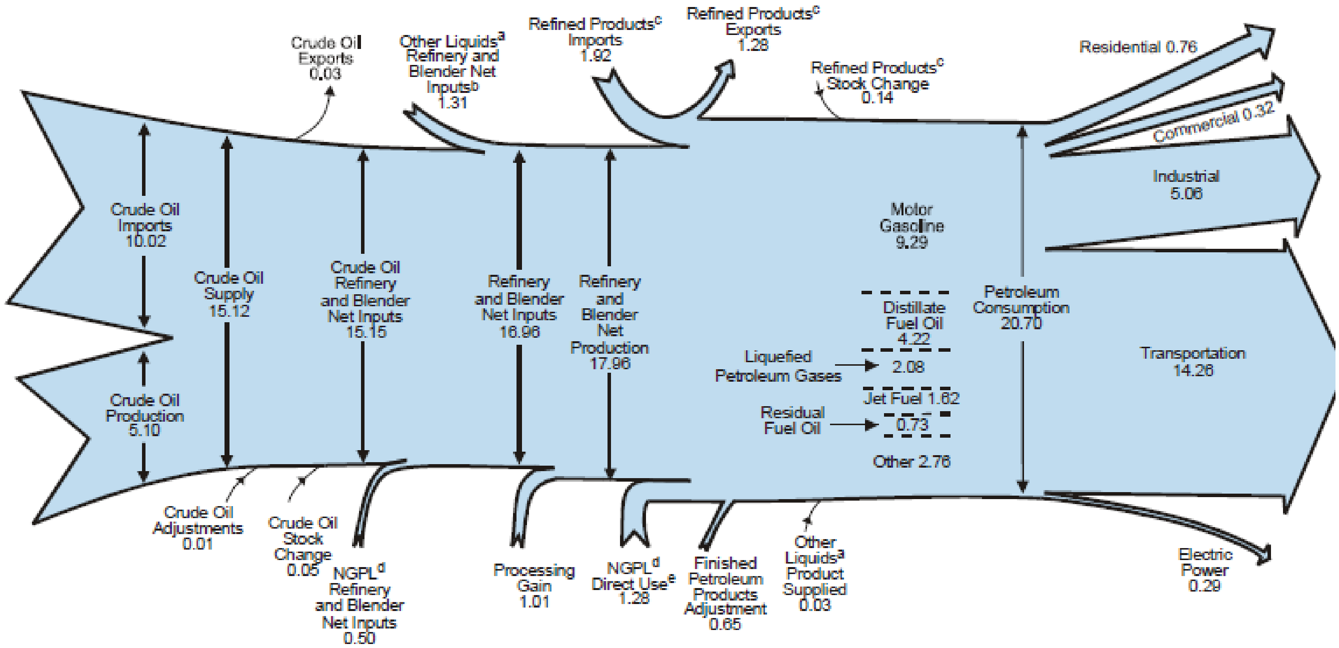
The hypermarket is a relatively new retailing concept that has been adopted by large convenience stores. As gasoline prices continue to rise, there are large numbers of consumers that are looking for cheap gasoline. The idea is that by selling their gasoline at a cheap price and almost no profit margin, the convenience store can entice more customers into the store. Profit margins in convenience stores can be triple that of gasoline, and therefore increasing convenience store sales can increase the profitability of the gas station immensely. The weakness of this hypermarket approach is that commercial users do not like to wait in the long lines to fill their trucks or commercial vehicles.

Supermajor branded franchises control the gas station industry by a majority. More than two thirds of gas stations in the United States are branded franchises; however, the number has recently declined. In 2005 the number of branded retail gas stations fell from 101,833 to 95,535, as the total number of gas stations fell by 1,511 to 167,487. Between 2005 and 2012, the total number of gas stations declined by over 11,000 to 156,065.[1] The reduction in branded gas sta-

1. NPN 2012 MarketFacts Survey

tions is widely attributed to the efforts of the major integrated oil companies to increase gallonage at existing stations in order to cut costs.[1]

Figure 1-1: The Production Flow of Petroleum



Source: eia.com - Annual Energy Review

Trade Organizations

There are four major organizations which affect the petroleum industry. Each of the organizations represents the retailers of petroleum based motor fuels.

NACS (National Association of Convenience Stores)

The National Association of Convenience Stores (NACS) was founded on August 14th, 1961. The idea was to create an international trade association to represent the booming convenience store industry. Today, the NACS represents more than 2,200 retail and 1,600 supplier company members. These NACS members conduct business in approximately 40 countries around the globe, with a majority of which are located in the United States. Since the NACS' inception, the association has acted as an advocate for the industry by producing market information and acting as a liason to its members to secure their competitive edge. The diversity of NACS membership reflects the diversity of the conve-

1. Standard & Poor's Industry Survey on Oil & Gas: Production & Marketing

nience store and petroleum marketing industry and the association's commitment to developing a robust competitive environment for its members.[1]

American Petroleum Institute (API)

The American Petroleum Institute (API) is a major national trade organization that represents the entirety of the United States' oil and natural gas industries from the upstream levels to the downstream levels. API has 400 corporate members, which include companies both large and small. These companies are producers, refiners, suppliers, pipeline operators, marine transporters, and the service and supply companies that are integral for each level of production or distribution. The API is not just limited to advocacy roles, the organization also has certification programs such as the API Monogram Program, which checks manufacturers of production, drilling, and refinery to make sure that they are following industry standards.

PMAA (Petroleum Marketers Association of America)

The Petroleum Marketers Association of America (PMAA) is a federation of trade organizations in 45 states. The association represents over 8,000 independent petroleum marketers. The organization acts as a voice for the retailing industry, and provides legislative and regulatory support for all petroleum marketers. The organization's members include franchise owners of BP America, CITGO, ConocoPhillips, Shell, Valero, and many others. These members account for approximately half of all gasoline, and 60% of all diesel fuel sold in the United States.

SIGMA (The Society of Independent Gasoline Marketers of America)

The Society of Independent Gasoline Marketers of America is an organization that represents many segments of the gasoline marketing industry. SIGMA has members in six of the seven major segments:

- Traditional motor fuel marketing chains, both major brand and private brand;
- Traditional convenience store chains;
- Truck stop/travel center chains;
- Warehouse clubs, grocers, and other "big box" and high volume retailers;
- Cardlock/fleet fuelers;
- and mobile refuelers

Becuase SIGMA is an advocate for a competitive wholesale gasoline market, the organization by choice does not represent the refiner direct-operated marketing chain. This is because SIGMA members do not produce their own gasoline and therefore must purchase their gasoline wholesale. SIGMA's membership includes 250 member companies which represent all 50 states and Canada. Members of SIGMA sold 92 billion gallons of the total gasoline consumed in the U.S. in 2011. The organization continues to add members, many of which are high volume retailers as is the current trend in the gasoline retailing industry.[2]

1. www.nacsonline.com
2. 2012 SIGMA Statistical Report