

Murphy USA

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John Royall: Good morning. Thanks for joining us. For those of you who don't know me, I'm John Royall. I work on Phil Gresh's integrated oils and refining team here at J.P. Morgan. I have lead coverage on the fuel, retail, and convenience store group.

Very happy to be joined today by Andrew Clyde, president and CEO of Murphy USA. Andrew's been CEO of the company for the length of its existence as a public company, since 2013, following a long career on the consulting side.

Andrew, I appreciate you joining us today. I know you have a prepared presentation and some very impressive numbers that you put out this morning, so I'll hand it over to you and let you begin.

Andrew Clyde: Great. Thanks, John, and thanks, J.P. Morgan, for hosting this. We're certainly getting used to this format. I'm still getting used to figuring out exactly where to look at the camera at these virtual conferences.

We have a virtual town hall this week and I'm getting a lot of advice from my kids these days on how to do some of these things. I'm glad to have you all join today.

I'll go through the slide deck that was sent out in our 8-K release. I'll just make reference to the page numbers for folks to follow along. Obviously, slide two we've got the usual cautionary statements, which I encourage you to read. Slide three has some background on those in attendance with me today.

Let me start with slide four. This is a chart that we've been really proud of. When we first put it together a few years ago, it was pretty impactful when you think about a several-year run as a public company spinoff to have your average share price higher year-over-year, your low share price higher year-over-year, and your high improve year-over-year.

Even in this COVID world, we didn't hit a low that was as low as 2019. I'll still take the over on beating 2019's high for this year. I know this is an energy conference. One comment I'd make when you look at this chart, early on there was a lot of volatility in our share prices. People looked at how fuel margins might behave relative to the underlying commodity.

Certainly in 2014 we had outsized margins when crude prices fell off and then were entrenched in 2015. We've seen that pattern before. Those of you who followed the renewable fuel standards and RINs, there was that period of political uncertainty.

As a large blender of ethanol into gasoline, we went through that period where we had to defend our position that this is built into our integrated margin just like it is with refiners. There's not a windfall for us or a material cost for the refiners. It's in the supply price at the refinery gate, etc.

One of the things that we've seen absent COVID is a little bit of narrowing in some of the volatility of our shares as we're seeing more now as a convenience retailer. Probably just with an outsized exposure to gasoline. We'll talk about how that's really paid off for us in the current environment.

One of the things this chart sets up is the boxes on the right-hand side. When we say "set the bar," what we did is we looked back and said from spin to 2018, we generated total shareholder returns of 14 percent on a compounded annual growth rate.

We did that essentially through three things. We took our EBITDA the first year of $340 million, it was around $285 million the year before the spin, and upped it to over $400 million. We reduced the shares outstanding by over 30 percent. We raised our multiple 50 percent as we went from an unknown spinoff to a company that was known for strategy and execution. We ask ourselves, "What will we have to do to maintain this trajectory over the next five-year period?"

The math was pretty simple. We needed to put a five in front of the EBITDA number first and grow EBITDA to over $500 million. Because of the significant amount of share repurchases we've done in the past, we only needed to reduce our share count by a million shares a year. We made a significant dent in that already this year and then continue to grow our multiple.

All we really needed to do is add another turn from a 9 to a 10 to achieve that. Those were the goals that we set for ourselves. Then the remainder of this deck really speaks to how we aim to achieve those goals, especially in a normal environment. If you turn the page to slide five, the chart on the left is what we call our simple formula for growing earnings per share.

This, at the heart, is a really, really simple business. We spend a lot of time trying to make sure we don't add complexity to it where it's not needed. The math is pretty simple. You start with the organic growth. Our strategy is to build and rebuild our assets where we have the right to win.

For us, this means building a fleet of 30 this year, 50 next year and the following years, of these larger 2,800-square-foot stores that have higher returns, higher performance, higher EBITDA per store than the average in our fleet.

Convert the kiosks that we were known for when this company started in 1997, in front of Walmarts, to larger 1,400-square-foot stores and really manage the portfolio for the long term. Our oldest stores are just barely 20 years old.

We don't have the aging, single-wall, steel tanks that many of the 40, 50-year-old stores that are trading out there at higher multiples go for. We've got a clean, environmentally sound network.

The middle three bars are really how do we improve productivity to our large base of stores. When we spun off, we had close to 1,200 stores. We have close to 1,500 stores now. When you have that large base, one-cent improvements can go a really long way when you're selling over four billion gallons of gasoline and diesel a year.

We'll do that by improving our fuel contribution, our fuel breakeven requirement, which is essentially our merchandise contribution minus the operating expenses, and then being disciplined around our corporate costs.

Really, improving that productivity does give us a competitive advantage. We'll talk about the industry structure and the relative advantage we've gained since spin relative to the industry average and then the third and fourth-quartile players out there in the industry.

For matter of reference, at the spin, our fuel breakeven was about 3.4 cents per gallon. That's the amount of fuel margin we needed to cover all our cash costs before credit card fees. We've taken that number close to a half a cent a gallon.

Meanwhile, the industry third-quartile performers have gone from below 20 cents per gallon to over 25 to 28 cents per gallon. That competitive gap continues to widen, which especially favors us in the current environment.

Then the denominator, the shares outstanding, we've been committed to shareholder distribution

since our spin-off. For every billion dollars of capital we spent on growth and improvement, we've bought back a billion dollars worth of our stock.

To date, we've repurchased over 35 percent of our shares. We're going to continue to allocate our capital in a very strategic and disciplined manner as we go forward.

If you turn to slide six, one of the things that we've been doing over the past two or three of these virtual calls is seeking to increase the already high level of transparency we've had with investors since the spin during this crisis to give folks a sense of how is this business performing in this environment.

As we had our Q1 conference call, we talked about March in three periods of 10 days and the first 10 days of April. We showed some prior last 10-day metrics for prior months in our previous investor meeting.

Today, with April and May results behind us, we're sharing our second-quarter-to-date unaudited financial results here on this page, then June month-to-date numbers.

In a nutshell, what I would say is our business is built for an environment like this, based on the customers we serve, the locations we serve them through, the offers we deliver, our customer associates' interaction with those customers, the strength of our supply chain and our partners, and the overall spirit of our employee base that's allowed us to contribute to these numbers.

As you go down the page, let me start with our fuel gallons. On an average per store month basis, we're down 28.6 percent gallons in April and May versus prior years. The industry as a whole was down about 50 percent. It's coming back at a slow clip. We've seen June month-to-date down 25 percent, so we're about 75 percent of our volume.

We've had some days where it's been at 80 percent, and it varies a lot state by state, market by market. We are seeing a steady recovery in volumes from a demand standpoint. Let's be clear, demand for light-duty passenger vehicles and trucks has still not recovered, but we believe it's recovered for us at a higher level than that of the industry.

How does this translate into total fuel contribution? If we're at 72 percent of our gallons for April and May, and our total fuel contribution is up 120 percent, that means the margins are at a significantly higher level than they were in the prior years. Even in June month-to-date, our contribution is still up 15 percent.

Effectively, what we see happening here is we saw this unprecedented falloff in crude prices before the COVID demand destruction took place. There were periods there where we were earning 50, 60, 70-cent margins as prices starting falling off.

For a high-volume, low-margin retailer like ourselves, if you're at 50-cent margins and you're normally at 12.5-cent margins, you're at 400 percent margin improvement. If your volumes were at 70 percent, you're still at almost 300 percent contribution improvement relative to your prior year performance.

We had levels that were 300 to 400 percent, and for the overall period, ended up +120 percent. For the industry, you had independents that may have been at a 30-cent margin to start with now that are at a 60-percent margin. They're up 200 percent, but their volume's cut in half. Their contribution level's only at 100 percent of what it was.

As margins started coming down due to competitive pressures, and then as crude prices are restored and product prices and margins compressed, the weaker industry players saw fuel contribution for a lot of this period below 100 percent of prior year.

What we've been able to do because of our historically low-margin, high-volume position is maintain fuel contribution well over 100 percent. Even when it got just under 100 percent for a couple of days last week, we saw, with crude prices fall-off and some other changes in the market, we're well back to over 100 percent.

That's how that dynamic played out. Being everyday low-price, high-volume, low-margin, our business model, on the left-hand side of the supply curve, took significantly more advantage from this position than those weaker participants on the right-hand side of the supply curve that effectively set the margin for the industry.

If you look at the merchandise acceleration, we were, on tobacco sales, already growing nine percent year-over-year in February, where the industry was down single digits. As we saw in March with the pantry stocking and some of the pre-buying, the sales continued to accelerate for a number of reasons.

One, we believe our proximity to Wal-Mart continues to be an advantage. Where many firms only sell single packs of tobacco, we've always been noted for selling a higher percentage of cartons. Our carton sales have increased significantly as the number of trips and transactions decreased.

We are seeing transaction counts in June now approximating very closely to prior year as those are catching back up. We made a significant investment, $30 to $40 million of investment, in our merchandise inventory to maintain in-stocks. We had an in-stock rate of 99.2 percent before. That increased to 99.3 percent.

We worked closely with our supply chain partner Core-Mark to help them as we went from twice-a-week deliveries to once-a-week deliveries and built up inventory. We invested in this period to maintain the inventory for our customers. As you can see, June month-to-date, that sales acceleration continues as we're close to 20 percent year-over-year.

Non-tobacco sales in the Q1 took a little bit of a dip, but now those have continued to increase, now at the same level as our tobacco sales. This is where I think the company showed agility in developing supply chains for hand sanitizers, masks, other personal protective equipment, etc.

We've seen a resurgence in some other categories as traffic and trips have started to increase. This was an area in Q1 that was mostly tobacco, less about non-tobacco. Now, both of those major groupings are performing at a really high level.

As a result of that, our merchandise contribution quarter-to-date shows improvement of close to 12 percent, and June month-to-date is an improvement on top of that as well.

On operating expenses, we've always been a pretty lean operator. They were down 3.3 percent quarter-to-date. One of the things we've found is we've made all the necessary investments for our people including designing, implementing, installing a protective barrier system ourselves in under a week. Getting the personal protective equipment to our staff and having customer service improvements at a greater level than many of our competitors during this period. Some of the velocity-based costs like supplies and certain maintenance actually decreased with fuel volume, so we ended up with a net savings there. Some of these savings are temporal in nature, associated with the reduced gallons.

Probably the most impressive number is the adjusted EBITDA for Q2 to-date of $197 million. We fully expect to end second quarter with record earnings for the period, which sets us up very well from a cash position as we enter into the second half of the year.

Do we know what's going to happen in the second half of the year? At this point, it's not exactly clear to any of us. Are we going to see a resurgence in virus cases? Is the economy going to fully

reopen? Are we going to see all the transactions come back to the same level?

Those are things that we're keeping a very sharp eye on. From a liquidity standpoint, debt standpoint, etc., we are extremely well-positioned to do this.

The remainder of this deck largely is material that is unchanged since the prior investor conferences. I'm not going to go through that in any great detail. One of the things I would highlight though is slide number 10. I think this is an area where there probably hasn't been as much focus in the past from investors.

It's a major part of our story of, "How do you get to $500 million in EBITDA on a continued basis?" That is our new store pipeline. Since I joined, we focused largely on building in front of the supercenters, the larger 1,200- and 1,400-square-foot stores.

When we realized that inventory of quality stores was getting smaller and smaller, we stepped back and said, "Which of our formats that fit within our capability set best positioned us for the future?" We identified this 2,800 store that could still be built on a very efficient modular basis, and that has been our focus. We had 15 in our plan last year, 30 in our plan this year.

We've built a pipeline where we're going to be able to build 50 of these stores on a sustainable basis going forward in our most attractive markets. Our capital plan has not slowed down at all this year because of our cash position. We continue to take advantage of real estate opportunities. Frankly, we look to see more opportunities come about as a result of the current environment.

We're excited about the EBITDA per-store contribution of these larger stores, and maintaining that balance at 50 stores with the 25 raze and rebuilds is a significant part of our continued comp improvement on key metrics in getting to our $500 million of EBITDA.

Last, I would note on slide 12, from a leverage standpoint, we maintain a very conservative balance sheet. We're probably at 1.6 times now based on current metrics. We're going to maintain a conservative position. I think that anchors the comment a made early.

Murphy USA was built for the current environment. I think these results and the momentum that we are carrying into the end of Q2 and into Q3 further prove that out.

John, why don't I wrap up there with my prepared comments. We've got about 10 minutes of

Q&A, which is what we had talked about. We'll do our best to answer your questions and any that you've received during that period.

John: Thank you, Andrew, really appreciate the update. I can probably speak for the entire analyst community. This level of transparency is very appreciated. You mentioned the strength in the fuel margin that has persisted, maybe for you guys, a little bit longer than some of your smaller competitors.

Recognizing that it's a very uncertain environment, at what point do you think we'll see a normalization in the margin? Is there a possibility that lags the recovery in volume?

Andrew: This is where we have a point of view. You referenced my prior consulting experience where we'd looked at this in detail. I think the simple economics of the industry structure answer your question.

If you look back historically, the break-even margin requirement of about the third quartile industry participant, market by market, set the floor for what the market margins should be. If the third quartile before was at about a 20- to 25-cent-per-gallon cash break-even, and the volume was cut in half.

That's what created the slowly declining margin structure that was north of 40 to 50 cents a gallon for a really long time. They needed that level of margin to cover their cash costs when they were down 50 percent in volume.

That's going to create their motivation to price rationally at a level that generates that break-even margin for them. The first quartile retailers, like ourselves, that are at less than 5 to 10 cents, in our case, a half a cent a gallon, we're pricing at the bottom of the market.

With that higher umbrella, you're making a choice, "Do I price for volume? Do I price for margin?" In a lot of cases, as we saw in the periods leading up to COVID, we were getting both volume and margin through our price optimization efforts.

What's the new normal? I have no idea. What I can tell you is that volume for the industry participants that are setting the margin structure for the industry, market by market, if their volume only recovers 80 percent, that's going to lead to a break-even requirement for them that's higher than it was pre-COVID.

Being down 10 percent volume impacts our fuel break-even significantly less. We'll be able to have maybe a little bit lower volume, but on a percentage basis, much higher relative year-over-year margins than we would have had in the past. That's the advantage of being on the left side of any supply curve.

You probably have some listeners today that are industrials, in chemicals, and others. It's all about industry structure. Are you on the left-hand side or the right-hand side? COVID and the demand destruction, whether it's three months, six months, a year from now, if it doesn't fully recover, the right-hand side of the supply curve goes up.

Our position on the left-hand slide doesn't change that much. For us, that means there's the potential for margin expansion that we can choose to take in margin, in volume, or a little bit of both.

John: Maybe sticking with the industry structure, can you talk about the structure as it stands? This is an industry in the US that's somewhat consolidated at the top but quite fragmented at the bottom. Do you think that some of the smaller operators can ultimately survive in the industry and an environment like we're seeing today? Could that usher in a period of shakeout?

Andrew: If you think about 2008 and the run-up in oil prices, you put that bottom 20 percent of the industry at significant risk. I was expecting to see a lot of bankruptcies happen then. Then you saw crude prices fall off after July 31st, 2008, and there was this period of significant margin expansion that bailed out those that were teetering on the edge.

What we're seeing here is a little bit of the opposite. To the extent there was some period of net benefit on a fuel contribution standpoint, it happened when crude prices fell off in February and March, but it was immediately followed by the demand destruction.

For those weaker players, many of them were barely staying at 100 percent of net fuel contribution during that period. They're probably experiencing something less than that now. Many have tried to invest in a me-too food service that has been temporarily closed during this period.

Many of them, from a tobacco standpoint, have a packs-versus-cartons approach, and we're probably taking some of that share. It's also coming at a time where significant investment is being required of those players.

The EMV investments that we've spent close to $80 million on for chip and pin at the dispenser, many of those smaller firms were waiting on that. The major oil brands that support them were going to allow some of that waiting, etc.

They postponed the investments, but when that liability shift happens, that's going to be difficult. Many of these dealers rent their locations. If they're unable to make their payments, might there be some foreclosures, etc.?

John, unlike the last period that shook up the industry, I think there's a set of compounding factors that are a little bit different this time that are probably more troubling for the bottom 10 to 20 percent of the industry. Like so many other brick-and-mortar retailers that didn't have advantaged business models, many may choose to close.

Then the question is those real estate owners, in many cases the jobbers that support those dealers, they have a choice to say, "Do I keep that store closed, or do we reopen it under some different ownership or structure in the future?"

John: I know you've been pretty vocal in preferring a build-versus-buy type of strategy. This type of environment where some of these guys are coming under stress, would that potentially make acquisitions more attractive than you might have thought about in the past?

Andrew: When you say "these guys," we're not talking about the bottom 10 to 20 percent because it's a disadvantaged model. It's not clear to me why anyone but a bottom feeder, aggregator would acquire them. That's really the role of many of the jobbers out there.

The biggest challenge frankly, John, we had was we had, in our view, an undervalued multiple, which didn't create the currency to pay up for companies at scale that were on the market. Frankly, looking at many of the deals that were out there, their EBITDA per store and other metrics were worse than ours.

You had a hard time getting your head around, "Why would I pay a premium multiple using an undervalued currency to buy a business that was performing worse than ours?" That was the paradox that you were in that would say, "We're better off building organically, and then balancing that with our capital allocation on share buy-backs."

If our average share buy-back price is $60 to $70 a share and we're at $115, that was a better investment and use of capital. The opportunity that we would look for would be one where you

could leverage a re-rated multiple that we've seen and would expect to see coming out of this COVID period where people realize Murphy USA's business is built for this environment.

Structurally, its exposure to fuel is a net benefit because of the industry structure and the changes that are going to take place. In the organic growth pipeline that we have in front of us, we believe that should award us a higher multiple than what we have today.

Then if opportunities come about where some better-than-average firms come on the market because of distress or a liquidity event, maybe a family business, a private business that's looking for, we're sitting in an advantaged position to do that, versus a disadvantaged position to do that.

We're always on the lookout for opportunities like that, where we could apply all the learnings we've had since our spend on a business, where there could be net benefits.

We just haven't seen anything like that to date, and the math didn't work to do that. In the next 6 to 12 months, the math may look completely different, and that might present opportunity for us.

John: I think we're out of time, so we'll wrap it up here. Andrew, thanks very much for your time and a very thorough update. We're looking forward to hearing about the remainder of the quarter in July.

Andrew: Great. John, thank you, and investors, thank you very much as well for your time.

John: That's it.

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