

7-Eleven Owner Upgrades: Seven & i Holdings to Purchase Sunoco's Assets for \$3.3bn

Seven & i Holdings Co Ltd. (TYO: 3382) – market cap as of 07/04/2017: ¥4.11tn (\$37.0bn)

Sunoco LP (NYSE: SUN) – market cap as of 07/04/2017: \$3.38bn

Introduction

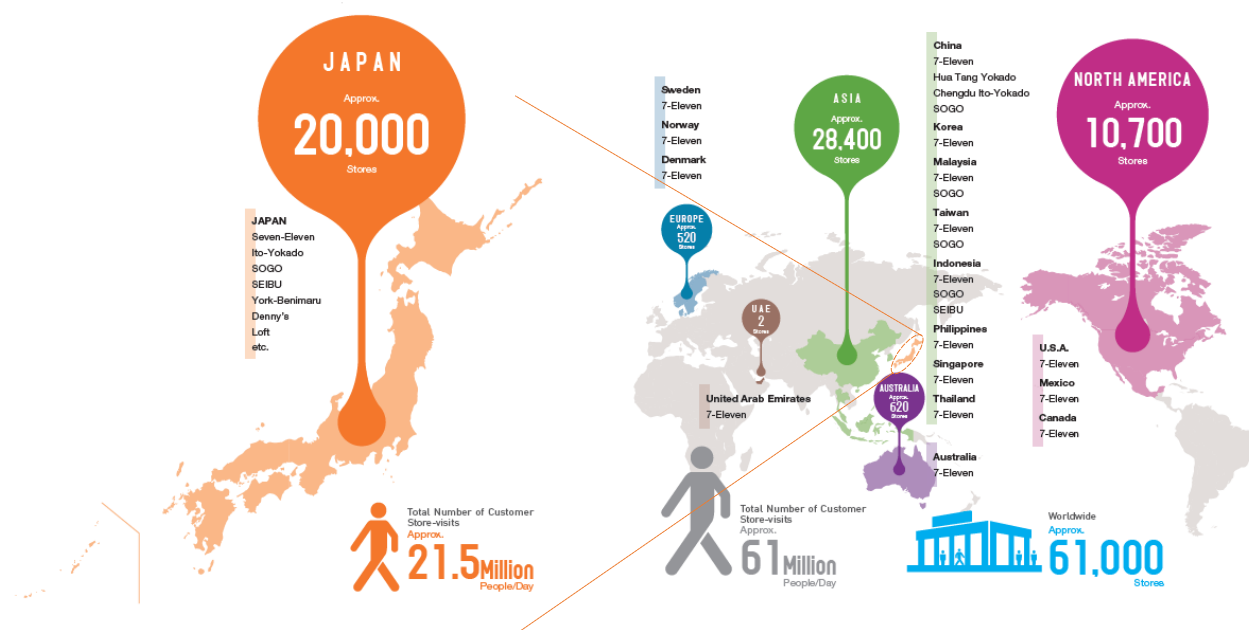
On April 6, 2017, the worldwide Japanese retail-store operator Seven & i Holdings Co. announced that it would acquire more than 1,000 gas stations and convenience stores owned by Sunoco LP in the U.S. for \$3.3bn. The owner of the famous 7-Eleven chain's acquisition of Sunoco was carried out in the light of the large potential which the company identifies in the U.S. market.

About Seven & i Holdings

Seven & i Holdings is a Japanese holding company founded in 2005 and headquartered in Tokyo. The company operates in the convenience stores, supermarket, and restaurant industries with 60,000 outlets spread out in 17 countries. With the acquisition of Sunoco, the company is now expanding its most famous brand, Seven-Eleven, throughout Japan and the US.

The holding's operating profit mainly derives from Convenience Store (86.3%), Superstore (2.1%), Department Store (1.1%), Food Services (0.3%) and Financial Services (14.1%), whereas the company's Mail and Other Services and Corporate divisions contributed negatively to the overall EBIT by 2.4% and 3.0% respectively. The operating profitability of the company is clearly skewed towards the Convenience Store segment and this is further stressed by the breakdown of the projected capital investment plan (as of the FY2016 Annual Report): 7-Eleven Japan and - more importantly for the transaction analysed - 7-Eleven Inc. were respectively budgeted ¥170bn (\$1.53bn) and ¥190bn (\$1.71bn) on investments, out of ¥492.7bn (\$4.44bn) in total capital expenditures.

As of FY2016, Seven-Eleven Japan has aggressively expanded with 1,651 openings and has reached ¥4,291bn (\$38.61bn) in sales (7.1% growth YoY). Seven Eleven Inc., which operates overseas, reported sales for ¥2,950.4bn (\$26.55bn) (4.1% growth YoY).



Company's figures by Geography

About Sunoco

Sunoco Inc. is a Pennsylvania-based company wholly owned by the American gas company Energy Transfer Partners L.P. It markets fuels and goods in 26 different American states and distributes more than \$4.7bn a year worth of goods.

Sunoco stores are divided between the company's operated and independently owned ones and leased ones: the former includes 430 locations whilst the latter accounts for almost 4,000. Additionally, the firm owns more than 650 APlus branded convenience stores.

Sunoco operates in Texas through its subsidiary Stripes LLC. Stripes is currently operating 645 stores in Texas, New Mexico and Oklahoma City and sells more than \$1bn of merchandise yearly, under the brands of Stripes and Sac-N-Pac.

Another significant portion of Sunoco business is represented by fuel and this specific market is targeted by the company via its subsidiary - Sunoco LP. This is a growth-oriented Master Limited Partnership (MLP) distributing motor fuel to convenience stores, independent dealers, commercial customers and distributors.

Sunoco operations in the fuel market do not only target retail and distributors as it also stands as the world's largest manufacturer and marketer of race fuels; Sunoco is also the official fuel provider for NASCAR and a sponsor for Indy Car.

Sunoco and all the other above-mentioned entities are part of a broader conglomerate, this being Energy Transfer Partners L.P (ETP) which owns one of the most diversified portfolios of energy assets in the United States. ETP also owns Sunoco Logistics Partners L.P., which operates a geographically diversified portfolio of crude oil and refined products pipelines.

Industry Overview

Multi-store retail chains in the U.S. are both publicly traded and privately owned, and the retail industry has a significant impact on both U.S. and global economy. The retail industry represents approximately 30% of the U.S. GDP and 31% of the world's GDP.

In 2015, global retail sales achieved \$22.6tn and are expected to grow to \$28tn by 2019. However, the retail industry does not seem to fulfill the rosy expectations that were rising two years ago. Indeed, Wal-Mart Stores, the world's largest U.S. based retail company, seemed to struggle in 2016 as they announced their plans to close 154 stores. Besides, Wal-Mart is not an outlier, as many of the large players in the retail industry closed down their branches. Macy's announced it will close 68 stores, Sears will do the same with 108 stores across the country and many of their peers are expected to follow in the near future. Analysts in the industry believe this is due to the rising popularity of e-commerce.

Despite this rather bleak global outlook, the convenience store and gas station segment of the retail industry seems not to follow the wholesale sector trend at all: 2016 was indeed a record year for convenience stores in the U.S. as they recorded in-store sales of \$233bn.

The main players in the convenience store sector are 7-Eleven Inc., Alimentation Couche-Tard, Speedway, Murphy USA Inc. and Sunoco LP. The top merchandise categories sold in convenience stores include cigarettes, packaged beverages and salty snacks.

Gas stations, which represent the other component of the asset sale, have also been profitable in recent times: gas sales volume in U.S. was indeed up 2.6% in 2016, thanks to the continued economy recovery.

Deal Structure

The \$3.3bn deal will be the second-largest acquisitions by a Japanese company on U.S. soil this year. The transaction comprises 1108 units of mostly convenience stores and some petrol stations which Seven & i will purchase from Sunoco for \$3.3bn paid in cash. The units to be bought are located mostly in Texas and eastern U.S., thus expanding 7-Eleven's presence in the area.

As part of the deal, Sunoco will supply 2.2 billion gallons of fuel annually for 15 years to a unit of the operator of the 7-Eleven convenience stores and these stores will retain the Sunoco brand. Given the nature of the deal – an asset sale including both convenience stores and petrol stations – it is hard to find close comparables to the transaction. However, based on Sunoco's latest financials, the transaction is valued at 38.9x FY2016 EBIT (where the latter has been computed as the share of operating profit generated by 1008 stores out of the 1345 owned by Sunoco in 2016). Despite being a rather approximate measure of the real value of the transaction, the deal seems to be quite expensive if compared to the industry average. The plunge in Seven & i's share price on the date of the announcement seems to support our hypothesis. The transaction is expected to close by August 2017.

Deal rationale

As reported by Seven & i Holdings, the acquisition of Sunoco is in line with the Medium-Term Management Plan announced in 2016 and the main rationale for the deal is to expand business scope and sales.

More specifically, 7-Eleven Inc. is pursuing a strategy to reach \$5,000 daily sales per store and a total number of 10,000 stores by the end of FY2020. Given these objectives, the acquisition of Sunoco's assets is perfectly consistent as the target is a leader in the convenience store market in the U.S. and has top-notch performance in both food & beverage and fuel sectors. Therefore, by acquiring Sunoco's businesses, 7-Eleven will expand its and will take on a significant portion of the Texas market.

The acquisition is also a valuable opportunity for Sunoco as the supply contract signed by 7-Eleven Inc. as part of the deal will allow Sunoco to focus more on its gasoline business (as the convenience store segment will end up in 7-Eleven's hands) and to reduce its debt pile (\$4.5bn as of December 2016).

Market Reaction

As the sale was announced, Sunoco's shares rose by c. 15% to \$27.45, and throughout Thursday the Texas-based company reached a peak at \$29.50, which represented a total 24% increase. On Friday, Sunoco's shares continued their up-trend, and are currently trading at \$29.68.

Seven & I, on the other hand, faced a slump in their share price by 1.8% on the day after the announcement, and thus closed at ¥4,444 (\$40.00). However, on the following day, the Japan-based company's shares went back up, and are currently trading at ¥4,637 (\$41.74).

Advisors

J.P. Morgan Securities LLP acted as Sunoco's exclusive financial advisor.

