

Murphy USA Inc. NYSE:MUSA

FQ4 2019 Earnings Call Transcripts

Thursday, January 30, 2020 4:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ4 2019-			-FQ1 2020-	-FY 2019-			-FY 2020-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS
EPS Normalized	1.46	1.54	▲5.48	0.17	5.04	5.25	▲4.17	5.68
Revenue (mm)	3569.53	3460.20	▼(3.06 %)	3458.90	14143.99	14034.60	▼(0.77 %)	14738.90

Currency: USD
Consensus as of Jan-30-2020 3:06 PM GMT

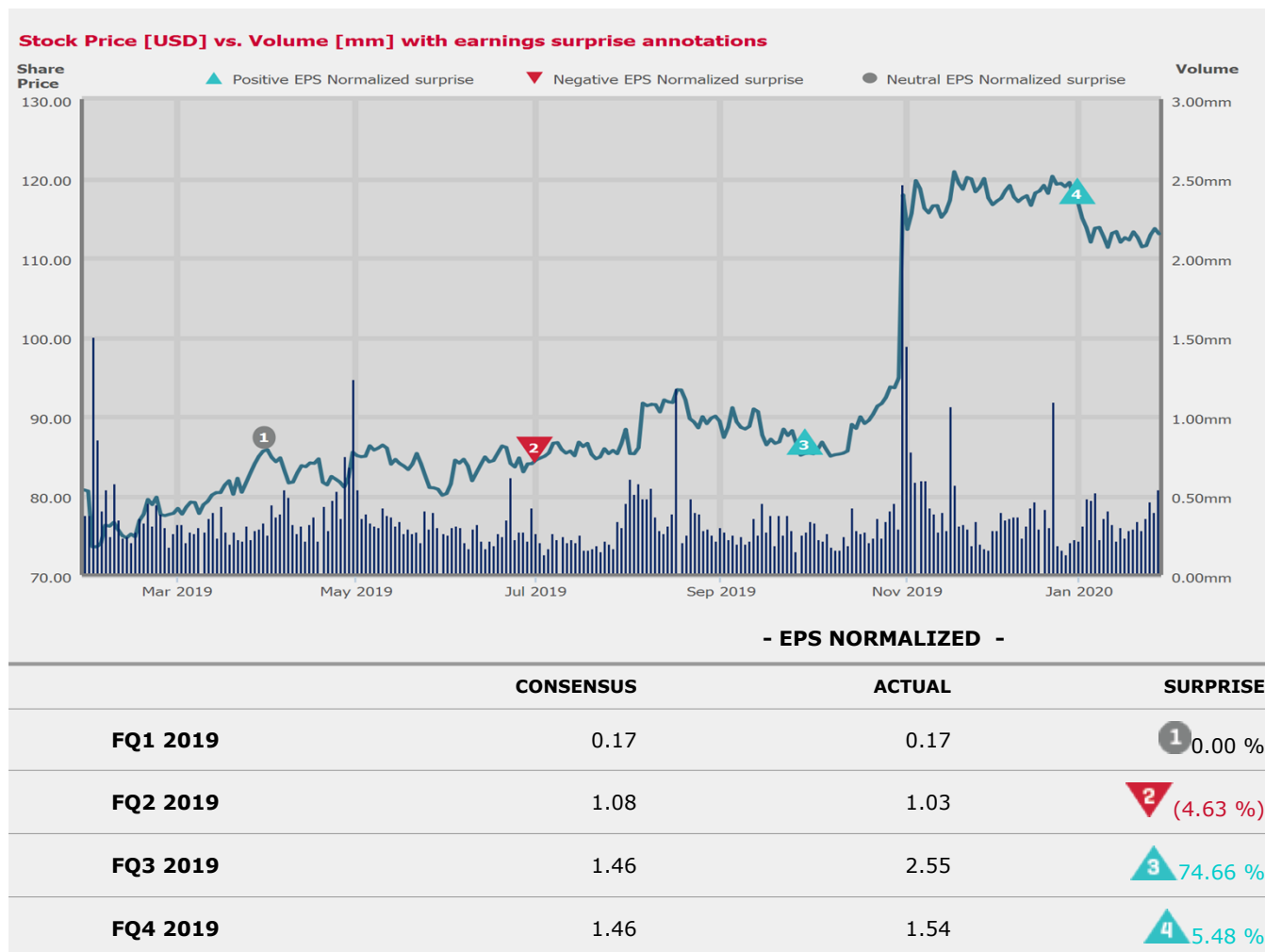


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Presentation

Operator

Ladies and gentlemen, thank you for standing by, and welcome to the Murphy USA Fourth Quarter 2019 Earnings Conference Call. [Operator Instructions] I would now like to hand the conference over to Christian Pikul, Senior Director of Investor Relations. Please go ahead.

Christian Pikul

Senior Director of Investor Relations & Financial Planning and Analysis

Great. Thank you. Good morning, everyone. Thanks for joining us. With me are Andrew Clyde, President and Chief Executive Officer; Mindy West, Executive Vice President and Chief Financial Officer; and Don Smith, Vice President and Controller. After some opening comments from Andrew, Mindy will provide an overview of financial results. We will then review our 2020 guidance metrics and open up the call to Q&A.

Please keep in mind that some of the comments made during this call, including the Q&A portion, will be considered forward-looking statements as defined in the Private Securities Litigation Reform Act of 1995, as such, no assurances can be given that these events will occur or that the projections will be attained. A variety of factors exist that may cause actual results to differ. For further discussion of risk factors, please see the latest Murphy USA Forms 10-K, 10-Q, 8-K and other recent SEC filings. Murphy USA takes no duty to publicly update or revise any forward-looking statements. During today's call, we may also provide certain performance measures that do not conform to Generally Accepted Accounting Principles or GAAP. We have provided schedules to reconcile these non-GAAP measures with the reported results on a GAAP basis as part of our earnings press release, which can be found on the Investors section of our website.

With that, I'll turn it over to Andrew.

R. Andrew Clyde

President, CEO & Director

Thank you, Christian. Good morning, and thank you to everyone for joining us today. 2019 was an exceptional year in Murphy USA's relatively short tenure as a public company. And as we enter 2020 with a lot of momentum, it's important to reflect on what underpin 2019 results, and how that shapes the sustainability and growth in the years ahead for earnings and the other share price drivers we control. This didn't happen by chance, it took a lot of planning and a lot of hard work and execution by our team to deliver the plan and we expect more in 2020.

So let's go through some highlights. We grew our per store fuel volumes and did so at very attractive margins, especially when you net the effects of Murphy Drive Rewards discounts and deferrals. In a year that started with an unprecedented increase in fuel prices, our retail pricing excellence initiative, reset customer expectations and reestablished our low-price position with better leadership, mindset, data and tools for executing, we not only grew volume, but did so very profitably. And as our 2020 guidance highlights, there is more opportunity to grow our fuel contribution.

As expected, fourth quarter 2019 volume and margin results in a rising price environment, fell short of fourth quarter 2018 results, which were buoyed by a steep price drop throughout the quarter. However, we are now seeing uncharacteristically higher margins in January as prices have fallen sharply, which is a bonus for starting off a new year, and once again, positions us to grow volume profitably.

Merchandise contribution grew 4.8% to a record \$419 million, driven by a 4.5% gain in per store tobacco volume as best-in-class execution and our new Murphy Drive Rewards platform provided the perfect foundation to take advantage of manufacturer programs. We expect to continue to take share and are carrying significant momentum into 2020.

Headwinds from vaping restrictions and T21 regulations are built into our guidance as is the cost of Murphy Drive Rewards, discounts and deferrals. From an MDR standpoint, 2019 was all about engaging the customer, and we did, as we now have almost 3 million fully enrolled members. 2020 will be about

monetizing MDR with our vendor partner support as we deliver greater value, more efficiently and effectively.

2019 also marked a shift in our store portfolio as we now have less than 50% kiosk in the mix. Thanks to the successful raze-and-rebuild program in our new store development. The shifts in fuel and merchandise discussed before, have led to better new store metrics as the larger 2,800 square foot stores ramp up to their higher potential, providing conviction to us around this format as we increase our NTA activity going forward.

Importantly, for Murphy USA, we achieved this growth with a continued focus on cost leadership. We ended the year up just 2% on per store operating expenses, of which 50 basis points was attributable to higher rents from more leased stores. Fourth quarter OpEx before credit card fees fell 4.5%, SG&A came in at the low end of guidance as we focused on delivering the most important initiatives in 2019 and pushed a few others into the future. Our fuel breakeven metric fell another 14 basis points to a new record \$0.67 per gallon in 2019.

Disciplined capital allocation remain front and center as we repurchased 1.9 million shares in 2019 with 300,000 shares repurchased in the fourth quarter. Looking through the 4 to 5-year lens we provided to investors early in 2019 of growing EBITDA towards \$500 million, buying back about a million shares a year and earning another turn on our multiple, we made significant progress towards these drivers of our share price. After Mindy cover some key financial metrics. I will come back and go over 2020 guidance, which provides another meaningful step in the right direction towards these long-term goals of creating shareholder value. Mindy?

Malynda K. West

Executive VP of Fuels, CFO & Treasurer

Thank you, Andrew, and good morning. Revenue for the fourth quarter and full year 2019 was \$3.5 billion and \$14 billion, respectively. This compares to \$3.5 billion and \$14.4 billion in the year-ago period. In the fourth quarter, this decrease was attributable to lower retail gasoline prices and lower gallons sold, partially offset by higher merchandise sales. The full year decrease was attributable to lower retail gasoline prices partially offset by higher fuel volumes sold and higher merchandise sales.

Average retail gasoline prices per gallon during the quarter were \$2.30 versus \$2.34, in 2018. And for the full year, retail gasoline prices averaged \$2.33 per gallon versus \$2.48 per gallon in 2018. Adjusted earnings before interest, taxes, depreciation and amortization or EBITDA was \$112.4 million in the fourth quarter versus \$148.9 million in 2018, for the full year, adjusted EBITDA was \$422.6 million versus \$411.8 million in 2018.

Adjusted EBITDA for the fourth quarter was lower than the prior year period due to lower retail margins and volumes, partially offset by higher merchandise contribution. And for the full year, adjusted EBITDA was above the prior year period due to higher volumes and higher merchandise contribution dollars, partially offset by lower all in margin. The effective tax rate for the fourth quarter was 23.1% and 23.5% for the full year. Going forward, we continue to use the federal income tax rate of between 24% and 26% for planning purposes.

As stated in the press release, net income for the full year 2019 was lower than 2018, partially due to 2 factors. The 2018 pretax receipt of \$50.4 million in connection with the 2010 Deepwater Horizon oil Spill combined with a pretax loss on early debt extinguishment of \$14.8 million in 2019.

Total debt on the balance sheet as of December 31, 2019, was \$1.037 billion, broken out as follows: long-term debt of \$999 million, primarily consisting of \$296 million carrying value of our 5.625% notes due 2027, \$493 million carrying value of our new 4.75% notes due 2029 and \$212.5 million of term debt.

In addition, we are carrying \$37.5 million of expected amortization under that term loan in current liabilities on the balance sheet. These figures result in an average leverage ratio that we report to our lenders of approximately 2.4x.

Our ABL facility remains in place with \$325 million cap subject to periodic borrowing base determinations, which are currently limiting us to approximately \$238 million as of December 31. And at the present time, the facility continues to be undrawn. Cash and cash equivalents totaled \$280.3 million as of year-end, resulting in net debt of approximately \$757 million. There were 30.5 million common shares outstanding at the end of the fourth quarter.

And then lastly, CapEx for the fourth quarter approximately \$56 million and \$215 million for the full year. Of the \$215 million spent in 2019, \$134 million was growth capital, including 17 new stores, 27 raze-and-rebuild projects and some upgrades to our terminals; \$20 million was spent on maintenance; \$11 million on corporate capital, largely comprised of technology projects, and the remaining \$50 million was spent on EMV compliance that are outside dispensers leaving us with about \$25 million to \$30 million of spend remaining in 2020 to reach compliance by October of this year.

That concludes the financial update. So I will now turn it back over to Andrew.

R. Andrew Clyde

President, CEO & Director

Thank you, Mindy. I'd like to wrap up with a review of our 2020 guidance metrics, and we'll start with organic growth. In 2020, we intend to build up the 30 larger format, 2,800 square foot stores, in addition to razing and rebuilding up to 25 high-performing kiosk and turning them into 1,400 square foot stores. As a reminder, going forward, we will almost exclusively be building 2,800 square foot or larger NTA stores as we optimize both our store locations and our merchandise offer. We're developing our pipeline targeting up to 50 NTAs in 2021 and beyond.

Looking at fuel contribution, building on our success in 2019, we expect to continue to grow volumes and are establishing a guidance range of 250,000 to 255,000 gallons on an average per store month basis. We will continue to refine our tactics and improve the team's execution capabilities in a dynamic and ever-changing retail environment to maintain our low-price position in the market and aggregate price-sensitive customers in an economically responsible manner.

Looking at the 2 primary components comprising our fuel breakeven metric, we are expecting continued growth from the merchandise category and are establishing contribution margin guidance between \$430 million and \$435 million. Importantly, this guidance reflects about a \$5 million headwind from the T21 initiatives and recently enacted regulatory restrictions impacting the vapor category.

We just returned from our National Leadership Conference, and I can tell you, our supplier partners are supported and excited to help us overcome these headwinds, given the impact our business had for them in 2019.

An equally important part of the breakeven metric is per store operating expenses. On this front, we anticipate a 1% to 3% increase in per store OpEx in 2020. I will point out the organization worked very hard to overcome transitory elements of higher OpEx in the first half of 2019 in order to deliver results within our 2019 guided range, coming in at a 2% per store increase. As we think about the landscape around cost in the business, there are several factors that will lead to slightly higher OpEx guidance going forward versus our historical performance since spend that demonstrated flat to declining per store cost. First is the fact that we are building larger stores that necessitate higher staffing levels versus the network average. Second, benefit and insurance cost continue to trend higher, including minimum wage creep, and although we have mitigated such headwinds in the past, we expect continued pressure in these areas to persist in the near term.

Last, as we lease more sites to accommodate our larger store footprint versus purchasing the land, which is our preference, rent expense will continue to move higher. As a reminder, rent expense constituted 50 basis points of the 2% increase in operating expenses we incurred in 2019. Importantly, in 2020, we will begin reporting operating expenses per store before rent and credit card fees going forward.

Cost leadership remains a priority for Murphy U.S.A. and will remain an area of focus to achieve our stated goals of limiting operating expense growth at or below the rate of inflation. From a corporate cost perspective, SG&A came in at the low end of the guided range in 2019 as we carried over some costs

for -- IT projects and other corporate initiatives, resulting in slightly higher 2020 G&A guidance of \$150 million to \$155 million, and for 2020, our all in tax rate should remain at or near 25%.

Our capital plan remains in the range of \$225 million to \$275 million as certain projects budgeted for 2019 will carry over into 2020. Our 2020 capital program earmarks roughly \$170 million to \$200 million for retail growth, \$15 million to \$20 million for maintenance capital, \$15 million to \$25 million of corporate capital and \$25 million to \$30 million of carryover EMV spend as we complete our network dispenser upgrade and certification process.

While we no longer offer specific guidance around fuel margins for a variety of reasons we articulated last year, we did provide an adjusted EBITDA forecast of \$406 million for 2019, when you use the midpoint of all other guidance elements into their models.

Clearly, several critical segments of our business performed above the guided range, resulting in \$423 million of reported adjusted EBITDA for 2019. In that same spirit, using a 3-year average all-in fuel margin of \$0.162 per gallon and the midpoint of our 2020 guidance, we would expect the business to generate about \$440 million of EBITDA this year. And while we will not be in the habit of updating guidance on a regular basis. I will add that with January fuel contribution dollars coming in better than expected, it's reasonable to conclude, there is potential upside to this math in the event the rest of the year plays out as planned.

I will also encourage all of you to review the GAAP to non-GAAP reconciliation in the back of the earnings release for information on depreciation and interest expense.

In closing, we recognize anything can happen tomorrow, in the coming month, or the rest of the year that could result in financial performance dramatically above or below our internal forecast and corresponding guidance metrics. We are maintaining our focus internally on what we can control and how to optimize our performance in any given commodity price environment. We do not, nor should investors, value the business on a single quarter or even a single year's performance.

We have clearly stated our goal of growing adjusted EBITDA to \$500 million over the next few years and believe we are on track to deliver that goal through high-quality organic growth and our relentless focus on continuous improvement. Coupled with our commitment to disciplined capital allocation and our share repurchase programs, we seek to maintain our long-term trajectory of share price appreciation.

As we put 2019 in the rearview mirror and rev the engine in 2020, we are pleased with our performance and very excited about the outlook for Murphy USA and for our investors. And on that note, operator, we can open up the call to Q&A.

Question and Answer

Operator

[Operator Instructions] The first question comes from Chris Mandeville with Jefferies.

Christopher Mandeville

Jefferies LLC, Research Division

Can we start-up on the fuel side, just with respect to the gallon comps turning negative, both on a 1 year and 2-year basis? Maybe can you just elaborate a little bit more on the unfavorable pricing environment? Speak to anything else that might have been at play on the results for the quarter and then incorporate some general competitive dynamics as well?

R. Andrew Clyde

President, CEO & Director

Sure. So if you remember last year, prices fell very sharply throughout Q4 and generated an opportunity for us to be very aggressive on the volume side and with periods of margins north of \$0.20 per gallon, we had that opportunity throughout the quarter.

This year was different. We didn't have the steep fall off, and we actually saw a run-up in prices in the latter part of the quarter. So it's that simple dynamic. And we've seen a lot of quarter-on-quarter comparisons in the past, where that's been the case. And then if you think about entering to 2020, we had some momentum coming in from falling prices than -- from the 2018 to 2019, but then prices started running up and we had that unprecedented increase. [We're] now seeing something different this year with prices falling pretty significantly in the second half of January.

So we're going to continue to see those sorts of trends, I would say, we didn't note anything of particular interest from a competitive or market dynamic, I would attribute almost all of this to the nature of the price environment, the amount of margin that you have to play with, and then what's optimal in terms of putting more margin on the street to gain volume. And we just didn't have those opportunities in Q4 this year, in fact, we had kind of the opposite with the run-up in prices.

Malynda K. West

Executive VP of Fuels, CFO & Treasurer

Chris, I would encourage you to look at the fourth quarter of 2017. That's actually a better comp to use, and if you use that as a comp, you'll see that we delivered actually the same volume on an average per store month, at \$242,000 and did it at a higher retail margin, generating a higher all-in contribution. So 2017 really is a better comp, but even so, 2017 was actually still a more favorable environment due to the volatility in that quarter.

And then what we saw in the fourth quarter of 2019 with a flat to rising environment. As Andrew said, it just was not an optimal period in which to grow volumes because of the sharp rise at the end. If we had taken that approach to discount prices to gain share, that would have resulted in materially lower fuel contribution dollars and just would not have been the responsible thing to do.

Christopher Mandeville

Jefferies LLC, Research Division

Okay. So is it fair to say, just as we think about the near term, that based on some of the pricing dynamics, thus far, we should be expecting a reversion back to positive territory for fuel gallon comps on a go-forward basis?

R. Andrew Clyde

President, CEO & Director

We would. And with guidance of 250,000 to 255,000 gallons per store month for the year, you would absolutely expect that.

Christopher Mandeville

Jefferies LLC, Research Division

Okay, great. And then turning to merchandise. I guess, can you help us understand why the non tobacco comps in margins, continuing to see some pressure while you continue to post very strong results on the tobacco front? And how much of this is really a reflection of the strategy and the use of MDR versus anything else?

R. Andrew Clyde

President, CEO & Director

Yes. So for the year, non tobacco margin contribution was up about 3.9%. We mentioned some reclassification of items from OpEx into merchandise contribution margin in the fourth quarter that would have caused the full year number to be up 4.3%. And so that weighed in as we made the year-to-date full year adjustments in Q4. And I would say there were probably some merchandising practices around some high theft items that also led to some declines in that performance.

Our targets for non tobacco merchandise in 2020 or high single digits. That's going to reflect a return of a more promotional intensive approach to candy, probably the most promotionally elastic product that we have. That was a strategy choice in 2019 as we focus more of our store associates' time on rolling out MDR. As I mentioned on the last call, we had a contest in October. And the associates blew that contest out of the water. So we expect to see more of that type of performance in 2020, so positive comps there.

We continue to complete the resets of our different formats, including our larger format stores. And so we'll be comping over those changes that we started in 2019 for the full year in 2020.

So I hope that addresses some of that. A lot of it was some adjustments in 2019 and probably some execution and then a little bit around the strategy around the store associates' time. But we expect that to be positive. Certainly, the overall mix of merchandise contribution. It is weighed heavily by growing the tobacco mix component of it.

Christopher Mandeville

Jefferies LLC, Research Division

All right. And then just a final one there being -- I apologize, I don't know the formal name for the regulation itself, but you called out a \$5 million headwind from vaping. I just want to ensure that I understand what exactly that was related to -- I'm assuming, if the flavor bans itself, but can you talk to that a little bit in terms of if that's a similar contribution that you had been seeing in 2019 to same-store sales in tobacco? Or if it's something somewhat different has there been any pull forward necessarily in the January time frame as we approach the flavor ban? And then finally, can you just talk about the contribution from leap year as we think about Q1?

R. Andrew Clyde

President, CEO & Director

Yes. So this is really the flavor bans that been enacted as well as the age 21 restriction. So if we look at 18 to 20-year-old purchases in our estimate of that, which we believe is lower than the industry average, in part due to our significantly higher than industry average age restriction compliance program results. And so that's really what it is. So we've just kind of rolled that out throughout the year. Certainly, the age restrictions came earlier in the year than we probably originally planned. And the flavor bans was probably in the mid-point of our best and worst case scenarios that we outlined.

Christopher Mandeville

Jefferies LLC, Research Division

And then maybe leap year?

R. Andrew Clyde

President, CEO & Director

Leap year, sorry. Yes, an extra day is always great. So just to make sure you account for that in the models. It's on a Sunday, I believe, which isn't the highest traffic day, but those have all been built into the guidance numbers as well.

Operator

Our next question comes from Bobby Griffin with Raymond James.

Alessandra Jimenez

Raymond James & Associates, Inc., Research Division

Good morning. This is Alessandra Jimenez on for Bobby Griffin. First, if we could start with merchandise margin. Was the merchandise margin drag from MDR in line with your expectations heading into the quarter? And when should we start to see that drag start to dissipate?

R. Andrew Clyde

President, CEO & Director

So the amount of the 30 to 40 basis points is consistent with what we've seen -- [is] consistent with what we've estimated, it's built into the guidance going forward in terms of the \$430 million to \$435 million contribution. So if you're looking at the uplift around tobacco, for example, and lot of the programs that require MDR membership and participation to get that, you're going to continue to see the higher volumes, relative share performance, higher contribution from those categories. And then you'll continue to see the discounts and deferrals associated with that.

So the numbers are pretty much built in, as you would see. So if you want to think about it kind of like the Core-Mark negotiation contract 5 years ago, you saw a onetime reset in the contribution margin. This has been a, if you will, a onetime reset down by the 30 basis points there that we're giving to the customers, but in return, we're seeing significant contribution margin improvements as a result of those programs. And then we'll be looking to find ways to execute programs related to Murphy drive rewards more efficiently, sweepstake-type programs, et cetera, which might impact the liability balance and flow through. And so there may be some adjustments that impact those numbers as well.

We continue to reevaluate a few times a year, the value of the points, and there have been some adjustments to those, but we expect these to be the kind of numbers you should expect going forward, but you should also expect the same top line and total margin contribution that is derived from having a program like this.

Alessandra Jimenez

Raymond James & Associates, Inc., Research Division

Okay. And then do you think that the contribution mostly impacted tobacco? Or did you see a lift in comps from other areas of the business?

R. Andrew Clyde

President, CEO & Director

Yes. So right now, the 2 big areas we've seen comp performance from MDR is clearly tobacco, but also on the fuel side. The other category, smaller categories will be a bigger focus point in 2020. But we knew that in the very first year, and signing up customers, you had to be able to demonstrate uplift in the program in your 2 biggest categories and for us, being fuel and tobacco, we did. And so that gives us then the opportunity to leverage those findings and those results across our vendor partner base as we have other programs, offers, et cetera, for our customers.

Alessandra Jimenez

Raymond James & Associates, Inc., Research Division

Okay, that's helpful. And then lastly for me, given the current industry dynamics and cost pressures impacting the smaller operators. Do you potentially see an environment where you could operate the business with fuel margins above the \$0.14 to \$0.16.5 range and still maintain your cost leadership?

R. Andrew Clyde

President, CEO & Director

We do. What I would say is that \$0.14 to \$0.16.5 range that, I think, we stopped using a couple of years ago. I think we've generated now \$0.162 as a 3-year average. And so we're certainly more comfortable working around that average than such a wide range. We just haven't seen the either the commodity type movements that would reflect what you'd have to believe to go back to a \$0.14 type number, nor if we've seen sort of the competitive dynamics that you would experience that as well. Yes, there's certainly pressure for the smaller operators, and you can look at the NEX data. You can look at the second, third, fourth quartile retailers breakeven metrics. And so as their cost pressures continue to go up, they're impacted by these headwinds the amount of investment they're going to have to put into EMV, many of them putting significant investment into food, but maybe not having the offer, the practices to get a return on that investment. There is a lot of pressure for them to raise prices to achieve the financial performance. They need to get a return on their investments. And so in that environment, we're able to both grow volume and margins, as we've demonstrated with our 2019 results. And I think our 2020 guidance has that same perspective in mind.

Operator

Your next question comes from John Royall with JP Morgan.

John Macalister Royall

JP Morgan Chase & Co, Research Division

So on the station OpEx, you guys had a big year-over-year decline in the per store metric in 4Q. I was just wondering if you could talk through some of the drivers there. Appreciate the color on the 2020 guide in the comments, but just wanted to understand the 4Q strength a little better?

R. Andrew Clyde

President, CEO & Director

Sure. So we had the reclass, and these were some cost of good items that we're showing up in supplies and some other categories that needed to be in the merchandise margin area and so that was one driver. Our maintenance for the quarter was a significant win. That was something where earlier in the year, we got caught up on prior year's deferred projects, and we really saw that play out in Q4, where we just had significantly less break-fix and planned maintenance out there. And so I think those were probably some of the -- probably the 2 biggest items.

John Macalister Royall

JP Morgan Chase & Co, Research Division

Great. And then for the raze-and-rebuild program, I was just wondering if you could talk through how much running room there is remaining there? I think you said you're under 50% kiosk now, and you're maintaining a pretty healthy pace in these conversions, what's the ultimate percentage kiosk you can get to? I assume it's not 0.

R. Andrew Clyde

President, CEO & Director

No, we've talked about it before. I mean, I think there's 3 things that are the criteria we use to identify raze-and-rebuild candidates. First, how old are they? And given we started building these stores in 1997, we've got a larger part of our mix approaching that 15 to 20 years. And in the late '90s, early 2000s. So we were building with our partner, Walmart; over 100 stores a year. So there's a number of stores in that kind of window that are up for consideration. You have to have the land available to do it. And so when we ultimately took possession of the land we had parcels that ranged anywhere from a quarter of an acre to well over an acre. You can't do a raze-and-rebuild and put a 1,400 square foot store on a quarter of an

acre, and so that would require cooperation with our partner to be able to do that. And then you really need to have the economics to be able to do it as well to get the -- what we call a reinvestment, return on investment -- the reinvestment economics. And I think that's one of the things that really distinguishes Murphy USA in the small formats, if you could take an existing store, tear it down, rebuild it at the end of the useful life and still get very, very strong returns on those.

And so with 25 stores a year. We've got a long runway, north of 10 years to be able to do that. I think one of the capital allocation questions we get from time to time with investors is, would you ever accelerate that from more than 25 stores to something greater than that. And so I think if we think about our NTA growth ramping up, maintaining capital allocation discipline and a balance between new growth and share repurchases, that's certainly a lever that we can consider. And if we start running into higher maintenance cost or issues in terms of, hey, the stores aren't as competitive, and we're seeing a degradation in the economics of those stores that could cause us to rethink the 25 a year number and perhaps something greater. And then we have the ability to pivot on our share repurchase program if we deem that to be a higher return and better use of capital.

Operator

[Operator Instructions] And we have a question from Benjamin Bienvenu with Stephens.

Benjamin Shelton Bienvenu

Stephens Inc., Research Division

I wanted to start with a question on D&A. It's, I think, surprised most today for your outlook for 2020. If you could just talk about D&A expense next year, what's driving such a material increase in that line item?

Malynda K. West

Executive VP of Fuels, CFO & Treasurer

Are you asking about DD&A, or G&A?

Benjamin Shelton Bienvenu

Stephens Inc., Research Division

Sorry, the depreciation and amortization.

Malynda K. West

Executive VP of Fuels, CFO & Treasurer

The depreciation is going up, similar to what it did last year, really, with the ramp-up in our build program, building more new sites. And so that's adding incremental G&A to the overall bottom line. And also with the increase in raze-and-rebuild activities, we have unamortized balances within those that also have to be written off. So we have some accelerated depreciation built into that number, too.

Benjamin Shelton Bienvenu

Stephens Inc., Research Division

Okay, fair enough. I wanted to ask about guidance in general. And when you look at 2019 guidance, you guys -- it proved to obviously be conservative on a number of line items. I'm curious what surprised you in 2019 to the upside? And when you think about 2020, what are the variables outside of just market environment around changes in fuel prices and how that could impact fuel, in particular, that we should be thinking about to drive upside or downside to kind of the midpoint of the metrics you've provided for 2020?

R. Andrew Clyde

President, CEO & Director

Sure. Well, you know, Ben, it's usually our practice to not get too far ahead of ourselves in terms of certain initiatives. So if I think about 2019, and the accomplishments there and what we delivered I wouldn't say it was a surprise, but it was kind of the expectation that we would be able to grow our fuel volume through our retail pricing initiative, and we were able to do that. I guess, the surprise in the year

was the massive run-up in prices in Q1 and our ability to grow volume and margins in that environment and throughout the whole year. Certainly, the refined product market tightened up over the course of the year. Colonial line space turned positive. We haven't talked about RINs in 2 or 3 calls, which is delightful for me on this end and our team.

And so I think there's just a lot of stabilization in the refined product market from that standpoint. And so you got to see the impact of our strategic initiatives play out. I think it was a surprise when we started seeing the number of Murphy Drive Reward customers signing up. But when you think about doing 3x the industry fuel volume, 5x the industry tobacco to have 6x the density of members per store versus some other public comps we have. I guess, that shouldn't have been a surprise, and then seeing that translate into an attractive platform for our manufacturing partners, our ability to translate that into value for our customers.

And seeing the significant uplift in tobacco volumes per store against the headwinds the rest of the industry was facing. We certainly didn't build all of that into the guidance that would have been pretty aggressive in betting on the come, but as it all kind of played out, I think it makes sense when you think about our customer, their value-conscious focus, our ability to deliver that value through a unique capability in doing so, delivering a better marketing return on investment for our supplier partners.

So I think that all just came together nicely. And as I said, when you add those 2 components to our new-to-industry stores and our raze-and-rebuild stores, we're just seeing higher performance out of those stores, which gives us both the conviction, and continue with raze-and-rebuild and the 2,800 square foot stores. So I think that was, again, just kind of a recap, going back to the beginning of my script around 2019, and those were the parts of the business that really operate at a much higher level, and they were part of the very intentional planning and initiatives that we've been talking about for 2 years, and we actually delivered on them, right?

And so when you think about 2020, we've now highlighted guidance in areas where we can continue to deliver on those, continue to grow volume profitably, continue to expand merchandise contribution and doing that even with some headwinds that are out there as well.

As I think about what are some of the risks in 2020. We certainly want to maintain our fuel volume growth and have the right markets to do it. I think IMO 2020, I think, we probably thought 2 years ago, it was going to be a lot bigger factor, and we see these big run ups, and we haven't seen that. So what sort of commodity environment might we have this year, especially in the second half of the year, when we have the driving season, higher volumes, et cetera. We're going to see falling prices in that period, which are generally more attractive.

We've seen some regulations on tobacco. Are those done? Or there going to be further restrictions, regulations, et cetera, that could impact that category differentially. I think we've got good line of sight on the benefits, the minimum wages and have that built in, certainly, any new FLSA treatment would only impact a very small number of our stores, so not too concerned there.

Benjamin Shelton Bienvenu
Stephens Inc., Research Division

That's helpful. I want to ask, it sounded like for the merchandise contribution for 2020, we should be kind of thinking of something similar to 2019 and that, you have continued strong merchandise sales growth, but merchandise margin compression. What, if anything, is considered as it relates to mix of merchandise? Because obviously, you had really strong tobacco sales growth in 2019 and that negatively impacted margins given the lower margin relative to the non tobacco. So to the extent you can opine on that, that would be helpful for us to think about what we should expect in 2020?

R. Andrew Clyde
President, CEO & Director

So I probably can't do a detailed walk on the unit margin. But what I would say is within the tobacco category, I would expect cigarettes to be -- remain relatively strong. But with the impact on vapor and a lot of the headwinds that we described associated with that, which is the higher-margin product. That will

be unfavorable to the unit margin. But at the end of the day, we don't take the unit margin to the bank, we take the contribution dollars. MDR will be fairly consistent, so not an impact there. As we look to grow non-tobacco contribution, as we said, high single digits versus around 4%. That should generally improve the overall contribution margin as well.

Operator

[Operator Instructions] And we have a question from Bryan Hunt with Wells Fargo Securities.

Bryan Cecil Hunt

Wells Fargo Securities, LLC, Research Division

Yes, when I look at your -- when I think about your framework for cash flow. Given the fact that where you've talked about EBITDA and CapEx taxes, interest, et cetera. It looks like it'll be marginally free cash flow, if beyond buying a million shares at the current level. Is there any reason to believe that you would fluctuate dramatically on roughly \$100 million of share repurchase, one direction or the other, if share prices were to move in one direction or the other?

R. Andrew Clyde

President, CEO & Director

So we authorized a \$400 million share repurchase program last year, and we don't expect to deviate from that. So I think that probably answers your question. We'll do more than a million shares a year to achieve \$400 million of repurchase in a 2-year period.

Bryan Cecil Hunt

Wells Fargo Securities, LLC, Research Division

All right, very good. My second question is, you touched on a lot of the risk there, Andrew, just on the last question. When you look at inflation, we get cigarette inflation every year, and you talked about minimum wage, but when you look across the merchandising front, are there any early year surprises that you're getting either on Sodas, coffee, et cetera, within your merchandising mix?

R. Andrew Clyde

President, CEO & Director

No, it's really too early to tell or see that, but there's nothing dramatic from that standpoint. I think the cost increases that we've seen on tobacco were pretty ratable, and there's a long history of that. And there are some offsetting industry volume trends associated with that. I think last year and the year before, we saw in the carbonated soft drinks, some price increases there. And I do think we saw continued shift from CSD products to other products as well, but I don't anticipate anything from what we've seen in the first 30 days. Of the year to impact our views for the rest of the year on that.

Operator

And at this time, I will turn the call over to the presenters.

R. Andrew Clyde

President, CEO & Director

Great. Well, thank you for joining the call today. As we said, we're really excited about our performance in 2019. The plans that we've laid out, executed against -- delivered exceptional performance. And we're looking forward to a great 2020 as laid out in our guidance. So we appreciate your support. Thank you.

Operator

Ladies and gentlemen, this concludes today's conference call. Thank you for participating. You may now disconnect.

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