

# BUY: CST Brands (NYSE :CST)

Prithish Ray - MiF FT 2013

Date	23-May-13	Current price	33.16	Target price	53
Market Cap	2,500	Net Debt	-66	Shares Outstand	75.4
EV	2,434	EBIT LTM	325	EV/EBIT LTM	7.5
EPS	2.88	P/E LTM	11.5	Price /TBV	1.9

*All values in USD millions, except per share data and ratios.*

CST Brands, a spin-off from the refining major Valero is a special situation BUY because

1. The spin-off will help the market discover CST's true price in the convenience retailer sector
2. The spinoff will also allow the new management of CST to follow a more active growth strategy
3. The company is attractively valued relative to its publicly traded peers.

## Background

After spinning off from parent Valero, CST Brands became the second largest publicly traded convenience store retailer in North America. CST employs nearly 11,000 Team Members at 1,880 locations throughout the South-western United States and Eastern Canada. Most stores are located on high-traffic commuter routes within metro areas. Of these nearly 80% of the store real-estate sites are company owned.

## Investment thesis

1. Unlocking value through spinoff - creating a publicly traded retail division will create interest in investors and the sell side. The independent business structure will help in easier price discovery and help stimulate demand among investors.
2. Focussed management with aggressive growth plans-Scope for adding value to the firm with a focussed management team offering aggressively-managed retail stores with optimized product offerings.
3. Improved capital allocation – As a minor subsidiary, CST had always missed out on capital allocation and growth opportunities. The new management is determined to invest heavily into the company's growth strategy and to do so it has \$550 mn of credit under the belt.
4. Opportunities for consolidation: The new pure retail structure of CST offers opportunities for making acquisitions in the highly fragmented convenience retail industry where 65% of stores are owned by individuals.
5. Possible takeover target – The pure retail structure also invites possible suitors to bid for CST for an acquisition.
6. Significant real-estate ownership – 80% of the 1,880 odd stores operate on self-owned real estate. This gives a competitive advantage to the firm to operate through the real estate cycles as it mitigates the impact of lease risks. It also adds a real-estate play to the company's business.
7. Scope for margin expansion –CST's product mix had thus far been ignored by its parent. Compared to its convenience retail peers, CST is over invested in low-margin products like

cigarettes and under invested in high margin products like in-house food products. The new management wants to turn this around and boost the margins of the company.

- Trading at a significant discount to peers – CST is trading at an LTM EV/EBIT of 7.5x while its peer group trades at a range of 12x-17.2x. CST's LTM PE is 11.5x compared to a peer range of 20.1x to 22.7x.

## Trading multiples

CST is trading at a discount to its peers in the pure-play specialty retail sector.

Peer group trading multiples							
Company Name	EV/Sales LTM	EV/EBITDA LTM	EV/EBIT LTM	P/E LTM	P/TangBV LTM	NTM Forward P/E	
Alimentation Couche-Tard Inc. (TSX:ATD.B)	0.4x	11.6x	17.2x	20.1x	8.7x	15.44x	
Casey's General Stores, Inc. (NasdaqGS:CASY)	0.5x	9.6x	14.5x	21.5x	5.0x	18.51x	
Susser Holdings Corporation (NYSE:SUS)	0.3x	8.6x	12.0x	22.7x	9.5x	21.31x	
The Pantry, Inc. (NasdaqGS:PTRY)	0.2x	5.8x	13.2x	NM	NM	-	
CST Brands, Inc. (NYSE:CST)	0.2x	5.5x	7.5x	11.5x	1.9x	14.35x	
Summary Statistics	EV/Sales LTM	EV/EBITDA LTM	EV/EBIT LTM	P/E LTM	P/TangBV LTM	NTM Forward P/E	
High	0.5x	11.6x	17.2x	22.7x	9.5x	21.31x	
Low	0.2x	5.8x	12.0x	20.1x	5.0x	15.44x	
Mean	0.4x	8.9x	14.2x	21.4x	7.7x	18.42x	
Median	0.4x	9.1x	13.9x	21.5x	8.7x	18.51x	

## Valuation

CST can be valued on the basis of its publicly traded peers. The average multiple of the peer group has been used as the target multiple. Valuation has been done on the basis of four different multiples and then the lowest of the four prices has been used to set a conservative target price. The calculated target price for CST Brands comes to \$53/share. This implies a P/E of 18.4x which is slightly below the 20+ P/E suggested by the EBIT growth – Return on tangible capital (ROTC) framework. (EBIT CAGR=10.3%, ROTC = 20%). This adds to the conviction that the valuation is conservative.

Valuation				
Company Name	Total Revenue	EBITDA	EBIT	Basic EPS
CST Brands, Inc. (NYSE:CST)	11,124.0	443.0	325.0	2.88
	TEV/Total Revenues	TEV/EBITDA	TEV/EBIT	P/Diluted EPS Before Extra
Mean	0.4x	8.9x	14.2x	21.4x
Implied Enterprise Value	3,893.4	3,942.7	4,623.1	
+ Net Cash	74.0	74.0	74.0	
= Implied Equity Value	3,967.4	4,016.7	4,697.1	4,654.29
/ Shares Outstanding	75.4	75.4	75.4	75.4
= Implied Price per Share	52.6	53.3	62.3	61.73
Mean Equity Value Across Multiples	Equity Value	Price Per Share		
High	5,360.54	62.3		
Low	3,320.24	52.62		
Mean	4,333.88	57.48		

All values in millions, except per share data and ratios.

## Market misperception

The market maybe undervaluing CST due to several reasons

- There may be some hangover of Valero's refining business multiple (PE 7.1X) that was typically applied to CST's earnings before the spin-off. It may take the market a little while to adjust.

2. There would be some selling pressure due to selling by Valero shareholders who have found themselves with CST's stock after the spinoff are not interested in holding CST. This selling pressure should abate in 3-6 months.
3. CST is a much smaller company compared to Valero and it may take a while for it to create due interest in the sell-side and investment community.

#### Management stocks and options

The top management is rapidly increasing its stake in the equity of the company. This can be taken as a sign of the insiders' confidence in the company:

1. Top management acquired 172,000 shares (0.2% of the firm) on 6th May
2. According to the form 10 filing the top management has been offered 253,400 shares (0.2%) as a retention plan
3. According to Form S-8 registration statement, 8 million shares (10.6%) issuable pursuant to the CST Brands, Inc. 2013 Omnibus Stock Incentive Plan at \$ 30.63/share.

#### Capital Expenditure and allocation

As a subsidiary of a parent company with ten times its revenues, CST's primary purpose was to provide Valero an adequate retail outlet to sell gasoline. Expansion opportunities for CST were not a priority of the firm and were often overlooked by the parent. Hence CST's operations did not receive an adequate share of capital investment. In a Form 10 filing, CST Brands has indicated that after separation, its first priority for capital allocation will be to fund its growth program. Thanks to structuring of the spin-off, the new management has plenty to capital at its disposal. Including its \$300MM revolver, CST Brands currently has > \$550MM in liquidity it can easily draw upon.

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## Appendix

### Balance Sheet

<b>Balance Sheet</b>					
<b>Balance Sheet as of:</b>					
<b>Currency</b>	<b>Dec-31-2009</b>	<b>Dec-31-2010</b>	<b>Dec-31-2011</b>	<b>Dec-31-2012</b>	<b>Mar-31-2013</b>
	<b>USD</b>	<b>USD</b>	<b>USD</b>	<b>USD</b>	<b>USD</b>
<b>ASSETS</b>					
Cash And Equivalents	-	102.0	132.0	61.0	70.0
<b>Total Cash &amp; ST Investments</b>	-	<b>102.0</b>	<b>132.0</b>	<b>61.0</b>	<b>70.0</b>
Accounts Receivable	-	123.0	145.0	113.0	224.0
Other Receivables	-	22.0	27.0	21.0	-
<b>Total Receivables</b>	-	<b>145.0</b>	<b>172.0</b>	<b>134.0</b>	<b>224.0</b>
Inventory	-	155.0	159.0	168.0	177.0
Prepaid Exp.	-	6.0	10.0	8.0	13.0
Deferred Tax Assets, Curr.	-	14.0	12.0	13.0	15.0
Other Current Assets	-	-	-	-	-
<b>Total Current Assets</b>	-	<b>422.0</b>	<b>485.0</b>	<b>384.0</b>	<b>499.0</b>
Gross Property, Plant & Equipment	-	1,614.0	1,678.0	1,863.0	1,861.0
Accumulated Depreciation	-	(476.0)	(525.0)	(587.0)	(603.0)
<b>Net Property, Plant &amp; Equipment</b>	-	<b>1,138.0</b>	<b>1,153.0</b>	<b>1,276.0</b>	<b>1,258.0</b>
Other Intangibles	-	54.0	47.0	41.0	56.0
Other Long-Term Assets	-	7.0	6.0	8.0	8.0
<b>Total Assets</b>	<b>=</b>	<b>1,621.0</b>	<b>1,691.0</b>	<b>1,709.0</b>	<b>1,821.0</b>
<b>LIABILITIES</b>					
Accounts Payable	-	87.0	84.0	95.0	117.0
Accrued Exp.	-	124.0	125.0	130.0	113.0
Curr. Port. of Cap. Leases	-	1.0	1.0	1.0	1.0
Curr. Income Taxes Payable	-	-	-	-	7.0
Other Current Liabilities	-	3.0	2.0	2.0	-
<b>Total Current Liabilities</b>	-	<b>215.0</b>	<b>212.0</b>	<b>228.0</b>	<b>238.0</b>
Capital Leases	-	5.0	5.0	4.0	3.0
Def. Tax Liability, Non-Curr.	-	113.0	124.0	123.0	121.0
Other Non-Current Liabilities	-	95.0	101.0	107.0	108.0
<b>Total Liabilities</b>	-	<b>428.0</b>	<b>442.0</b>	<b>462.0</b>	<b>470.0</b>
Common Stock	-	1,031.0	1,094.0	1,082.0	1,196.0
Additional Paid In Capital	-	-	-	-	-
Retained Earnings	-	-	-	-	-
Treasury Stock	-	-	-	-	-
Comprehensive Inc. and Other	-	162.0	155.0	165.0	155.0
<b>Total Common Equity</b>	-	<b>1,193.0</b>	<b>1,249.0</b>	<b>1,247.0</b>	<b>1,351.0</b>
<b>Total Equity</b>	<b>=</b>	<b>1,193.0</b>	<b>1,249.0</b>	<b>1,247.0</b>	<b>1,351.0</b>
<b>Total Liabilities And Equity</b>	<b>=</b>	<b>1,621.0</b>	<b>1,691.0</b>	<b>1,709.0</b>	<b>1,821.0</b>

## Income Statement

Income Statement					
For the Fiscal Period Ending	12 months Dec-31-2009 USD	12 months Dec-31-2010 USD	12 months Dec-31-2011 USD	12 months Dec-31-2012 USD	LTM 12 months Mar-31-2013 USD
Currency					
Revenue	7,063.0	8,518.0	10,916.0	11,148.0	11,124.0
Other Revenue	-	-	-	-	-
<b>Total Revenue</b>	<b>7,063.0</b>	<b>8,518.0</b>	<b>10,916.0</b>	<b>11,148.0</b>	<b>11,124.0</b>
Cost Of Goods Sold	6,094.0	7,457.0	9,788.0	10,013.0	9,976.0
<b>Gross Profit</b>	<b>969.0</b>	<b>1,061.0</b>	<b>1,128.0</b>	<b>1,135.0</b>	<b>1,148.0</b>
Selling General & Admin Exp.	633.0	664.0	695.0	705.0	705.0
R & D Exp.	-	-	-	-	-
Depreciation & Amort.	101.0	105.0	113.0	115.0	118.0
Other Operating Expense/(Income)	-	-	-	-	-
<b>Other Operating Exp., Total</b>	<b>734.0</b>	<b>769.0</b>	<b>808.0</b>	<b>820.0</b>	<b>823.0</b>
<b>Operating Income</b>	<b>235.0</b>	<b>292.0</b>	<b>320.0</b>	<b>315.0</b>	<b>325.0</b>
Interest Expense	(1.0)	(1.0)	(1.0)	(1.0)	(1.0)
Interest and Invest. Income	-	-	-	-	-
<b>Net Interest Exp.</b>	<b>(1.0)</b>	<b>(1.0)</b>	<b>(1.0)</b>	<b>(1.0)</b>	<b>(1.0)</b>
Other Non-Operating Inc. (Exp.)	1.0	2.0	1.0	1.0	2.0
<b>EBT Excl. Unusual Items</b>	<b>235.0</b>	<b>293.0</b>	<b>320.0</b>	<b>315.0</b>	<b>326.0</b>
Impairment of Goodwill	-	-	-	-	-
Asset Write-down	(13.0)	(5.0)	(3.0)	-	-
Legal Settlements	-	2.0	-	-	-
Other Unusual Items	-	-	-	-	-
<b>EBT Incl. Unusual Items</b>	<b>222.0</b>	<b>290.0</b>	<b>317.0</b>	<b>315.0</b>	<b>326.0</b>
Income Tax Expense	76.0	97.0	103.0	105.0	109.0
<b>Earnings from Cont. Ops.</b>	<b>146.0</b>	<b>193.0</b>	<b>214.0</b>	<b>210.0</b>	<b>217.0</b>
Earnings of Discontinued Ops.	-	-	-	-	-
Extraord. Item & Account. Change	-	-	-	-	-
<b>Net Income to Company</b>	<b>146.0</b>	<b>193.0</b>	<b>214.0</b>	<b>210.0</b>	<b>217.0</b>
Minority Int. in Earnings	-	-	-	-	-
<b>Net Income</b>	<b>146.0</b>	<b>193.0</b>	<b>214.0</b>	<b>210.0</b>	<b>217.0</b>

## Cash Flow Statement

Cash Flow					
For the Fiscal Period Ending	12 months Dec-31-2009	12 months Dec-31-2010	12 months Dec-31-2011	12 months Dec-31-2012	LTM 12 months Mar-31-2013
Currency	USD	USD	USD	USD	USD
<b>Net Income</b>	<b>146.0</b>	<b>193.0</b>	<b>214.0</b>	<b>210.0</b>	<b>217.0</b>
Depreciation & Amort.	90.0	94.0	101.0	103.0	106.0
Amort. of Goodwill and Intangibles	11.0	11.0	12.0	12.0	12.0
<b>Depreciation &amp; Amort., Total</b>	<b>101.0</b>	<b>105.0</b>	<b>113.0</b>	<b>115.0</b>	<b>118.0</b>
Asset Write-down & Restructuring Costs	13.0	5.0	3.0	-	-
Other Operating Activities	(2.0)	8.0	18.0	(3.0)	(2.0)
Change in Acc. Receivable	9.0	(11.0)	(30.0)	41.0	41.0
Change in Inventories	-	(3.0)	(5.0)	(5.0)	(5.0)
Change in Acc. Payable	-	7.0	(2.0)	4.0	4.0
Change in Other Net Operating Assets	(5.0)	19.0	(3.0)	2.0	(63.0)
<b>Cash from Ops.</b>	<b>262.0</b>	<b>323.0</b>	<b>308.0</b>	<b>364.0</b>	<b>310.0</b>
Capital Expenditure	(64.0)	(105.0)	(130.0)	(156.0)	(179.0)
Sale of Property, Plant, and Equipment	5.0	3.0	5.0	2.0	1.0
Cash Acquisitions	-	-	-	(61.0)	(61.0)
Divestitures	-	-	-	-	-
Invest. in Marketable & Equity Secur.	-	-	-	-	-
Net (Inc.) Dec. in Loans Originated/Sold	-	-	-	-	-
Other Investing Activities	(3.0)	(2.0)	(2.0)	-	2.0
<b>Cash from Investing</b>	<b>(62.0)</b>	<b>(104.0)</b>	<b>(127.0)</b>	<b>(215.0)</b>	<b>(237.0)</b>
Short Term Debt Issued	-	-	-	-	-
Long-Term Debt Issued	-	-	-	-	-
<b>Total Debt Issued</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>
Short Term Debt Repaid	-	-	-	-	-
Long-Term Debt Repaid	(1.0)	(1.0)	(1.0)	(1.0)	-
<b>Total Debt Repaid</b>	<b>(1.0)</b>	<b>(1.0)</b>	<b>(1.0)</b>	<b>(1.0)</b>	<b>(1.0)</b>
<b>Total Dividends Paid</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>
Special Dividend Paid	-	-	-	-	-
Other Financing Activities	(205.0)	(220.0)	(150.0)	(219.0)	(145.0)
<b>Cash from Financing</b>	<b>(206.0)</b>	<b>(221.0)</b>	<b>(151.0)</b>	<b>(220.0)</b>	<b>(146.0)</b>
Foreign Exchange Rate Adj.	1.0	1.0	-	-	-
<b>Net Change in Cash</b>	<b>(5.0)</b>	<b>(1.0)</b>	<b>30.0</b>	<b>(71.0)</b>	<b>(73.0)</b>

## Profitability Ratios

Profitability ratios					
For the Fiscal Period Ending	12 months Dec-31-2009	12 months Dec-31-2010	12 months Dec-31-2011	12 months Dec-31-2012	LTM 12 months Mar-31-2013
Return on tangible capital	NA	20%	21%	20%	19%
Return on Equity	NA	NA	18%	17%	NA
EBIT Margin	3%	3%	3%	3%	3%
EBIT CAGR	10%				