"The Secrets Behind Casey's Success," May 29, 2011

The Company Behind Casey's Success
The company has come a long way from its humble start as a collection of small-town gas stations in the 70's

Ankeny, Ia. -- Less than a year after fighting off a hostile takeover by North America's second-largest owner of convenience stores, Casey's General Stores has settled back to doing what it does best: finding new ways to make money and expand in a slow economy.

New money-making efforts include the addition of a foot-long sub sandwich, much to the dismay of the Subway chain, which is trying to block Casey's from using the term ""footlong" in advertising, and delivery pizza, which Casey's is testing at a store in Clive.

On the expansion front, Casey's added 88 stores--74 through acquisition and 14 through new construction--during the nine months that ended Jan. 31, bringing to more than 1,600 the number of stores it now operates in Iowa and 10 surrounding states.

The publicly traded company began as a collection of gas stations in rural Iowa towns in the 1970s. It's been the only major convenience store chain to target communities of fewer than 5,000 residents, and it is now positioned to have a much larger footprint.

"Today, you can go about 500 miles in any direction and run into a Casey's," said chief executive Robert Myers from his office in Ankeny.

Recent growth has occurred despite the hostile takeover attempt a year ago by Alimentation Couche-Tard, a Canadian company that operates nearly 5,900 convenience stores in North America, including more than 3,800 Circle K stores.

That takeover battle cost Casey's more than $27 million, plus a $500 million debt restructuring that allowed it to buy back 25 percent of its own stock.

The seven-month effort helped convince shareholders of a truth that management has always known: Casey's is an atypical operator whose strengths aren't always appreciated.

Those strengths include the fact that Casey's is the only large convenience store chain with its own distribution system, and that it is a leader in selling prepared food and other items inside its stores where profit margins range from 30 to 60 percent, compared with single-digit margins for gasoline sales.

Another traditional Casey's strength has been a strong balance sheet, which had very little debt before the takeover effort.

That strong balance sheet, coupled with an undervalued stock price and Casey's position as an industry leader, made it an attractive target in early 2010 for Couche-Tard.

Chain's DNA includes imagination, caution

"The main thing that sets them apart is the strength of their food service program, which they continue to enhance," said Linda Lisanti, a writer at Convenience Store Magazine.

"They are very true to their business model, which focuses primarily on smaller communities," she said, although in recent years, the chain has also placed stores in larger communities, including the metro areas around Des Moines, Omaha and Kansas City.

Founders Don Lamberti and K.C. Fish launched the business with an imaginative, but conservative, business plan in the late 1960s, and those twin threads have been part of Casey's corporate DNA ever since.

When Lamberti retired in 2002, he said the best decision he ever made was during the Arab oil embargo of 11973-74 when gasoline stations were failing in waves. Casey's was just beginning its first round of major expansions, and officials worried whether they'd have gasoline to sell at the new stores.

"We determined that the cost of the stores could be carried by inside sales," Lamberti said in 2002. "We said, 'If we have to, we'll just put black bags over the pumps and not use them until gasoline is available.'"

As it turned out, they never needed the black bags.

But that early concept of boosting in-store sales of high-profit items, especially prepared food such as pizza, put Casey's years ahead of most competitors.

Casey's jumped ahead again in the 1990s by being one of the first chains to voluntarily replace underground storage tanks in advance of government regulations that required removal of the old tanks. Many operators refused to remove the tanks until new regulations required it. By then, many smaller operators couldn't afford the expense and had to go out of business, creating another expansion opportunity for Casey's.

Self distribution is another thing that sets Casey's apart, Lisanti said.

"Only a handful of operators own their own distribution," she said. It's a move that cuts out a key middleman and boosts profits.

Myers, Casey's current chief executive, is the guy who made self distribution work. His service with the company began in the 1980s, when Casey's built its headquarters in Ankeny, just off Interstate Highway 35.

A key part of the campus was the warehouse and distribution center, which the company continues to use more than 20 years later to deliver goods to its stores.

Myers was a local guy who grew up in Saylor Township, the unincorporated area between Des Moines and Ankeny, the same area where Lamberti had.

Myers was nine years younger than Lamberti, and after high school went into the Army. That was in 1966, two years before Lamberti and Fish bought their first service station in Boone.

By the time Myers retired from the Army as a colonel in 1988, Casey's was nearing completion of its headquarters and distribution facility in Ankeny. That's when Lamberti made what may have been his best hiring decision ever.

Much of Myers' military career had been in logistics.

Lamberti figured: Who better to run Casey's new distribution chain than a military logistics officer, who had been responsible for figuring out complicated schedules to make sure soldiers were fed, clothered and armed when, where and how they needed to be?

Myers took the job and worked his way up the chain of command, becoming chief executive in 2006.

Looking for the next 60 percent profit item

The key to Casey's success has always been its in-store sales of grocery items and prepared foods.

It was one of the first chains to begin selling prepared foods, including doughnuts, coffee and pizza in the early 1980s, and today it remains the most successful large chain handling prepared foods, Lisanti said.

They key to Casey's success is its profit margins of roughly 30 percent for grocery and non-food items and 60 percent for prepared foods.

Convenience stores discovered a long time ago that they could charge more than grocery stores for essentials, such as milk, juice and snack foods, as well as for must-have non-food items, like cigarettes. The stores have been criticized for charging more, especially in towns or neighborhoods lacking grocery stores. But the simple fact is that customers will pay more for the convenience of picking up those items when they stop to buy gas, thereby avoiding a trip to the supermarket.

It’s why major grocery chains, including Hy-Vee and Dahl’s, have added gasoline pumps and detached convenience stores in recent years.

The entry of grocers into the convenience store business is a concern to most convenience store chains, but not so much for Casey’s, Myers said, because so many of its stores are in small communities that don’t even have a grocery store.

The ultimate irony for Casey’s is not that it competes successfully with grocery stores. It’s that Casey’s has become a profitable fast-food outlet.

For more than a decade, the signature product of Casey’s has not been gasoline, or cigarettes or beer. It’s pizza, which Casey’s introduced in 1984.

With a profit margin of around 60 percent, it’s easy to understand why the chain’s managers love pizza.

In fact, they are now experimenting with pizza delivery at a store in the Des Moines suburb of Clive.

So far, Myers said, “we’re very pleased with the numbers we are seeing out of pizza delivery. But the question is: Are we making money? Are we making that 60 percent gross?”

“We’ve made it very lucrative for the delivery people,” Myers said, noting that like most places, Casey’s charges $2 to deliver pizza. But unlike most places, he said, Casey’s givers the full $2 to the delivery person, plus tips, instead of the traditional $1, plus tips.

So far, he said, the addition of a delivery service has boosted carry-out sales along with delivery sales.

“Our customers are excited, and we’re excited,” Myers said.

But before adding pizza delivery at other stores, he said, “we’re going to be careful about this. We’re going to have to make sure that it is profitable for us. And then we are going to have to be really sure about the markets that we adapt this program to.”

Moving too quickly can lead to costly mistakes. An example was Casey’s move into--and then out off--fried chicken.

Not long after Casey’s introduced pizza in 1984, it added fried chicken. The move involved buying special frying equipment and training employees to use it, just like the chain had done with pizza.

Fried chicken looked like it was going to be a big seller until managers discovered it had a much shorter shelf life. Unlike pizza, chicken could not be safely kept under a heat lamp for more than about half an hour, and the product was dropped.

Myers expects sub sandwiches to be Casey's next in-store success story. The chain is in the process of enlarging many of its stores to handle more products and more traffic and include a small seating area.

"A down economy does not treat us like it does other retail sectors," Myers said. "It presents us with opportunities."

Sidebar on Pg. 1

1. **Expansion**
   Casey's has taken advantage of uncertainty in the marketplace. During the oil embargo in 1973-74, Casey's began its first wave of major expansion. Casey's added 88 stores during the nine months that ended Jan. 31. At left is the first Casey's store in Boone.
2. **Financials**
   One of Casey's strengths has been a strong balance sheet with very little debt. Casey's took on $550 million in debt restructuring that allowed it to buy back 25 percent of its own stock. This helped convince shareholders that the company was undervalued.
3. **Food Offerings**
   In the 1980s, Casey's was one of the first chains to sell prepared foods, such as doughnuts and pizza. Casey's profit margins are roughly 30 percent for grocery items and 60 percent for prepared food. The company is now trying pizza delivery.

Sidebar on Pg. 2

Robert Myers won't say what he thinks is a fair price for Casey's shares, months after the company beat back a takeover attempt.

But he did say that if the bidding had ever gotten "to the real value of this company," plus the premium that he believes it is worth, "it would have been a different situation."

Couche-Tard's initial bid was $36 a share at a time when Casey's stock was trading between $30 and $32 a share. That was a year ago last April. By September, Couche-Tard had raised the bid twice, eventually to $38.50.

Then, 7-Eleven, the nation's second-largest owner of convenience stores, joined the bidding, offering $40, and later $43 a share.

By the time it ended in November, Casey's had rejected all bids and beaten back an attempt by Couche-Tard to place directors on Casey's board.

"It was all a question of value," Myers said.

Casey’s share price peaked at $44.67 in September, right after 7-Eleven’s second offer. It dropped below $36 in March when third-quarter results were lower than expected because of the cost of defending against the takeover.

The share price was traded between $38 and $40 most of this month.

“When you spend $27 million because of a hostile takeover, that’s what’s going to happen,” Myers said of the share price drop.