2004 SOI Highlights

The Convenience Store Industry's 2003 Performance

NACS SOI Annual Report

Convenience Stores Rebound in 2003

'Real' sales increase, strong pretax profits reverse three-year slide

The convenience store industry strongly rebounded from its three-year slump, with 2003 sales surging 16.0 percent over those of 2002 to reach a record $337 billion; pretax profits increased a robust 54.6 percent to reach $4.04 billion.

The increase in revenue dollars from those of 2002—$46.4 billion, the largest one-year gain ever reported—was driven by strong increases for both in-store sales and motor fuels sales. The industry had reported record revenues in each of the past three years based on sales increases of $7.6 billion in 2002, $13.6 billion in 2001 and $35.4 billion in 2000, but after factoring in a higher store count and a higher CPI, especially with respect to wholesale cigarette and motor fuels prices, the end result for all three years was negative "real" growth. However, in 2003, even after factoring in consumer price index (CPI) changes, convenience store sales showed solid "real" growth in the 4 percent range.

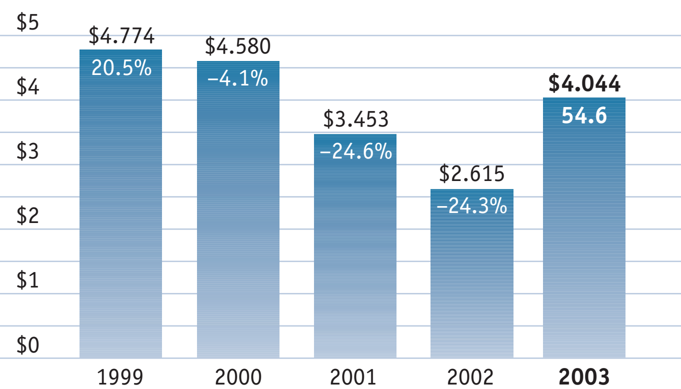
Meanwhile, the industry's 54.6 percent increase in pretax profits reversed three years of declines: -24.3 percent in 2002, -24.6 percent in 2001 and -4.1 percent in 2000. In 2003, pretax profits per store rebounded to $30,700, the third-highest figure ever reported. Despite this strong growth in pretax profits, pretax profits per store still were not as high as they were in 2000 before the three-year slide when they averaged $38,300 per store.

Motor fuels sales dominate overall revenues

The industry's motor fuels sales jumped 21.8 percent to reach $220.8 billion, a figure that exceeds *total* industry sales from as recent as 1998. The growth in motor fuels sales was driven by a 4.4 percent increase in the number of stores selling motor fuels, as well as an increase of 15 cents per gallon (to $1.55) in the average price of motor fuels

TOTAL CONVENIENCE STORE INDUSTRY PRETAX PROFIT

BILLIONS OF DOLLARS/PERCENT CHANGE



Source: NACS 2004 State of the Industry

TOP TEN PRODUCT CATEGORIES

AVERAGE SALES PER STORE/PERCENTAGE OF IN-STORE SALES

	Average Sales per Store	Percentage of In-Store Sales
1. Cigarettes	$304,250	34.5%
2. Foodservice	$115,400	13.1%
3. Packaged Beverages	$114,778	13.0%
4. Beer	$96,590	10.9%
4a. Beer Stores Only	$137,377	14.9%
5. General Merchandise	$39,466	4.5%
6. Candy	$32,756	3.7%
7. Salty Snacks	$27,458	3.1%
8. Other Tobacco	$24,545	2.8%
9. Fluid Milk Products	$23,220	2.6%
10. Packaged Sweet Snacks	$15,186	1.7%

Source: NACS 2004 State of the Industry

TOP TEN PRODUCT CATEGORIES

CATEGORY GROSS MARGIN TOTAL (MILLIONS)/CATEGORY GROSS MARGIN CONTRIBUTION

	Industry Category Total (millions)	Gross Margin Contribution
1. Cigarettes	$7,941	22.5%
2. Foodservice	$7,498	21.3%
3. Packaged Bev (non-alcoholic)	$5,295	15.0%
4. Beer	$2,649	7.5%
5. General Merchandise	$2,036	5.8%
6. Candy	$1,961	5.6%
7. Salty Snacks	$1,193	3.4%
8. Other Tobacco	$934	2.6%
9. Fluid Milk Products	$820	2.3%
10. Health and Beauty Care	$724	2.1%

Source: NACS 2004 State of the Industry

SELECTED EXPENSE PROFILE

AS A PERCENT OF GROSS PROFIT

	2001	2002	**2003**
Labor	38.6%	42.1%	**38.5%**
Depreciation/Amortization	9.8%	9.1%	**9.9%**
Occupancy	6.8%	7.1%	**9.1%**
Credit/Debit Fees	5.0%	4.8%	**5.8%**
Utilities	5.2%	5.3%	**5.7%**
Repairs/Maintenance	4.0%	4.4%	**4.3%**

Source: NACS 2004 State of the Industry

for the year. For stores selling motor fuels, motor fuels revenues averaged $2.12 million. Even though motor fuels sales accounted for 65.5 percent of the industry's total sales in 2003, they accounted for only 35.2 percent of total industry gross margin dollars for stores selling motor fuels.

Foodservice sales lead in-store sales growth

For the first time ever, the industry's merchandise sales topped $100 billion ($101.0 billion in 2003). Total in-store sales were up 6.3 percent to $116.2 billion, driven by foodservice, which zoomed up 13.3 percent to reach a record $15.2 billion, making foodservice the number two in-store category. Spearheading the strong growth in foodservice was a 13.9 percent increase in the combined food prepared on-site and commissary/other packaged products (includes packaged sandwiches) categories, as well as a 13.3 percent increase in hot dispensed beverage sales, particularly coffee and specialty coffees. Cold dispensed beverages (up 11.2 percent to $2.2 billion) and frozen dispensed beverages (up 13.9 percent to $1.4 billion) also saw strong sales increases.

Cigarette sales hold their own

After experiencing a double-digit percentage drop in cigarette sales in 2002, attributed largely to the loss of sales to mail-order and Internet cigarette merchants, the convenience store industry held its own in 2003 with respect to cigarette and tobacco sales. Cigarette sales, which are by far the largest in-store sales category (34.5 percent of all in-store sales), increased 1.8 percent to $40.0 billion, but on a per-store basis declined slightly, dropping 0.6 percent to $304,250 per store. While Internet and mail-order merchants continue to grow sales, convenience stores were able to hold their sales volume by capturing a greater share of sales from brick-and-mortar retailers. According to Management Science Associates data, which does not include Internet, bootleg or mail-order sales, the convenience store industry grew cigarette market share from 60.2 percent in 2002 to 62.0 percent in 2003. Meanwhile, the other tobacco category, which includes smokeless, cigars and loose tobacco, saw a strong 11.1 percent increase in sales to $3.2 billion, which placed it as the number eight in-store category.

If it's a beverage, it sold well in 2003

The trend seen in foodservice sales, where all beverage categories experienced robust sales increases, also was apparent in packaged beverage sales at convenience stores. Packaged beverages (non-alcoholic), the third-largest in-store category, grew a strong 13.0 percent to $15.1 billion. Meanwhile, beer ranked fourth, despite a drop in the number of stores selling beer from 75 to 70 percent (likely from local and state regulations that either prohibit or strongly discourage beer sales in convenience stores). Total industry beer sales grew 5.8 percent to $12.7 billion. However, it's worth noting that for stores selling beer, this category jumps to number two in terms of in-store sales per store, reaching $137,377 or 14.9 percent of in-store sales.

Another strong year for general merchandise sales

Rounding out the top five in-store categories, general merchandise saw a 19.1 percent growth to $5.2 billion, largely

SELECTED ANNUAL CHANGE IN RETAIL SALES

AVERAGE ANNUAL PERENTAGE CHANGE

	2000	2001	2002	**2003**
Total Retail Sales	7.2%	3.1%	2.5%	**5.4%**
Convenience Stores Total	15.1%	5.0%	2.7%	**16.0%**
In-Store	4.3%	7.6%	-2.4%	**6.3%**
Motor Fuels	23.2%	3.4%	6.0%	**21.8%**
Total Retail Gasoline	28.8%	-0.6%	-3.3%	**15.0%**
Grocery Stores	3.3%	5.1%	1.5%	**3.1%**
Restaurants	7.4%	4.5%	4.4%	**7.1%**
Drug Stores	7.5%	8.5%	8.3%	**6.7%**
Discount Dept. Stores	2.0%	1.2%	-3.3%	**-5.0%**
Warehouse Clubs	21.1%	18.4%	16.5%	**12.9%**

Source: U.S. Department of Commerce

on the strength of increased sales of prepaid telecommunications and an increase in undefined items in the other general merchandise category, perhaps arising from dollar-store format type merchandise. The rest of the top 10 categories were candy ($4.3 billion), salty snacks (up a robust 24.8 percent to $3.6 billion), other tobacco products ($3.2 billion), fluid milk products ($3.1 billion) and packaged sweet snacks ($2.0 billion).

Expense reductions help grow profits

The huge jump in convenience store profits was largely a result of improved operating efficiencies. For one, it stands to reason that after three straight years of declining profits—with the last two years of declines exceeding 25 percent—stores unable to compete due to operating inefficiencies and/or lackluster sales exited the industry. In fact, according to TDLinx, 9,478 stores closed in 2003.

Another factor leading to increased pretax profits was that in-store margins increased 1.4 percentage points to 30.8 percent, the first time that in-store gross margins have exceeded 30 percent since 1998. The increase for in-store margins is directly attributable to increased sales in foodservice, where margins are much more robust.

Finally, retailers controlled costs as revenues increased. Labor expenses in dollars essentially were unchanged from 2002, but as a percentage of total sales dropped from 7.1 percent of total sales in 2002 to 6.3 percent of total sales in 2003. A major factor in controlling labor costs was the reduction of non-store workers, which were cut by more than a quarter, from 1.1 to 0.8 employees per store. This reduction likely was related to continuing consolidation within the industry. Overall, total employees per store dropped from 11.4 to 10.9 employees.

SELECTED CONSUMER PRICE INDICES

AVERAGE ANNUAL PERCENTAGE CHANGE

	2002	2003
Overall CPI	1.6%	2.3%
Food at Home	1.3%	2.2%
Food Away from Home	2.5%	2.1%
Cigarettes	8.8%	1.4%
Motor Fuels (incl. diesel)	-6.6%	16.6%

Source: U.S. Department of Commerce

Credit/debit fees a growing challenge

While convenience stores were able to reign in most of their expenses in 2003, a significant expense continued to grow: credit/debit card fees. Credit/debit card fees, as a percent of gross profit, jumped 20.8 percent in 2003, and now equal 5.8 percent of gross profit. As a percentage of total sales, credit/debit card fees are 0.9 percent of total sales, drawing closer to the industry's total pretax profits, which were 1.2 percent of total sales. Credit/debit fees consumed 5.8 percent of the $420,100 average per store in gross margin dollars in 2003. This means that these fees cost the average store more than $24,265 in 2003. On an industry-wide basis, the total cost of credit/debit fees was approximately $3.2 billion.