THE PANTRY, INC: A CASE STUDY

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This case examines the Convenience Store industry, with specific emphasis on The Pantry, a leading independent operator. The Pantry has been experiencing profit losses recently, after a change in leadership and in strategy, from growth-by-acquisition to a focus on same store sales improvements. The purpose of this case is to provide information to aid students in identifying major issues within a company and formulating solutions to the issues presented by primarily examining the areas of Business Level Strategy and External Environment. Strategy Implementation is a secondary use for this case as well.

INTRODUCTION

It was February of 2011 and Pantry CEO Terrence "Terry" Marks had just concluded another quarterly earnings call in which he was forced to defend the company's dismal financial results. Marks was hired as CEO in late 2009, after longtime Pantry leader Peter Sodini announced his retirement in August of that same year, but had yet to deliver positive returns for the company's shareholders. Under Sodini's leadership, The Pantry had been transformed from a modest consortium of convenience and gas outlets into a regional powerhouse of more than 1600 company-operated convenience stores, quick-service restaurants, and travel centers. Sodini's impressive record was anchored by a growth-via-acquisition approach, which emphasized portfolio management over more traditional retailer competencies, such as price or shopping experience. Given the convenience industry's high degree of fragmentation, Sodini's appetite for acquisitions proved fertile, but the economic downturn of 2008 and 2009 eventually exposed some of the company's underlying weaknesses. A majority of The Pantry's margin contribution was being derived from the sale of tobacco and refined petroleum—two categories with a history of contracting demand, wholesale pricing volatility, and a host of regulatory encumbrances. Likewise, the company's retail portfolio lacked a consistent brand identity, further impeding its ability to become a primary destination for key user groups.

As a former Coca-Cola marketing executive, Marks understood the value of brand loyalty as well as the untapped potential of the food service product category, which could prove to be a profitable point of distinction in a crowded and increasingly competitive marketplace. In his first address as CEO, Marks vowed to slow the growth of acquisitions, consolidate brands, and deliver growth through improved same-store sales; but, after losses of $165 million in his first year, the company's first quarter of 2011 loss of more than $12 million did little to assuage investor angst. With losses mounting, and the competitive and regulatory environment likely to intensify, Marks and his team needed to reconcile their plan for growth against the harsh realities of the new marketplace. Was organic, same-store sales growth truly the way forward? Or, would the company be better served to embrace its legacy as an industry consolidator, focusing instead on delivering growth through acquisitions and proficient portfolio management?

INDUSTRY OVERVIEW

Featuring some 144,000 domestic retail outlets and accounting for more than $625 billion in annual retail sales, the convenience store industry represents a significant share of the American retail landscape. In terms of total store count, the industry's 144,000 outlet footprint outnumbers all other major retail channels, *combined* (Industry Resources, 2011b). Like other popular retail formats, convenience and gas facilities come in a variety of configurations, locations, and sizes. In general, this includes smaller format retail stores, "between 400 and 3,000 square feet, featuring a mix of between 500 and 1,500 SKUs [stock keeping unit] that operate at least 13 hours a day and carry a limited selection of grocery items, including at least two of the following: toilet paper, soap, disposable diapers, pet foods, breakfast cereal, toothpaste, ketchup and canned goods" (Longo, 2009, p.30). In addition to basic consumables, "convenience stores sell the majority of gasoline purchased in the country—more than 80% of all fuel sold in the United States" (Industry Resources, 2011a, para. 1). Table 1 presents a glossary of terms that appear throughout this case.

MIX AND PROFITABILITY

While operators tend to highlight the convenience factor of their particular store(s), they also compete on the basis of catering to consumer needs, tastes, and preferences (Convenience Stores in the US, 2010). Stores generally offer the same basic product categories, but specific products and sub-categories can vary greatly by location, market, or region. The tobacco category, which includes cigarettes, cigars, moist snuff, and chewing tobacco, represents the largest share of in-store sales (30%), followed by non-alcoholic beverages (20%), and beer and wine (16%). Although cigarette consumption in the U.S. has declined over the past several years, the industry still relies on tobacco sales and gross profits (Convenience Stores in the US, 2010).

Accounting for more than 80% of the petroleum sold at retail, convenience stores remain synonymous with gasoline. "In 2010, sales of automotive fuels are expected to account for about 71% of the total sales of gas stations with convenience stores—little changed from their share in 2005. Gasoline retailing is a high volume, low margin business and accordingly its contribution to industry profit does not match its importance in revenue" (Gas Stations with Convenience Stores in the US, 2010, p.11). In fact, according to the National Association of Convenience Stores (NACS), more than 60% of gross industry profits are realized from the sale of higher-margin food, beverage, and tobacco items (Industry Resources, 2011b).

INDUSTRY STRUCTURE

The convenience store industry is both saturated and highly fragmented, with more than 60% of outlets currently operated by single-site proprietors (Halkias, 2010). Recently, the trend among petroleum refiners, such as ExxonMobil and Royal Dutch Shell, has been to reduce direct exposure to retail by divesting company-owned stores and real estate. By exiting retail, petroleum producers eliminate traditional brick-and-mortar impediments, such as human resources, inventory, and litigation. Since 2005, Royal Dutch Shell has transitioned hundreds of facilities to regional or individual wholesalers. As of 2010, Shell retained fewer than 1,000 company-owned properties in its network (Lofstock, 2008). Despite the recent exodus by major petroleum marketers—as well as significant consolidation efforts by a number of larger operators—the industry remains attractive to entrepreneurs of all sizes. "The low-level differentiation of products retailed in this industry and minimal customer loyalty are conducive to the entry of new players. Moreover, costs are not prohibitive for smaller players and the industry is not highly labor-intensive" (Convenience Stores in the US, 2010, p.27). Fragmentation remains a considerable by-product of the industry's minimal entrance barriers, but the ease with which new operators enter and exit the market has not precluded larger operators from advancing scale and market share. In 2009, the industry's top 10 independent firms accounted for more than 20% of industry revenues, but occupied less than 10% of the total U.S. store population (Longo, 2009). Table 2 depicts the top 10 convenience store chains in terms of total store count (Longo, 2010).

COMPETITIVE LANDSCAPE

The convenience store industry is marked by high levels of fragmentation and saturation, making competition for consumer dollars intense. In some cases, competition transcends traditional retail channel boundaries. "It's a fragmented [channel]," notes Alain Bouchard, CEO of Canadian-based Alimentation-Couche-Tard. "Even when you have good positioning in a market, there are always a large number of competitors, including those from other channels" (Abcede, 2010, p.37). For example, some competing retail formats, such as club and mass-merchandise stores, have begun to challenge the convenience store industry's grip on retail gasoline sales. These non-traditional retailers now garner a sizeable share of the gasoline market, and their share is expected to increase (The Pantry, 2009).

In addition to competitive pressures, convenience store operators shoulder a significant regulatory burden. Since taxes on tobacco and alcohol remain popular revenue sources for both state and federal legislators, these additional costs are typically passed on to consumers in the form of higher prices. Most recently, the U.S. congress legislated a federal expansion of the State Children's Health Insurance Fund (SCHIP); lawmakers financed this program with a new $10 per carton increase in federal excise taxes (Briant, 2009). Empirical data suggests a 10% price increase in tobacco retails can result in as much as a 4% decline in net consumption—in most cases, these declines are over and above normal, annual attrition rates for tobacco users, which have averaged between 1% and 4% annually (Koch, 2009). Additionally, convenience stores that market retail gasoline are subject to costly petroleum storage and containment requirements, which add significant fixed operating costs to a store's business. The underground storage of petroleum poses additional long-term risk to operators, who must hedge against future financial liabilities incurred as a result of potential tank breaches and/or underground spills. Adding insult to injury, gross margins generated from the sale of gasoline are often diluted by interchange fees paid to issuers of credit and debit cards, collectively referred to as the payment card industry (PCI). Whereas fuel retailers earn petroleum margins on a per-gallon basis, credit card issuers exact exchange fees based on a fixed transaction percentage. Thus, as the average retail price of a gallon of fuel rises, the margin percentage earned by the retailer decreases (Industry Resources, 2011a).

INDUSTRY LEADERS

Although multi-store operators account for a relatively small percentage of the total convenience store industry footprint, there a handful of sizable, established institutions of both the regional and international variety. The Pantry (PTRY, NASDAQ Exchange), Alimentation Couche-Tard (ATD.B, Toronto Exchange), and Casey's General Stores (CASY, NASDAQ Exchange) are three of the largest publicly traded convenience store operators in the United States, while industry leader 7-Eleven is currently owned by a private Japanese equity group.

7-ELEVEN

With an 18.9% share of the U.S. market, industry giant 7-Eleven is currently the largest and most well-known convenience store operator (Convenience Stores in the US, 2010). 7-Eleven is owned by Seven-and-I Holdings, a private Japanese equity group, and a majority of its worldwide locations are franchised to independent proprietors (7-11, 2011). For many years, 7-Eleven was a publicly traded retailer focused on traditional, corporate operation. More recently, the company's private ownership group has transformed it into one of the world's leading franchise concepts. In 2011, Entrepreneur Magazine named 7-Eleven the fourth-best franchise opportunity in North America—just one slot below McDonald's, and five spots ahead of Subway Restaurants (Entrepreneur, 2011). To capitalize on its increased popularity, 7-Eleven executives have pursued a variety of store growth strategies, including acquisitions and consolidations, new store development, and conversions of existing convenience outlets (Industry Resources, 2011b).

ALIMENTATION COUCHE-TARD

With 6,000 company-operated convenience facilities, including more than 4,600 that dispense motor fuel, Alimentation Couche-Tard (ACT) ranks as the second-largest independent convenience store operator in North America. Since 2000, the company has completed dozens of major acquisitions, including the 2004 acquisition of Circle K Stores. In the U.S., ACT stores trade primarily under the Circle K banner but the company also maintains a host of related international brands and affiliated quick-service restaurant franchises (Alimentation Couche-Tard, 2011).

In addition to extensive consolidation activity, Couche-Tard is regarded for its unique, decentralized operating structure, which includes 11 geographic divisions and a worldwide franchise and licensing arm. With operating authority ceded to regional business units, ACT believes the decentralized model enables it to minimize operating expenses, streamline the decision-making process, and quickly cater to unique, market-specific needs. The decentralized approach, according to ACT, creates a competitive advantage over rivals. "Comparative information in the C-store industry is notoriously hard to obtain but we have the equivalent of 11 separate companies in disparate geographies, totally open to our scrutiny" (Alimentation Couche-Tard, 2009, p.2). Table 3 outlines core measurements of Couche-Tard historical performance.

CASEY'S GENERAL STORES

Casey's General Stores operates more than 1,500 convenience outlets across nine Midwestern states, including Illinois, Missouri, and Iowa, home of the company's corporate office. Unlike Couche-Tard, Casey's leadership team favors a traditional corporate structure, with most decisions and strategic directives coming at the behest of the home office. Casey's stores feature a standard selection of convenience items, including tobacco, beverages, snacks, and store-brand gasoline (Casey's, 2010a). As of 2010, more than 60% of all Casey's stores were located in areas with populations of fewer than 5,000 persons, while only 13% of its stores were located in communities with populations exceeding 20,000 persons (Casey's General Stores, 2011a). By locating stores in small, rural communities, the company believes it can mitigate conventional competitive pressures from larger, national retailers (Casey's General Stores, 2011b). Additionally, the high-concentration of outlets has enabled Casey's to perpetuate a self-distribution network, giving it a distinct operating advantage over rivals (Casey's, 2010).

Casey's is perhaps best known for its proprietary food service programs. For nearly 30 years, the company has been refining and augmenting its approach to food and today more than 97% of Casey's stores feature one-or-more prepared food offerings, including made-from-scratch pizza, fresh doughnuts, and sandwiches (Casey's, 2010). Casey's boasts a net profit margin nearly two times the industry average—thanks in no small part to the returns generated from food service. Table 4 outlines core measurements of Casey's historic performance. Tables 5 and 6 outline performance measurements of other competitors, Tesco and Susser, respectively.

Casey's strong financial results, coupled with its distribution and food service prowess, have made it a prominent target of larger, acquisition-hungry operators. In April of 2010, Couche-Tard commenced a $2 billion hostile takeover attempt and shortly thereafter, industry leader 7-11 joined with a competing bid to purchase all of Casey's outstanding stock. Ultimately, Casey's board staved off the takeover attempts but the company remains a compelling acquisition target, nonetheless (Ho, 2010).

CORPORATE HISTORY: THE PANTRY

With more than 1,600 outlets across 13 eastern states in the U.S., The Pantry is one the nation's largest independent convenience store operators (unaffiliated with a petroleum supplier) and *the* largest in the Southeast (The Pantry, 2010). Since 1996, the company has executed more than 90 single and multi-site acquisitions, bringing its total store count from 379 to approximately 1,670 (The Pantry, 2010). Having successfully tucked dozens of smaller, regional chains into its multi-state network, the company's portfolio of retail brands remains multi-faceted. Whereas 90% of the firm's locations operate under either the 'Kangaroo Express' or 'Kangaroo' banners, remaining stores are fashioned with one of several unrelated namesakes, including 'Pantry', 'Golden Gallon', 'Lil' Champ', and 'Petro Express' (The Pantry, 2010).

LEADERSHIP AND CULTURE

The Pantry is led by Terry Marks, an external marketing executive hired to replace outgoing CEO Peter Sodini, who retired in the fall of 2009. Marks' pedigree is primarily in marketing and food service, and prior to joining the Pantry, he served Coca-Cola Enterprises in a variety of marketing and sales capacities. Upon arrival, Marks proceeded to restructure the company's senior leadership team, nominating several former Coca-Cola executives to strategic positions. He also recruited several key executives from related retail disciplines, including Vice Presidents from Advance Auto Parts and Borders Booksellers (Oller, 2011).

The Pantry maintains a traditional top-down hierarchy, including a centralized corporate office and support center. For purposes of structure and operational reporting, it clusters large concentrations of stores into distinct operating units. These divisions are led by Vice Presidents who retain responsibility for store operations in specific geographies. This system is essentially a hybrid of two other major convenience operators—Alimentation Couche-Tard, and Casey's General Stores. Couche-Tard operates completely autonomous, decentralized companies, while Casey's strictly conforms to the more traditional, top-down management approach.

FINANCIALS

For its fiscal year ending 2010, The Pantry recorded a net operating loss of $165 million on total retail sales of $7.2 billion (Yahoo! Finance, 2010). The loss, which erased the profits earned during the previous four operating years, was driven primarily by impairment charges, including the write down of goodwill and real estate holdings, as well as the settlement of class-action litigation. Despite a 5.6% increase in same-store merchandise sales, net cash flow from operations fell to $154.8 million, down from $169 million in 2009. Conversely, same-store gallon sales declined for the third consecutive year, while total fuel revenues increased by more than 16%, reflecting a $0.40 increase in average retail fuel prices. Fuel gross profit for fiscal 2010 decreased $46 million, finishing at an average of $0.129 cents per gallon sold, down from $0.149 cents per gallon sold in fiscal 2009. Thus, the net decline in fuel margin contribution was a function of both decreased gallon sales, and diminished per-gallon gross profit. Exhibits 1 and 2 display The Pantry's financial statements.

Shares of Pantry stock trade publicly on the NASDAQ exchange under ticker symbol PTRY. Since 2006, the stock has been especially volatile, trading between a high of $65 in the spring of that year, to a low of around $10 in the summer of 2008 (The Pantry, 2011b). With approximately 22 million shares outstanding, and a current price of $15.55, The Pantry's market capitalization is approximately $354 million (Yahoo! Finance, 2011). For purposes of benchmark, convenience store operators are often grouped in the grocery retail sector. Table 7 denotes Pantry's market capitalization, P/E ratio, and other key operating metrics, relative to these competitors.

To facilitate growth, The Pantry has historically relied on a sale-leaseback financing model, which involves packaging one or more assets, selling them to a finance company, and then securing fixed, long-term leases to remain in the facilities. In lieu of non-cash depreciation expenditures, convenience operators often exchange these long-term lease commitments for stronger near-term cash and liquidity positions. As of 2010, The Pantry owned the real property at 394 of its locations, but maintained leases on the remaining 1,200+. By retaining a limited equity position in the majority of its underlying assets, The Pantry carries long term debt commitments of more than $1.2 billion, including the aforementioned lease obligations (The Pantry, 2010). The Pantry's 2009 annual report describes the company's approach to sale-leaseback financing: "When appropriate, we have chosen to sell and then lease back properties. Factors leading to this decision include alternative desires for use of cash, beneficial taxation, minimization of the risks associated with owning the property and the economic terms of such lease finance transactions" (The Pantry, 2009).

MARKETING MIX

The Pantry's network of convenience stores and travel centers offers a standard assortment of beverages, food products, tobacco, general merchandise and motor fuel. Most stores are open 24 hours per day, seven days per week, and are typically located on highly traveled roads, both in and around city centers. Revenues are derived primarily from three product categories: motor fuels, merchandise, and services. In fiscal 2010, gasoline sales accounted for more than 75% of the company's gross revenues and about 30% of its gross margin contribution. Gasoline retails are highly volatile, meaning The Pantry's aggregate revenues can rise and fall in concert with general market fluctuations. As of 2010, more than 95% of Pantry locations dispensed motor fuel, while 67% of those assets retained one of several co-branded partnerships, including Marathon, Texaco, Shell, Citgo, Chevron and ExxonMobil. The remaining 25% of gross revenues are attributable to in-store merchandise sales and services (ATM's, Lottery, etc.), which produce more than 70% of the company's operating margin (The Pantry, 2010).

With respect to merchandise, tobacco and related sub-categories contribute nearly 40% of Pantry's in-store revenues—up from 34% in fiscal 2009, and just over 31% in fiscal 2008. Although cigarette taxes are generally lower in the southern United States, a portion of this increase can be attributed to the $10-per-carton increase in federal tobacco taxes, levied by Congress in calendar 2009. Since 2007, profits generated from tobacco sales have accounted for an average of 12.7% of The

Pantry's total gross margin (The Pantry, 2010). Table 8 prescribes Pantry's merchandise sales mix, by category, for the previous five operating years.

In recent years, Pantry marketers have established a host of private-label merchandise offerings aimed at combating pricing influences of key suppliers. The company's private label portfolio includes Celeste brand water, soft drinks, sports and energy drinks, Kangaroo brand motor oil, batteries, and lighters, and Cowboy brand beef jerky. (Pierce, 2010). In addition to traditional convenience store product categories, The Pantry is also heavily vested in branded food service operations. As of 2010, the company operated 240 quick service restaurants under well-known brands such as Subway, Quizno's, Hardee's, Krystal, Church's, Dairy Queen, Baskin-Robbins, and Bojangles, as well as a number of branded, proprietary food concepts, including Grill Depot and Hot-to-Go (The Pantry, 2010).

Convenience store facilities are often less than 3,000 square feet, making shelf and merchandising space inherently more valuable than in related trade channels. At an average of 2,800 square feet per store, Pantry assets are comparable to the remaining market, but the absence of a shared heritage means store layouts, designs, and equipment packages vary greatly by location (The Pantry, 2010). As of September 2010, approximately 34% of the company's stores were located in coastal and resort areas, such as Jacksonville, Orlando, Myrtle Beach, Charleston, St. Augustine, Hilton Head, and Biloxi, while approximately 30% of its stores were situated along major interstates and thoroughfares, which afford high traffic and customer counts (The Pantry, 2011a). Recently, The Pantry has made a concerted effort to shed underperforming assets, and many of the associated closures have occurred in Florida—a market prone to cyclical changes in new home construction, tourism, and population. Nevertheless, with a 1600 store portfolio concentrated entirely in the Southeastern U.S., The Pantry's market penetration is unmatched by rivals in the region. Table 9 outlines the distribution of Pantry locations, by state.

In the U.S., self-distribution remains a core competency of grocers and other large format retailers. For the convenience industry, self-distribution is the exception, with most operators relying on wholesalers and third-party distribution companies. In fiscal 2010, The Pantry procured nearly 60% of its in-store merchandise from a lone grocery wholesaler—the McLane company (The Pantry, 2010). The balance of its in-store merchandise is received via third-party distributors, such as Coca-Cola, Budweiser, & Frito-Lay, which provide direct-store-delivery services to down-channel retail partners.

For convenience store operators, the percentage of gross revenues devoted to direct advertising trails that of other similar retail channels. This inversion exists, in part, because of the traditional sales makeup of convenience outlets, which is weighted heavily toward high-ring petroleum transactions. In fiscal 2010, The Pantry spent $4.6 million on advertising, or approximately one half of one percent of its total revenue (The Pantry, 2010). By comparison, Safeway Grocers, a major grocery store conglomerate, spent $500 million on advertising and promotion in 2009, or roughly 10% of its total merchandise sales (Safeway, 2009).

Many convenience store shoppers report being highly habitual, but research suggests these users can also be receptive to in-store signage, displays, and promotional activity. Twenty-five percent of convenience store users reported that in-store loyalty programs provided them with the most incentive to shop, followed by in-store displays (16%), banner or window signs (14.4%), gas pump signage (13.3%), and in-store promotional signage (12.8%) (Convenience Store News, 2010). The Pantry's approach to promotional activity is not unlike the industry at large, but the company does tend to focus its promotional efforts in specific markets or geographies. For example, in 2010, company marketers launched a coffee cup promotion specific to the Raleigh-Durham market. The promotion included co-branding of cups with popular collegiate basketball team mascots, and enabled consumers to vote for their favorite college by purchasing refill cups containing that particular team's insignia (CSP Industry News, 2010).

Traditionally, convenience store operators have steered clear of market-best pricing structures, but within the channel, certain operators have built a reputation for price. Additionally, the limited merchandising footprint afforded by convenience outlets often means volume on non-core categories are relegated to a lone brand or supplier. For example, convenience retailers may stock 40 to 50 varieties of cigarettes, but limit their selection on bread and milk to a single brand. Consequently, for convenience operators to maintain share on critical categories, such as tobacco, both selection and price are important elements of a successful value proposition. Conversely, on fill-in categories, such as toothpaste or ketchup, convenience operators maintain price points far above general market averages.

Competition for fuel dollars is largely price-driven and the high-concentration of fuel outlets further dilutes individual pricing-power. This is especially true during periods of wholesale cost fluctuations (Convenience Stores in the US, 2011). To manage its fuel-pricing activities, The Pantry employs fuel pricing automation software (KSS), which enables it to quickly balance volume and margin objectives with changing market conditions (KSS Fuels, 2010).

A CHANGE IN STRATEGY

Spurred by requisite uncertainty over the future of refined petroleum, as well as escalating declines in annual tobacco consumption, many domestic convenience store operators have turned to food service as a means to sustain and grow profits.

The food service category is attractive to convenience operators primarily because it affords higher gross margins, and appeals to a much broader segment of the target consumer base. Research suggests the convenience channel is ripe for food service share increases, particularly in light of recent declines in the quantity of quick-service restaurant establishments. A recent study commissioned by The NPD group found that convenience operators fared well during the last recession but still have plenty of opportunity with the afternoon and evening day parts (Francella, 2010). According to a related study, just 21% of convenience store trips occur during lunch and dinner time, while only 16% of convenience users report buying prepared foods (Convenience Store News, 2010). While other retailers exploited food service opportunities, weaned their dependence on petroleum, and carved out specific operating niches, leaders at the Pantry had focused almost exclusively on acquisition (Oller, 2011). As one industry insider put it, The Pantry "had a history of overpaying for acquisitions and paying for it by sale-leaseback and to maximize capital, [which leads to] higher-paying leases and higher rent. They've kind of put themselves in a corner and have to fight their way out" (CSP Industry News, 2011).

Shortly after taking the helm at Pantry, new CEO Terry Marks outlined an ambitious strategy for growth, anchored largely by a move toward improved food service programs and customer experience. Marks and his team acknowledged a fundamental need to improve the quality of the company's food offerings, store level leadership teams, and in-store experience. Without dismissing the potential for future acquisitions, his vision for The Pantry centered on three essential objectives: craft a scalable, proprietary food service offering upon which future iterations and day parts could be built; Create a new, customer-friendly food-service culture, marked by a renewed empowerment of store-level associates; and focus retained earnings and working capital on technology improvements, brand consolidation, and freshened, more inviting store interiors. In an interview with one trade publication, Marks described the comprehensive, foundational nature of the challenge before him:

"New stores, both through acquisition and new construction will continue to play an important role in our long-term growth and we will be disciplined in our approach. We believe, however, that the clearest investment opportunity before us today is our own stores, to improve their ability to meet consumer needs and drive sustainable shareholder returns over time" (Holtz, 2009, p.2).

"FRESH INITIATIVE" AND THE BEAN STREET COMPANY

With an eye toward improving the quality of the firm's existing assets, Marks and his team set out to change the basic perception of both customers and internal stakeholders. The team's first deliverable was a thorough redesign of standard operations practices, collectively referred to as the 'Fresh Initiative'. In addition to tactical in-store changes, such as wider shopping aisles, less cluttered common areas, and a highlighting of promotional offers, the program's centerpiece was an all-new, proprietary coffee offering dubbed 'Bean Street Coffee'. (Oller, 2011). Launched in test markets in the fall of 2010, Bean Street Coffee affords new taste profiles and flavors, enhanced coffee serving stations, upgraded lids and cups, and a dedicated, brand-specific website. In the past, at 52 cups per store, per day, The Pantry's coffee business had never eclipsed traditional industry averages. Vice President of Marketing, John Fisher, noted the importance of the upgrade, relative to the company's strategic objectives: "This coffee re-launch reflects the transformation taking place at The Pantry. Our goal is to be the customer's choice for a delicious, satisfying and convenient cup of coffee" (Convenience Store Decisions News, 2010). On the heels of the Bean Street launch, company officials also announced plans to roll out a host of proprietary new grab-and-go food options, including salads, wraps, and gourmet sandwiches, and signed a multi-store development commitment with Subway (Holtz, 2009).

PEOPLE FIRST, THEN PEOPLE

In addition to tangible upgrades, Marks and his team recognized that shopper experience also hinged on the quality of a user's in-store experience. That meant a cultural shift in the way store-level associates served and interacted with customers. To support all of the physical upgrades associated with the revised strategy, Pantry leaders proceeded to invest heavily in associate training and development programs. Most notably, the company added dedicated hospitality associates to its updated stores and tasked them with maintaining the coffee bar, and cultivating relationships with customers (Oller, 2011). Accompanying the financial investment was an about-face on traditional, autocratic management styles, which belied the company's new culture of empowerment. Employees at every level were accustomed to simply following direction, not diagnosing and reconciling problems. As new Vice President of Human Resources Larry Wilson described it, "team building [needed] to replace the command-and-control structure" (Oller, 2011, p.40). In the end, executives were hopeful that the culture of employee empowerment would yield a deeper, more robust connection to the company's new vision (Oller, 2011).

CAPITAL INVESTMENTS

The final transformative component of Marks' revitalization plan involved a re-focusing of working capital on asset and technology enhancements. The plan called for a consolidation of interior and exterior store brands and putting data intelligence technology to work for company marketers. It also sought to identify and exploit previously undeveloped scale opportunities, including consistency between the private-label and exterior brand strategies. As Marks framed it, "the benefits from a scale standpoint that The Pantry has are in many cases unleveraged" (Holtz, 2009, p.2).

The process of crafting a consistent brand identity began with a contraction of the company's private label assortment, which executives acknowledged as ineffectually wide, and a gradual migration toward a singular, unifying exterior brand name. In 2010, Marks' team selected the 'Kangaroo Express' namesake as the preferred exterior brand and proceeded to revamp its logo and accompanying symbols. What followed were market-specific rebranding efforts, which the company intends to carry forward in the ensuing years.

Finally, on the subject of technology, Marks and his team understood that maintaining an efficient item assortment could have a material impact on stated sales and margin objectives. By investing in a new point-of-sale system (POS), Retailix, the company hoped to gain significant, timely insights into the purchasing habits of its users. Marks described the limits of the current technology and outlined his priorities for the Retailix system: "Our belief is we're going to have to walk toward a more balanced model, and to do that well, it requires us to have a really clear understanding of the performance of categories down to the SKU level in terms of what's in the basket when a certain item is purchased. And today we simply don't have that level of granularity" (Holtz, 2009, p.2).

Subsequent to the POS conversion, the company also added a new workforce management solution, as well as additional refinements to its existing fuel pricing software. Marks tasked new Chief Information Officer Paul Lemersie with the integration: "Our goals and objectives are to simplify the complexity we've inherited through the mergers and acquisitions," he said, "and we're doing that not only in POS but all of the enterprise applications as well" (Oller, 2011).

WOULD IT BE ENOUGH?

With a string of unprofitable quarters now on his resume, Terry Marks knew shareholders would have little patience for additional losses. Most of the company's stores had already been leveraged to finance prior growth and he wondered if the current rate of cash flow could support his ambitious revitalization plans. At the current pace, how many stores could he realistically makeover, and would these assets deliver the necessary sales growth? Were there alternative growth strategies that he hadn't considered, such as returning to an acquisition-based approach? How could he ensure that logo and brand consolidation efforts achieved the desired effect? To what degree could softening fuel margins derail his growth plans? These were just a few of the questions Marks pondered as the company ventured into another quarter. He hoped that the next call would be much better than the last.

TABLE 1
Glossary of Terms

Term	Definition
SKU	Stock Keeping Unit
Sin Tax	Tax on goods and services that generate negative externalities such as cigarettes and alcohol.
SCHIP	The State Children's Health Insurance Fund
PCI	Payment card industry; credit and debit card issuers
PTRY	NASDAQ Stock symbol for The Pantry
ATD.B	Toronto Stock Exchange stock symbol for Alimentation Couche-Tard
CASY	NASDAQ stock symbol for Casey's General Stores
ACT	Abbreviation for Alimentation Couche-Tard
C-Store Industry	Abbreviation for Convenience Store Industry
KSS	Knowledge Support Systems Ltd. which supplies fuel pricing automation software
TSCO.L	London Stock Exchange symbol for Tesco
GRG.L	London Stock Exchange symbol for Greggs PLC
TFM	NASDAQ stock symbol for Fresh Market
OCDO.L	London Stock Exchange symbol for OCADO Group
WN-PA.TO	Toronto Stock Exchange symbol for George Weston Ltd.
SUSS	NASDAQ stock symbol for Susser Holdings Corporation
D01.SI	Singapore Exchange International stock symbol for Dairy Farm International Holdings
SVU	NYSE symbol for Supervalu Inc.

TABLE 2
Top 10 Domestic Convenience Store Chains

Rank - 2010	Company Name	Total Stores	Company-Operated Stores	Franchised/ Licensed Stores
1	7-Eleven	6523	1708	4815
2	BP North America	4727	37	4690
3	Shell Oil	4636	29	0
4	Exxon Mobil Corp.	4060	717	3343
5	Chevron Corp.	4015	397	3618
6	Alimentation Couche-Tard	3455	2910	545
7	Speedway SuperAmerica	2759	1526	1233
8	CITGO	1820	0	1820
9	Sunoco, Inc.	1811	368	1443
10	Valero Energy	1671	999	672

Note. Data obtained from Longo, 2010.

TABLE 3
Historical Performance Metrics, Alimentation Couche-Tard (000)

	2010	2009	2008	2007	2006
Revenue	$16,439	$15,781	$15,370	$12,087	$10,157
Cost of Revenue (COGS)	$13,886	$13,344	$13,146	$10,082	$8,365
Gross Profit	$2,553	$2,436	$2,223	$2,004	$1,791
Total Operating Expense	$15,997	$15,376	$15,057	$11,729	$9,825
Operating Income	$442	$404	$312	$358	$331
Net Income	$302	$254	$189	$196	$196
Net Worth	$1,614	$1,326	$1,253	$1,145	$966
Cash	$220	$173	$216	$141	$331
Current Assets	$1,031	$844	$945	$759	$863
Total Assets	$3,696	$3,255	$3,320	$3,043	$2,369
Current Liabilities	$882	$789	$862	$787	$689
Total Liabilities	$2,082	$1,929	$2,066	$1,897	$1,403

Note. Data obtained from Alimentation Couche-Tard, 2010.

TABLE 4
Historical Performance Metrics, Casey's General Stores (000)

	2010	2009	2008	2007	2006
Revenue	$4,637	$4,691	$4,843	$4,025	$3,492
Cost of Revenue (COGS)	$3,844	$3,967	$4,155	$3,442	$2,966
Gross Profit	$792	$724	$688	$583	$526
Total Operating Expense	$4,456	$4,551	$4,709	$3,928	$3,394
Operating Income	$182	$139	$134	$98	$99
Net Income	$117	$86	$85	$62	$60
Net Worth	$824	$721	$647	$572	$523
Cash	$151	$145	$154	$107	$75
Current Assets	$310	$284	$313	$240	$192
Total Assets	$1,388	$1,262	$1,219	$1,129	$988
Current Liabilities	$240	$221	$259	$234	$245
Total Liabilities	$564	$541	$571	$557	$465

Note. Data obtained from Casey's General Stores, 2010.

TABLE 5
Historical Performance Metrics, Tesco (000)

	2010	2009	2008	2007	2006
Revenue	$36,453	$33,359	$32,354	$21,489	$20,179
Cost of Revenue (COGS)	$33,502	$30,769	$29,871	$19,856	$18,630
Gross Profit	$2,951	$2,590	$2,483	$1,633	$1,549
Total Operating Expense	$34,238	$31,398	$30,445	$20,155	$19,013
Operating Income	$2,214	$1,961	$1,909	$1,353	$1,166
Net Income	$1,491	$1,320	$1,453	$953	$803
Net Worth	$29,479	$28,201	$20,633	$12,502	$11,540
Cash	$1,321	$1,307	$1,223	$455	$678
Current Assets	$7,297	$8,096	$4,099	$2,100	$1,918
Total Assets	$29,479	$28,201	$20,633	$12,502	$11,540
Current Liabilities	$10,258	$10,890	$7,076	$4,108	$3,845
Total Liabilities	$20,130	$20,248	$12,571	$7,207	$6,743

Note. Data retrieved from Tesco PLC (2011); GBP to USD (2010); GBP to USD (2009); GBP to USD (2008); GBP to USD (2007); GBP to USD (2007). Data converted from GBP (£) to USD ($)

TABLE 6
Historical Performance Metrics, Susser (000)

	2010	2009	2008	2007	2006
Revenue	$3,931	$3,307	$4,241	$2,718	$2,265
Cost of Revenue (COGS)	$3,458	$2,880	$3,803	$2,455	$2,044
Gross Profit	$473	$427	$437	$263	$221
Total Operating Expense	$3,861	$3,265	$4,175	$2,691	$2,244
Operating Income	$70	$42	$66	$26	$21
Net Income	$1	$2	$16	$16	$(4)

Net Worth	$214	$210	$204	$184	$161
Cash	$48	$18	$8	$8	$33
Current Assets	$210	$172	$127	$156	$117
Total Assets	$914	$873	$824	$854	$422
Current Liabilities	$178	$174	$145	$181	$106
Total Liabilities	$701	$663	$620	$670	$261

Note. Data retrieved from Susser Holdings Corporation (2011).

TABLE 7

Pantry Financial Metrics versus Grocery Industry Leaders

	Leader	**Pantry**	**Pantry's Rank**
Market Capitalization (in $)	1,074.95B	372.04M	34 / 39
P/E Ratio (ttm)	4,103.38	N/A	N/A
PEG Ratio (ttm, 5 yr expected)	2.52	1.07	18 / 39
Revenue Growth (Qtrly YoY)	27.60%	4.80%	18 / 39
EPS Growth (Qtrly YoY)	135.40%	N/A	N/A
Long-Term Growth Rate (5 yr)	35.40%	15.00%	Jun-39
Return on Equity (ttm)	82.98%	-41.01%	33 / 39
Long-Term Debt/Equity (mrq)		410.39	N/A
Dividend Yield (annual)	4.10%	N/A	N/A

Note. Data obtained from Yahoo! Finance, 2011.

TABLE 8

Historical Merchandise Mix, The Pantry (%)

	2010	**2009**	**2008**	**2007**	**2006**
Tobacco products	39.10%	34.20%	31.50%	31.10%	31.00%
Packaged beverages	15.3	16.4	17.7	17.5	16.9
Beer and wine	15	16	16.3	15.6	15.9
General Merchandise	4.9	5.5	5	5.9	6
Fast Food Service	4.7	4.7	4.4	4.3	4.2
Salty Snacks	4.3	4.4	4.4	4.4	4.5
Self-Service Fast Foods	3.9	4.5	5.5	5.5	5.7
Services	3	3.3	3.5	3.5	3.4
Bread and cakes	2	1.8	2.2	2.2	2.2
Dairy products	1.9	2.1	2.5	2.5	2.7
Grocery & Other	1.1	1.8	1.7	2.2	2.1

Newspapers & Magazines	1.1	1.3	1.2	1.3	1.5
Total	100	100	100	100	100

Note. Data obtained from The Pantry, 2010.

TABLE 9

Store Locations by State, The Pantry (%)

	Total	**2010**	**2009**	**2008**	**2007**	**2006**
Florida	25.3%	415	440	453	461	441
North Carolina	23.3	382	384	385	387	325
South Carolina	17	279	284	283	277	236
Georgia	8	131	132	133	136	125
Alabama	6.9	113	114	81	83	77
Tennessee	6.4	104	104	104	104	101
Mississippi	6	99	100	99	82	73
Virginia	3	50	50	50	50	50
Kentucky	1.8	29	29	30	30	31
Louisiana	1.7	27	27	26	25	25
Indiana Total	0.6	9	9	9	9	9
Total	100%	1,638	1,673	1,653	1,644	1,493

Note. Data obtained from The Pantry, 2010.

EXHIBIT 1

Consolidated Income Statements, The Pantry (000)

	Fiscal Year Ended				
	Sep 30, 2010	**Sep 24, 2009**	**Sep 25, 2008**	**Sep 27, 2006**	**Sep 28, 2006**
Revenues:	**(53 weeks)**	**(52 weeks)***	**(52 weeks)***	**(52 weeks)**	**(52 weeks)**
Merchandise	$1,797,860	$1,658,926	$1,636,711	$1,575,922	$1,385,659
Fuel	5,467,402	4,731,205	7,358,915	$5,335,241	$4,576,043
Total revenues	7,265,262	6,390,131	8,995,626	$6,911,163	$5,961,702
Costs and operating expenses:					
Merchandise cost of goods sold (exclusive of items shown separately below)	1,190,396	1,071,842	1,041,474	989,894	867,717
Fuel cost of goods sold (exclusive of items shown separately below)	5,202,717	4,419,861	7,096,648	$51,105	$42,948
Store operating	536,618	515,635	516,085	$499,613	$437,935
General and administrative	97,949	101,452	90,014	$97,707	$83,141
Goodwill impairment	230,820	-	-	$-	$-
Other impairment charges	36,259	2,084	3,175	$-	$-
Depreciation and amortization	120,605	108,712	108,326	$95,887	$76,025
Total costs and operating expenses	7,415,364	6,219,586	8,856,722	$6,793,646	$5,759,657
Income (loss) from operations	(150,102)	170,545	138,904	$117,517	$202,045
Other income (expense):					
Gain (loss) on extinguishment of debt	791	4,007	-	$(2,212)	$(1,832)
Interest expense, net	(85,990)	(89,283)	(92,833)	$(72,199)	$(54,661)

Total other expense	(86,781)	(85,276)	(92,833)	$(73,829)	$(55,693)
Income (loss) before income taxes	(236,883)	85,269	46,071	$43,688	$146,352
Income tax benefit (expense)	71,268	(31,178)	(17,492)	$(16,956)	$(57,154)
Net income (loss)	$(165,615)	$45,091	$28,579	$26,732	$89,198
Earnings (loss) per share:					
Basic	$(7.42)	$2.43	$1.29	$1.17	$3.95
Diluted	$(7.42)	$2.42	$1.29	$1.17	$3.88

*** As adjusted in The Pantry's 2010 Annual Report, Note 1--Summary of Significant Accounting Policies**

Note. Data obtained from The Pantry, 2010.

EXHIBIT 2

Consolidated Balance Sheets, The Pantry (000)

	Fiscal Year Ended				
	September 30, 2010	**September 24, 2009**	**September 25, 2008**	**September 27, 2007**	**September 28, 2006**
ASSETS					
Current Assets:					
Cash and Cash Equivalents	$200,637	$169,880	$217,188	$71,503	$120,394
Receivables (net of allowance for doubtful accounts)	92,118	92,494	109,050	84,445	68,064
Inventories	130,949	124,524	132,248	169,647	140,135
Prepaid expenses and other current assets	21,848	18,142	12,706	14,662	18,783
Deferred income taxes	11,468	14,959	14,845	10,594	8,348
Total Current Assets	457,020	419,999	486,037	350,851	355,724
Property and Equipment, net	1,005,152	1,028,982	990,916	1,025,226	745,721
Other Assets:					
Goodwill	403,193	634,703	627,653	584,336	440,681
Other intangible assets	6,722	29,887	32,564	34,802	12,496
Other noncurrent assets	24,363	40,584	31,560	34,224	33,285
Total Other Assets	434,278	705,174	691777	653362	486462
Total Assets	$1,896,450	$2,154,155	$2,168,730	$2,029,439	$1,587,907
LIABILITIES AND SHAREHOLDERS' EQUITY					
Current Liabilities:					
Current maturities of long-term debt	$6,321	$4,317	$27,385	$3,541	$2,088
Current maturities of lease finance obligations	7,024	6,536	5,322	5,348	3,511
Accounts payable	144,358	140,730	171,216	192,228	139,939
Accrued compensation and related taxes	14,736	22,804	20,217	15,739	19,676
Other accrued taxes	31,748	25,164	27,226	26,416	27,440
Self-insurance reserves	29,681	30,904	33,775	32,873	29,898
Other accrued liabilities	37,866	31,386	39,936	40,812	34,978
Total Current Liabilities	271,734	261,841	325,077	316,957	257,530

Other Liabilities:					
Long-term debt	753,020	769,563	819,115	746,749	602,215
Lease finance obligations	450,312	458,509	459,711	452,609	240,564
Deferred income taxes	38,388	109,260	90,708	74,667	72,435
Deferred vendor rebates	10,212	17,392	20,875	23,937	23,876
Other noncurrent liabilities	64,675	70,415	63,685	60,692	54,280
Total Other Liabilities	1,316,607	1,425,139	1,452,794	1,358,654	993,370
Commitments and contingencies					
Shareholders' Equity:					
Retained Earnings	100,562	266,177	220,605	189,378	162,646
Total Shareholders' Equity	308,109	467,175	389,859	353,828	337,007
Total Liabilities and Shareholders' Equity	$1,896,450	$2,154,155	$2,168,730	$2,029,439	$1,587,907

Note. Data obtained from The Pantry, 2010.

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