From Texas to Tokyo: What Couche-Tard's Pursuit of 7-Eleven Means for the Industry

Introduction

Last month, the Japanese operator of 7-Eleven [XTKS: 3382] rejected a friendly takeover bid from the Canadian retailer Alimentation Couche-Tard [TO: ATD], which controls the Circle K brand. At $14.86 per share, the bid valued the business at $39bn, which would have made this Japan's biggest-ever buyout by a foreign company. Whilst the bid was rejected by a special committee on the grounds that it was undervalued and on concerns that it would raise eyebrows from regulators, it does leave room to speculate on any potential new bids and the renewed interest in M&A activity in Japan, considering the struggling valuations in the public markets. This article will explore the background and history of both companies, the strategic rationale behind Couche-Tard's bid, the potential synergies and challenges that such an acquisition could present, and the implications for the global convenience store market. As we delve into the details of this unfolding corporate battle, it is evident that the outcome could significantly redefine the landscape of retail convenience worldwide.

About 7/11

The 7-Eleven convenience store was founded in Dallas, Texas, in 1927, although the name itself was adopted only two decades later. Executives from its parent company, Southland Corporation, were known as the "7-7-7" for their ability to work from 7 AM to 7 PM, seven days a week. In 1973, Ito-Yokado, the predecessor of Seven & i, signed a licensing agreement with Southland to develop the concept in Japan. After the US parent filed for bankruptcy, Ito-Yokado seized the opportunity to take over the whole group in 1991, during a time when concerns in corporate America about Japanese technological, managerial and financial advantages were at a peak.

Since then, convenience stores, so called *konbini,* have become a major force in Japan's retail landscape, known for their innovation. They offer a variety of products including fresh bento, affordable Cabernet Sauvignon, gelato, clothing, funeral items, cosmetics, metal dinosaur kits and concert tickets. Customers can also pay taxes and manage their banking there. The operations rely on automation, robotics, well-organized supply chains and effective logistics. Nowadays it is hard to imagine life in Japan without these convenience stores. After years of consolidation, Japanese market is now dominated by three major players: 7-Eleven, Family Mart, and Lawson, which collectively operate over 50,000 stores in the country. Nearly half of those are managed by Seven & i, attracting 22m customers daily. Moreover, the group has a global network of almost 85,000 stores, but most of its earnings come from the 21,000 locations in Japan, 13,000 in the US and Canada, and around 600 under its subsidiaries in China. In addition to 7-Eleven, it also operates and franchises other brands, including Stripes, Laredo Taco Company, and Speedway, the petrol station chain it acquired from Marathon Petroleum for $21bn in cash in 2020. This acquisition expanded Seven & i's expansion in the US, following its $3.3bn purchase of parts of Sunoco's convenience store and gas station business in 2017. With the addition of Speedway, Seven & i's share of the US convenience store market rose from 5.9% to 8.5%, further distancing itself from its closest competitor, Canadian retailer Alimentation Couche-Tard. "This allowed us to take a historic step towards becoming a global retailer," said Ryuichi Isaka, chief executive of Seven & i.

About Circle K

It's interesting to note that Circle K was also established in Texas. It started in El Paso where businessman Fred Hervey bought three Kay's Food Stores in 1951. Hervey changed the name of the stores to "Circle K Food Stores, Inc." and progressively grew the business into neighbouring states including Arizona and New Mexico. By 1957, the company had established its headquarters in Phoenix. Due to its early success, Circle K grew quickly, and by 1975 it had 1,000 locations nationwide. However, when financial problems arose in 1990, Circle K had to file for Chapter 11.

Circle K operates a large chain of convenience stores in the United States and abroad, offering customers a variety of food products as well as fuel under both its own Circle K brand name and other various brands like Shell. Circle K operates under several business units mostly through company-owned stores or others under franchise agreements.

As of 2020, Circle K operates 9,799 stores in North America, with 2,697 stores in Europe and additional franchised stores worldwide, totaling over 14,800 locations. Although the U.S. market continues to account for the majority of the company's income, Circle K's worldwide footprint has expanded dramatically under Couche-Tard's direction. In terms of financial health, Circle K's profit margin (profit/loss before financial income and expenses in percent of revenue) in the 2022/23 fiscal year stood at 3%, down from 4% the previous year, with an EBITDA of DKK 761m. The return on equity was a robust 14%, while its solvency ratio improved to 50%, reflecting a strong balance sheet.

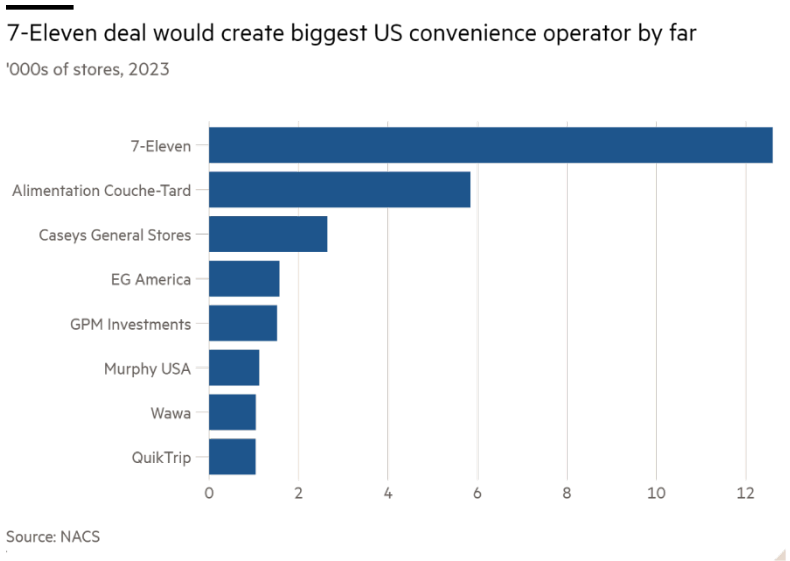
Circle K's ownership journey is marked by several key transactions. After its acquisition by Tosco Corporation in 1996, Circle K changed hands again when Phillips Petroleum acquired Tosco in 2001. Following the merger of Phillips with Conoco in 2002, ConocoPhillips briefly owned Circle K before it was acquired by Alimentation Couche- Tard in 2003.

Couche- Tard then continued to aggressively pursue acquisitions to further strengthen Circle K's market position. In 2014, the acquisition of *The Pantry* added over 1,500 stores across the U.S. to Circle K's portfolio, while the 2016 acquisition of *Topaz* expanded its presence in Ireland. More recently, there has been speculation surrounding a potential acquisition of *EG Group*, a U.K.-based fuel and convenience retail operator, indicating the company's continued expansion strategy.

Deal Rationale & Structure

Couche-Tard's proposal to buy in cash all shares outstanding in Seven & i came became public on August 19, lacking specific details at the time. Following the announcement, Seven & i's shares rose by 22%, increasing the market capitalization of the firm from $31bn to $39.2bn as investors speculated on the premium Couche-Tard would need to offer to execute such a significant deal in Japan. However, on September 5, Couche-Tard came with a lower-than-expected offer of $14.86 per share in cash, resulting in a $39bn bid, which was immediately rejected by Seven & i, whose enterprise value at the moment was around ¥8.6tn, or close to $60bn, including ¥3tn of net debt and minority interest. In a letter to Couche-Tard, the board of Seven & i stated that the offer "grossly undervalues" the Japanese group and does not reflect regulatory risks associated with the transaction.

The deal would be extremely beneficial for Couche-Tard, as it would create a global leader in the convenience store sector with over 100,000 stores across Asia, North America, Australia, and Europe. Seven & i is particularly attractive to foreign investors because about 75% of group revenues come from outside Japan, although it has more 7-Eleven stores than any other country. In the US, where most overseas sales come from, a deal would create the country's biggest convenience store operator with over 14,000 locations in the country, many of which sell petrol. Couche-Tard's gross profit margin for road transport fuel in the US was 45% per gallon for the fiscal year ended in April 2024, while average retail gasoline prices were around $3.60 per gallon. Thus, this deal could potentially create a huge additional stream of revenues to Couche-Tard, however, US administration and the FTC are likely to challenge this move and require selling some stores, especially given the administration's strong focus on gasoline prices. JPMorgan analysts estimate that a merged entity would capture a 12.5% market share in the US, even if 10% of the stores were sold to address competition issues. This would put Couche-Tard in a dominant position, with 7 times the number of stores as its nearest competitor, Casey's. Thus, many analysts believe that Couche-Tard has been pursuing Seven & i for several years, making multiple attempts to negotiate a friendly agreement, in order to realize this potential and reduce the risk of 7-Eleven becoming even more powerful in the US. "Ultimately, this could be a defensive strategy, because if Seven & i applies the logistics prowess and relentless product development schedules of its Japan business to the US, then it will hammer competitors, like Couche-Tard", said Michael Causton, co-founder of retail research agency JapanConsuming.



Source: Financial Times

Couche-Tard's interest in acquiring a stake reflects the broader experience of Western investors in Japan. For the past two decades, the company has periodically pursued Seven & i but has faced several obstacles, including a natural resistance among Japanese companies to being acquired, the historic absence of governance pressure on them to prioritize shareholder interests, and the prevalence of defense mechanisms. However, the company has become more approachable because of the influence of two activist investors, who launched vocal campaigns encouraging management to improve returns. This shift has been supported by the M&A guidelines introduced last year by the Ministry of Economics, Trade and Industry (Meti), which effectively require Japanese companies to consider bona fide (fair) takeover offers seriously rather than simply ignoring them.

However, a combination of Couche-Tard and Seven & i would risk raising the prices of beverages and food items as well as limiting the choice of jobs and employers in certain markets where the two companies compete directly with one another. Moreover, there is a lot of concern around how the Canadian group would manage a traditional Japanese business as, while Seven & i is known for providing superior customer experience, Couche-Tard has been historically more focused on increasing the margins. Here an important question arises whether the Canadian retailer would be able to receive high profits without deterioration of the customer experience.

Seven & i said the bid was "opportunistically timed and grossly undervalues" the business. Indeed, while the yen has likely reached its lowest point and is expected to appreciate, governance and stewardship codes have become stricter, and activist investors are now a significant part of the story. Moreover, Senen & i's share price is struggling with stocks being traded at an enterprise value of only 0.7x projected sales. The group has long struggled with a heavy conglomerate structure, with operations spanning financial services, hotel and restaurant management, underground parking, and other often unrelated ventures that have generated mixed returns and have seemed ready for divestment. Last year, activist investor ValueAct Capital called for changes in the company's management and the spin-off of underperforming businesses. Yet, like many other Japanese companies, its domestic market strength and operational expertise have not led to significant returns for shareholders.

Another activist campaign led by Dan Loeb's Third Point hedge fund resulted in the removal of chair and CEO Toshifumi Suzuki, with Ryuichi Isaka stepping in as the new CEO. In recent years, Isaka has restructured the company's board, appointed a progressive international chair, and divested some non-core assets while committing to accelerate international growth. However, some investors argue that these changes have not been sufficient. Furthermore, Alicia Ogawa, an expert in Japanese governance reform, notes that many of the new non-executive directors are not genuinely independent, having come from suppliers or companies with deep ties to Seven & i. Despite a rise in share price since Couche-Tard's offer became public, the company's stock performance has still lagged behind Japan's benchmark TOPIX so far this year and over the past five years.

Finally, since Isaka's appointment, Seven & i has deployed $25bn in acquisitions, but its market capitalization has done nothing in yen terms, and even less in dollar terms, because of the negative shareholder returns over the period. While the total shareholder return for Couche-Tard over the same period was 191% after deploying $12bn of capital. That difference in performance has created a gap in market capitalization and valuation between Couche-Tard and Seven & i: the former has a market capitalization 1.5 times larger than the latter with about 20% of the number of stores. That, along with the changing M&A guidelines and the company's need to start prioritizing the shareholders' interest, has opened a rare opportunity for the Canadian group.

Takeover Battle

The ongoing takeover battle between Canada's Alimentation Couche-Tard [TO:ATD], the owner of Circle K, and Japan's Seven & i Holdings, the operator of the 7-Eleven chains, while seeming to remain friendly for now, could be on the road to a more aggressive approach by Couche- Tard in the future. Despite the initial rejection of Couche-Tard's $39 bn bid, both parties have indicated a willingness to engage in further discussions, suggesting that the deal is not entirely off the table.

Seven & i Holdings turned down the offer of $14.86 per share in cash that valued the company at $38 bn, calling it "opportunistically timed." The company's board argued that the proposal failed to reflect 7-Eleven's true value and the complexities surrounding regulatory risks in the U.S. market. However, the Japanese firm remains open to considering a more suitable offer, stating it would be willing to have "sincere discussions" should a proposal fully address these concerns.

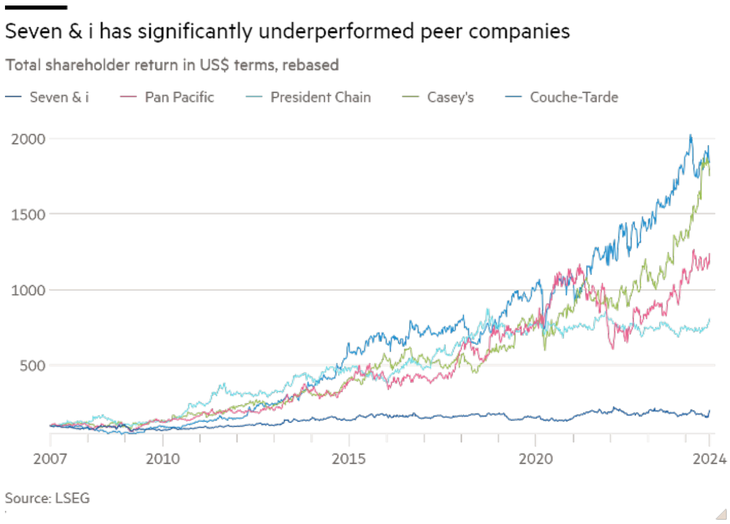
A key factor behind the rejection was the belief that Couche-Tard's bid severely undervalued Seven & i's business. The offer of $14.86 per share in cash was deemed insufficient by a special committee set up by Seven & i to evaluate the proposal. The board also emphasized the pivotal role 7-Eleven stores play in Japan's infrastructure, particularly in times of natural disasters, further justifying its high valuation.

Couche- Tard has downplayed these issues, suggesting that any antitrust concerns could be managed by divesting certain sites. Still, these concerns remain a crucial point for Seven & i's board. Couche- Tard also committed to "continuing to serve" an important role in Japan's emergency response.

In anticipation of a prolonged takeover battle, Seven & i has enlisted Japan's largest investment bank, Nomura, to advise its board. The bank is expected to help navigate the complexities of the offer and assess its potential impact on the company's shareholders.

While the takeover remains friendly for now, speculations are arising about the possibility of a more aggressive approach by Couche-Tard [TO:ATD]. If discussions fail to progress, the Canadian company could potentially pursue a hostile takeover, bypassing the board and appealing directly to Seven & i shareholders. This possibility keeps the deal in play, even as both sides position themselves for what could be an extended negotiation process.

For now, Seven & i has left the door open for future talks, but only if Couche- Tard returns with an improved offer that fully accounts for the regulatory risks and the intrinsic value of the Japanese convenience store giant. The next few months will determine whether the friendly nature of the current bid will remain or escalate into a more contentious takeover battle.



Source: Financial Times

Conclusion

The attempted acquisition of Seven & i Holdings by Alimentation Couche-Tard has brought to light the complexities and challenges of global expansion in the convenience store industry. While the initial offer was rejected, the willingness of both parties to continue discussions suggests that the story is far from over. This potential merger represents more than just a strategic business opportunity; it is a clash of different corporate cultures, market dynamics, and regulatory landscapes. Should the deal eventually go through, it could create a formidable global player, reshaping the convenience retail sector across multiple continents. However, the outcome remains uncertain, hinging on regulatory approvals, potential counteroffers, interloping buyers and the ability of both companies to navigate the evolving demands of shareholders and consumers alike. As the situation unfolds, this case will undoubtedly serve as a defining moment for the convenience store industry, signalling whether consolidation or competition will drive the future of this global industry.

TAGS: Japan, Retail, 7-Eleven, Circle K, Takeover

