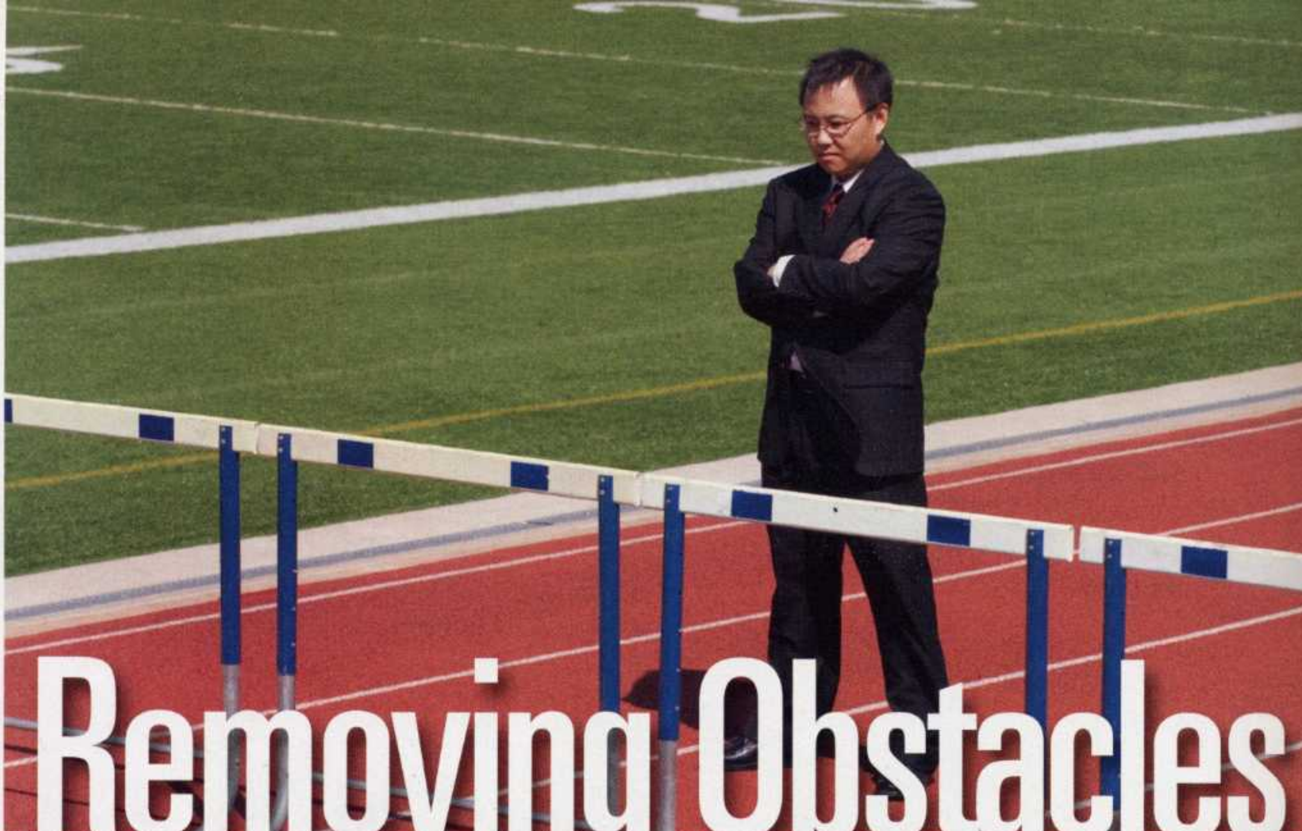

Removing Obstacles

Market ripe for independents who know the risks of expansion

By Bill Donahue

Clicking on a recent e-mail from a small, hard-nosed retailer revealed just three words: "I need capital."

In a follow-up, this single-store retailer in the Northeast explained he hadn't yet come into the funds he needs for a potential three-store acquisition he believes could drastically alter his business' financial picture. Though the capital has not yet fallen into his lap, that doesn't mean he's not looking.

"There are guys out there—friends of mine—with big, beautiful stores, but they can't make any money [because of the competition]," says the retailer, who spoke on condition of anonymity pending the outcome of the deal. "You have to keep trying. We're in the worst market in the world, but there are still home runs out there."

Predicted changes to the lending side of the business could make finding capital for enterprise expansion less burdensome for "the little guys." That wasn't the case just a few years ago, according to Dennis Ruben, managing director for Chicago-based NRC Realty Advisors. Historically, single-store operators and small chains without a strong relationship with a local bank have had trouble borrowing money.

"I am seeing investors trying to figure out how to fit into this space, and a couple of new lenders are coming in as a result," says Ruben. "They might be more expensive with higher rates, but the money is there. There's a void, and they're trying to take advantage of that. I think we'll see more lenders coming in to fill gaps not being filled by the bigger lenders."

Terry Monroe, a former convenience retailer and current president and COO of St. Louis-based American Business Brokers, agrees. He characterizes the current growth environment for smaller operators as "very good."

"I'm seeing more and more money coming into the business than ever before," says Monroe, whose firm offers consulting and brokering services related to valuations, franchise opportunities and other real-estate matters. "It's a viable industry and it's not rocket science, so it's attractive to investors. Everyone wants to be in the convenience-store business these days, and that's creating demand [for more lending options]."

ONE TO GROW ON

Do you intend to grow your store count by the end of 2007?

Source: Kraft/CSP Daily News poll. Based on 178 respondents.

Justified Growth

The availability of sale-leaseback dollars, specifically, could be particularly alluring to smaller operators for several reasons. Sale-leasebacks occur when an owner sells property—in this case, a store—and then immediately leases it back from the new owner. The primary benefit comes from the immediate inflow of cash. The retailer uses the same building, which still generates revenue, plus he or she has the cash in hand that can be used as working capital for growth.

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TERRY MONROE *American Business Brokers*

"[Smaller operators] won't get the same lease rates as [a larger firm such as Alimentation Couche-Tard], but they can get a lot of capital to grow," Ruben says. "You can get almost 100% financing if you can show a unit will perform at a certain level in a few years. ... It's a good way to grow a company without a lot of your own capital."

Despite the increase in the number of lending options, a small retailer will most likely still need to do some shopping. And when a retailer does find the right lender, his proverbial house must be in order, according to Steve Montgomery, president of consultancy b2bSolutions LLC, Lake Forest, Ill.

"There is no question that to secure financing is more difficult for many owner-operators, especially those new to the industry," he says. "What a bank or any lender wants to see is a solid business plan, and many smaller operators are not sure how to write one or what it should contain."

For example, borrowers with a location in mind should have a site-validation study completed to forecast fuel, in-store and, where applicable, car-wash and foodservice volumes. For benchmarking purposes, he should also have a general understanding of the economics of the industry. Relying solely on a broker's word or the seller's estimates typically will not be accepted by lenders as the basis for a loan, experts say.

One pitfall that unfortunately causes some borrowers to play the "if only I would've ..." game comes from underestimating the amount they intend to borrow. "In some cases, they have under-forecasted the cost of capital or the amount they will need," says Montgomery. "They assume the business is cash-positive and will remain so, or that it will not need any repairs in the first year or two. While we hope that's the case, it's not always true."

Dirt for Sale

The availability of decent sites doesn't seem to be an issue. More good locations are becoming available as major oil companies "rationalize" their retail portfolios and shift their models from corporate-run stores to dealer-run sites viewed primarily as outlets for distribution—pumps in the ground. "It's a trend that looks like it's going to continue," says Ruben.

Growth is the natural evolution in a "biggest is best, mine is better than yours" society. But growth has different definitions for different operators. For some, it means newer, bigger stores. For others, it means investing in what's already there. Either way, industry experts suggest that reinvesting in good assets improves the long-term health of a business.

"A business is like a relationship: It's growing or dying, and it's going forward or going backward," says Monroe. "It's the old adage of pay me now or pay me later. You have to put the money back into the business and reinvest, or when you finally do go to sell it, there will be nothing left to sell."

Adding stores, however, should be pursued only if a retailer has the passion to grow and firmly believes it will improve his or her financial outlook. The most common reason for most businesses going under is burnout, according to Monroe, who admittedly retired from convenience retail after three years because he wasn't a "detail person."

Some retailers begin life with a basic store, then upgrade to something more in line with their profit, revenue and customer-count expectations. Still, much like moving into a bigger home in a nicer part of town, upgrading to a bigger or better store has the potential to cause some tense moments.

A retailer should have a plan in place so that if he's unable to sell his first store, he can buy the new location and operate—and financially support—both until the first store sells. And the seller wants reassurance that a transaction will go forward, with no surprises.

The Right Stuff

While the challenge of acquiring capital for growth appears to be dulling, the operational challenges that follow the signing of the paperwork remain. The issue often comes down to something as simple as: How can one person who's used to spending his or her time in one store now be in two places at once?

"Naturally, this is not possible with more than one [store]," says Montgomery. "The changes tend to be geometric rather than arithmetic. … This means you have to rely on your team to a heavier extent than you did before. You have twice the employees and that means your people skills come more into play."

Increased costs usually follow, which comes back to having a clear understanding of how much money is needed upfront. While labor expenses will most likely rise, so could the costs of technology, such as digital video recorders, which in turn could help an operator run multiple stores more effectively.

When making any kind of growth decision, however, it all comes down to a few simple tenets: preparedness (or due diligence) and focus.

"Retailers need to step back and do a complete evaluation of the whole business," says Monroe. "It comes back to more information. You can never get anyone to change their mind, but you can give them more information to make a *new* decision." ■