

MERCANTOR PARTNERS



SHOP TALK T.O.C.
THREATS, OPPORTUNITIES, AND CONSOLIDATION
IN MID AND DOWNSTREAM FUELING

Joe Petrowski



SIGMA Nashville | November 2014

Shop Talk: Threats, Opportunities, and Consolidation

- Supply Growth
- Demand Destruction
- Fuel Diversity
- Market Structure
- Wholesale Marketing
- Capital Markets– The MLP Era
- Refining
- Terminals
- Retail Sites

Supply Growth

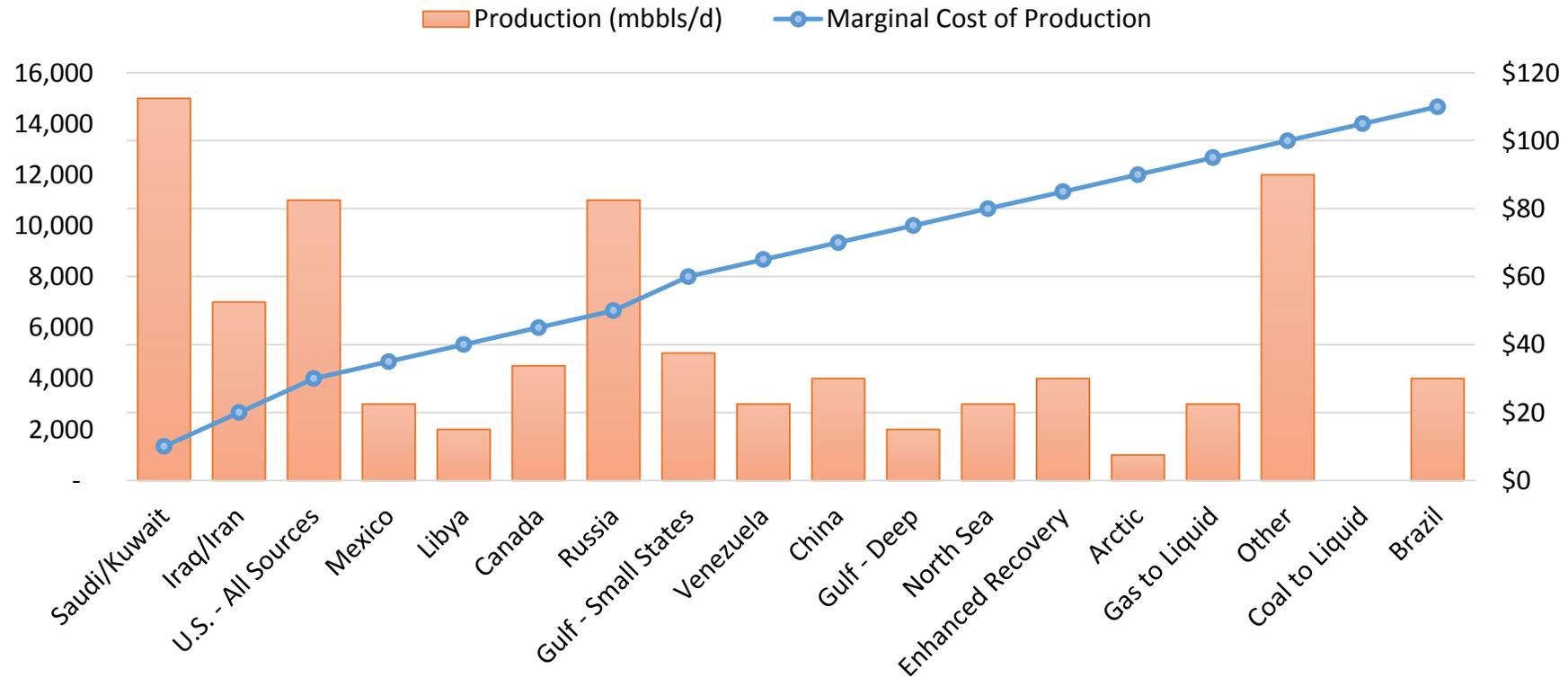
- US oil production to surpass 8 million barrels/day within 3 years
- Combined with incremental natural gas from several formations, another 28 BCF of natural gas or 5 million barrels equivalent comes to market
- Privatization in Mexico and Venezuela increases supply
- Shale formations in Canada, Poland, Black Sea, and South China Sea to be tapped
- Wind and solar continue growth
- Lower unit price accelerates OPEC “leak”

Supply Continued

- Cost of finding and extracting dropping faster than prices
 - New Technology
 - Element Recycling
 - Economies of scale
- Saudis and other oil rich countries increasing production
 - As prices decline, more oil is produced to balance budgets
- Privatization in Mexico and Venezuela increases production
- Brazil sitting on 15 million barrels per day production capability

Supply Continued

Top Oil Producers

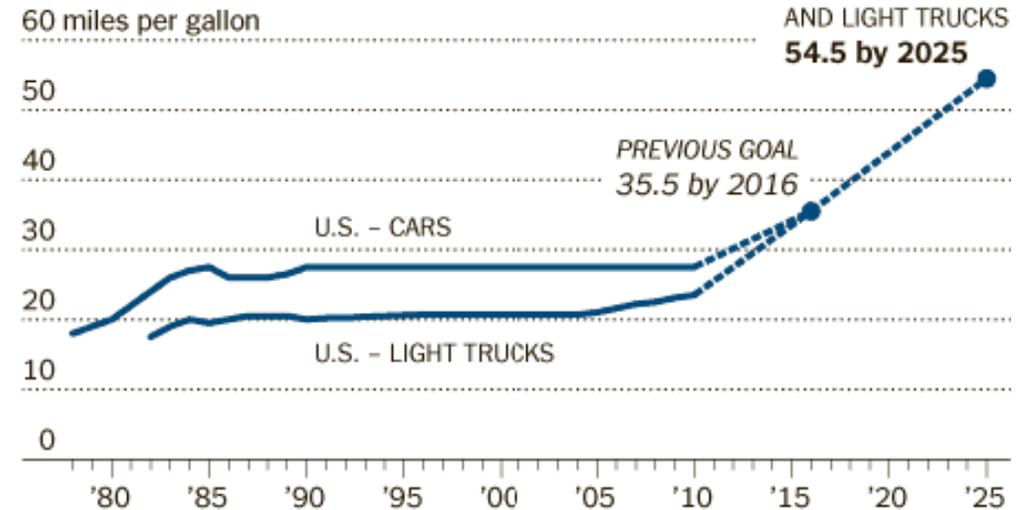


Source: Energy Information Administration

Demand Destruction

- Transport fuel demand expected to decline from ~170bil gal/yr to ~160 bil gal/yr
- Potential loss of 33 billion gallons annually
 - Higher café standards (~11bil gal/yr)
 - Natural Gas (~9bil gal/yr)
 - Demographics (~5bil gal/yr)
 - Electric (~4bil gal/yr)
 - Bio (~3bil gal/yr)
 - Hydrogen (~1bil gal/yr)
- More efficient retail distribution & supply chain model

Fuel-economy standards



Source: National Highway Traffic Safety Administration

Consolidation will drive stronger margins.

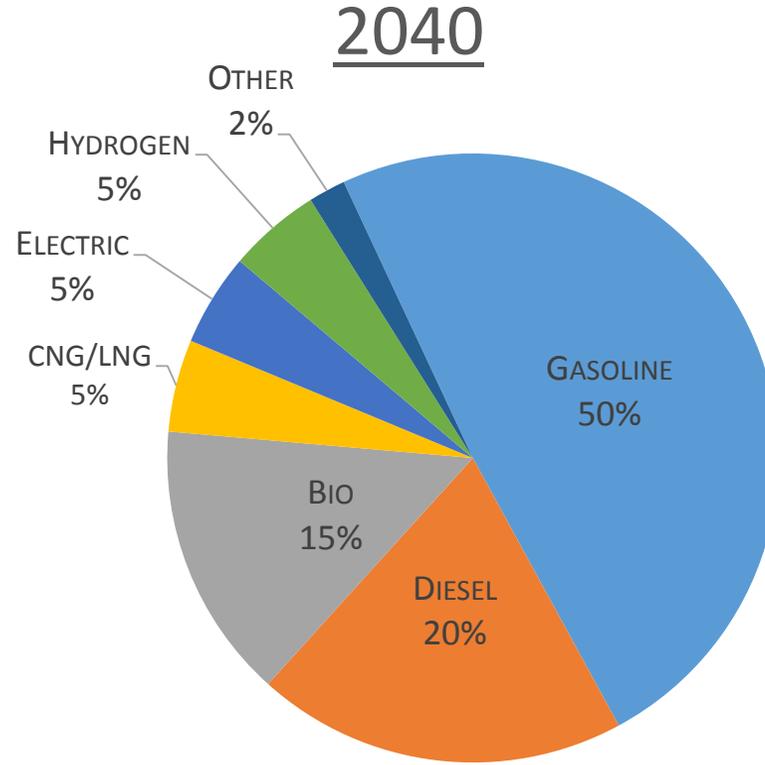
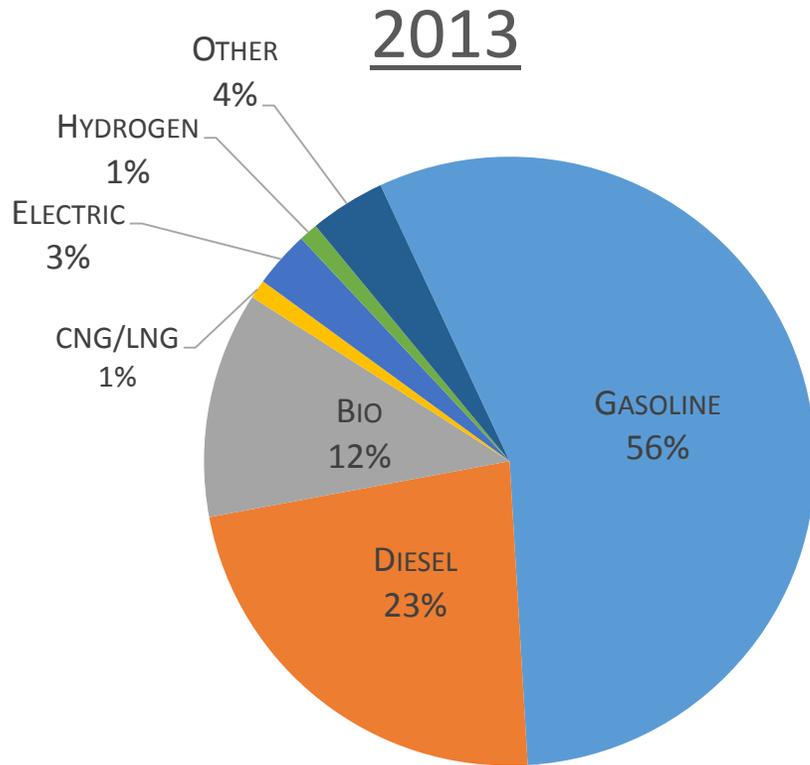
Demand Destruction

- Transport fuel demand expected to decline from ~170bil gal/yr to ~160 bil gal/yr
- Potential loss of 33 billion gallons annually
 - Higher café standards (~11bil gal/yr)
 - Natural Gas (~9bil gal/yr)
 - Demographics (~5bil gal/yr)
 - Electric (~4bil gal/yr)
 - Bio (~3bil gal/yr)
 - Hydrogen (~1bil gal/yr)
- More efficient retail distribution & supply chain model

Age Group	Avg. Annual Miles	% of Pop. in Age Group		
		2010	2030	2050
15-19	6,244	7.02%	6.62%	6.47%
20-34	13,709	20.50%	19.07%	19.21%
35-54	15,117	27.72%	24.70%	23.93%
55-65	12,528	11.69%	10.78%	10.96%
65+	8,250	12.97%	19.30%	20.17%

Consolidation will drive stronger margins.

Fuel Diversity



Retailers must have multi-fuel flexibility.

Market Structure

- Potential for grocery stores/wholesale clubs to increase market share from ~8% to ~30% by cross branding with manufacturers to offer rebates
 - France 52%, Australia 40%, UK 30%
- Convenience stores selling food will put pressure on retail gasoline margins to drive customer visits inside
- Niche jobbers and open dealers will be acquired by MLPs with tax advantage

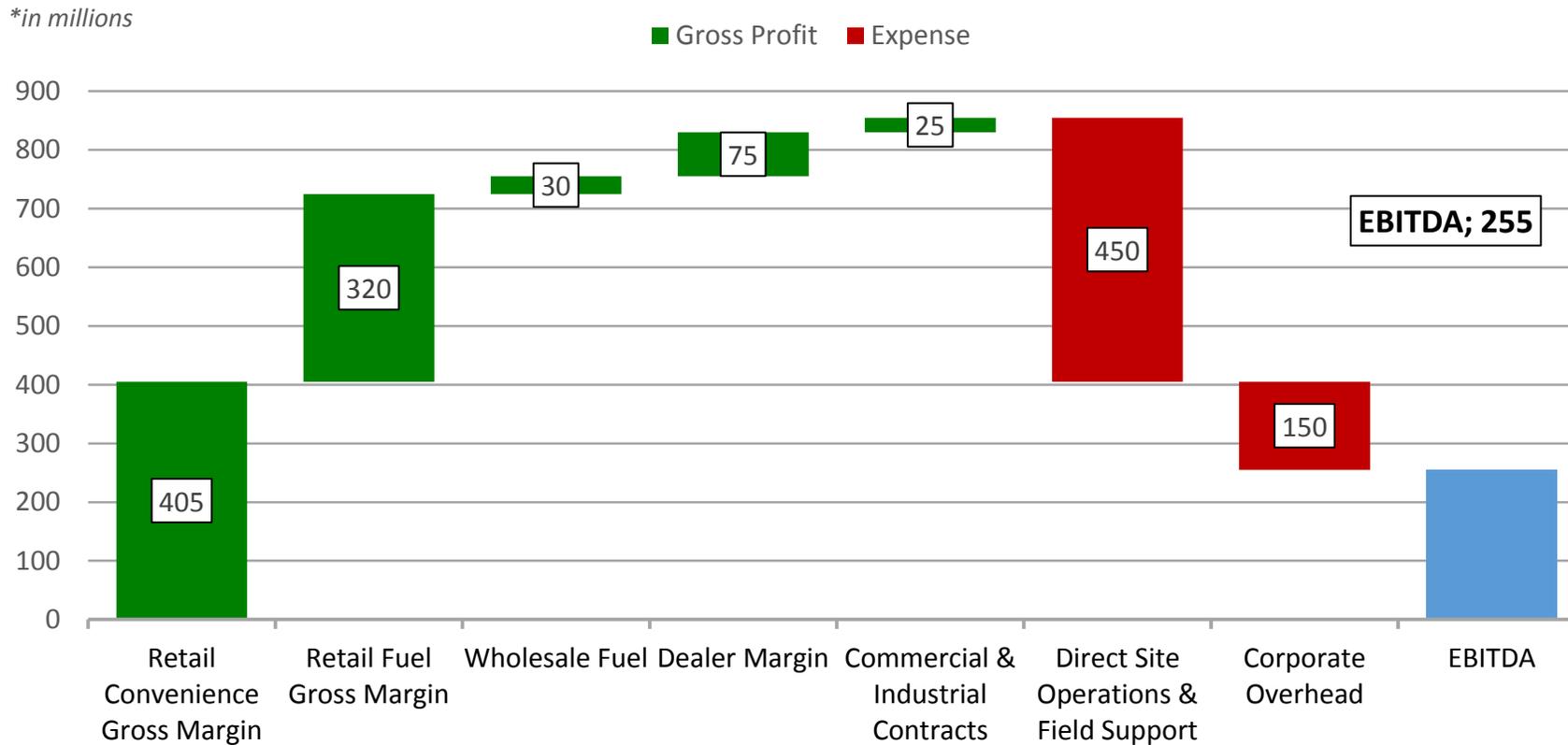
Future Retail Fuel Market Share Estimates

	Number of Firms	Number of Sites	Avg. Vol. per Site	Annual Volume
Convenience Retailers	32	56,000	2 mil gal	112 bil gal
Grocery/Hyper-marts	15	14,000	1 mil gal	14 bil gal
Mega Distributor	2	5,000	1 mil gal	5 bil gal
Super Distributor	20	18,000	1 mil gal	18 bil gal
Single Site		12,000	500,000 gal	6 bil gal
Unmanned		10,000	500,000 gal	5 bil gal
TOTAL:		115,000	1.4 mil gal	160 bil gal

Only those that are part of a large network with full food service, information technology capabilities, brand recognition, and aggregate purchasing power will prosper.

Mega Distributor

Mega Distributor EBITDA Bridge



\$1.7 bil 7x equity value

\$1.0 bil Total debt

\$2.7 bil Enterprise value

One company will supply up to 8.75 billion gallons or 7% of total US demand.

Supply Growth | Demand Destruction | Fuel Diversity | **Market Structure** | Wholesale Marketing | Capital Markets – The MLP Era | Refining | Terminals | Retail Sites

Wholesale Marketing

- Demand for nationwide distributor – The Amazon of Distribution, McDonalds vs. Burger King
 - Geographic Reach
 - Fuel Diversity
 - Service Capability (1 invoice)
 - Risk Management

MERGERS, ACQUISITION & GROWTH > MERGERS & ACQUISITIONS NEWS
 October 1, 2014
Speedway Closes on Hess Retail Deal
 Rebranding poised to begin at more than 1,200 Hess Express, WilcoHess locations
 Published in *CSP Daily News*

MERGERS, ACQUISITION & GROWTH > MERGERS & ACQUISITIONS NEWS
 October 22, 2014
Insider's View: C-Store Industry Consolidation Continues to Accelerate
 A third-quarter review of mergers & acquisitions and capital markets, part 1
 Published in *CSP Daily News*

MERGERS, ACQUISITION & GROWTH > MERGERS & ACQUISITIONS NEWS
 November 3, 2014
CST Wraps Up Nice N Easy
 Joint transaction with CrossAmerica closes on major-chain acquisition
 Published in *CSP Daily News*

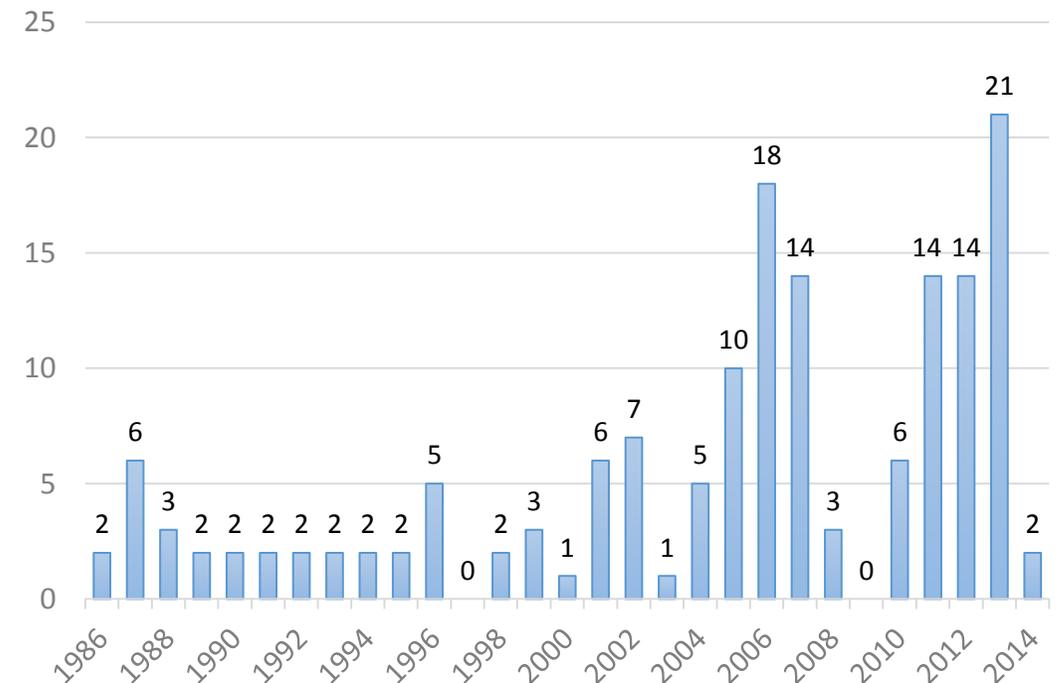
MERGERS, ACQUISITION & GROWTH > MERGERS & ACQUISITIONS NEWS
 October 2, 2014
CST Brands Completes Lehigh Purchase
 Lehigh Gas Partners changes name to CrossAmerica Partners
 Published in *CSP Daily News*

Capital Markets – MLP Era

Capital Spending in Energy, Next 7 Years

Interstate Pipelines	\$85 bil
Field Services	\$20 bil
Distribution	\$90 bil
GTL (Gas to Liquids)	\$70 bil
CHP (Combined Heat Power)	\$60 bil
New Gas Fired Generation	\$80 bil
Fischer Troupe	\$20 bil
Total	\$425 bil

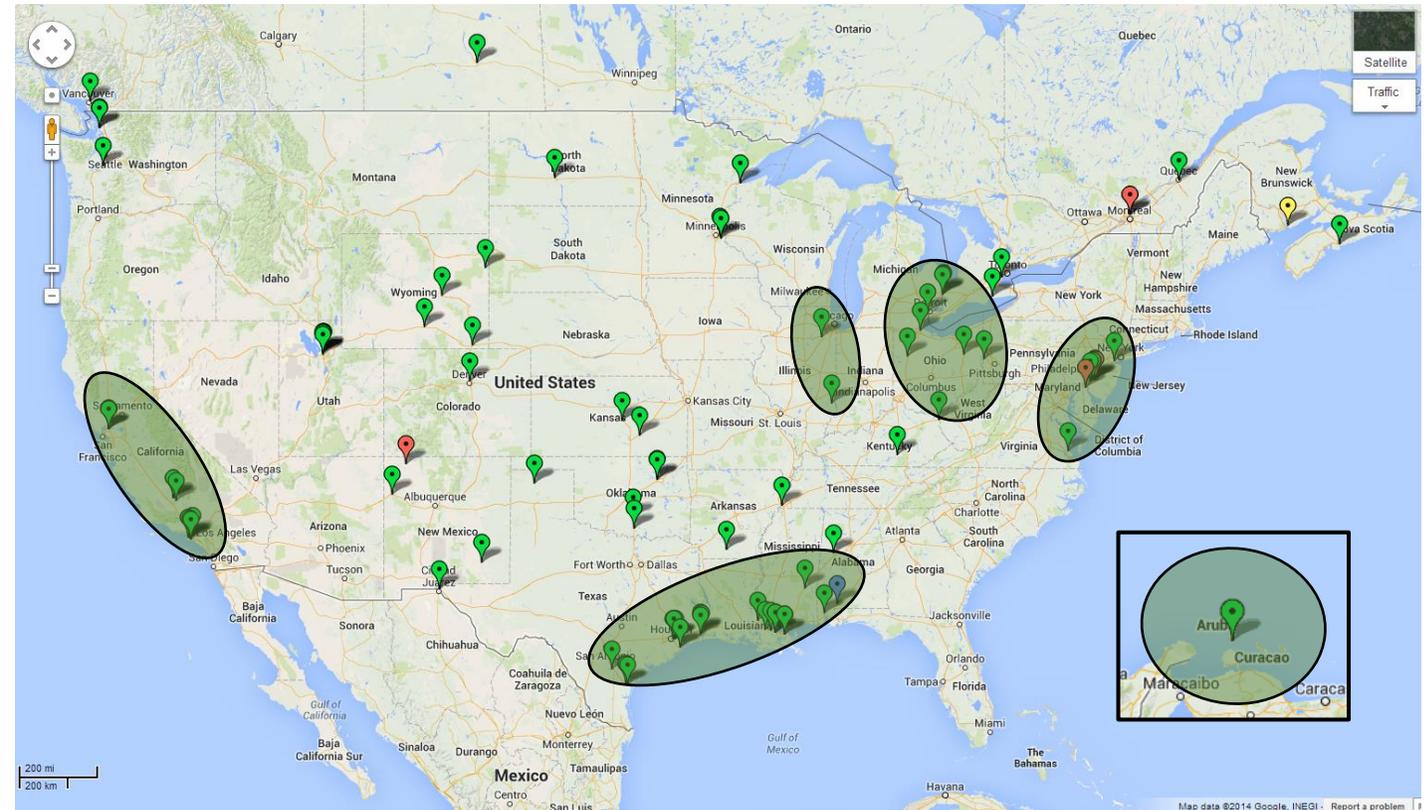
MLP IPOs



Source: Alerian 05/14/2014

Refining

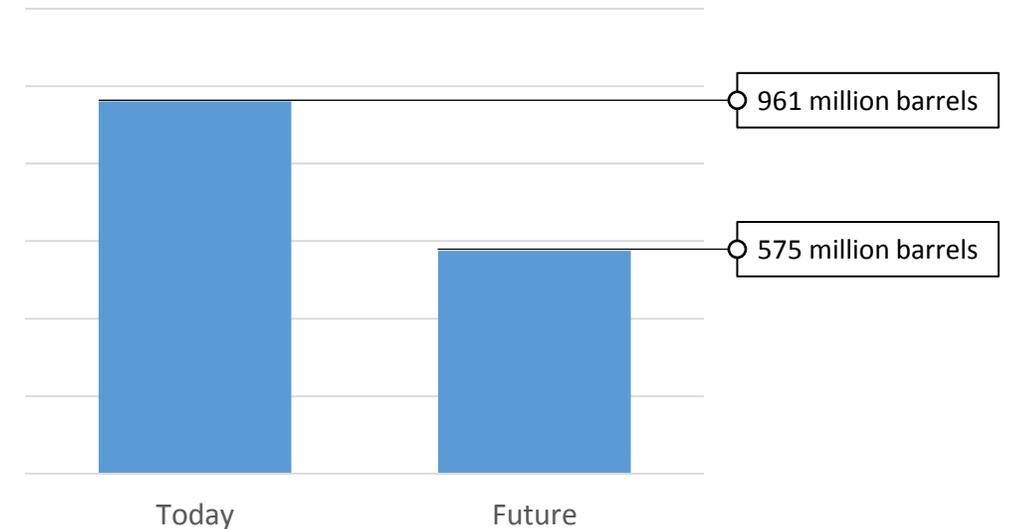
- Decline in demand for transport fuels and EPA mandates will cause many refineries to shut down leaving only the most profitable.
- Export Refineries to stay



Terminals

- Gasoline demand expected to decline from ~135bil gal/yr to ~102 bil gal/yr
- Big Market Players with robust network expected to prosper
- Success of Terminals dependent on
 - Waterborne locations
 - Blending capability with large number of tanks
 - High optionality
 - Turning on average 18x per year

U.S. Terminal Capacity

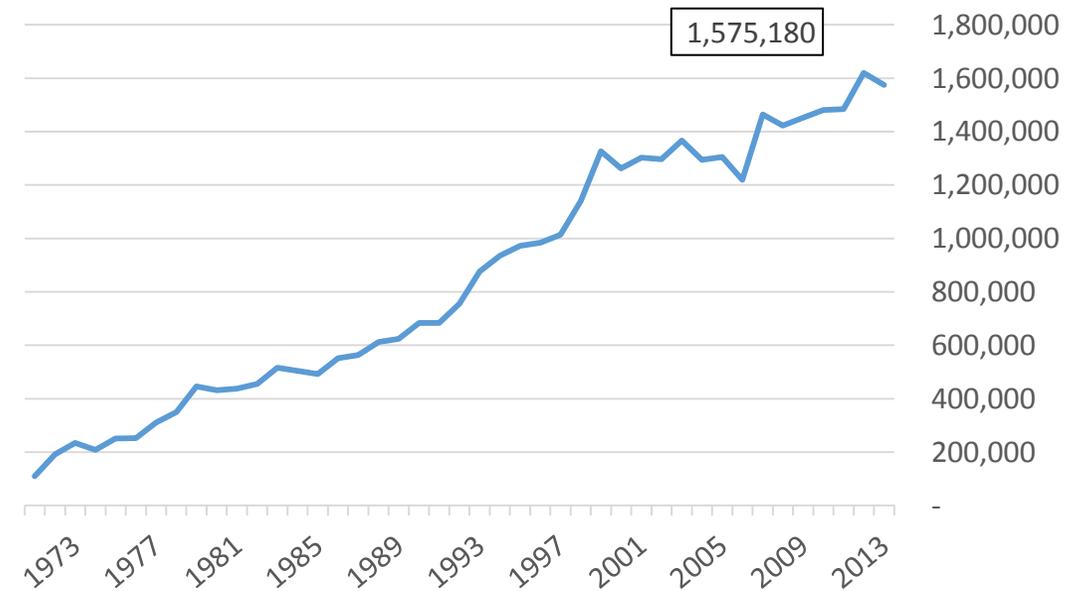


U.S. demand for terminal capacity will decline nearly 40% in 10-15 years.

Retail Sites

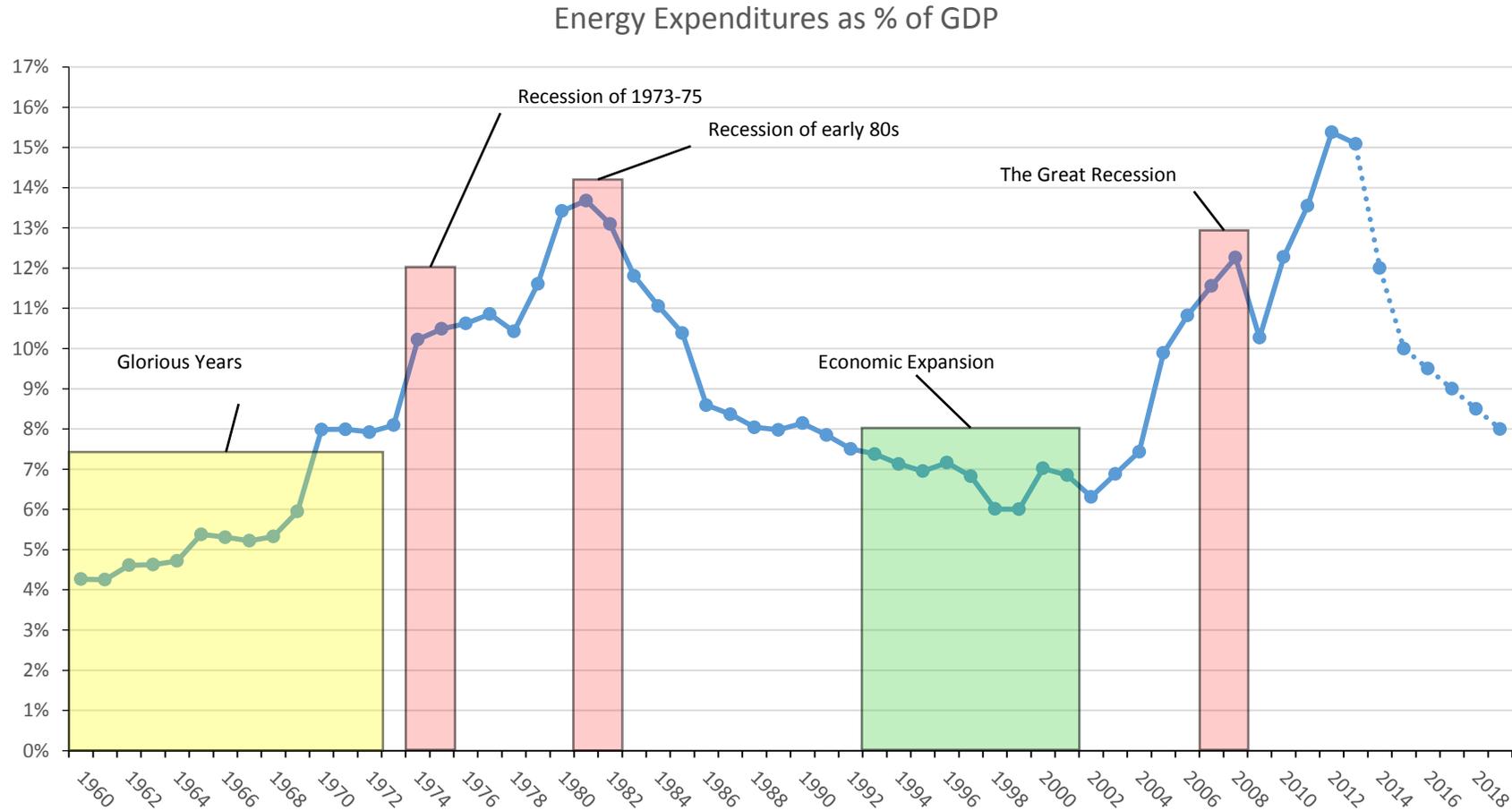
- Total number of sites in decline
- Significant growth in volume per site.
- Average Volume - Convenience Store with fuel (Gal/Yr)
 - 2013: 1,575,000
 - 1973: 110,400
 - Average Growth rate of 7% per year

Average Annual Volume per Convenience Store with Fuel



Source: NACS Fact Book, 2013

Energy Expenditure and GDP



Economics of Hydraulic Fracturing

US fracking uses 500 million gallons of water and 200 million gallons of fracking fluids annually.

Fracking Fluids

Biocide	\$20/gal
Degreaser	\$160/lb
NaOH (Caustic Soda)	\$380/ton
HCl (Hydrochloric Acid)	\$30/liter

Cost per mmbtu

Water Cost per mmbtu	\$0.80
<u>Fluid Cost per mmbtu</u>	<u>\$2.40</u>
Total Cost per mmbtu	\$3.20



Source: U.S. Energy Information Administration based on data from various published studies. Canada and Mexico plays from ARI. Updated: May 9, 2011

Joe Petrowski

Managing Partner | Mercantor Partners

(508) 532-4911 | joe@mercantorpartners.com