BY KEITH **REID**

Lending opportunities are hot for petroleum marketers

# CASH FLOW

THERE IS A LOT OF ACTIVITY GOING ON with retail sites in the industry today. The major oil companies are continuing to sell off notable portions of their already diminished company operations. These sites are being purchased by a range of different entities from major convenience store operators to smaller local marketers.

Perhaps even more interesting, is the aggressive return of lending to the industry. At the end of the 1990s going into the 2000s there was a glut of financial opportunity that drove some aggressive acquisition activity during the period. However, it was too much of a good thing with some very bad debt thrown into the mix leading to a shakeout among retreat many lenders. Now, walk down any petroleum trade show floor and a notable number of exhibitors are offering financial services. NPN decided to ask a selection of lenders and real estate service providers for feedback on the new real estate and lending market. These include:

**R.H. "Tod" Butler, Jr.**
**Vice President**
**Matrix Capital Markets Group, Inc.**
**Richmond, Va.**

Matrix's Energy & Multi-Site Retail team is recognized as a national leader in providing transactional advisory services to petroleum marketing and convenience store chains, restaurants and lodging companies.

**Terry Monroe**
**President**
**American Business Brokers**
**Effingham, Ill.**

American Business Brokers specializes in convenience store and gas station industry site transactions. This allows ABB to discuss the industry and environmental issues with a buyer in layman's terms, and use that same knowledge with the seller to provide the best perspective to buyers.

**Michael R. Phelps**
**Senior Vice President**
**Citi Petroleum Finance Group**
**Irvine, Calif.**

Citi Petroleum Finance Group is a leading provider of loans and other financial services to the retail petroleum industry, financing dealers and jobbers nationwide. It also administers the Shell Finance Program, available exclusively to Shell branded marketers.

**Dennis Ruben and Evan Gladstone**
**Executive Managing Directors**
**NRC Realty Advisors, LLC**
**Chicago, IL**

NRC Realty Advisors, LLC is a national leader in the structured sale of commercial real estate, and has assisted its clients in realizing their financial goals in the sale of over 10,000 properties throughout North America since the Company's inception in 1989.

### *NPN:* Why are we seeing such a resurgence of financing in the petroleum retailing/convenience industry today? How long will it last?

**Butler:** The resurgence of financing is reflective of the capital markets in general where there is a surplus of capital chasing deals in all industries. Environmental issues no longer present a problem to knowledgeable lenders and default rates in petroleum retailing/convenience have remained low since 2003. How long will it last? My guess is that defaults will trigger a tightening both in advance rates and interest rates that will remove liquidity from the industry very quickly. There have not been any high profile defaults since 2003 but defaults are inevitable as this credit cycle matures.

**Ruben/Gladstone:** Many lenders and sale-leaseback providers are attracted to the industry because of the ability to loan or invest funds at attractive rates with reasonable risk. At the moment, sale-leaseback financing is much more readily available than long-term mortgage financing. Because of the absence of a vibrant debt financing market, several sale-leaseback investors have entered the industry within the past two years. It should last as long as rates and yields are attractive and there are no significant defaults.

**Monroe:** Everything is cyclical. Having said that, people in the finance industry have taken notice that the convenience store industry is a very stable business in the sense of cash flow. It is very rare that there are many accounts receivable to be concerned about and if a store is ran correctly it can be very profitable. Enough profit to support a good return on money that needs to be parked. As soon as another hotter place to park money comes along, all of the money people will be on to the next thing. Anyone remember the .Com companies?

### *NPN:* Are there any types of financing that are particularly popular today, for example sale-leaseback arrangements? And, what type of marketer/need best benefits from the particular financial offerings?

**Ruben/Gladstone:** Sale-leaseback financing is very attractive at the present where fee real estate is available. It is particularly well suited for operators seeking to buy out their competitors or expand into new markets. It is also desirable for operators who wish to recapitalize their companies or build new stores in existing markets.

**Phelps:** The sale leaseback product is certainly gaining visibility in the industry but many deals we have seen have had high implicit pricing. Conventional term debt structured with rate flexibility, such as that provided by derivatives/swaps, amortization to 20 years and prepayment accommodation, is still a powerful tool for growth and balance sheet optimization.

**Butler:** Every company is different so there are many forms of "popular" capital. The most popular is the senior secured debt financing traditionally used by operators and buyers looking to own their real estate. Sale-leaseback has enjoyed some popularity among companies who believe that ownership of real estate is not the highest and best use of their capital resources.

**NPN: What are marketers looking to do with the funds? Is it real estate, capital investments or a combination of both?**

**Butler:** Many marketers are looking to grow either through new development or acquisitions. There is also a significant increase in the amount of reinvestment in current locations. Some marketers are seeing this an opportunity to refinance higher rate debt and to possibly recapitalize their companies and take some equity out of their companies.

**NPN: On the real estate front, has the latest round of major oil sell offs prompted any significant action? Are these sites going to just the big c-store operators, or are opportunities available for anyone?**

**Ruben/Gladstone:** The majors have sold the majority of their company-owned sites primarily to their own distributors over the past several years. The only company actively selling to smaller operators is BP, which has been building its a.m./p.m. convenience store franchise in a number of Midwest and East Coast markets with assistance from NRC. Jobbers are selling branded sites which they purchased over the past 12-24 months from the majors to individual dealers with long-term supply agreements.

**Phelps:** The trade press headlines certainly herald the growth of the major marketers in this acquisition arena, but several major oil company divestitures have been purchased or are in the process of being purchased by traditional jobbers.

**Butler:** Before BP decided to sell assets with a.m./p.m. franchises attached we worked with a number of successful purchasers of markets being divested by BP. This was an excellent opportunity for our clients to grow in markets contiguous with their existing operations. The Conoco divestment should be a boom to existing jobbers and Shell still has some markets left to divest that jobbers may have a chance at.

**Monroe:** So far from what we have seen, it is only going to be the big c-store operators getting the deals and operating the stores. However, it will be interesting with B P selling off stores and wanting to convert them (to) a.m./p.m. stores with regular franchise agreements and fees. How the landscape will change and the same with 7-11. I think that you will see many individuals get into the business going forward, with all of the awareness that is becoming available to the public about the c-store industry. The c-store industry from the entrepreneur's point of view has a lot of opportunity and I think you will see more people migrating to the business.

**NPN: Major oil companies aside, are we seeing a general period of selling and acquisition among marketers, and is it significantly greater than typical?**

**Butler:** The trend to consolidation in the petroleum retailing/convenience industry has been increasing since 1997 and will continue to increase. The primary factors in this consolidation are the demographics of company owners who are getting older and suppliers who are demanding that people get larger. There may be periods where capital is less available that will slow this trend temporarily, but over time the increase in the trend will continue to accelerate.

**Phelps:** It does seem to be an active buy/sell period driven not only by major oil company divestitures but also by normal course of business generational transfers, jobbers' need for growth and a contingent of opportunistic sellers.

**Monroe:** No, it is not any greater than usual. The rule of thumb is that generally 20 percent of all businesses are for sale at any given time. Therefore, when you take into account the attrition of people retiring, dying and changing careers I don't think you are out of the ordinary.

**NPN: The financial services meltdown in the petroleum/convenience industry of the early 2000s came about because of some overly high risk portfolios. Are there mechanisms in place or the willpower to prevent that this time around?**

**Ruben/Gladstone:** Almost all of the lenders who were responsible for the "aggressive lending" to the industry are gone, and the securitization capital markets, which provided the means of funding those loans, are no longer available. The lenders making loans to the industry have adopted some fairly conservative lending policies, which should serve to reduce delinquencies and defaults and avoid many of the mistakes of the past.

**Monroe:** Yes, there are — the lenders. From what I could see from the late 1990s and early 2000s, it looked like there may have been more financing based on the real estate values rather than on the cash flow of the business. The lenders that we are dealing today are cash flow lenders with a strong emphasis on real estate, but not too heavy. For example, a c-store may have cost $1.5 MIL to build, however its cash flow will only allow it to afford a debt of $1.2 MIL. So if you don't try to force the issue and stay within the cash flow that is available you will be OK and will not experience a melt down in the industry. Here again, those around when Clark went through bankruptcy will remember seeing stores that were worth maybe only $400,000, that were carrying mortgages of $700,000 to $800,000. How did they get those mortgages so high? I can only comment on what I have seen and what it looked like to me.

**Butler:** There have been many highly leveraged transactions done over the last 3 – 4 years and more will be getting done in the future. There are also a number of highly leveraged companies in the industry. There are also a number of variable rate financings that have been done. It is the combination of high leverage and the potential for rising interest rates that presents the greatest chance for defaults. Any sign of defaults will trigger more defaults as lenders tighten their advance rates and interest rates continue to increase. **NPN**