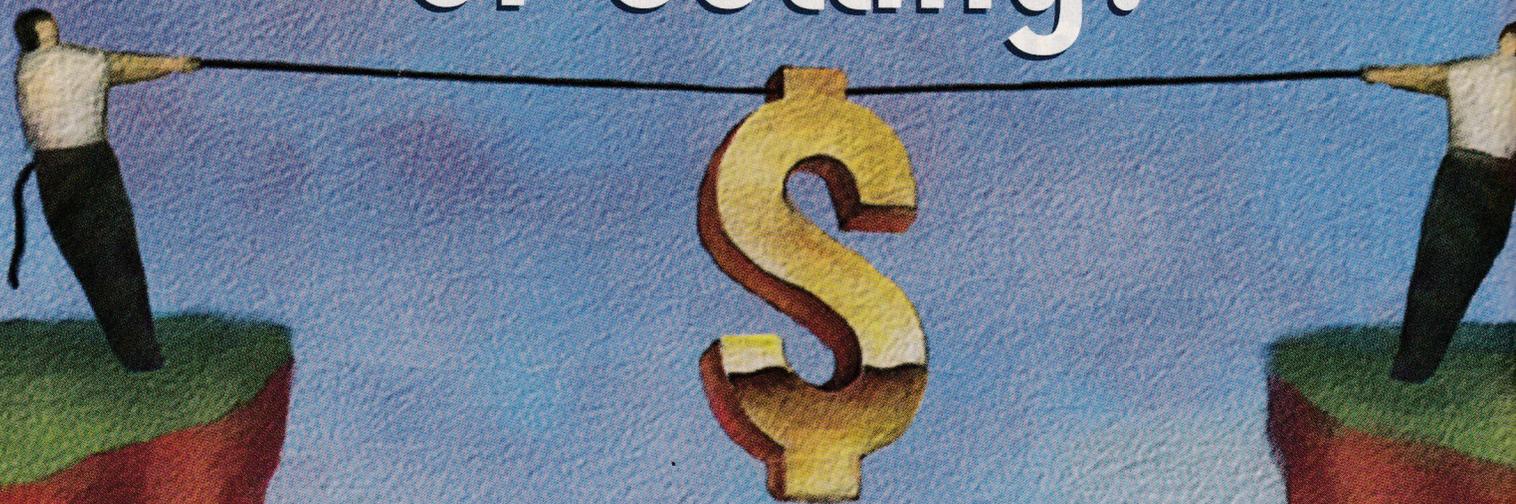


Are you buying or selling?



You better do something.

The inaugural Petroleum Retail Finance Summit brought together a diverse group of c-store and petroleum industry leaders to discuss new financing opportunities and how to take advantage of them.

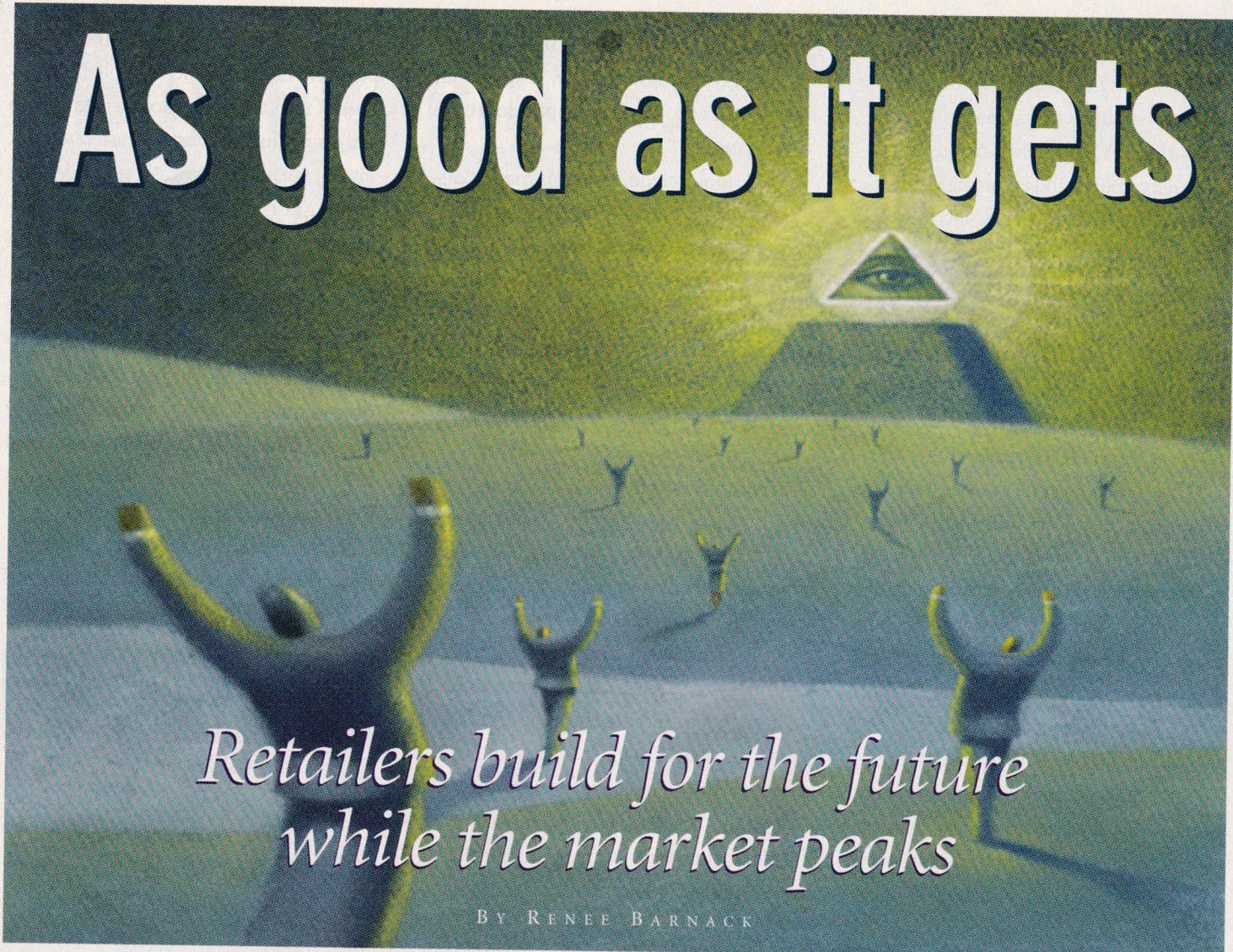
PETROLEUM RETAIL
FINANCE SUMMIT



Sponsored by



As good as it gets

A surreal landscape with a pyramid in the background and an eye in the sky. In the foreground, several figures are standing with their arms raised in a gesture of triumph or celebration. The scene is set against a dark, textured background.

*Retailers build for the future
while the market peaks*

BY RENEE BARNACK

With money now so readily available to c-store operators and petroleum marketers, some feel there must be a catch. Others are busy making the most of the market while it lasts. The market today is most likely as good as it is going to get.

Take advantage of the opportunities while they are here, advised Don Hakes, president of FMAC's Energy Finance Group, headquartered in Parsippany, N.J. He encouraged retailers to consider taking advantage of the low interest rates available now and use the money to grow their business. "If history repeats itself, which it generally does, we are going to see some upswing in interest rates," he said. "You might have some downswing, but it's nominal in comparison to what the upside risk is."

Many operators are taking advantage of the money that is now

available to upgrade stores and buy additional sites. The continuing transformation of profit centers is where Hakes finds retailers are focusing. Although fast feeders are still an attractive profit center, the food-service bandwagon is changing course. More c-store retailers are now concentrating on leasing space to quick-serve restaurant (QSR) operators, rather than run it themselves, he said.

"Early on, we had a number of jobbers or c-store operators that wanted to get into the QSR business. They wanted to take a chance, open up the site and run it themselves," Hakes said. "After doing one or two of those, they have come around in their thinking and are now leasing that space, taking the lease income and letting the operator that knows how to operate that business do it."

Several of the participants confirmed that was the conclusion they came to after operating QSRs themselves. "After doing three or

four of those, we decided it just wasn't worth the money," said Steve Kirkham, owner of Rockytop Markets, Harriman, Tenn. "Since then, we have done two co-branded units with Wendy's where the space has been leased. That has been a real good match."

"We've come around to the same conclusion," added Loring Perez, CFO for Spectrum Holdings, Inc., based in West Point, Ga.

"From a borrower's standpoint, you can get a lot more credit from a lease than as an operator," Hakes said. "It is easy for us to value QSRs as a lender because of our diversity of lending. If you have quick-serve space leased there is solid reoccurring cash flow that's coming in and can be valued. Because of the unique requirements of the QSR industry, it's harder to get your arms around the financial projections if you are operating it yourself."

In addition to the changing winds of how food service fits into the picture, Hakes is also seeing an erosion of service station garages. "Many of the inquiries we have are to renovate service stations to include other profit centers," he said.

Finding the right price

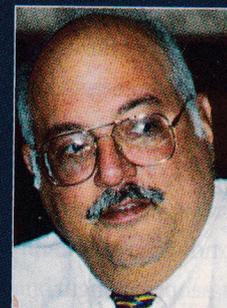
The cost of acquiring sites seems to be increasing, with Texas and the Southeast hotbeds right now, according to Hakes. While those who have been in the acquisition game for a while were once funding deals with three to four times cash flow, today five to six times is more standard. Why the big change? What it comes down to is a simple dynamic of cash flow and the ability of borrowers to pay more, based on long-term fixed rate funding. "What is happening, in a nutshell," he explained, "is the same thing that happened in the QSR business in 1991."

"There is a mismatch today," Hakes said. "If you encounter a seller who is not aware of the availability of capital, you can buy that operator's sites for three to five times. Others are more astute, especially in the Southeast because they are getting calls three times a month by acquirers bidding against each other. Some people are just not aware of the change in the dynamics of the market and how you can pay for acquisitions."

Paying seven times cash flow can be hard to swallow. "In my opinion, six and a half is about the upper limit I would be willing to pay normally for a c-store site," said Perez. "But people are bidding seven, even seven and a half times ... that's nuts."

"It's important that the financing work, but the decision to acquire and be in this business includes a lot of other factors. It's a location-driven business and you have to be certain that the locations being acquired work long-term. The price of an operation should reflect its quality. It's better to pay a little more for a very good location as opposed to paying a cheaper price for a location that has a smaller margin and cash flow."

—Loring Perez, CFO, Spectrum Holdings, Inc.



What comes to mind, Perez said, is a time while he was in banking and Florida condo owners were putting their keys on the banker's desk, since they had been working for the bank for the past six months anyway. He wonders if c-stores are headed for this same scenario. "Somehow that vision comes back," he said, "that one day some guy's going to have bought a company at seven or seven and a half times cash flow and made the loan long-term, there is a reduction in margins, value goes down and now he's working for the lender. So he walks in and hands over the keys."

That situation references the dumb money of the '80s real estate market and junk bonds, Hakes explained. "The dynamics work at seven times. If you want to be in the game you are either selling at seven times or buying at seven times. That's where the market is going to go," he said. "The mismatch is in financing short to buy long, that's where the market has been. This looks expensive to you guys because you've been in the market so long. To me, this is a correction. Long-term fixed rate financing for long-term fixed rate assets—seven times is a reasonable multiple."

"There is going to be real industry money at risk at seven times," Hakes said, "and most likely there will be equity in that deal. There is a built-in buffer in the market when you have to start putting real money into it, you are going to be a little more prudent in what you buy. That three to five times market is not going to last."

"It is the ideal time to either buy or sell," Hakes said. "It's a time of consolidation. You are either here to buy or sell—take the opportunity. The acquisition binge is already happening, based on the need for capital and '98 standards. Buyers are out looking for sites. A lot of the jobbers with retail sites will go quickly. The wholesaler without any retail sites is not really going to be in the path of acquisitions, primarily because cash flow financing is not available for nonretail acquisitions."

The thing to remember is that the acquisition needs to work for you, Hakes said. "There is a buying frenzy going on right now," he said. "A lot of people are figuring this out. That's why we have hundreds



"Asking for financial statements and looking at the financial viability and the size of a lender is just as important as looking at the financial viability and size of potential vendors."

—Bob Lee, president, AMBEST Inc.

of million-dollar deals in the shop—many of our borrowers have recapitalized their companies, giving them the flexibility needed to acquire additional sites.

How this unfolds over the next few years is yet to be seen, but Hakes believes it will continue on a larger scale. "You are going to see further consolidation ... you are going to see many big operators.

"The market is smart today and the dynamics of the operator have changed," Hakes noted. "Most of the time today, you have to have more than 20 stores to make money. Eventually, you have to be the right size operator to make money. As the market consolidates, the economies of scale be-

come very important. You are going to have to decide if it's best to sell or acquire assets. Today you know the money is here. It's available, the dynamics are right, and you can probably find some good acquisitions."

Consolidation parallels

There are similarities in what happened in the QSR business, but Hakes said the consolidation is happening in a much more compressed time frame for the c-store and petroleum industry.

One of the reasons for consolidation historically, Perez explained, is because the consumer market has been saturated and no one wants to cut the size of the pie. "So

you get rid of some operations by merging and acquiring and cutting off locations to end up with more market share in the ones that are left," he said. The c-store industry appears to be entering into that phase, then added that he is starting to see that happen, sites being acquired, then closed purely for economic reasons.

Hakes agreed. He said he finds that a small percentage of sites are typically closed when an operator makes an acquisition.

Shopping spree

Now that money is accessible, marketers are utilizing these resources to acquire new sites and grow their business. The timing is right to act now, said Hakes. "If I had a nice solid entity and a good solid cash flow, I would dedicate a team to go out and find opportunities," he said. If you are in the acquisition mode, he said, it is to your benefit to get them involved as your lender early on in the process.

Kirkham asked, "Even if we are just considering approaching a company about an acquisition, you'd want to be involved from the very beginning?"

"Definitely," Hakes said. "I would focus on utilizing FMAC's full services as well as the capital. When you acquire somebody, you have to worry about liability of funding, timeliness, and being comfortable with the people. Most of the acquisitions we see tend to have time constraints on them. It is to your benefit to get us involved early on to assist in the process."

When considering the purchase of a site, Don Bloom, president of Centerville, Ohio-based Kwik n Kold, said things are not always as they appear. If considering a site that is not showing a profit, he asked, "how do you get around the issue that they are doing

BACK TO SCHOOL

The new opportunities cash flow lenders offer means the c-store and petroleum industry has to go back to the drawing board and rethink financing strategies. Before cash flow lenders entered the picture, banks were basically the only way to borrow.

Don Hakes, president of FMAC, provided background on the origin of cash flow lenders at the Petroleum Retail Finance Summit. "The collateralized mortgage backed security market (CMBS) started in the early '80s. It was an esoteric class at the time," he said. "The asset backed security market started in the mid '80s and was a derivative of the CMBS market. It took a little longer to get going, primarily because people seemed to be more comfortable with real estate based loans. Basically, the cash flow component is factored in, meaning the business is worth a lot more as an ongoing entity than it is as the sum of its parts. Banking has always been the sum of its parts."

'x' number of gallons a month and 'x' number of sales, but the P&Ls are garbage?"

One way is to look to normalize those items to get a true assessment of the site, Hakes said. "If buying a site in your general area, we know you are probably going to operate that site similarly to your other sites. We can then take the gross revenues and back into some adjustments for operating costs. It gets back to the philosophy that if you are a strong corporate entity, there is a lot of flexibility in what we can do for you. If you are currently running tight debt coverages, it's much more difficult."

Those that are taking advantage of the opportunities that exist in the market today are doing very well, but Hakes said he does not see enough people taking advantage of the current market dynamics. "I wonder if this is news to everybody, that the dynamics of the market are the way they are, or if we are just seeing it in such a way that it is difficult for everybody to get a grip on. It seems like everything is becoming very expensive, but I don't see that it's going to change. This borrower's market will not last forever."

Although Spectrum has been in the acquisition mode for a while, Perez said the problem is that the price of the assets to be acquired seems high because if you are a quality operator, you always end up comparing them to what you've got. "It's a hard task to try to say I'll accept stores that do 35% of my volume and buy that much cheaper and be OK," he explained. "The other thing is you compare it to what else you can put your money in. If I'm going to have to pay eight times EBIDTA for an operation, I can do better by putting it in a couple of good stocks. You ques-

tion whether you should make that investment to do that. That's what you have to wrap your brain around."

Other factors also come into play when looking at acquisitions, aside from having money readily available, said Paul Doucette, CFO for The Store 24 Inc., based in Waltham, Mass. "It hasn't been our business strategy to look at acquisitions thus far, so the fact that there is a change in the financial market that should drive business strategy in many cases doesn't connect. You also need the organizational structure and technology to handle it," he said.

Hakes foresees chains that are sitting still are not only missing opportunities, but may quickly find themselves surrounded by larger competitors. "If you are going to hang around as a 30- or 40-unit operator, you are going to be surrounded by a lot of big operators in the short order," he predicted. "I think you are probably either an acquirer or a seller in today's market."

From the incremental overhead side, one of the advantages of having an existing chain and adding more is that your incremental overhead is less, Doucette noted. "Is there a rule of thumb when I am looking at that as to average dollars assigned?" he asked.

"There is a sliding scale for that," Hakes said, "as far as the number of sites and the

incremental overhead we'll attach. It fluctuates. There are a lot of moving parts and each acquisition will have different allocations."

With the number of restrictions on acquisition levels from banks, Sonja Hubbard said she finds it encouraging to have someone come at you with the idea that they like to see acquisitions and that they understand the industry. Hubbard is CFO for E-Z Mart Stores, Inc., a 410-store chain based in Texarkana, Texas.

"It's a lot easier to deal with someone that understands the industry," Hubbard said. "I end up retraining bankers, primarily because they don't understand the environmental aspects or cash flow of the business. They see the debt and low margins and panic, not realizing the cash flow that is generated."

The reason some are leery of the money available through cash flow lenders, Kirkham suggested, is that it almost appears too good to be true. "What I see is that you guys are breaking tradition, based on what we have been used to as far as having to go to the banks. It is almost too good to be true." The group agreed that it is imperative for borrowers to do almost a reverse due diligence and ensure they are dealing with a quality lender, because unfortunately some lenders just can not deliver the funds.

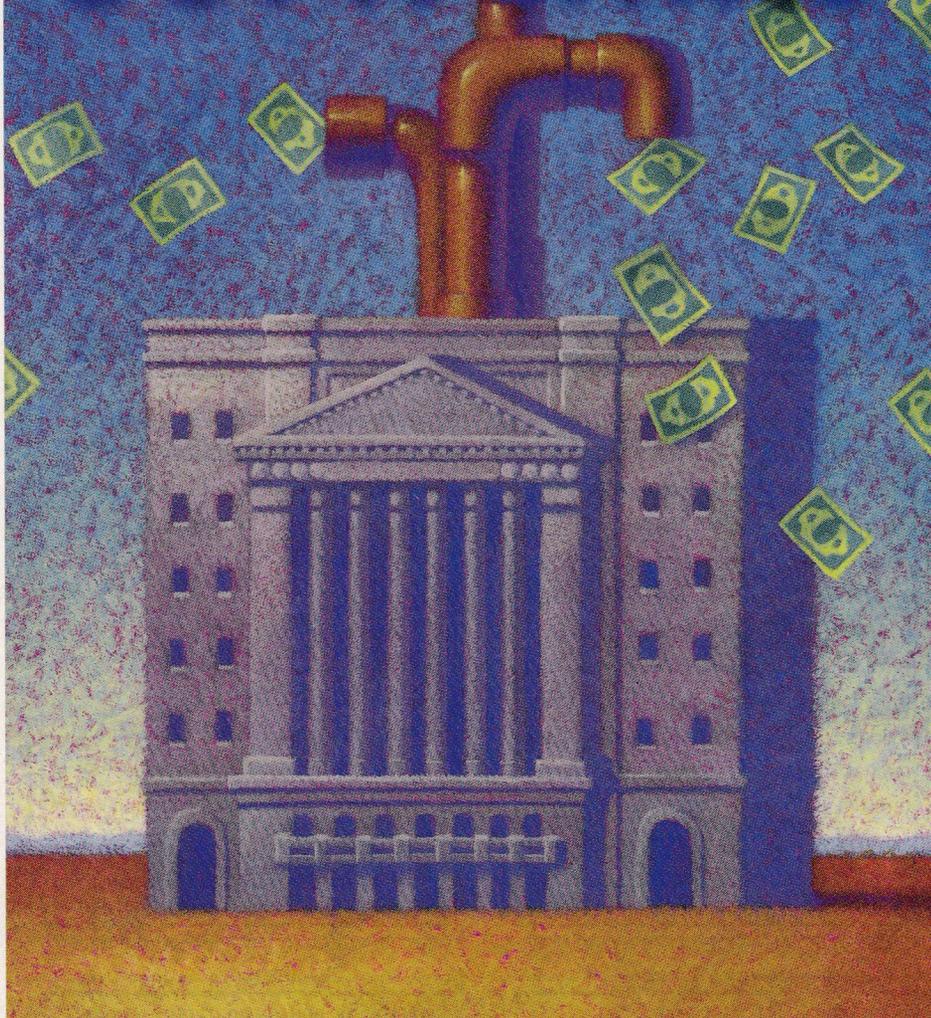
"When dealing with traditional lenders," Kirkham said, "there are all these different covenants and you have been programmed not to go out and seek more opportunities. I'm sitting in my office feeling like I have the staff and computerization to triple in size. I want to know that if I find the right deal, I can grow some more. I feel that's possible with FMAC's Energy Finance Group." □

"What I see is that you guys are breaking tradition, based on what we have been used to as far as having to go to the banks. It is almost too good to be true."

—Steve Kirkham, owner,
Rocktop Markets



Get it while it's hot



PART II

*Retailers ask
need-to-know financing
questions.*

After talking about new financing trends and growth opportunities in the industry, the discussion moved towards sizing up tomorrow from a financial perspective.

Addressing FMAC's view of the truck stop/travel plaza industry, Bob Lee, president of AMBEST, Inc., wanted to know if the company would be continuing its focus on that segment in the future. AMBEST is a 135-member truck stop co-op based in Brentwood, Tenn.

"We do have a couple of people who have great exposure to that market and have created a niche for us inside that market," Hakes said. "I believe that we are the largest financier in the truck stop and travel plaza market, we have done an enormous amount in that business and have become very comfortable with it.

"When you look at the c-store business and retail petroleum, it becomes very complicated because of all the different profit centers. We view truck stops as swollen c-stores—bigger numbers and they tend to have more profit centers," he stated. "It's a market in which we will definitely continue to be involved."

"The impression I got," Lee said, "is that you are staying away from new builds in the truck stop arena. It seemed you weren't doing that within the c-store segment."

The new builds are considered accommodations, Hakes explained. "If we underwrite a construction loan it will

then sit on our balance sheet anywhere from 18 to 24 months. That's not productive. If we have a client that we've done previous business with or we are looking at a portfolio of loans and part of the package is to fund that transaction, we accommodate that client. It helps to have a good solid operation and to have worked with us before.

"In the truck stop business we've seen a lot of inquiries for one-site construction deals," Hakes said, "which is not our primary interest. If somebody has four or five units and wants to refinance those, then we will provide capitalization. It goes back to the fact that we don't need a whole lot of clients, we need a select few that we can continue to do business with. That's when the construction product comes into the picture."

Ground zero

In examining the construction issue, Kirkham inquired about whether it becomes more attractive if local lenders are utilized first. "What if we go out through our local lender and get a 12-month construction loan and ask you to get a letter saying you will take it out after that period? Does that make it easier or more at-



Sonja Hubbard, Don Bloom and Paul Doucette absorb the information-sharing about financing obstacles.

tractive to accommodate construction issues?" he asked.

That would probably make it a cleaner transaction, Hakes said. FMAC has given take-out letters to borrowers before, he said. "Typically you have a relationship with a local lender that knows where you built that site and has mechanisms to maintain or monitor the construction phase," he said. "If you are able to do that, it is probably a cheaper way to do it. It is easier for us to get

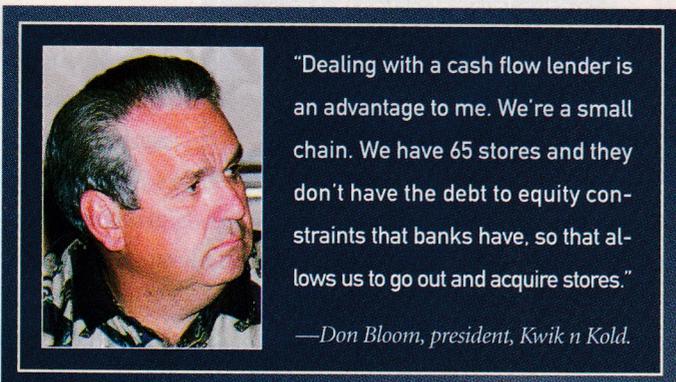
involved after the transformation from the construction to the seasoning period."

This business is not cut and dry, Perez noted. Normally, he said, stores season out in the second year. "Sometime during the second year they

achieve the level of sales and such that we projected... It doesn't normally happen in the first year. Actually, if you break even in the first year that's perfectly fine with a lot of sites," he said. "But some sites come out of the shoot... you open the door and it's already 90% of the volume and that's wonderful. Others are future growth sites, perhaps located on the edge of a city and the city is growing that way. It could take three or four years for those sites to hit their stride, so you do need interest-only on them. How do you solve that?"

Interest-only loans have been provided, Hakes said, but are typically negotiated issues. "For an existing client, it's a fairly easy process," he explained. "To come out of the shoot doing something of that sort for a small portfolio, it's going to be a little more difficult because it's not our core business.

"The moral to all these questions that are coming up is that we are in the busi-



"Dealing with a cash flow lender is an advantage to me. We're a small chain. We have 65 stores and they don't have the debt to equity constraints that banks have, so that allows us to go out and acquire stores."

—Don Bloom, president, Kwik n Kold.

you can take," Hakes said. The meat of the language of an estoppel could be extracted easily enough and inserted into the lease being negotiated, or you could have an estoppel executed when signing the lease, he said.

There are basically two reasons for the estoppel, Hakes explained. "To allow us to occupy a site and to give us the right to record a lease hold mortgage," he

said. "As we are providing mortgages, whether it is a fee first mortgage or a lease hold mortgage, they need to be recorded on the title and lease as public record, so those are the two items that we need to get out of that estoppel issue.

"The estoppel is the most negotiated document we have. I'd venture to say there are very few that are the same," Hakes said. "There is always something that is negotiated. And you're right, it is very difficult to go back and get that once you have a lease and you're paying rent." He suggested if retailers are expecting to make some acquisitions and have some lease hold sites, it would definitely be a benefit to have that language negotiated up front. "It's not going to hurt you if you don't use it," he said.

"What's the highest mix of lease-to-own transactions you would do?" Perez asked.

FMAC has done some transactions that are 100% leased, Hakes said. One sizable transaction that was funded included some

40-odd leased sites, he said, and included a couple of estoppels that they were unable to get. "If you are coming to us with a transaction and the economics of the transaction work—certainly we like to have the

Sonja Hubbard, E-Z Mart Stores, Inc.:
"Is the fixed charge coverage ratio basically the only covenant that you have? What other kind of documentation is necessary?"



Don Hakes, FMAC: "That is the only covenant. Other documentation includes semi-annual corporate and store level P&Ls, depending on the size of the transaction. It is a little less cumbersome than the banks."



real estate involved—but an all lease hold transaction is not a big problem for us," he explained.

Predators Ball

"It is a borrowers market right now," Hakes told the participants. "The capital that is available should allow for a sizable amount of acquisitions, so whether you are the buyer or seller, if you are sitting still you are probably missing the opportunity. We anticipate a lot of consolidation in the marketplace. The transformation of the units will probably continue, the multiple, the profit centers, we also

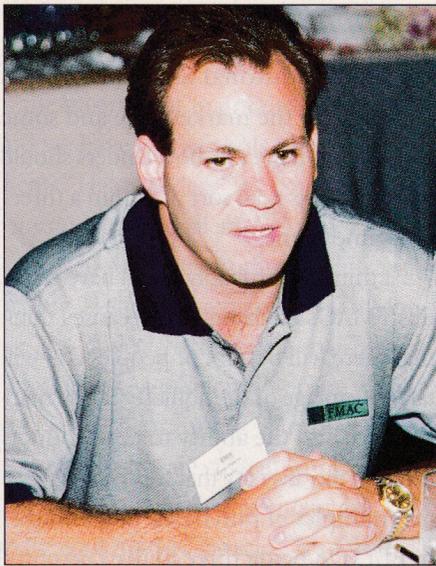
see some additional financial sources coming into the marketplace and some consolidation in cash-flow lenders should happen... this is all sort of within a three-year time frame.

"I think we probably could have called this 'FMAC's Predators Ball' because I think that there will be a lot of people who will take advantage of the liquidity in the marketplace and the ability to tap products through the diversity that we create. We see the multiples of purchases, the multiples of EBITDA being three to five currently, moving probably in the next year to two

years to a seven or eight multiple. That sort of parallels the quick-serve restaurant business that we saw from '91 to currently. In '91 you paid three to four times for a solid oper-

ating Taco Bell, today you will pay seven to eight, sometimes even further out than that. And that was over a seven year period. We see that happening at a much more condensed time period for this industry."

As the c-store and petroleum industry continues to transform, the group agreed that financial services will become a bigger part of the picture. From the financial perspective, the time to act is now to secure a solid future. Keep in mind Hakes' comment about either being a buyer or seller in today's market. It's something all operators in this industry should be thinking about, and acting on. □



Don Hakes, president of FMAC's Energy Finance Group, answers key questions that came out of the Petroleum Retail Finance Summit.



Participants at the Petroleum Retail Finance Summit discuss finance trends with Don Hakes, president of FMAC's Energy Finance Group.

■ **How long will the existing low interest rate environment last?**

That's difficult to predict, but I will say that the rates are far more likely to increase rather than decrease at this point. When examining the possibilities that lie ahead, the upside presents a far greater risk. The point is, I wouldn't wait for the market to get any better than it is right now or you will be missing out on some excellent opportunities to advance your business. You already know what is available today, the time is right to make a move. Don't worry about what the future holds, focus on what exists now and take advantage of that.

■ **Will the cost of acquiring sites continue to escalate?**

Yes. We see a lot of similarities in what happened in the quick-serve restaurant industry to what is now occurring in the c-store and petroleum industry. Cash flow multiples expanded with the QSRs from four to six times in 1991, rising up to six to eight times in 1998. The multiples almost doubled as far as the selling price.

That will most likely happen within a

much tighter time frame for the c-store and petroleum industry. Multiples are projected to expand from what is three to six times right now to five to eight times by the year 2001.

■ **Do you foresee further consolidation in the petroleum/c-store industry?**

I'm sure most everyone involved in the industry will agree that there will likely be more consolidation in the future. In fact, we are actually helping to fuel that. The real question is whether you intend to be a buyer or a seller. That's the perplexing decision in today's marketplace. If you are not either buying or selling, you are missing out on a lot of opportunities.

As the market consolidates, the small-to medium-sized operators will become substantially larger players. You are going to see a lot larger operators down the road and if you are not expanding, you may not be able to compete. The benefit for those that are growing is that as the market consolidates, those that remain will see greater profits as the pieces of the pie get larger.

■ **What advice do you have in selecting a lender?**

Look for a lender that is interested in being involved in the industry long-term and is committed to growing with you as your business expands. FMAC is looking to partner with operators and build long-term relationships.

At FMAC, we've seen in excess of 40% of the previous year's business repeat the following year, which is a testament to the fact that we are relationship lenders. Because we provide the servicing and in general take a significant risk in our bond pools, our position is enhanced as a lender

to maintain long-term relationships with borrowers. We are not in the business of going out and trying to find a million customers, we are looking for a finite number of customers who we can have long-term relationships with as opposed to doing one-off type of transactions.

■ **Is cash flow lending here to stay?**

The reality is that the securitization market, the asset backed market, is a \$100 billion a year market that is not going to go away overnight. There are a lot of new entrants into this market making money available for the industry. Some consolidation will probably happen, but FMAC will definitely be around long-term.

The perception of the market is that all cash flow, or securitized lenders, are only in it for the short-term—that we are somewhat like investment bankers. That is not true, although I would advise people to look closely at who they select as a lender. It's important to do your homework. FMAC's financial strength and the history we've had in lending to other retail concepts, specifically the QSR industry, stands on its own merits.

FMAC has been in the business since 1991 and has lent in excess of \$5 billion, the majority to branded retailers. We are committed to the c-store/petroleum industry and have lent in excess of half a billion dollars in the first year. We are here for the long-term and are committed to servicing this industry.

■ **Will this new lending format replace banks?**

We do not intend to replace traditional banking. We are basically unwinding a mismatch of funding that has been in the mar-

ketplace, which has been funding long-term assets for short-term capital. Banks are traditionally structured to provide quality product for fixed rate long-term lending which is tied to long-term assets.

In effect, we are supplementing banks, not replacing them. Most of our funded transactions result in having a bank as part of the lending team providing the short-term funding.

■ **What benefits does FMAC offer as a cash flow lender?**

Basically, what it comes down to is that we encourage you to concentrate on running your business. One big advantage is that we know the industry and you don't have to spend time educating us, which is what frequently happens when dealing with banks and traditional lenders. We understand the cash flow and environmental concerns and know what the margins are ... we want to come on board as your financing partner to assist you in growing your business.

A main benefit in cash flow lending is greater advances on assets, usually 70% of valuation (real estate appraisal plus business value). Also, the loan advance is often greater than 100% of the MAI appraisal. Covenants are also far less cumbersome than what is required with banks and personal guarantees are generally not required for multi-unit operators. □

FMAC expresses its appreciation to CSP and all the participants of the Petroleum Retail Finance Summit.

For more information contact:
FMAC Energy Finance Group
1-888-295-3622
9 Campus Drive
Parsippany, NJ 07054