Company Name: Murphy USA Inc. (MUSA)
Event: Jefferies Virtual Consumer Conference
Date: June 23, 2020

<<Christopher Mandeville, Analyst, Jefferies LLC>>

Good morning, everyone. My name is Chris Mandeville, I'm the Staples Retail and Distribution Analyst at Jefferies. It's my pleasure to have you joining us virtually this morning. Obviously, it's not ideal in that we're not in Nantucket, but nonetheless, we're still set up very much for a wonderful conversation with the folks at Murphy USA, represented by CEO Andrew Clyde. Andrew, thank you for joining us this morning.

<<Andrew Clyde, President and Chief Executive Officer>>

You're welcome. Well, thanks Chris for having us. Hope we're back in Nantucket next year, but this format has turned out to be pretty efficient so far.

<<Christopher Mandeville, Analyst, Jefferies LLC>>

Well, great to hear that. And we all do as well, hope that we're back there in 2021. Andrew, I don't know if you had anything to start in terms of maybe a minute or two wanting to make a few comments. But if not, we can certainly jump right into Q&A if you like.

<<Andrew Clyde, President and Chief Executive Officer>>

Yeah, maybe just kind of an overview. This is our, I guess, third of these in the last couple of months. In the process of these we have been releasing additional information to provide additional transparency to investors, how Murphy USA is doing throughout the recovery. And I think the key message I want to say is, this isn't to beat our chest and say, look how well our business is performing during this period, which just raises questions around sustainability, how long can it endure, but rather to point out that, number one, this is a business that was built for this type of environment. Number two, the industry structure and how that's created this new fuel volume margin equilibrium is sustaining. And that a number of the advantages that we're demonstrating throughout this environment are ones that are going to remain sticky and stay with us regardless of the extent to which demand ultimately evolves to. And so I know you probably will have some questions about the details of that, so why don't we jump into it and then I can elaborate further.

<<Christopher Mandeville, Analyst, Jefferies LLC>>

Yeah, absolutely. And I'll just remind folks on the line as well, that you do have a portal whereby you can submit questions and we'll try our best to actually accommodate that during the conversation here. So Andrew, before we get to the Murphy model, how advantaged it is, irregardless of the COVID environment, versus pre and post, you mentioned the word sticky, and I'm curious of your thoughts there with regards to what we might find ourselves seeing three to

five years from now? And the byproduct of COVID, how it influences the consumer and how they shop and how they interact with retail concepts and the like? We've certainly seen or heard the narrative of consolidation of trips throughout even this morning. For that matter, you had a few clients who brought up the fact that work-from-home will be in an increasing dynamic that might detract from VMTs. So maybe you could just walk us through your thoughts there?

<<Andrew Clyde, President and Chief Executive Officer>>

Ya three to five years is a long period to see what trends are more temporal versus permanent. I go back to the 2008, 2009 recession. We saw an increased level of frugality from consumers coming out of that period. It's stuck in a number of forms around seeking discounts, online models, et cetera. And so if you add a level of frugality with social distancing with the work flexibility and the impact on commuting, some of those will be sustained in different forums and we'll just continue to evolve. We spent trillions of dollars in technology as nations and firms. And so we're seeing the advantages of those. I think a lot of firms are going to say, while we may not go to an entire remote work model, there are certainly ways where we can be flexible and productive.

I don't have any predictions. I saw for as many articles about, "hey, remote work is the new way of doing things," there's as many articles pre-COVID where Silicon Valley firms were saying "we've lost our innovation edge, we've lost our ability to collaborate," because folks aren't in the workplace together and these technologies haven't delivered that. I think what we learned through COVID was the collaboration and working on the challenging opportunities that we've had since the spin built the relationships, trust, communication, living through our company's principles that allowed us to work so successfully during this period. And so during town halls with employees, we've asked people to remember, it wasn't just the technology that allowed us to do it. It was the human interaction and problem solving and the desire to punch above our weight as a company and do things that we didn't think we could do. That really motivated people to come to work here and we can't forget that. And we've got to reaffirm some of those principles.

Some of the trends like electric vehicles were not affecting us to start with. Some of the commuting is going to be more in the markets, for example, where you live versus the Southwest, Southeast, Midwest markets that are more rural that we operate in. Someone asks a question about public versus private transportation. We don't have public transportation in our headquarters town of 20-plus-thousand people and so different firms will be impacted to a greater extent than others. And so if I was on one of the coasts, I'd have a different set of concerns versus the model that we have. That's a little bit more insulated. So expect things to change. They would have changed anyway, just with the evolution of society and how we take advantage of technology and the like. I think the big question is will fuel demand fully recover. And then the question is where is it most likely to recover the least, and where is it most likely to recover the most? And I think our markets are better positioned from a recovery standpoint.

<<Christopher Mandeville, Analyst, Jefferies LLC>>

Great, great. And sticking with the concept or theme of a relative positioning, subject matter that we can't avoid and whenever we bring up the industry and C-stores is just fuel margin capture, the current environment of COVID and how historically you've been advantaged on pricing. And in turn, you don't necessarily acquire the same type of retail margin to drive profitability relative to some of your peers. So if you can talk a little bit about those dynamics as well as how you envision your margins over time kind of evolving?

<<Andrew Clyde, President and Chief Executive Officer>>

Sure. So if you think about the sector and you think about the future where you probably have higher inflation, higher taxes, lower interest rates, lower commodity costs. The advantaged sectors are going to be those that are able to pass on costs to consumers. And this industry, I can't think of a better one that passes on higher costs, and lower costs, to consumers because we do it every day with our fuel prices. And you can look at the COVID environment. I've spoken to it before. That marginal independent with a breakeven cash fuel margin requirement that's gone from below $0.20 to $0.25 to $0.28, when their volumes cut in half their breakeven doubles. And that is why we saw when prices fell off and then demand fell away, the shallowest rolling seven-day glide slope on fuel prices down than I've ever seen in my 30-year career.

And it was supported by the marginal players at the top and the rational players who take their price from them, and that isn't going to change. And in fact, we've seen that, pre-post 2008, 2009, we saw it kind of pre-post spin. There are a number of periods throughout this firm's history, where we've seen that at the industry and the firm level, but you often miss it unless you look at the big periods of demand shocks, or others where there's a step level change in that. And that is one of the prior periods we're in now. And so great example, we're now close to 80% of volume year-over-year, but our contribution margin is still up 15% to 20% in June.

And that is in a rising price environment. We're north of $0.20 per gallon versus $0.11 a year ago. And for us to maintain those margins, it's not that we're being less aggressive. It's that the top of the market is just that much higher because they have to maintain their fuel contribution, because in this environment their fuel breakeven requirement got higher. Ours has actually improved - the amount - and we'll talk about tobacco and share gains and the operating cost improvements. Our breakeven has actually now turned negative, right? And so we're in a position where on the far left hand side of the supply curve, the gap between the bottom and the top has grown and while the industry will work hard, because the barriers to exit are low. A marginal player has very little fixed costs.

They're either paying the rent to a jobber above them. So, it's all variablized, or they're not seeking to recover that capital., they'll sell the things for real estate for their retirement. These dynamics really work. And so we will see the industry participants at the right hand side, continue to push up margins. Their ability to pass on $0.05 to $0.10 cost to customers is a short putt. And we see that all the time, just with the normal volatility. And firms like ourselves are going to be able to take advantage of that price umbrella and in almost any volume recovery scenario our fuel contribution will be higher than it was before, because of those dynamics.

<<Christopher Mandeville, Analyst, Jefferies LLC>>

Right, right. So, volumes are down roughly 20% or so as it stands right now, but yet, as you alluded to, and you've shown in some of your prior presentations that in-store merchandise is seeing great success. So, I think that'd be counterintuitive for a lot of investors in that you're seeing lots of traffic at the pump, but yet great success in store. So maybe, you can talk about that interplay, how that's different for Murphy and how the consumer reacts or kind of goes to you in terms of shopping occasion versus a traditional c-store. And then let that kind of evolve into just really how you are in fact driving such great success in both tobacco and non-tobacco?

<<Andrew Clyde, President and Chief Executive Officer>>

Sure. So, we break our categories down between those attached to fuel and those not attached to fuel. And the carton cigarette purchases for us, and some of the other bulk tobacco purchases - rolls of moist smokeless tobacco, are a destination to Murphy USA that has zero correlation with fuel traffic. And what we've seen through this COVID period is our carton volume going from the 40% range to exceeding the 60% range. And the consumer behavior here is one of – I want to maximize value, I want to do it with the fewest number of trips. I want to continue to buy the premium brands that I buy at the greatest value. And if I can combine it with another trip, that's great. And because we've stocked up on inventory, which by the way, the recent price increases benefited us. We have the product that our customers want, whereas the dealers and the smaller chains, as well as some of the bigger chains, just don't offer cartons. They sell single packs based on convenience.

So, we're positioned to win in those categories with our 1,400 square foot stores and larger, we're able to capitalize on the bulk beer and alcohol purchases. And if you thought about pre-COVID, 50% of our trips were to and from – a customer's going to or from a trip to Walmart, if all they want to do is run in and grab a 30 pack of bud light, it's a lot easier to come in our store, whether you fill up or not, and pick that up. And then single packs, packaged beverage, other items are more attached to fuel, but where our non-tobacco merchandise has grown is through innovation of sanitizer, masks, PPE. Lotto lottery has really picked up. It's somewhat its own destination also, and we're just less impacted by having to close down some of the prepared food and some of the dispensed beverage offers that some other firms might be exposed to.

So, an advantage that grew in the non-attached to fuel categories, innovation growth on the non-tobacco categories and we have seen fuel pickup, right? So, as we go on from kind of the 70% level to the 80% level, we have a number of states now that are above 90%, many above 85%. But there's a number of them that are still in the low-70s, where those States have just not returned to work in the same way or their economies have not recovered to the same extent. But we expect the same type of recovery there and we continue to exceed the industry around some of these key sales metrics that we've shown before.

<<Christopher Mandeville, Analyst, Jefferies LLC>>

And very much what you just outlined right there, I suppose I'm curious if that's more or less how you would refute any type of investor that questions the sustainability of your outperformance right now, I guess of course, we've had some elevated levels of unemployment

benefits out there and you do largely cater to the low-income consumer. So, just curious on how you would respond to such a question?

<<Andrew Clyde, President and Chief Executive Officer>>

So, we were doing 9% year-over-year tobacco growth in February pre-COVID. So, we've been lapping the industry, because of all the investments we've made around tobacco pricing, the new tools and capabilities there that are getting more precise, the MDR work, the collaboration to target differentiated investment programs from the manufacturers in those categories. I'm gonna be the last one to say, hey, we're going to maintain a 20% year-over-year growth rate in a category like tobacco, but we're going to continue to outpace the industry, and as we saw last week, they had their pricing increases, that we can now expect two to three times a year, and because of some of the investments we've made in inventory and supporting Core-Mark going from two times a week to one time a week, we're gaining a greater advantage when we have those price increases on our inventory. On non-tobacco, we showed the innovation to get into categories that we weren't in, there's more opportunities to do that there, the good news, bad news around prepared food and dispense beverage is we knew that was an opportunity going in pre-COVID around the larger store.

We've identified through benchmarking several million dollars of improvement opportunity there. We know what we need to do there from a capability standpoint and how to leverage MDR. So, as we come out of that, there's still opportunities to grow our business. As PPP goes away, one of the things that impacts our consumer as well as the competitors is the marginal competitor will see some of the their benefits, where they took on the PPE, go away and that's going to force their margin requirement to go up further, which then goes back to the question about sustainability of this new fuel volume margin equilibrium. And so if there's more pressures coming out of PPP and other stimulus to the marginal player that raises their breakeven that's going to just increase the sustainable umbrella we have relative to them, and as volumes recover for us and their breakeven continues to increase that advantage does get even bigger.

So, we're pretty bullish from that standpoint. And if this was the first time in history this was happening, I think investors would have the right to be skeptical, but you can go back and look at a decade of trends using NACS data and correlate the increase in breakevens to the industry fuel margins. You can look at the top of market fuel margins versus the bottom of market and see that the spinoffs, the divestment from the majors, the rationalization you've read around the grocery store and the cost clubs in terms of how they're thinking about fuel, what we saw in 2008-2009 say, this fundamental industry structure ability to pass on price, margins set on the marginal player is a well-established trend. You just need a dynamic like this to really highlight it in a way for a firm like us to gain recognition for being one of the biggest beneficiaries of it.

<<Christopher Mandeville, Analyst, Jefferies LLC>>

All right. And sticking to the subject matter of MDR, your loyalty program. Maybe, you can just give us a sense of where we are in terms of innings and maturation of that program? How it's been received from the consumer perspective and how dangerous you've become with utilizing the info that you now have to perform some targeted marketing?

<<Andrew Clyde, President and Chief Executive Officer>>

Sure. What's impressive is we're a year anniversary on the completion of the national rollout. We still have a 4.8 rating with 250,000 reviews, and you can go out there and find programs like this that have been around for a decade that don't have that rating, that number of review, et cetera. And so, by definition, while we will be a quick learner, we're still very much in the early innings.

And so what we've discovered we have is an incredible tool for creating stickiness with our customers around fuel and tobacco, we have an incredible capability to see the longitudinal data associated with those customer transactions and be able to do surveys targeted by various segments for the benefit of the manufacturers, where they've now seen that we've gone from being the most efficient user of their marketing dollars at scale to now the most surgically targeted user of their marketing dollars as we pinpoint unique segments, et cetera for different offers.

And for these manufacturers that are having declining volumes, et cetera, one of their biggest levers is going to be reduce marketing spend in general and target it to those that create the most advantage for them. And so, we absolutely have that capability and I think we have spent a lot of time refining it for our two biggest categories, but mainly around the tobacco side. Why is it early innings? Because there is still so much more we can do in terms of monetizing the data, leveraging it across other categories, using it as a way to drive trial experimentation, adoption of our food and beverage offers, as limited as they are there is still much more we can do on that front. We've made some efficiency gains from the system standpoint and the platforms.

And so, a lot of the technology that we started with that was specialized. I mean, it's been – some that's been commoditized in the last two to three years, and so there is opportunities there to do even better at scale. And I think the key thing we learned during COVID is one, we can use it as a way to communicate very effectively to our customers and those that have tried us because you see about the carton and the tobacco increases, it's a way to maintain that stickiness, that post COVID, we expect to maintain it, probably a larger share of those share gains than we would have without it, it's still early innings in terms of what we can do, we're very proud of what we've done in basically one year.

<<Christopher Mandeville, Analyst, Jefferies LLC>>

Got it. Okay. And then turning to your breakeven margin right now, it's terribly well in a good way obviously, and I think I actually heard you referenced earlier today that if that turns negative year-to-date. So I suppose the question is then where do we go from here? How do you continue to move even into further negative territory? Are there any specific OpEx buckets that you can highlight for us, or is it maybe more a function of continuing to drive gross profit in stores?

<<Andrew Clyde, President and Chief Executive Officer>>

Yeah. In the very short-term, we'll continue to see as volume recovers benefits in OpEx from traffic driven categories. So utilities, lighting, supplies, things that are more volume throughput related. Employee costs have largely normalized, but we're paying out a lot more commissions than we were before, which is a good thing. So those are what we call positive negative variances when those operating expenses are higher, but they're associated with significantly higher merchandise sales.

And I think Chris, that's really the key, right, is when you invest in costs, are you getting a return on the margin from your merchandise, or if you're making investment in a capability, are you getting it all offsetting cost increase? And so, we've got plenty of examples where we've done that on costs and we've seen the merchandise improvement or we've invested in a capability. And sometimes it's just better talent that can leverage a team at scale around loss prevention or other areas where you can reduce costs and then your platform scales better for future growth.

One of the things coming out of COVID is we'll do 25 to 30 new stores this year, but our pipeline for future new stores is well over 125 at various stages of the real estate cycle. So that 50 stores a year growth rate of the larger format that's 2x the square foot of our prior format is intact and on track and we haven't dialed back at all. We haven't seen the opportunities yet to accelerate real estate purchases, largely because firms that are getting the PPP are hanging on, but we fully expect firms, whether it's a bank branch or a QSR or some that were highly impacted by this, that create an opportunity for us to get an attractive piece of real estate. We're flush with cash and able to then go accelerate those real estate purchases.

It won't affect 2020 growth, it'll modestly affect 2021 growth, but it secures 2022, 2023 growth, which if you go to our value formula, we spent a lot of time talking about why fuel contribution is going to grow and be sustained. The fuel breakeven is going to continue to get advantage, but that organic growth is a big part of our future growth that I think is highly underappreciated by the market. And we didn’t dial back, we've actually doubled down on the ability to continue to grow that.

<<Christopher Mandeville, Analyst, Jefferies LLC>>

And maybe seeing as our – coming to the tail end here of our fireside, one more question on capital allocation. So as of your last update in May you're north of $300 million on cash balance, I would hazard to guess that it's better than that now at this point in time, as you've outlined throughout the last 25 minutes now you've got a high degree of confidence in the business model, the ability to continue to generate ROI enhancing types of, or move forward ROI enhancing types of initiatives, you’ve seen pre-and-during COVID success. So where do we deploy this $300 million and why not necessarily become a little bit more aggressive on buybacks?

<<Andrew Clyde, President and Chief Executive Officer>>

Well, that's exactly right. And this was the perfect environment to think about that. And I'm not picking on you, but I mean, broadly the investment community is kind of looking at 2021 earnings a lot closer to $500 million. So I think recognizing or must be recognizing some portion

of the thesis that we've outlined to get that a year or so earlier than we had projected, but if we're fairly valued at $115 a share when we are fairly valued at $115 a share several months ago, when the outlook was significantly lower, by math, the only thing that's different now is we're at a multiple that's trading at a significant discount historically to peers and where we've been of late.

And that's that valuation mismatch, it doesn't stay open for long, but that's when we're an aggressive buyer of our shares, because we see the line of sight in the value creation plan to growing $20 million a year EBITDA from the new stores. At our offsite this last week, we spent a lot of time looking at how to raise the returns further on those stores and close that EBITDA to EBIT GAAP that you've referenced, but by the way, other peers in the sector have as well, unless you're out buying stores and you're putting a ton of goodwill on your books.

And we do have confidence around the earning stream from what we've seen historically and what we've seen recently. So this is kind of the time in which we would look to take advantage of that valuation mismatch and continue that capital allocation strategy we've implemented since our spin.

<<Christopher Mandeville, Analyst, Jefferies LLC>>

Well you have proven masterful on that front for years now, so let's wrap it up there. Andrew, thank you once again for spending the time with us today. And thank you for everyone who joined us.

<<Andrew Clyde, President and Chief Executive Officer>>

Great. Thanks Chris for hosting.

<< Christopher Mandeville, Analyst, Jefferies LLC >>

Take care.