October 11, 2011

Dear clients and colleagues,

The US economy is still on a recovery path. Economic indicators are mixed but generally still indicating growth. One number we pay particular attention to, is truck-miles driven, since trucking is highly correlated to GDP growth. This week we will profile a company that has huge leverage on the improvement of the US economy, TravelCenters (TA US - US$3.40) http://www.tatravelcenters.com

Business overview and history

TravelCenters is the second largest truck stop operator in the US with 234 locations, including 40 franchised. A typical TA or Petro location has a large parking lot that can fit almost 200 trucks and 100 cars, sells fuel and diesel, offers truck maintenance and repair and has a large building with full and quick service restaurants, showers, convenience stores and even fitness facilities, primarily catering to truck drivers.

Fuel sales are about 80% of revenues and have a low gross margin of around 5% while non fuel sales have a gross margin exceeding 55%.

The market

There are over 6000 truck stops in the US and the top 10 players have 20% of the market. TA is the second largest player with 234 centers, behind Pilot/FlyingJ. The industry is directly affected by trends in the trucking industry and as such is highly correlated to GDP growth.

Trends are encouraging. Volumes y-o-y have now been growing for 20 months and pricing (ex fuel surcharge) is also on an uptrend.

In the longer term, legislation limiting the number of consecutive hours drivers can drive could be a positive for TA as truckers will have to take more rest in truck stops.

Competitive advantages and competition

In a fragmented market, truck stop operators have little pricing power and must maintain the lowest fuel price to attract traffic. However, TA has several advantages to attract more fleet and drivers. With more truck parking spots per location and more diesel dispenser, customer wait time is much reduced. In addition, the company has more amenities like 60% more showers per site than FlyingJ. Other differentiators include more table restaurants as well as over 1000 truck service bays opened 24/7 and a road squad with more than 400 vehicles assisting truckers with roadside emergencies.

The competition is very fragmented but with Pilot acquiring FlyingJ, pricing, especially for fleet owners has become much more rational.

Growth strategy

The company's strategy is to improve its locations. Amongst initiative: price sign enhancement, that is adding highway signs displaying fuel prices, to allay the perception that TA charges more. The company is also increasing the number of sites with branded gasoline. Currently only 64% offer brands such as Exxon/Mobil, Shell, etc. Branded sites sold 87% more gallons on average thus also driving traffic inside the store.

The company is also remodeling its table service restaurants and improving its loyalty card program. Finally, TA is acquiring distressed stores affected by the crisis. It recently acquired 8 centers that were renovated, rebranded and reopened. These stores were acquired for around 4x trailing cash flow.

Management

TA was spun-off from HPT (Hospitality Trust) in 2007. Many members of the executive team were at HPT prior to the spin-off. HPT owns 8.5% of TA stocks and the president and CEO owns 4.9%.

Risks

The company has important fixed costs and has huge operating leverage. Although the balance sheet is solid, a recession would significantly reduce earnings power. In addition, proposed legislation to privatize state rest stops could create new competitors with prime locations.

Market data

Market Cap US$95M, P/tangible Book: BV: 0.2x, P/E (12/2012) 4.0x, EV/EBITDA (12/2012) 2.7, dividend yield, nil.

Valuation

We use a DCF model with a growth rate of 7% for the next 7 years and a growth rate at maturity of 5% and a risk premium of 8.5%. Our target price is US$7.20.

Have a good week.

The Global Alpha Team