RESEARCH & CONSULTING

NSW SERVICE STATIONS INSIGHT

FEBRUARY 2017

HIGHLIGHTS

The rationalisation of sites and industry amalgamations have been significant over the past decade, as traditional operators began to focus on upstream activities, making way for the entry of the supermarket chains in the early 2000s

In line with population, NSW accounts for the largest number of service stations in Australia at 30%, moderately above Vic and Qld at 22% respectively

Service station ownership in NSW is highly concentrated within a select group of operators, with the four largest providers by brand accounting for 50% of NSW service stations. Caltex, BP, Shell-Coles Express and 7-Eleven are the largest players

In 2016, service station sales in NSW totalled $175.5 million, well above the level recorded in 2015. The sale of Shell -Coles Express service stations represented 28% of the total

The development of new service stations in NSW is increasing with 38 NTI sites established in 2015 and 2016. Development has been concentrated in key growth corridors where population growth has been significant

With secure globally recognised tenants offering solid leasing covenants and long-term cash flow, interest in the service station sector has grown rapidly in recent years.

Service Station Market Overview

Over the past two decades, the service station industry has changed markedly with traditional fuel providers reducing retail operations to focus on the more profitable upstream oil and gas sector. Once dominated by the likes of Shell, BP, Mobil and Caltex, the entry of the supermarket chains in the early 2000s raised the stakes, ultimately increasing competition and altering the traditional model of what consumers were being provided.

Following the mergers of Woolworths Limited to Caltex Australia and Coles Myer to Shell in the early 2000s, the most notable trend in the industry has been the reduction in the number of retail service stations, down from around 20,000 sites in the 1970s to around 6,400 today. This trend has been facilitated by a clear preference for higher volume outlets along key arterial roads where there is greater traffic volume, thereby providing increased economies of scale. This has come at the expense of independent operators as sites with supermarkets gained considerable market share by offering subsidised petrol prices through discount docket schemes.

The rationalisation of sites and industry amalgamations has been significant over the past decade as existing operators expanded at a time when there were new market entrants. In addition to the Woolworths and Coles respective mergers, Mobil sold its 295 service stations to 7-Eleven in 2009, taking their total store count to over 650. Following their divestment, Mobil exited the fuel retail industry to focus on upstream activities, albeit 7-Eleven announced plans in 2014 for the Mobil brand to be reintroduced to their petrol stations which came in response to the growing demand for premium fuels.

Similarly, following the sale of Shell's downstream assets to Vitol in 2014 to form Viva Energy, Shell withdrew from the fuel retailing space in Australia (Shell branding was retained). Other notable acquisitions include Puma Energy acquiring Matilda Fuels, Gull Fuels (WA), Ausfuel Group (NT) and Neumann's Petroleum. More recently and in one of the biggest acquisitions in the sector's history, BP purchased the Woolworth's petrol station business in late 2016 (for $1.79 billion), thereby taking control of its 527 petrol stations and 16 development sites. As part of the arrangement, Woolworths and BP will develop a joint fuel convenience store called Metro which will be trialled at pilot sites.

NSW SERVICE STATIONS

National Service Stations by State

Through industry amalgamations, the rationalisation of sites and a larger volume of fuel being sold from each site (at the expense of sites in secondary locations), the number of petrol stations in operation within Australia has declined to approximately 6,400, down from 8,370 in 2000 and around 20,000 in the 1970s.

In line with Australia's population being heavily skewed towards the eastern states of Australia, NSW, Vic and Qld has the largest number of service stations in Australia, collectively representing 74% of the national total. Notably, this proportion is slightly below the eastern states proportion of Australia's population at 77%. NSW accounts for the highest proportion at 30%, while Vic and Qld account for 22% respectively.

NSW Service Stations by Brand

The NSW service station industry is characterised by a moderate level of market concentration with the four largest providers by brand accounting for approximately 50% of service stations by number. Standalone Caltex branded service stations (excluding Caltex Woolworths) represent 17% of all service stations in NSW. Excluding BP's recent purchase of the Woolworths petrol station business, BP branded petrol stations accounted for 14% of all service stations in NSW. Taking into consideration the recent purchase of Woolworth's petrol business, this proportion will rise substantially, eclipsing Caltex and making it the largest provider by number in NSW.

Beyond this, Shell-Coles Express, 7-Eleven and Caltex Woolworths represent the next largest operators, accounting for 10%, 8% and 8% respectively by number. There is a large proportion of independent operators in NSW, accounting for 22% of service stations, a large share of which are located in regional and coastal areas of the state. The balance (21%) consists of smaller operators including Metro Petroleum (6%), Shell (2%) and Speedway (2%).

Service Station Sales

In response to an increase in demand for defensive assets which offer long-term cash flow and a secure long-term tenant, the weight of capital being directed towards the service station sector has grown substantially in recent years. Once dominated by the major operators and a select group of wealthy privates, low interest rates and elevated yield metrics (compared to the housing market and fixed interest) has enticed smaller private investors and self-managed super funds into the market, particularly in the sub $5 million range.

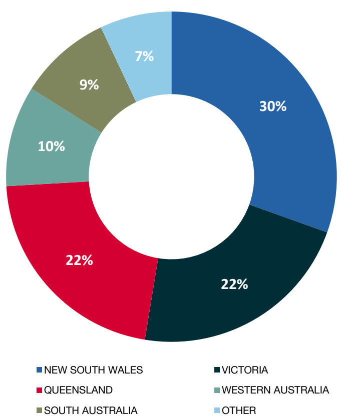
The appeal from investors in recent years has been underpinned by long term lease covenants, stable income backed by a globally recognised brand with fixed rental increases and low costs given outgoings and remediation is paid by the tenant.

As per Knight Frank Research's Service Station Database, service station acquisitions in NSW (excluding BP's purchase of Woolworths) totalled $175.5 million in 2016 across 39 transactions. This result was up 48% from 2015 where sales volumes in NSW totalled $118.6 million across 31 transactions. This increased activity comes as the market has shown broadening demand for well located service stations as investors move up the risk curve.

Unlike other commercial stock, demand for service stations is not metro centric with 66% of sales in NSW (by volume) in 2016 stemming from regional acquisitions. Notably, this is partly the result of the tightly held nature of metro service station assets where there is a high concentration of major operator ownership (BP and Caltex etc). Alternatively, there is a higher provision of independent operators in regional and coastal areas outside of Sydney.

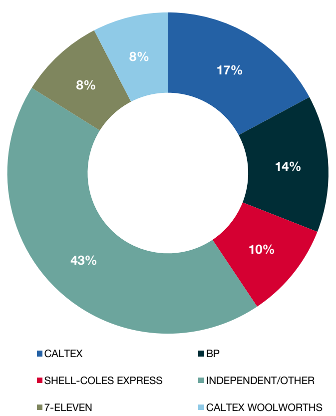
By brand, Shell-Coles Express service stations represented 28% (by volume) of NSW service station sales in 2016 at $50 million, underpinned by the recent sale of 190-198 Princes Highway, South Nowra for $11.32 million. The newly completed

FIGURE 1
Service Stations by Location
By State



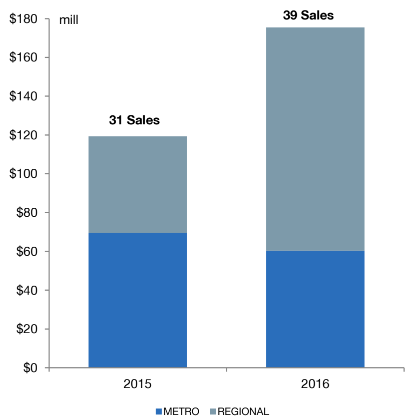
Source: Knight Frank Research, Australian Govt.

FIGURE 2
NSW Service Stations
By Brand



Source: Knight Frank Research, Fuel Check

FIGURE 3
NSW Service Station Sales
By Region & Year

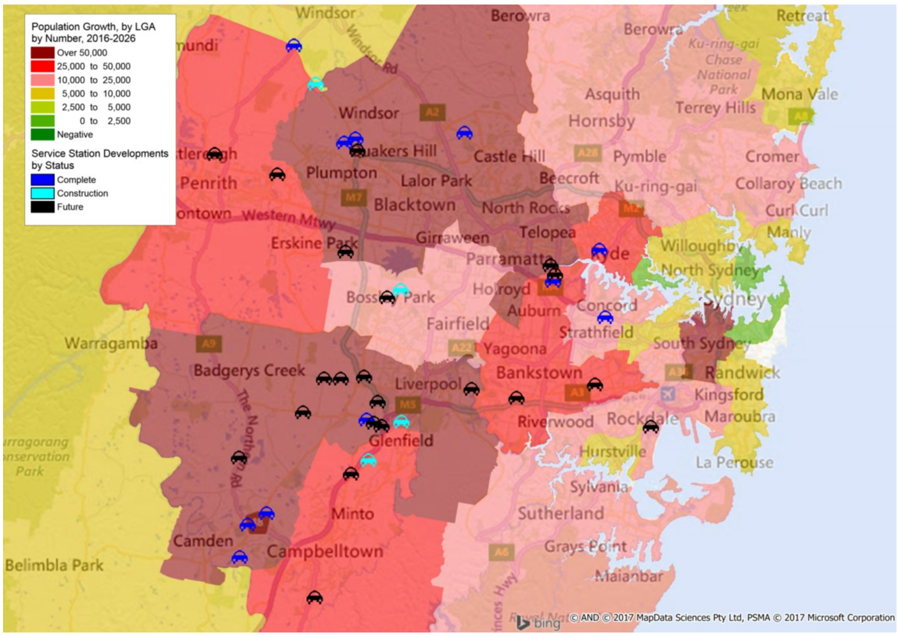


Source: Knight Frank Research

MAP 1

Sydney Service Station Supply and Population Growth

Service Station Completions (2015 & 2016) and Future Pipeline



Source: Knight Frank Research, ABS

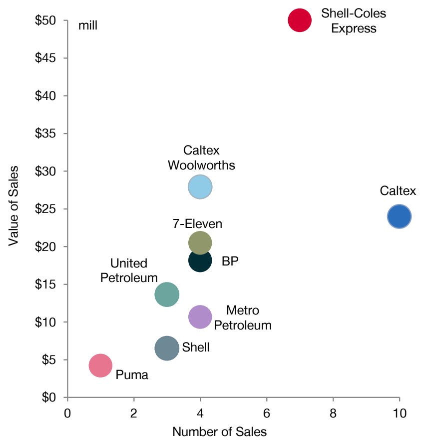
Shell Coles Express service station also included a freestanding Hungry Jack's restaurant and adjoining Subway restaurant, reflecting a net initial yield of 5.09%. The sale of several high profile Caltex Woolworths service stations in Sydney meant the Caltex Woolworths brand represented the second largest volume of sales in 2016, totalling $27.9 million for the period. Included in this was the sale of 662 Windsor Road, Kellyville for $9.4 million, representing a net initial yield of 5.0%. Beyond this, sales volumes in 2016 (for NSW) were also strong for Caltex branded service stations ($24.0 million) as well as 7-Eleven ($20.5 million).

With respect to yields, considerable compression has occurred for both metro and regional assets, underpinned by robust demand. For service stations backed by a globally recognised brand and whereby the tenant takes responsibility for the petrol tanks, metro yields have tightened from around 7.5%-8.5% in 2012 and 2013, to circa 5.5%-6.5% at present. Regional assets with solid leasing covenants are trading marginally higher, averaging 6.0% to 7.0%. There are outliers to this, with a handful of recent sales across both metro and regional areas trading at circa 4.0%.

FIGURE 4

2016 NSW Service Station Sales

By Brand, Value & Number

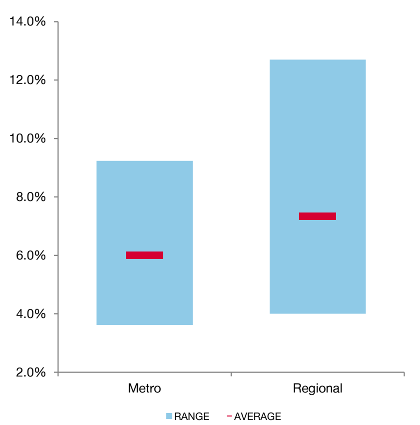


Source: Knight Frank Research

FIGURE 5

NSW Service Station Yields*

By Region, Net



Source: Knight Frank Research

* Based on actual sales in 2015 and 2016

NTI Sites

Off the back of increased petrol consumption due to a growing number of vehicles in NSW, coupled with continued population growth, the development of New to Industry (NTI) service stations has increased markedly over the past two years as operators look to capture market share and establish sites in key growth areas. Alternatively, a buoyant residential development market in Sydney in recent years has reduced the pool of future service station development sites in infill locations.

Knight Frank Research has identified 38 NTI sites which have been completed in 2015 and 2016 across NSW, while there are a further seven currently under construction. By region, 66% or 25 of completed NTI sites have stemmed from regional NSW with a particular focus around the Greater Hunter region. Notable NTI sites in this area include 7-Eleven at 210 Wollombi Road, Cessnock and Caltex Woolworths at 93 Pacific Highway, Charlestown.

For Sydney, recent completions have been largely concentrated in key growth corridors, namely being the South West and North West. Highlighted by Map 1, there have been several NTI sites opened adjacent to new estate areas where population growth has been significant. This includes a new BP at Smeaton Grange, a 7-Eleven at Edmondson Park and a new BP at Marsden Park.

With NSW's population expected to grow by a further 550,000 residents over the next five years alone, a number of operators are seeking to construct sites in strategic precincts which take advantage of this growth. At present, Knight Frank Research has identified 74 sites across NSW which either have a DA in place or are in the planning phase to construct a service station by 2020. Of the future pipeline, 59% are located in regional and coastal areas while the balance will stem from the broader Sydney area. The development of future service station sites in Sydney is heavily aligned with recent development trends, whereby the pipeline of NTI sites are located adjacent to the population growth corridors of the North West and South West (see Map 1).

OUTLOOK

The ownership structure of the service station sector is anticipated to change further over the next five years as major oil companies continue to scale down retail operations to focus on upstream activities. As a result, Coles and other independent operators are expected to increase their presence in the industry. In the short term however, an interesting period lies ahead as BP's purchase of the Woolworths service station business flows through and both established and new industry entrants look to gain market share. In order to gain market share, operators are likely to place a greater emphasis on convenience, range and fuel discounts through instore purchasers.

With the housing market becoming increasingly competitive, driven by a surge in price growth across the south eastern capital cities of Sydney and Melbourne, there is likely to be further spill over demand from private investors and self-managed super funds in this sector. The divergence between assets with high road exposure and anchored by a national tenant will remain, with sharp yield contraction expected for blue chip assets.

Following an extended period of consolidation in the sector through industry amalgamation and the rationalisation of sites, an increase in the number of service stations in NSW is expected over the next five years, underpinned by a solid pipeline of potential NTI sites. A lack of available sites at infill locations for development coupled with inner and middle ring locations being well serviced by existing operators means the next wave of NTI sites in Sydney will follow population growth in the growth corridors of the South West and North West.

With new market entrants aggressively seeking assets in the sector, investor demand will remain high while continued downward pressure on yields is expected, however restricted by the lack of available stock.

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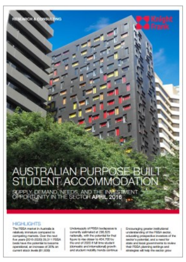

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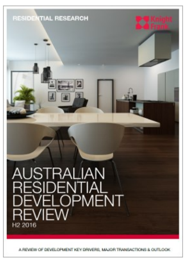

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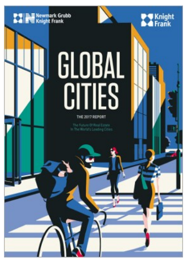

Global Cities 2017

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