Corner Capital | Energy. Capital. Advisory.

Mergers & Acquisitions • Financing & Restructuring • Strategic Advisory & Special Projects

Downstream Energy Capital Markets Update: 1Q 2023

Public US equity markets rebounded 7.5% from 2022's broad sell-off in the first quarter, buoyed by generally positive economic growth and business sentiment since the start of the year. Lower oil prices probably played an important role in the improved business sentiment, along with the reopening of China. However, the geopolitical backdrop remains challenging with no end in sight to the war in Ukraine, combined with renewed US-China tensions. The collapse of Silicon Valley Bank (SVB) in March, which was the second largest bank failure in U.S. history, sent bank shares on a downward spiral and rocked leveraged loan & private financing markets.

Inflation cooled for an 8th consecutive month to 6.0% year-over-year in March, and the labor market proved resilient. Turmoil in the US banking sector, coupled with moderating inflation, led to a smaller-than-expected rate hike from the FOMC last month (25bps vs. the previously expected 50bps). However, inflation is still running ahead of the Fed's target, and we think rates will, overall, remain "higher for longer."

Corner Capital clients, along with many companies in our industry, experienced flat-to-declining fuel volumes, growing inside sales, and fuel margins ahead of long-run averages during the quarter. Diesel margins remained robust, but national gasoline rack-to-retail margins finished the quarter at about 37cpg, down from 2022's average of about 43cpg. Although our clients have continued to enjoy elevated fuel margins, rising cost pressures, including labor and credit card fees, are beginning to take bigger bites out of their bottom-lines.

In this quarter's letter, we discuss many of these factors and their impact on M&A and capital availability in our space. Should you ever want to "talk shop" or "throw the ball around", please do not hesitate to reach out. We look forward to visiting with you as we continue to navigate 2023!

Mergers & Acquisitions: Return of the Downstream "Megadeal"

Across all industries, the value of M&A activity fell 20% from the previous quarter and was halved from Q1 of last year (as seen on the chart to the right).

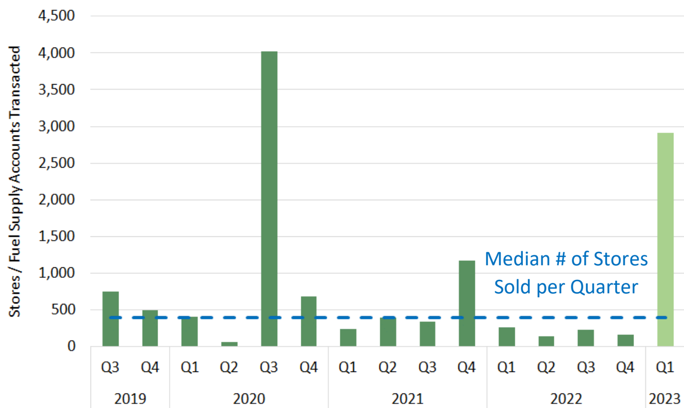
Why? Uncertainty. As Suzanne Kumar, a VP with Bain & Co's M&A practice, stated: "It's less about the level and more about the ability to make an assumption about what interest rates will be."

However, M&A activity in convenience retail and wholesale fuel distribution experienced the exact opposite phenomenon during the first quarter (as can be seen in the two charts below):

M&A values slump across most sectors…

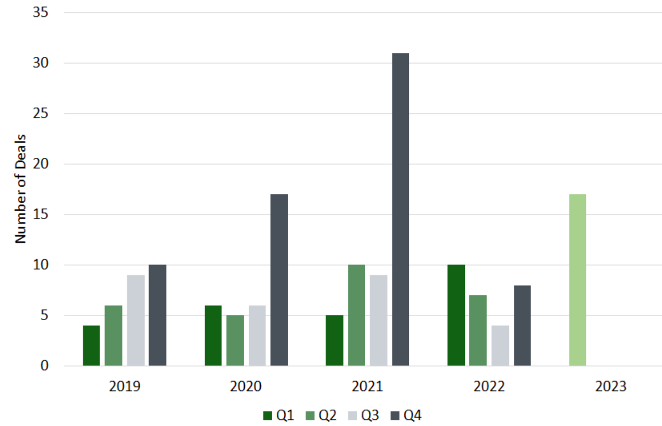
Sources: Dealogic, Axios.

…but M&A activity in our industry surged upwards, measured by number of stores transacted…



Source: Corner Capital Proprietary Transaction Database.

…and by number of deals.



Source: Corner Capital Proprietary Transaction Database.

As indicated by the charts above, our industry saw one of the most active quarters of M&A activity in recent memory. The relative strength in Downstream Energy deal flow compared to other industries can be attributed to a number of factors: **i)** lower cost of debt capital due to industry resilience and a strong base of hard assets/real estate for lending, **ii)** higher synergy potential (buyer-projected synergies averaged 60% of target EBITDA in our industry over the past 10 years versus 10% for all other industries), and **iii)** increased demand for ratable cash flows in times of uncertainty.

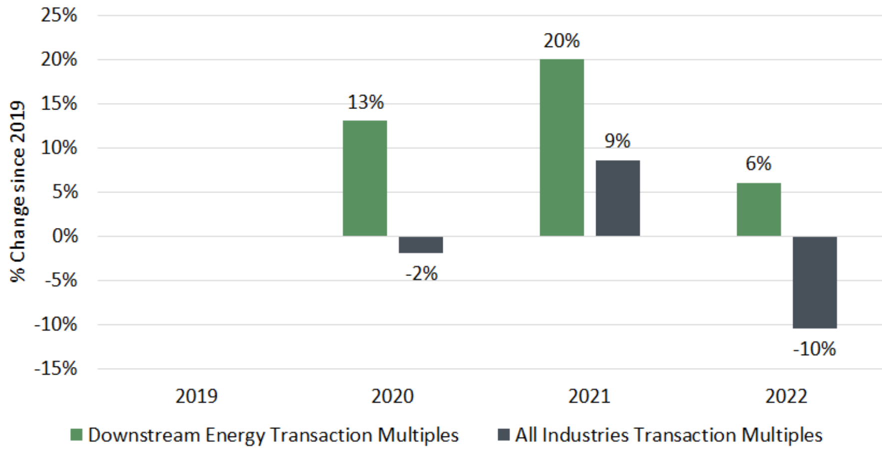
If 2022 can be characterized by the lack of "headline" transactions in our space, then the first quarter of 2023 should be marked by their resurgence. Notably, Alimentation Couche-Tard announced a 2,200-site acquisition from TotalEnergies in Europe, and a 45-store acquisition from Big Red Stores in Arkansas. The company expects EUR 120MM of synergies from top-line growth and merchandise uplift from the TotalEnergies acquisition, and anticipates that Big Red's predominately large-format sites will provide ample space to enhance food programs. After incorporating these acquisitions, Couch-Tard is still below its target leverage ratio of 2.25x, and the company told investors that it still has ~$10Bn of incremental balance sheet capacity.

Major oil continues to reposition, as ExxonMobil and BP both made significant retail acquisitions this quarter. Many of our branded wholesaler clients are concerned about the prospect of competing with their own supplier on the street.

In February, BP announced that it will buy TravelCenters of America for $1.3B, including 280 travel centers (mostly leased) across 44 states. According to BP, the acquisition will provide a platform to support decarbonization efforts, allowing the oil major to offer biogas, EV charging, biofuels, and later hydrogen at TA's locations. The deal will give BP a leveraged short in the volatile U.S. diesel market and help it compete with larger chains such as Love's and Pilot Flying J. We believe BP to be a player in other potential deals as the company seeks to grow its guaranteed network for gasoline and diesel volume.

ExxonMobil entered its first retail joint venture in March by joining Global Partners to purchase 64 Houston-area c-stores from Landmark Group, a Shell JV. Last year, Shell bought out Landmark, it's JV partner, to acquire nearly 200 locations—the 64 sites acquired by the ExxonMobil / Global JV represent the Exxon-branded portion of the original package.

Downstream multiples have held near cyclical peaks, leading Jobbers to ask: "Is now the right time to sell?"



Source: Corner Capital Proprietary Transaction Database, Pitchbook.

Transaction multiples have held up well in our industry, ahead of pre-pandemic 2019 levels by 6%, on average, compared to broader M&A multiples which have fallen 10% below pre-COVID levels (as shown in the chart to the left).

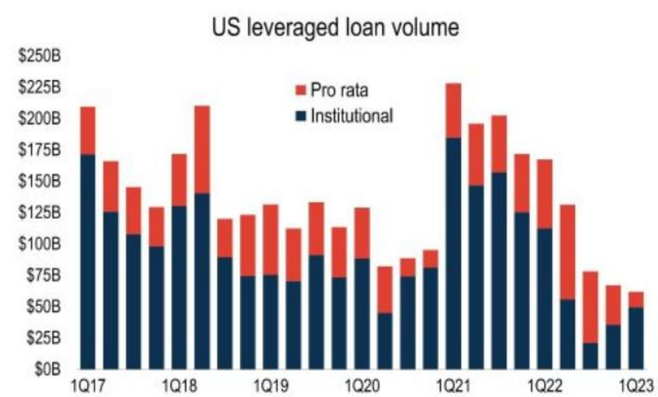
Although many of our clients are enjoying sustained fuel margins near record levels, the cycle can change quickly and without warning. The current rising cost environment favors large, geographically diverserse operators, and major oil's reintegration presents a risk for branded wholesalers. Small-to-midsize distributors should ensure they have ample capital availability to support their growth plans and increase scale, or consider an exit while multiples are still high.

Financing & Capital Availability

New leveraged loan issues in the first quarter saw their lightest quarterly output since 2016, and primary market volume declined nearly 70% year-over-year (as seen in the chart to the left).

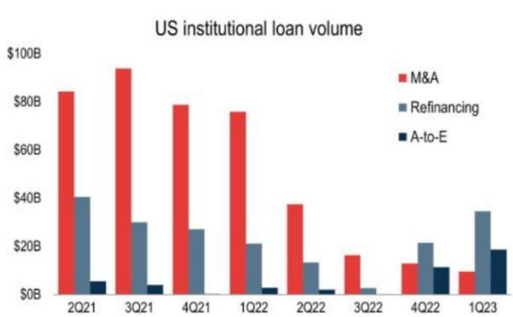
New issue proceeds were predominately used to refinance existing debt this quarter, a sharp contrast to the loan volumes dedicated to M&A in 2021 and the first half of 2022 (lower left chart). With a significant amount of loans maturing in 2024 and 2025 (lower right chart), we expect to see more refinancings across all industries through the remainder of 2023.

Despite a promising start to the new year for leveraged loan issuance, the primary market was derailed by the banking crisis and heightened recession fears.



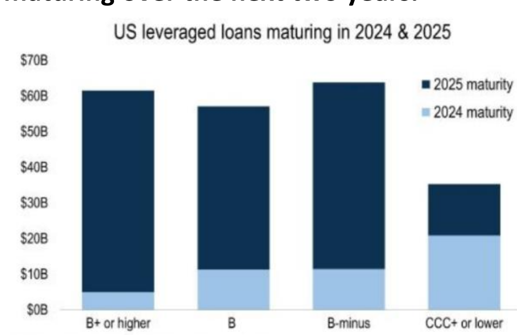
Data through March 23, 2023
Source: PitchBook | LCD

Refinancings dominated leveraged loan activity this quarter…



Data through March 23, 2023
Source: PitchBook | LCD

…which should continue given the value of loans maturing over the next two years.



Data through March 17, 2023. Chart excludes unrated borrowers.
Source: Morningstar LSTA US Leveraged Loan Index; PitchBook | LCD

It is worth adding that our firm has raised more than $100 million of debt capital for our clients over the last several months, with the debt sourced in our most recent recapitalization project priced at less than 6.3% "all-in." You may find this relevant if you have fixed-rate debt with a near-term maturity or are looking to secure "dry powder" for new builds/acquisitions.

The figures above reflect loan trends across all industries, but specialty lenders in the convenience retail & wholesale fuels space have gotten comfortable with our industry's resilience. In the wake of the banking crisis, we are seeing clients move away from riskier local lenders in favor of national, industry-focused banks that typically offer pricing around SOFR + 2.50%, leverage limits of 6.25x, and 75% LTVs on total business enterprise value.

Closing Thoughts

It would be great to check in as you continue to navigate evolving capital markets in 2023. Whether to discuss potential capital solutions, or to talk at a high level about what we are seeing in the market, our team is only a phone call away.

Sincerely,

Investment Banking Team
Corner Capital Advisors

Andy Weber
(805) 895-7280
AWeber@cornercapitalpartners.com

Carl Ray Polk, Jr.
(936) 635-5949
CRPolkjr@cornercapitaladvisors.com

Don Mitchell
(713) 898-6694
DMitchell@cornercapitaladvisors.com

Rob Thomas
(904) 616-6902
RThomas@cornercapitaladvisors.com

Sean Stewart, CFA
(512) 423-0422
SStewart@cornercapitaladvisors.com

Barton Taylor
(832) 723-6908
BTaylor@cornercapitaladvisors.com