THE GLOBE AND MAIL

Looking for a way to play high fuel prices? Couche-Tard is worth considering

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Companies are facing several stiff challenges this year, from soaring inflation and war, to rising interest rates and a looming economic downturn.

Alimentation Couche-Tard Inc.
ATD-T (/investing/markets/stocks/ATD-T/) +2.01% ▲ sits in the middle of this turmoil – so what will it take to get the stock moving higher again?

Shares in the Quebec-based operator of Circle K, Couche-Tard and Ingo-branded convenience stores in Canada, the United States and Europe have outperformed the S&P/TSX Composite Index this year.

But most investors are probably not celebrating. After the share price essentially doubled over the four years from May, 2018, to May, 2022, following a succession of deals that increased the company's store count by 40 per cent, the shares have fallen 18 per cent since mid-May.

The stock is now trading at levels seen last July.

The reason: Though convenience stores might appear to be relatively immune to weaker economic activity and sliding consumer confidence, Couche-Tard faces several obstacles.

Soon after Russia invaded Ukraine, the company suspended operations at its stores in Russia, and then lost control of them.

As a result, Couche-Tard announced a US$56.2-million charge when it released its fiscal fourth-quarter financial results this week. This contributed to a decline in profit, to US$477.7-million from US$564-million in the same quarter in 2021.

Other challenges are simmering.

Inflation is a big one. Couche-Tard reported that its expenses jumped 19 per cent in the fourth quarter from last year, as inflation surged to four-decade highs and exerted pressure on wages.

Sluggish fuel sales are also a problem, given that Couche-Tard sells fuel at about three-quarters of its stores.

In Canada, the number of fuel litres sold in the fiscal fourth quarter increased by just 4.3 per cent compared with last year, even as travel restrictions eased and more people returned to work. Worse, the number of gallons sold in the United States during the quarter actually declined by 1.9 per cent from last year, as drivers cut back in reaction to soaring gasoline prices.

But there's a bullish case here, starting with those gas prices: Couche-Tard has been able to fatten its margins on sales outside of Europe.

In the United States, gross fuel margins widened to 46.12 US cents a gallon in the fourth quarter, up 11.67 US cents. In Canada, margins expanded to 13.41 cents a litre, up 2.49 cents.

While that might not be good news for cash-strapped drivers, investors and analysts believe it shows that the company can offset rising operating expenses.

"In the last two years, the costs of running a convenience store have gone up, so that's why we're seeing margins sustained at a higher level," said Aaron Lanni, portfolio manager at Medici, a Quebec-based investment manager that owns shares in Couche-

Tard.

At the same time, analysts estimate that the company is saving more than US$100-million a year through its recent rebranding strategy in North America and benefiting from a more flexible supply chain, adding to the company's ability to maintain margins at a higher level.

"Couche-Tard's initiatives on procurement, trading and marketing are clearly paying off, and we believe these initiatives can support continued outperformance, particularly in periods of high volatility," Mark Petrie, an analyst at CIBC Capital Markets, said in a research note.

What's more, fuel volumes have room to improve. Mr. Lanni said that volumes are still 16 per cent below levels seen before the pandemic, as many people continue to work from home or look for alternatives to pricey fill-ups.

As the world slowly returns to normal, volumes should improve. And while electric vehicles don't require fuelling stations, EVs will likely remain a small slice of the overall fleet of vehicles for more than a decade. Fuel sales will decrease in the long term, but it will be very gradual and compensated by an increase in margins, Mr. Lanni said.

Lastly, there's more than fuel sales guiding the stock. Most transactions are at the convenience stores rather than the pumps, where the company is turning its attention to a category known as fresh food, fast. In North American stores, sales in this group are on track to double next year, to US$400-million.

"By standardizing and centralizing food production at commissaries (moving away from store, which is more labour-intensive), Couche-Tard is scaling its high quality and localized food offering profitably," Chris Li, an analyst at Desjardins Capital Markets, said in a note.

The shares have frequently sold off over the past five years amid doubts about growth, only to rebound to new heights soon after. This dip could be another opportunity.

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