BETTING ON SAM

BY SAMANTHA OLLER | SOLLER@CSPNET.COM

In talking to Sam Hirbod, you quickly pick up on some things.

He is always plugged in, juggling a BlackBerry and iPhone in two hands, a Bluetooth headset next to an ear. He's courteous, but he has one eye fixed on the business at all times.

He embraces buzzwords: creativity, brand, backstops, change, deep dives, differentiation, transparency. He has a professor's tendency toward answering a question with a question.

And Hirbod, president and CEO of Pacific Convenience & Fuels LLC (PC&F), San Ramon, Calif., is keenly aware of the widespread interest in his company and the speculation about its stunning August 2008 acquisition of ConocoPhillips' nearly 600-strong store network—a surprising twist in the continuing tale of major oil's retail sell-off.

With this in mind, he first wants to debunk some myths. That oft-quoted, $800-million estimate of the purchase price? Wrong. While the final price tag may be "well north" of $500 million, it is actually less than the estimate, he says.

The rumors of ConocoPhillips having equity in PC&F? Again, wrong. Hirbod cops to some "creative financing"—how else could one buyer dish out for what is believed to be the largest C&G acquisition of 2009 in a catastrophic financing environment? But he insists that ConocoPhillips' role is limited to supply.

Photos by Scott Mitchell

“I CAN BRING MY RELATIONSHIPS TO THE TABLE, I CAN BRING MY MARKETING SKILLS, AND I CAN DO ALL OF THE FINANCIAL WIZARDRY AND TECHNICAL PIECES TO IT, BUT AT END OF THE DAY, PEOPLE WERE **BETTING ON SAM.**”

RAY CLEEMAN SMJ CAPITAL ADVISORS

HOW PC&F IS MAKING ITS MARK:

1. Customized graphics—a PC&F hallmark—reflect the store's location near Denver's Pepsi Center, home of the Denver Nuggets.
2. When PC&F first assumed ownership of ConocoPhillips' retail network, tobacco supplied 40% of in-store sales; the retailer wants to trim this to 30%.
3. Plans are in the works for a new financial services offering, with tests to roll out in middle to late 2010.
4. A new partnership with Quiznos promises to supercharge PC&F's efforts to grow foodservice's share of in-store sales from a low of 4% to industry average and beyond.
5. As part of its remodel of this former ConocoPhillips company-op, PC&F removed the bulletproof glass separating the cashier from customers.

Not to be cliché, but it truly was a win-win, he asserts.

"A lot of times, people are creative by just wanting to win so that the other side loses," says Hirbod. "I think true creativity comes from finding a way where neither side loses, but rather both sides win. If you define creativity that way, you can get both sides to agree that's the intention and premise you're working off, I think the possibilities are endless."

The exec, who opened his first c-store only 13 years ago, now commands a network of 578 company-op and dealer locations sprawled across Washington, Oregon, California, Nevada, Colorado and Texas. Revenues for PC&F rang up just short of $4 billion in 2008.

How Hirbod—a relative unknown on the national c-store scene—won the highly competitive bid is just one part of the tale. His plans for the assets and how PC&F will grow from such a massive base is still being written. He shared his story with CSP in an exclusive sit-down interview, surrounded by a highly qualified management team that, combined, has more than 60 years of experience in the c-store business.

But what's also clear is how much PC&F's success depends upon Hirbod and his ability to muscle aside strong competition—Chevron and Alimentation Couche-Tard, among others—in an attempt to expand beyond the Western frontier toward the East Coast. A former welterweight and an avid kickboxer, Hirbod is the kind of guy you want to have in your corner, not coming at you from the other side.

But it's wrong to consider him a bully. "You put in your knowledge, hard work, want to do everything right, and you're ambitious," says Hirbod's business partner, David Delrahim, of Hirbod. "I don't categorize Sam as being aggressive. He's someone who has knowledge, knows what he wants and works really hard to get it."

CREATION THEORY

In the beginning, there was one c-store in Menlo Park, Calif. After studying

the industry and his options for two years, Hirbod bought his first station in 1997 and proceeded to work the shifts and experience the business from the inside out.

He leveraged the store—"at the time, money was cheap and real estate was expensive," he says—and bought another. In three years, the company grew from one station to three. In the fourth year, it expanded to 22 stations through ground-ups and small acquisitions, then rose to 40. A distribution arm served 50 sites.

That company, Bed Rock Oil, has since wound down in size. However, the experience of building the jobbership helped Hirbod hammer out his retail business strategy.

Each of those first stores had a hook: location, real-estate value, accessibility, barriers to entry. "I early on defined success by being able to identify every one of those variables, so that we could make better decisions every time we had a new store come in," says Hirbod. "It's the same strategy today."

Thirteen years later, PC&F embraces metropolitan areas for many of these same variables: sustainability, barriers to entry, and the greater margin potential. In fact, Hirbod defies anyone to find a company that has infiltrated metropolitan areas as much as PC&F.

"How many privately or publicly held companies could say that they operate in the heart of San Diego metro, the heart of L.A., the heart of the Bay Area, the heart of Portland, heart of Seattle, and the heart of Denver?" he asks.

It's a flash of Hirbod's characteristic confidence, but also perhaps a battle cry.

"We understand it and know the business in metro areas," he says. "We understand how to swim in those waters. And we specialize in those things. So it doesn't bother us at all; we welcome it."

At the same time, Hirbod is quick to point out the mistakes he made, growing from a single-store operator to a midsize jobber in the Northwest. Namely, he sometimes overpaid because he didn't yet understand values, or what he calls the "expensive schooling of deal making."

[STATS]

PACIFIC CONVENIENCE & FUELS LLC

SAN RAMON, CALIF.

NO. OF SITES: 578 (235 company-op, 343 dealer) in Washington, Oregon, California, Nevada, Colorado and Texas
ANNUAL REVENUES (2008): $4 billion
FUEL BRANDS: Conoco, 76, Chevron, Valero
AVERAGE STORE SIZE: 2,800 square feet with six MPDs
CAR WASHES: 110
COMPETITIVE DIFFERENTIATION: PC&F focuses on metropolitan markets that have high barriers to entry and offer strong margin opportunities. Foodservice is its main in-store prospect as the retailer attempts to transform a tobacco-centered sales mix toward one that offers greater revenue opportunities. Car wash is another major source of revenue; PC&F is slowly transitioning its network to friction technology.

"The other thing is learning how to do deals and being creative," he continues. "The first five years, I probably bought and sold 80 different sites. And in those 80 sites, there are probably 60 to 65 different escrows. And I learned something new in every single deal, which ultimately prepared me for this."

BUILDING A PLATFORM

In 2006, Hirbod got a call from an old friend in Los Angeles who was picking up and turning 100 to 200 dealer sites at a time from major oils—"pump and dumping," if you will. "His lenders had told him, 'If you have an operating arm, we sure could lend you a lot more money and help you grow,' " Hirbod recalls. "So he asked if I'd be interested."

At first Hirbod was reluctant; he admits he's not an easy man to partner with—"I'm not easy to satisfy." But after some negotiations, he decided to lead the operations side of the deal. In 2007, Hirbod banded together with that L.A. friend, Michael Saei, and two other partners—Allen Goodman and David Delrahim—to form PetroSun West LLC. In November 2007, they acquired 95 stores from Time Oil Co.

(Only Delrahim remains as a partner today, with a 10% stake in PC&F, and 70% ownership in Platinum Energy, Agoura Hills, Calif., a sister company that supplies PC&F's dealer network.)

Time Oil had all the hallmarks of a company founded in the wake of the Great Depression: It had been debt-free since 1942, Hirbod says, and everything was paid for in cash. In its last 10 years, the company had adopted a fee-op model wherein it owned the fuel and charged rent based on gross sales to a commission operator who ran the c-store. PC&F still has 75 of these arrangements within its 100-site fee-op network.

While Time Oil has great "dirt," the stores themselves were dilapidated. But the real estate was not the only allure for PetroSun.

"There were two things that were really attractive from Time Oil: one was the dirt, and two was that they were really free agents," says Hirbod. "They didn't have long-term contracts with any oil company. So, all of a sudden, we controlled about 100 million gallons that we could go out with and get some oil companies' attention."

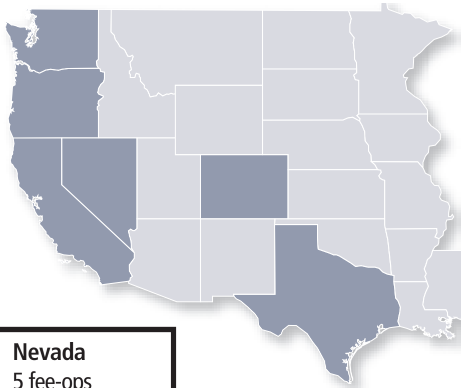
The acquisition helped establish the infrastructure PetroSun needed to shoulder a larger c-store network. And it provided an argument to

DENVER NUGGET: With more than 60 company-operated locations in Colorado, PC&F competes head-to-head with Alimentation Couche-Tard company-ops in the state.

"LOSING AND NOT FINISHING THE DEAL WAS REALLY—AND I MEAN THIS TRULY—NOT AN OPTION. IT WOULD HAVE BEEN CATASTROPHIC IN EVERY SENSE OF THE WORD."

PC&F'S RETAIL EMPIRE

With 578 sites scattered across six states, Pacific Convenience & Fuels ranks among the top five privately owned chains in sheer store count. While the bulk of its company-ops reside in California, all are located within a metropolitan area with high barriers of entry and high margin opportunity.



California 70* dealers 125 company-ops	**Colorado** 65 company-ops	**Nevada** 5 fee-ops
Oregon 16 dealers 15 fee-ops 24 company-ops	**Texas** 1 company-op	**Washington** 10 dealers 50 company-ops 60 fee-ops

Source: PC&F LLC *150 by end of Q1 2010*

finance further growth.

"Without the platform, we could never go out to the financial market, so it played that role as well," he says. "Every financier would start out by asking, 'What's your platform? How can you take this down when you're a little mouse and you want to swallow a lion?' "

THE ART OF THE DEAL

PetroSun had ConocoPhillips' retail assets in its crosshairs ever since the major oil announced plans to exit the retail business in 2006. With the Time Oil acquisition under its belt, the company joined thousands of other suitors in bidding for stores. It was competing against more than 2,200 bids, Hirbod says, ranging from blocks to the entire portfolio.

Popular wisdom suggested that the stores would be sold off piecemeal. So when news broke in August 2008 that ConocoPhillips was selling all 600 of its sites to a newly formed affiliate of a little-known Northwest operator, the industry reaction was shock. Consider the competition: Among others, Couche-Tard, with its vast retail network and resources, was rumored to be a leading contender.

Even greater, consider the complications of a regional player paying for such a massive entity.

"Generally speaking, it's highly unusual for a jobber to take that many sites—that's very extraordinary," says Kenneth Shriber, managing director of Petroleum Equity Group Ltd., Chappaqua, N.Y., which provides financing for major and independent oil assets. "We're not in the traditional age of financing where you could go to a bank and get 65% to 75% financed and then come up with the gap. … Today, other options have to be reviewed, analyzed."

It is also unusual for ConocoPhillips to sell all of its retail sites to one jobber, he says. "Not many companies want to give one operator that much presence and so much power," Shriber says. "They have leverage because of the sheer nature of the business. If five to 10 years down the road they agree to pay liquidated damages and want to rebrand all of these sites, then ConocoPhillips is gone from the whole West Coast."

Hirbod says it is precisely PC&F's commitment to nurturing and growing ConocoPhillips' brands that, in the end, won the deal. While bidders had to, at minimum, agree to a 13-year supply contract with ConocoPhillips, PetroSun's bid extended this to 27 years.

"Why would you do that? My answer is, 'Why not?' " says Hirbod. "It's your confidence in the company and the brand, and your mindset of where you think the industry is going, and what you think is going to happen with unbranded fuel and supply.

"These were incredibly important conduits to ConocoPhillips' most important refineries on the West Coast," he says of the stores. "They didn't want to sell it to someone who was going to slice and dice it. This was a supply deal."

For its part, ConocoPhillips spokesman Ric Sweeney would provide only the following statement: "ConocoPhillips and Pacific Convenience & Fuels have enjoyed a successful supplier/marketer business relationship since 2007. We currently supply branded fuel to approximately 300 locations with plans to add additional sites. We look forward to continuing to grow our branded presence with Pacific Convenience & Fuels in the future."

Other factors that may have sealed the deal:

Company-Op Focus. While some bidders may have intended on selling all of the stores to dealers, PC&F was focused on growing company-ops. The company outlined plans to improve store margins—at the time, less than 24%—up to industry standards "and beyond," says Hirbod. The company also committed to building four to five sites per year on the 40 land banks included with the transaction.

Volume Infusion. As part of its bid, PetroSun threw in 75 of its 120 c-stores to be part of the new entity formed from the ConocoPhillips sites, bringing with it a volume infusion of 100 million gallons.

Transparency. PetroSun identified

its weaknesses. For example, the company did not yet have a strong supply chain established, but it hoped by partnering with its current c-store franchise, Circle K, that it could build one. "That's one of strengths transparency brings you," says Hirbod. "When you identify the things you are weak at, you seek out ways to compensate."

Cold, Hard Cash. When PetroSun first submitted its bid, it included a cashier's check to ConocoPhillips "well into the seven figures, with nothing attached," Hirbod says.

"A lot of people thought I was stupid. I thought it was the best investment I ever made," he continues. "We were able to get a voice at the table very, very quickly, and my only goal was to get to that table."

BRAIN TRUST: PC&F's Sam Hirbod (left), Chris Wilson, Jeff Smith and Charlene Kovacsik aim to bring the company's newly acquired retail assets in line with industry standards and beyond.

PAYING THE TAB

Winning the bid was just one front of the war. Financing the acquisition was entirely another.

"As we went out to the Street, clearly this was the worst debt and equity market since the Great Depression," says Ray Cleeman, head of SMJ Capital Advisors, New York, and PetroSun's financial adviser for the deal. "We were very fortunate that, regardless of the tenor of the market, we were able to generate a tremendous amount of interest from both debt and equity players to participate in the financing."

Cleeman credits a few factors working in PetroSun's favor. For one, ConocoPhillips fully supported the acquisition, testifying to Hirbod's management strengths and the plans for the assets.

The contribution of the PetroSun sites was another powerful hook. "PetroSun was a very viable company on its own that had a tremendous amount of cash flow," says Cleeman. "It showed to people he could operate a large pool of assets in disparate areas and take something that was not necessarily a perfect asset and really turn it around and make it come out perfectly."

Regardless, nailing financing was truly a "moving carpet," Cleeman recalls. From May 2008 until the financial market fell apart in October, PetroSun's options began to narrow—and grow increasingly oppressive.

"We went from a LIBOR plus 400 to a LIBOR plus a 1200 atmosphere," says Hirbod, pointing out that this was not the final figure. "That was an incredibly difficult roller-coaster ride, because you've already signed the contract, the price is already set, and the cost of funds is a part of the price of what you've paid."

Although he declined to provide specifics, Cleeman describes the finance package thusly: "There's a way to look at it with an A, B and C loan, and each loan in itself was tiered with a different credit risk, credit exposure and different multiple. It wasn't a plain-vanilla piece of debt you could find from your local commercial banker."

Regarding the rumor that ConocoPhillips financed part of the deal, Cleeman said he could not comment due to a nondisclosure agreement. "But I will tell you that there were many choices at the end of the day, and we weren't left with one bullet in the gun," he says. "Whomever we did go to at the end, there were options; there weren't as many as we'd like, but there were options."

PetroSun ultimately secured short-term financing that, Hirbod says, "gave us enough flexibility where we weren't going to get choked within the first two to three years."

As Hirbod sees it, the company had made a calculated gamble that had to pay out. "I can tell you PetroSun, Sam Hirbod, in every sense—we were all part of this deal," says Hirbod. "Losing and not finishing the deal was really—and I mean this truly—not an option. It would have been catastrophic in every sense of the word."

Hirbod and the deal had become inextricably intertwined. "I can bring my relationships to the table, I can bring my marketing skills, and I can do all of the financial wizardry and technical pieces to it, but at end of the day, people were betting on Sam," Cleeman says.

CULTURE OF CHANGE

Only 10 months since the ConocoPhillips acquisition closed, Pacific Convenience & Fuels has been quick to transform the major oil's retail assets, true to its culture of change.

When PC&F took ownership of the ConocoPhillips retail network, more than 40% of sales came from tobacco. The retailer is working to break the 30% mark. Why the purposeful decline?

"We're not really looking at tobacco as being overdeveloped; we're looking at other parts of the store being underdeveloped," says Charlene Kovacsik, director of marketing. "We're looking to expand OTP because it's a growth category within that segment, enhancing it and meeting consumers' needs, but we're not looking to make that a bigger part of what we're doing."

Foodservice, meanwhile, supplied only 4% of in-store sales. PC&F has managed to grow this figure "close to the double digits" in less than a year, says president and CEO Sam Hirbod, and its goal is to reach the 20% mark.

PC&F's c-stores already feature a selection of packaged sandwiches supplied by its wholesaler Core-Mark International, prominently displayed in an open-air cooler near the store entrance that also stock fruit cups and salads. In December, the company rebranded the line Healthy Choices.

Next up: a partnership with Quiznos, which will be providing sandwiches for the stores via four regional commissaries, and the building of 20 full-size Quiznos adjacent to PC&F stores, with the first 10 built in 2010.

The team's research on financial services is also complete, and PC&F plans to begin testing an approach in middle to late 2010. "We feel confident knowing what types of financial services will meet customers' needs," says Hirbod. "We're trying to find the right vehicle."

Across the rest of the store, the retailer takes an incremental approach to category management.

"Most people manage their c-stores by categories. We want to manage ours by SKUs," says Hirbod. "We do a deep dive in every aspect of our business, including our c-stores.

"We'll continue to take a look at dollars that are available from vendors and suppliers in a given category and SKU, but that's not the ultimate driver for us. The ultimate driver is what the consumer ultimately wants and needs."

It's this approach that Hirbod credits with an increase in in-store sales just shy of the double digits for 2009.

COMPLEX RELATIONSHIPS

At 8 a.m. on Jan. 30, 2009, escrow closed on PetroSun's ConocoPhillips acquisition; this was a month and half after the original closing date. "And the night before, I wasn't sure if it was going to finish," Hirbod admits. "It was a moving target past the final minute. Not to the final minute—*past* the final minute."

While Hirbod cites the precarious financial markets as the biggest threat to the deal, transitioning nearly 280 dealers was a formidable challenge, with some dealer representatives threatening legal action if ConocoPhillips and PetroSun did not honor their first rights of refusal.

The din grew so loud that Tower Energy Group, a wholesaler based in Torrance, Calif., which had originally signed an agreement to supply PC&F's California dealers, dropped out of the deal. Hirbod and Delrahim then formed Platinum Energy to assume the dealer network, which currently oversees 85 sites, and plans to expand to 200 by end of first quarter 2010.

Tower Energy already had a history with PetroSun: It had acquired 16 sites from PetroSun that were a piece of the Time Oil acquisition, and it bought two sites in Northern California that were part of the ConocoPhillips transaction.

Hirbod alleges the negative buzz was driven by other bidders hoping to get a piece of the deal. "There was never an intention on our part but to deliver the best possible deal and supply contract to dealers," Hirbod says. "And the dealers knew that."

More than 90% of the dealers in the ConocoPhillips acquisition are purchasing their sites as part of the first right of refusal, according to Hirbod. "The ones that didn't wish to purchase, we, for the most part, ended up honoring their contract, or improving their terms, extending their terms, and adding some goodwill value to their business," he says.

Meanwhile, although the acquisition covered a broad swath of the Western United States, not all markets fit within PetroSun's strategy. On the same day the ConocoPhillips acquisition closed, PetroSun sold 92 sites in Utah and Kansas City to K&G Petroleum LLC, a Littleton, Colo.-based distributor.

"We're not interested in penetrating a metropolitan area that does not have a strong backstop as it relates to real estate and margins, which is why we divested the Kansas City and Utah markets," Hirbod says. "We're not interested in having a business model where you have zero or negative margins parts of the year."

While PetroSun met with various bidders, K&G stood out because of its commitment to retail and willingness to align with ConocoPhillips' brands for the long term, says Hirbod, citing another strength of the bid.

Another brand relationship forged in late 2008 was with Circle K. PC&F has 230 sites under a 23-year agreement with the franchise, making it Circle K's largest franchisee.

"It's supply chain. It's category management. It's research. It is a platform that allows us to do different things, to get data, so that we can truly be a data-driven company," says Hirbod.

Although it may be Circle K's largest franchisee, the relationship is more complex. Some Circle K company-ops

BRAND POWER: ConocoPhillips' fuel brands and Circle K's franchise program serve as PC&F's face to the customer. Behind the signage, PC&F is focusing on continuous improvement inside the store and encouraging team members to challenge the conventional thinking and not be afraid of mistakes.

compete directly with PC&F locations. Hirbod also poached two members of his management team—Charlene Kovacsik, marketing director, and Chris Wilson, general manager of operations—from the franchise. And the exec himself is calculated about his commitment to the brand: "As long as Circle K continues to bring value for our business, sites and consumers that is incrementally better than the options, our relationship will continue."

Kovacsik is more circumspect, crediting Circle K for the flexibility of its franchise offering and citing that, in the end, they both want what's best for the consumer. "We don't look at them as competition," she says. "We really look at ourselves as franchisees with a store near theirs. We really look at trying to serve the needs of consumers."

CONSOLIDATION & CLEANSING

From one to 572 stores within the space of 13 years—Hirbod has certainly shown an appetite for acquisitions. And even as PC&F absorbs ConocoPhillips' massive retail network, it is already contemplating the Next Big Thing.

"What is an exaggerated expansion last year could easily be a basic platform next year," says Hirbod. "It's a matter of how quickly we can digest the bite we just took off, how efficient we can make it."

PC&F isn't, he stresses, overleveraged. Rather, the company's current assets will give it the footing it needs to expand. It's a prospect that investment banker Cleeman is only too happy to support.

"If [Hirbod] wanted to go out and raise more capital and help grow his business, I don't think it would take me more than four phone calls to line up literally any amount of capital," says Cleeman. "Hundreds of millions of dollars easily done in a phone call."

But Hirbod is trying to avoid the mistakes of consolidators past who grew quickly, only to implode under the weight of unfulfilled expectations.

"Two phenomena are happening in our industry: consolidation and cleansing," says Hirbod. "They look the same, and you can't tell them apart on paper. You have to have a depth of knowledge to identify the sites that go out of the network vs. those that deserve to be consolidated. We're working diligently to identify those."

So diligently, in fact, that an acquisition may be in the works for first or second quarter 2010. PC&F is aggressively considering its Northeast options. But don't expect Hirbod to put a number or limitations on his final growth target.

"We've always been formula-based," says Hirbod. "We will allow our formula to set our heights and sights. So if we concentrate on making sure our platform is strong enough, we don't have to worry about what that number is or what we'll become. It'll take care of itself." ■

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