Murphy USA Inc | Raymond James 2022 Institutional Investors Conference | March 7 2022

Bobby Griffin:

Well, good morning everybody. Thank you for joining us here at the conference. For those who don't know me, I'm Bobby Griffin, cover consumer hard lines, specialty retail, as well as convenience stores. This morning we're privileged to have the senior management team at Murphy's USA with us. In attendance from the company are CEO, Andrew Clyde, CFO, Mindy West, VP of finance and investor relations, Christian Pikul, Chris Click, senior vice president of strategy, and Mitchell Freer from investor relations as well. This morning's format is going to be a presentation by Andrew followed by a little bit of Q and A at the end. So with that first, Andrew, thank you for joining us. It's great to see everybody here in person again after two years of virtual. So with that, I'll turn it over to you.

Andrew Clyde:

Great. Thanks Bobby, and it's great to be back here at the Raymond James Conference. I think everyone who was here in March, 2020 had no idea what the next two years, let alone the next couple of months, were going to be like. But I certainly felt the enthusiasm of investors getting back in person and we certainly felt grateful that we had the relationships with investors through conferences like this. So when we got together via Zoom or Teams over the last couple of years we had those relationships so that we could continue to tell the story that Murphy USA's been telling. We did post an updated investor relations deck this morning, and I'll go through that today. It presents really a continuation of the story we've been telling over the last few years, but I think in the current environment we really want to highlight some of the points that really make our model distinctive and sustainable in this environment.

Andrew Clyde:

So we'll get past the usual disclosure and on the first slide, you know Mindy and I are now entering our tenth year leading this company since our spend. And we are especially proud of our total shareholder returns that we've generated, whether it's a one year, three or five year or since the spend, but I think what we're most proud of is the sustainable business model that we've built. We took a low cost model and made it even lower cost. We reinforced an everyday low price position with customers that wins in every environment. And along the way we've been able to develop this incredible base of engaged staff and associates who upsell our product and loyal customers along the way.

Andrew Clyde:

What we've seen really over the last decade, but really in the last couple of years is a structural shift in our environment. As industry costs are rising, right, and our costs are not going up as much, in fact they're coming down. As a result we need less fuel margin offset those changes versus the competitors. So what happens is we take share profitably as our value gap to the competitor's increases and we can

invest those cash flows in our customers, our staff, and new stores. And what we'll talk about today is how some of these structural shifts sustain the advantage that we have. Inflation, we're all seeing it, higher labor cost increases our cost advantage. The higher fuel margins that we're seeing boost the returns of existing in new stores and our EBITDA range, as you see here on the right hand side, has really reset at a higher level. And we'll talk a little bit about the margin shifts there.

Andrew Clyde:

What I love about this business is how simple it is. As investors you should love the simplicity of the value formula for how we drive earnings per share growth. It starts with organic growth versus M&A, we're going to build and rebuild assets where we have the right to win. And where we did make a strategic acquisition in the midst of COVID, we just celebrated our one year anniversary of the QuickChek acquisition, we really bought a distinctive food and beverage capability and we really think of that as kind of a strategic one off acquisition. But with that, we're able to grow our network of both Murphy and QuickChek stores, we get to rebuild stores that allow us to grow market share and share a wallet. And then there are growth platforms that we can expand there.

Andrew Clyde:

Productivity improvements on same stores have been a huge driver of value creation for our business. We spun off our break even requirement was three and a half cents a gallon. It's now zero. On over four billion gallons well over 130 million EBITDA improvement on a base when we spun off of less than 300 million. We have many opportunities to continue to improve the productivity of our stores, and one of the things we're finding with the QuickChek acquisition is they do some things very, very well, but as a smaller company not at scale, we're able to transform many aspects of that business as well. And then I think one of the hallmarks of Murphy USA has been our disciplined capital allocation. Our focus on organic growth, but then a balance focused on repurchasing shares, maintaining our balance sheet flexibility to win in every environment.

Andrew Clyde:

So let's talk about the structural shifts. Look, pre COVID fuel margins were elevating slowly, and if you go back to a 2000, the industry structure was evolving as the major oil companies divested their company owned and operated chains. Firms like Murphy USA and CST were spun out. And while there's consolidation, there's still a lot of fragmentation. 60% of the industry is single owner operators. And our margins edged higher to about 16 cents per gallon in 2017 to '19. I mean when we were having this conference back then 16 cents seemed like a lot when we were earning 14 or 15 cents just a few years before that. So what happened with COVID? It accelerated the shift.

Andrew Clyde:

If you think about the higher unit cost of the marginal player, when volumes were cut in half their unit cost doubled and it required them to sustain a higher level of margin than ever before. But our unit cost was zero and we didn't lose as much volume and it recovered faster and we gained share on our other products. And so that demand destruction of the COVID onset increased the breakeven unit cost for the weaker retailers and we had low street prices and we just had a massive fall off in crude prices and there was rational behavior in that period. So we sustained a period of higher margins.

Andrew Clyde:

We expect the future equilibrium to settle at a higher level because the headwinds to these weaker retailers persist in many forms and our zero break even and recovered demand creates the advantage. The chart on the upper right here shows our historical fuel margins and volumes at constant 2022 store months. And what you can see on the far left 2015 to 2019 excluding 2014 was the amount of contribution on that ISO curve that we generated from a various mix of volume and margins. And we lost some volume during that period. 2014 was an exceptional year. Why? Crude prices were high and they fell sharply. That's when we make the most money.

Andrew Clyde:

But during this COVID period our fuel margins went north of 25 cents per gallon all in, right, and that really created the reset in the EBITDA. We no longer give guidance on fuel margin or EBITDA, but we do provide a modeling marker and this year it was at 21 cents. And you can see where the upside case exists in 2022, potentially up to 4 cents if we're able to continue to stain margins at that level. And the table at the bottom just shows how that translates from 2021 or 2022 modeling assumptions and some of the upside there. So a significant upside case exists. So let's talk about the advantage.

Andrew Clyde:

First one is low cost, right, our low cost model allows us to retain a higher level of the residual margin the entire industry is earning. And make no doubt about it, the cost pressures that are impacting other retailers they impact us as well. We've had higher wage costs, we had increases last year, but we have lower staff levels at our store and we have other benefits that we provide to our staff and so we're not experiencing the same level of cost pressure as our peers. Payment fees are tied to higher prices, we're paying over a penny a gallon more in payment fees, credit card fees than we did a few years ago. But so are our competitors. And rising interest rates, lease modifiers, that really impacts firms that are over leveraged on their balance sheet. We own close to 90% of our real estate, including the stores in front of the Walmart super centers. So our fixed cash costs are going back into the business, creating value for our customers, not paying higher leases year over year with interest rate cost and inflation.

Andrew Clyde:

We talked about the industry break even requirement increasing. Here's a simple fact, the higher cost and lower gallons cannot be made up by merchandise alone. So you got to pass it through in the penny profit on fuel. That incremental requirement is a material amount on top of the already significant gap that exists today between the marginal retailer and Murphy USA. And future regulations could widen that further, the table here on the right shows what is the incremental margin requirement from some labor cost scenarios? So we modeled a wide range of labor cost scenarios, the worst case scenario is just a federally mandated $15 an hour minimum wage. For us the impact could be up to two cents a gallon. For the third quartile retailer that kind of sets the margin structure the incremental impact could be north of 10 cents per gallon. That's on top of an existing 15 to 20 cent differential between their breakeven requirement than us.

Andrew Clyde:

I like to use a supply curve example where the low cost player on the left hand side, the marginal retail player is on the right hand side, and the supply curve is getting steeper. We have these increases, we're

not immune to them, but the gap grows. Right, and so when you think about how does that late to Murphy USA, even if you only had the halfway point you could see another five cents right there in incremental pressure to the industry that translate to advantage to us. So low cost always beats high cost.

Andrew Clyde:

What do we do with our low cost model? We reinforce our everyday low price position to win with the customers. We really invested in this capability, beginning in 2018, 2019, store by store playbooks, greater technology, greater information. And then the price volatility that we've seen over the last couple of years created the perfect opportunity to differentiate our positioning and widen our margins. So you can see how our fuel margin has grown since the first quarter of 2018, but our price differential has grown as well. So we're taking some of that residual, investing it back into price to grow share while still earning high margins, given the industry structure.

Andrew Clyde:

And so if we could gain share during these extreme periods, right, the falling price environment and the COVID offset onset period and then the subsequent rising price period, we're now well positioned to sustain gains in a higher price environment. Why? Because when you start getting north of $4 a gallon customers become more and more price sensitive and they trade down to low price value brands like Murphy USA. That's exactly what we saw in 2007 and 2008 as Murphy USA's market share grew and higher price branded players market share shrunk.

Andrew Clyde:

And so you can see here on the bottom right the market share gains that we had relative to the Opus retail volume estimates for our particular markets. So we're gaining share while growing margin because of our low cost position. Now on the Murphy USA side some of the high velocity of merchandise that we have comes from our tobacco category and some might view that as a headwind. But here's a simple truth about tobacco is the contribution margin for combustibles continues to grow as the manufacturers increase their price, we're gaining share and contribution. And because we do about five times the industry average we are the most efficient from a marketing ROI standpoint for the manufacturers to invest in their lower harm, lower risk non combustible products. So this growing contribution platform we have on combustibles allows us to help transition towards a world of other nicotine products that are higher margins. And because of our Murphy driver words loyalty program we have unique insights about the customers that allows us to differentiate ourselves with the manufacturers.

Andrew Clyde:

So I think we surprised folks about a year ago when we announced the acquisition of QuickChek. Murphy USA had never done an acquisition before, and we highlighted this is a way to really buy the capabilities around food and beverage versus trying to build those out. And everything we've seen in our first year of integration really validates the investment we made. We bought one of the leading C store retailers in food and beverage and you can see some of the proof points there. Their non tobacco represents 83% of the merchandise contribution, their food and beverage profit margins are well over 63%. So a leader certainly amongst any of our public peers within that space. They're innovative, they've been doing customer self checkout and ordering since 2006 and a leader in technology. They also complement our fuel performance, their everyday low price, we're making them more consistently

everyday low price. We're getting leverage out of the supply contracts, but they are a high volume retailer as well. So well positioned there.

Andrew Clyde:

It's another growth platform. We built five new stores last year and we're building up the pipeline to grow there. And the synergy opportunities continue to grow. We liken this as kind of Murphy USA 2.0. While they have a lot of distinctive strengths and capabilities, it also reflects just the lack of scale of a chain of 160 stores and the improvement opportunities that exist across many of the same things we found at Murphy when we spun off the company in 2013. The integration focus is going to deliver value in the short term, but it also creates opportunities for growth. A lot of this is just simple business transformation. While despite Murphy not having done M&A before, many of us have led companies through transformation, and in fact we led Murphy USA through a transformation since the spin. So we're applying and have already adopted our fuel pricing capabilities at every store, we're renegotiating fuel and third party contracts, and we're enhancing performance management on what we found to be a very strong complimentary culture on the people side.

Andrew Clyde:

Scale matters in this business, so we've already applied our fuel inventory management technology where the carriers can see the inventory at the store so it reduces stockouts on fuel. I mentioned we've renegotiated fuel and we're renegotiating third party contracts. And one of the opportunities we're spending a lot of time on this year is integrating systems and the overall platform for the future. And there's opportunity for growth.

Andrew Clyde:

So we are doing a detailed food and beverage strategy on both brands, and it's helpful to do it on a strong food brand and a brand where frankly, customers don't think about a fuel focused brand like Murphy USA from a food side to really understand where do we have the right to win with customers around food and beverage offerings so we can maintain the efficiency and velocity of the Murphy brand that stands for the best national brands at the best value, without encroaching on labor costs that many others have while taking an incredible food and beverage brand in QuickChek that has loyal customers. And we see many opportunities there to continue to optimize around pricing, promotion, menu assortment, menu mix, supply chain, SKU rationalization, and the like.

Andrew Clyde:

We have a number of inflight pilots. We have eight stores with charging stations out of the 160 at QuickChek, and so we'll speak a little bit more about EVs and what that means in their markets versus the Murphy markets.

Andrew Clyde:

So on EVs, this is a topic that just to make top of fold news. So what have we learned about electric vehicles? Well, first of all, they're premium luxury cars today. Second, most of the charging happens at home or at work and the Murphy customer demographic is not the one that's buying EVs. And to make charging economics work you need a certain level of utilization and crossover to be profitable. Whether you're putting your money in or someone else's money, including government funds, in there. And so you take a typical QuickChek site, look, it's higher density in New Jersey and New York, they have larger lots, there's greater crossover potential. We talk about our Kingston, New York store. Ideally positioned

between New York City and Albany. People stop there, there's nothing else along the way. It has the utilization to make sense. It would be profitable for us to have built it on our own, it's certainly profitable for Tesla who built it. And we're getting great crossover from it.

Andrew Clyde:

Murphy markets, lower density, smaller lots, less crossover potential. We actually did an analysis looking at our headquarters town, El Dorado, Arkansas 20,000 people, we have an incredible 1,400 square foot store there. It's two hours south of Little Rock, Arkansas. It's kind of like Kingston. Right, it's two hours away from people driving from Little Rock south to I-20 to go to Ruston, Monroe, or [inaudible]. You would need over 800 electric vehicles coming through El Dorado a month to make that part of the equation work and you'd need north of 300 in El Dorado, right, to round out the economics for one complete charging station.

Andrew Clyde:

We know of two electric vehicles in El Dorado and there's 1,440 registered in the state. So there are markets like Kingston that are ideal for this, but there's a large proportion of our markets that are not. And so we'll continue to evaluate this, but from the capital allocation standpoint we're going to be very focused on winning with our customer today, and we'll always be prepared for any future. So we're going to stay focused on organic growth, we've got a great set of opportunities balanced across the portfolio. We're diversifying across our Murphy and our QuickChek brands across geographies, across formats. The NTI activity that we have supports these new platforms, whether it's EV charging at some QuickChek locations, or it's an enhanced food and beverage offering at a Murphy USA platform. And a big part of our business is raise and rebuilds. We did over 30 last year, we got 35 targeted this year.

Andrew Clyde:

If you said, "Where would you ideally build in one of these rural markets today?" You would build in front of the Walmart or the super center. That's the real estate we own and we get to end of year, end of life on those assets we're rebuilding with larger assets that we're not only gaining share of wallet, but we're gaining market share based on our Murphy Drive Rewards customer feedback. And guess what, the structural shift we talked about, that rising margin environment just makes those returns look more attractive. So on the right you can see our low double digit unlevered after tax returns growing with higher fuel margins and then the returns we get from our raise and rebuilds. And all of our productivity initiatives and strategic initiatives can further bolster our returns.

Andrew Clyde:

The good news is this business continues to be a free cash flow machine that supports both growth and shareholder distributions. I think one of the hallmarks since our spin has been our discipline capital allocation, where we balance between growth and share repurchases. And I think reality is the discounted valuation, our transformation agenda and organic growth relative to the M&A story that kind of dominated the sector made us a little less understood. And with that valuation gap, we've repurchased about 50% of the shares since the spin. Our focus remains on long term organic growth, that's our top priority. We're going to maintain an appropriately leveraged low cost balance sheet. And frankly, we have found few differentiating M&A targets, and we've seen a lot more since having done the one deal being in the deal flow that would make M&A a focus for us.

Andrew Clyde:

The structural margin creates a lot of optionality for us. We have the cash and free cash flow to already front load the one billion dollar share repurchase program we announced in December. If we earn the upside margin case above our 21 cent model case, we've made it very clear how we would redeploy that excess free cash flow to further front loading our share purchases. And we also began a dividend program and we put its growth on autopilot where we have committed to grow the cash pool by 10%. And by reducing share count a million shares a year the dividend growth will be about 15%, and that's frankly on autopilot.

Andrew Clyde:

So what does this mean? Every year we update this chart where we raise the bar. We believe Murphy USA is really the advantage value player in our sector. You can see our share price returns, the high, the average, and the low higher every year since the spin. And as we think about the walk forward between 2022 and 2026 off of our lower model base, there's the opportunity to get EBITDA to 800 million from synergy capture, productivity improvement, strategic initiatives, and organic growth. And that's only growing margin from 21 cents, the model case, to 22 and a half cents through various initiatives, mix of stores, mix of markets, et cetera.

Andrew Clyde:

Assuming you buy back a million shares a year, maintain, improve your current multiple, it's a very attractive share price for you to model and then you've got the upside on top of that. So we believe we have a sustainable business model that we translate into a winning value proposition that's being delivered through our engaged customers, our engaged staff and loyal customers in a capital allocation model that's going to let us grow and deliver back for our shareholders. So I think with that, Bobby, happy to take any question.

Bobby Griffin:

Yeah, I'll start it off and then maybe we'll see if the audience has something, we got about five minutes. I guess one for more near term and topical question oil has been covering around 115 probably a barrel right now, fuel margins surprisingly have been very strong to kind of start the year in January and February, even with the rising crude, so maybe what have you seen over the last couple weeks, or what are your expectations on how fuel margins have maintained even with crude moving significantly higher pretty quickly?

Andrew Clyde:

Sure, like I think the biggest surprise to all of us in 2021 was in a year where you had persistently rising prices we didn't see the margin compression that we'd seen in the past. And it gets back to the industry structure. The marginal player was facing labor supply chain and other challenges throughout the year where their motivation is to continue to push and pass through those increases in higher prices with an additional penny margin increases above that. And so for us normally lagging on the way up our margins would be compressed, our margins weren't compressed. And so as we've continued the journey from a hundred to 115, I don't know if we're going to get to 130 or 150 or where it's going, but we suspect that dynamic will increase. And what that really does is create a set up for an environment like 2008 or 2014 because it's not, if oil prices fall and fall sharply it's when, and by how much, and that's when our higher volume position starting with a strong margin position allows us to make even greater returns.

Bobby Griffin:

I guess the second part of the question too, maybe you guys have seen multiple cycles in oil and multiple different rounds of consumer gas prices, at what level do you see a consumer start to change their behavior? Four bucks a gallon? 4.50 in terms of purchasing patterns, trip patterns, or even what they're spending in the store?

Andrew Clyde:

Yeah I studied this deeply back in 2007, 2008. $4 was about the magic number in which you started to see sort of macro demand elasticity and real changes and smart cars were showing up on the street everywhere. Between 3.50 and $4 a gallon back then you really saw a shift in consumer behavior as consumers shifted towards lower price brands. That was 2008, you fast forward 14 years vehicles are more efficient, you know just on 2022 dollars, I don't know if that number is $4 and 50 cents or $5 a gallon, but it will be at a higher level. But the first thing that we will see and we're already starting to see is consumer shifting to low price brands. And so we will win in that environment and then if macro demand actually gets to that point where it becomes elastic at a higher level we'll still be well positioned in that environment.

Bobby Griffin:

I guess last we got about two minutes or so left, I don't know if anybody from the audience has maybe if not I'll ask one final question. But you know, one of the [crosstalk].

Speaker 3:

Great presentation, great story. The two questions I had is, how much of your cost advantage is driven by you owning 90% of the real estate on the expense side and then there's been some news in the press about, in New Jersey particularly, the being able to pump your own gas. What's the cashflow implications of that for your QuickChek-

Andrew Clyde:

QuickChek business, yeah. So the break even requirements that we're talking about are before rent or capital structure. So you could say on the one hand that advantage is on top of it. I think you just have to go back to the Pantry in its final days, by having over levered itself so much from M&A, having so much of its real estate portfolio in the form of sales lease backs and rent, that in a difficult environment they began pricing for cash margin and lost significant share. And so you could see in an environment where someone gets so over levered and then has those additional fixed cash cost that it will show up in how you price in the same way the other cost structured advantage that we have. And we absolutely saw that, and we've seen it with other players as well that just get too over levered, right. Because there will be some period where something is tight or volatile for a period. So that advantage helps you win in the long run under any scenario.

Andrew Clyde:

On full serve, yeah, there's a proposal out that says if stores have less than four pumps, so you think about these are the marginal dealers, they could elect to have self service only. They will still have to have somebody there, and so I'm not really sure how that plays out. If you look at those two to three pump dealers, our customers aren't going there so we really don't see that as an impact. I would certainly like to think that we just move the whole market to self serve, but you know we'll see, they haven't made progress on that in the past. Maybe it'll be different this time.

Speaker 3:
Thank you.

Bobby Griffin:
With that we're right on time. So Andrew, thank you for the time. We'll head to the breakup.

Andrew Clyde:
Great. Thank you, Bobby.