Do Low Gas Prices Pose Trouble for Canada’s Best Growth Stock?

Description

Fool contributor Matt Smith recently dubbed **Parkland Fuel** (TSX:PKI), Canada’s best growth stock, displacing **Dollarama** as Canada’s investment sweetheart.

Don’t get me wrong, I think Parkland’s got a great future ahead of it, but I wouldn’t go as far as anointing it Canada’s best growth stock. Shareholders of **Premium Brands** or **Canada Goose** would undoubtedly beg to differ.

But I digress.

What’s got me worried about Parkland’s expansion plans are lower gas prices. I know what you’re thinking. Aren’t lower gas prices better for gas station owners?

Well, not really. That’s because drivers generally pocket the savings rather than spending more on their visits to fill up. And if you think people will drive more just because gas is 10 cents a litre cheaper, while some will, it’s not likely to move the needle regarding revenues and profits.

In fact, gas stations are barely getting by when it comes to fuel sales.

Inc. magazine recently reported on the woes of gas station owners south of the border, suggesting privately held gas stations have experienced little to no revenue growth over the past 12 months, while generating profit margins of less than 2%.

“To put this into context, the average privately held company in the United States is seeing a more than 8% growth in revenue, year over year, with an average net profit margin of nearly 7%,” Sageworks analyst Libby Bierman said. “Gas stations are drastically underperforming the private company averages on these metrics.”

Parkland’s business model helps

“The owners of these gas stations should not be confused with ‘big oil,’” Bierman says. “Rather, this industry is full of small business owners like those we see in other retail operations where volume is important, and even small changes in profitability, whether positive or negative, are significant to the owners."

Of course, Parkland being one of North America's largest and fastest-growing independent fuel marketers is in a much stronger position than owner/operators of single gas-station locations.

Parkland's business model includes company-owned or leased locations (596 at the end of 2017) and dealer-owned or leased sites (1,252).

In the case of the company locations, Parkland either runs it or by an independent retailer on its behalf. That retailer gets a flat-rate commission for every litre sold. The retailer pays Parkland rent and a percentage of the convenience store sales.

In the case of the dealer locations, the company has five-year or more extended fuel supply contracts set at independently published rack prices. That's Parkland's only source of revenue.

So, at the company locations, Parkland loses when prices go down because the retailer gets the same commission but the retail price is lower. However, it still gets the same rent and percentage of convenience store sales.

Not to mention it owns the refinery in Burnaby, B.C., which gives it a big supply advantage over its competitors. In many respects, Parkland is less a retailer of fuel and convenience store operator and more a refiner and supplier of fuel.

The balance between owning company locations and the real estate on which those locations lie and dealer locations where it has no costs beyond what it takes to deliver fuel makes its business model very flexible.

Where real estate prices are reasonable and appreciating, it makes sense to have company-owned locations. In cities such as Vancouver, where real estate is out-of-this-world expensive, it makes sense to act as a supplier exclusively.

Do low gas prices pose trouble?

In the first nine months of 2018, Parkland sold 12.6 billion litres of fuel and petroleum products to customers in Canada and the U.S. Soon, it will also supply some Caribbean nations, providing economies of scale that very few gas stations, independent or those part of a chain, possess.

When you consider that the average 7-Eleven franchisee earns US$37,000 before tax in a year, I'd much rather be in Parkland Fuel's shoes than the poor man or woman who's essentially bought themselves a poor-paying job.

Parkland's consolidating ways will continue in 2019 and beyond. Low fuel prices aren't the kiss of death for Parkland, but they're also not a panacea for revenue growth either.

They're likely a wash.

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