

Murphy USA Inc. NYSE:MUSA

FQ4 2023 Earnings Call Transcripts

Thursday, February 8, 2024 4:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ4 2023-			-FQ1 2024-	-FY 2023-			-FY 2024-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS
EPS Normalized	6.65	7.00	▲ 5.26	5.80	25.16	25.62	▲ 1.83	26.21
Revenue (mm)	5317.73	5068.90	▼ (4.68 %)	5081.50	21778.29	21529.40	▼ (1.14 %)	21855.93

Currency: USD

Consensus as of Feb-08-2024 4:34 AM GMT

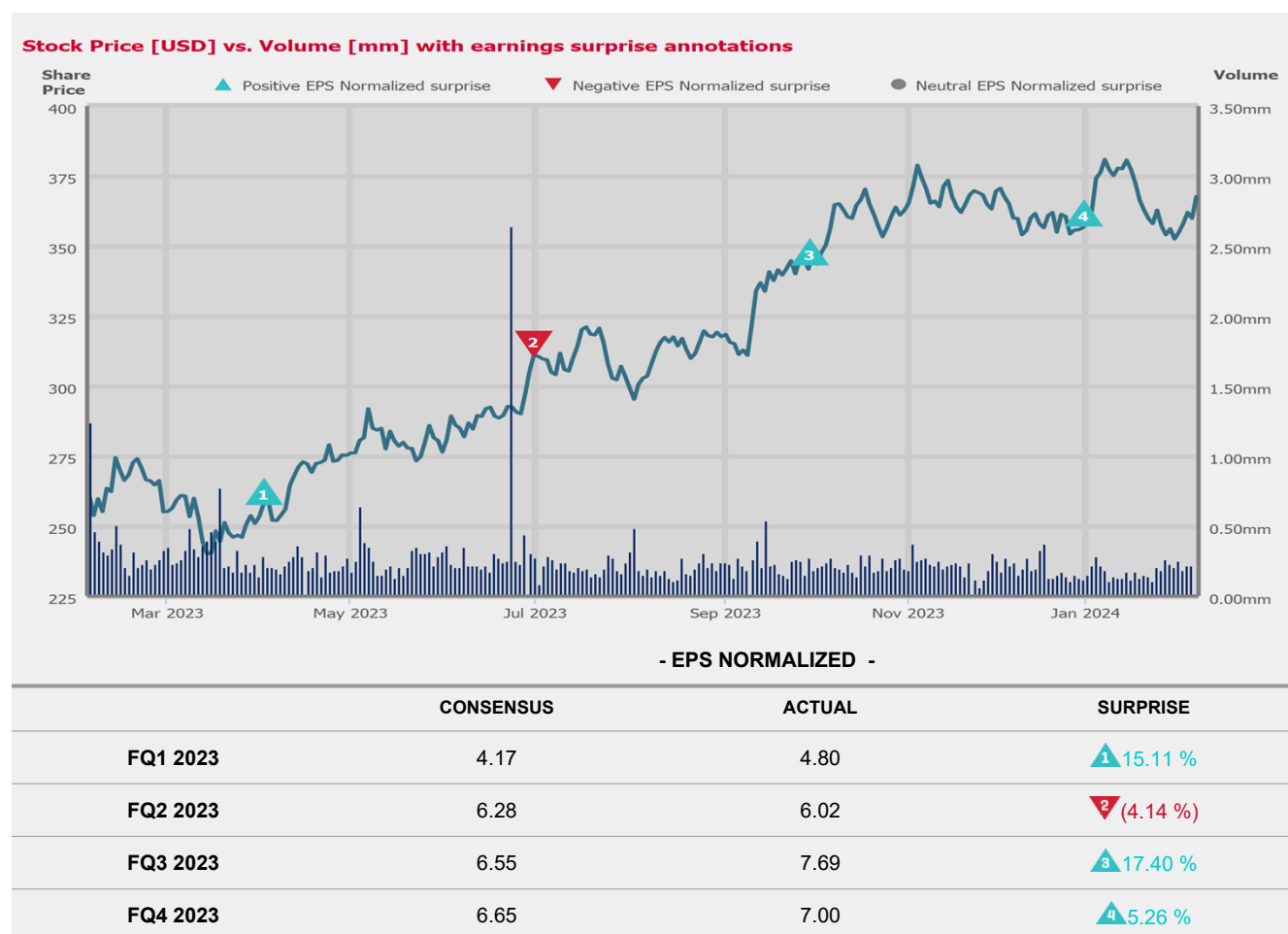


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Call Participants

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Presentation

Operator

Thank you for standing by. My name is Christine, and I will be your conference operator today. At this time, I would like to welcome everyone to the Murphy USA Fourth Quarter 2023 Earnings Conference Call. [Operator Instructions] I will now turn the floor over to Christian Pikul. You may begin your conference.

Christian Pikul

Vice President of Investor Relations & FP&A

Thank you, Christine. Good morning, everyone. I appreciate you joining us today. With me are Andrew Clyde, President and Chief Executive Officer; Mindy West, Executive Vice President and Chief Financial Officer; and Donnie Smith, Vice President and Controller. After some opening comments from Andrew, Mindy will provide an overview of the financial results and kick off our guidance conversation. After some follow-up comments from Andrew, we will 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 will turn it over to Andrew.

R. Andrew Clyde

President, CEO & Director

Thank you, Christian, and good morning, everyone. We are excited to discuss our fourth quarter 2023 performance, which reaffirms the strength of our strategy and business model as well as our enduring commitment to driving sustainable value for all our stakeholders.

When looking at our fourth quarter and full year 2023 results, it's clear to us that Murphy USA is delivering results, and it all revolves around the concept of more. And let me tell you what I mean by more.

I often share that I believe the Murphy USA and QuickChek brands are serving the largest and fastest-growing customer segment in the U.S.: customers who are struggling to make ends meet, living paycheck to paycheck and who value affordability above all else.

When we look at our most loyal customers through the lens of our loyalty data, what do we see? First, we continue to get more from the same customers. When we look at a large panel of customers who've been shopping with us every month since 2019, we see that they are spending 50% more at Murphy USA in 2023 than they were in 2019, about \$177 per month.

Second, we are getting the same for more customers. New loyalty members that visited us for the first time in 2023, are making the same frequency of trips as the 2019's most loyal cohort, about 5 transactions per month. But they are spending at higher levels and they are shopping more of the store with 28% of them having bought fuel, tobacco and nontobacco each month.

In addition, we're getting more from our existing stores. As we continue to build on our history of lowering our fuel breakeven margin requirement and improving our coverage ratio, new initiatives are helping us maintain that trajectory. For example, one element of our digital transformation initiative focuses on upsell suggestions at the QuickChek touchscreens. Early pilots show uptake of suggested sell items have more than doubled. At Murphy, creating personalized offers through machine learning initiatives is resulting in more share of wallet captured from the same customers.

Same initiatives and investments, they allow us to achieve more with less. Last year, we piloted a more sophisticated demand forecast and production planning tool at QuickChek stores. This initiative has resulted in driving a larger basket with better availability of items while also improving labor scheduling accuracy. In other words, doing more with less staff hours. The pilot stores have demonstrated a 20% uplift in grab-and-go products, leading to an increase in contribution of 6% net of spoilage due to stronger in-

stock positions during periods of peak demand, increasing our speed of service and giving customers more of what they want. The same demand forecast is now fine-tuning our labor scheduling.

We're also getting more from our new stores. We added 22 new stores to the Murphy-branded network in 2023. And while supply chain and permitting issues have deferred some of the financial impact of our new store program, most importantly, performance of these new stores has not been compromised. The 74 new Murphy banner stores added over the last 3 years averaged about 290,000 gallons per store month in 2023, nearly 20% higher than the network average in 2023, delivering more gallons to more customers.

From a merchandise perspective, we are seeing total merchandise sales per store month of about \$205,000, about 15% higher than the Murphy network average, which is impressive given these stores are still ramping to their full potential. We've also put 13 new QuickChek stores into service over the same 3-year period, helping QuickChek generate record results in food and beverage sales and margins in the fourth quarter.

Additionally, we are excited to share that QuickChek has received recognition for the #1 spot in the CSP survey of the 20 best C-store coffee programs in 2023 and the #2 best gas station for food in the USA Today. This recognition confirms what we already know: that QuickChek is a world-class food and beverage platform known for its high-quality fresh offer and innovative programs that keep customers coming back for more.

In addition to new stores, we are getting more from our legacy network of kiosks when our raise-and-rebuild program converts them into 1,400 square foot stores with an expanded center store offer and higher merchandise contribution. In short, these stores are selling more gallons and more merchandise. The raise-and-rebuild stores from calendar years 2020 through 2022 averaged 307,000 gallons per store month in 2023, about 27% higher than the network average. They averaged 230,000 per month in merchandise sales or about 27% higher than the Murphy network average also.

Given our performance against this backdrop and the environment which we compete that is characterized by flat to negative macro demand, especially in fuel and cigarettes, this begs the question: if we are getting more in the marketplace, what does that mean for everyone else? We believe it means others, especially those who don't have their own unique value proposition are getting less. We're taking share. Based on what we have all observed over the past few years when certain segments of the competition loses sale and sees their cost increase, they are relegated to make it up in the form of higher fuel margins.

So what does this mean for Murphy USA? It means we also take home more cents per gallon at each store, which in turn funds more organic growth, more investments in distinctive capabilities that will generate even more in the future, allowing us to buy back more shares. This is the virtuous cycle and flywheel that defines Murphy USA.

So I know the million-dollar question remains. If you're getting more from other parts of the business in the future, do you still expect to capture more fuel margin? And the short answer is yes, and I will cover that in a little bit more detail after Mindy reviews quarterly results and kickstarts to guidance conversations with some details around our 2024 capital plan. Mindy?

Malynda K. West

Executive VP of Fuels, CFO & Treasurer

Thank you, Andrew. And continuing in the spirit of the more theme, I would like to say good morning to everyone. Sorry, I know that was bad. I'm going to hit a few operational highlights, and then I'm going to move on to financial results, and then I will discuss our 2024 capital plan.

So starting with fuel. In 2023, total volumes were up 1.1% versus 2022 with per-store volumes of 242,000 gallons per month, finishing within our guided range of 240,000 to 245,000 gallons. Given the volatility experienced in 2022, I think it's important to think about fuel volume performance on a 2-year stack, which shows Murphy USA per-store month volumes are up 5.6% versus about a 7% decline in the OPUS data in our markets. That translates to roughly 12% of share that we have taken from others.

Turning to merchandise. Total contribution dollars came in at \$803 million or up 4.7% versus 2022 and in line with our guidance of \$795 million to \$815 million. Exceptional execution and promotional activity in the tobacco category led to strong share gains, driving a 4.6% increase in total tobacco contribution. Remarkably, we recorded over \$2 billion in cigarette sales in 2023, growing our cigarette market share to 20% and growing smokeless to 15% share of market. Nontobacco growth accelerated in the fourth quarter with food and beverage sales and margin up 5.4% and 5.7%, respectively, on a per-store month basis.

Looking at OpEx. Per store operating expenses, excluding payment fees and rent, averaged \$33,200 per month in 2023, right at the midpoint of our guidance range of \$32,500 and \$34,000 per store month. About 1/3 of this increase was attributable to employee-related expenses with 2/3 coming from other areas, particularly pressure in maintenance and loss prevention.

However, keep in mind, some of this increase is attributable to our evolving format mix. If we exclude larger-format, new stores and raise-and-rebuild activity, we estimate that average per store month operating expense would have been up about 4% versus the 4.9% we reported.

Now for some of the standard financial items. Revenue for the fourth quarter and full year 2023 was \$5.1 billion and \$21.5 billion, respectively, compared to \$5.4 billion and \$23.4 billion in the year ago period. EBITDA for the fourth quarter and full year 2023 was \$275 million and \$1.06 billion, respectively, compared to \$230 million and \$1.2 billion in the year ago period. Net income for the quarter was \$150 million versus \$118 million in 2022, resulting in reported earnings per share of \$7 versus \$5.21 in the year ago period. Net income and earnings per share for the full year was \$557 million and \$25.49, respectively, versus \$673 million and \$28.10 per share in the year ago period.

Average retail gasoline prices in the fourth quarter were \$2.97 per gallon versus \$3.19 per gallon in the fourth quarter of 2022. Retail gasoline prices for the full year averaged \$3.19 in 2023, \$3.63 in 2022.

The effective tax rate in the fourth quarter was 23.6% and 24.2% for the full year. And for forecasting purposes, our 2024 guidance remains within a range of 24% to 26%. Total debt on the balance sheet as of December 31, 2023, remained at approximately \$1.8 billion, of which approximately \$15 million is captured in current liabilities, representing 1% per annum amortization of the term loan and the remainder of reduction in long-term lease obligations as they are paid through operating expense. Our \$350 million revolving credit facility remained undrawn at year-end, and these figures result in gross adjusted leverage that we report to our lenders of approximately 1.7x. CapEx for the fourth quarter and full year was \$108 million and \$344 million, respectively, and within our adjusted guidance range of \$325 million to \$375 million.

Looking ahead into 2024, we expect to accelerate new store growth and raise-and-rebuild activities compared to last year. Coupled with new EBITDA-generative capital projects that are not tied to new stores, including up to 50 of our 2,800 square foot store renovations, we are effectively utilizing operating cash flow to grow the network and grow EBITDA. Our commitment to higher returns in new stores and across the network means we will continue our digital transformation investments to drive in-store sales and margin.

As a result, we expect total spending to increase to a range of \$400 million to \$450 million. Keep in mind, this capital program comprises not just spend on new stores for 2024, but also preconstruction and other spending on future [indiscernible] as we ramp up to higher level of sustainable store growth in 2025 and beyond as conditions allow.

As is historically the case, the majority of this capital is earmarked for growth projects, which translates to well over \$300 million in 2024, and includes between 30 and 35 new stores that have a high probability of opening this year, including up to 4 new QuickChek stores. It is important to remember that in order to add 30 to 35 new stores this calendar year, that means the capital plan must reflect a higher level of projects to achieve that guided range after risk adjusting our build program for potential delays.

This means we can potentially put more stores into service in 2024 or get a head start on 2025 new stores, underscoring our ongoing commitment to organic growth as our highest priority in growing the business over the next 5 years.

Additionally, in light of the success of our raise-and-rebuild program results to date, we are looking to increase raise-and-rebuild activity when conditions allow. In 2024, this means we are initially targeting between 30 and 40 raise-and-rebuild opportunities with the potential to do more depending on scheduling and other factors. And then beyond growth, we are earmarking roughly \$80 million for maintenance capital, which includes \$15 million of IT maintenance capital, a category we have previously identified as corporate and project spend in prior years. So that leaves approximately \$50 million for corporate capital needs, ongoing technology projects and other strategic initiatives underway.

Now before I turn it back over to Andrew and as mentioned in the earnings release, we repurchased 442,000 shares during the quarter and just over 1 million shares for the full year, resulting in cash and cash equivalents balance of \$118 million at year-end, which is up \$61 million from 2022 net of our balanced capital allocation of \$344 million of investment and \$333 million of share repurchase, once again clearly demonstrating the accretive benefits of our positive free cash flow business.

And with that, I'd like to turn the call back over to Andrew.

R. Andrew Clyde
President, CEO & Director

Thanks, Mindy. Let me now quickly take you through some additional elements of our 2024 guidance. I'll start with a few more details around organic growth. We completed a total of 28 new stores in 2023, including 6 QuickChek stores, and we executed 31

raise-and-rebuilds. As discussed in our third quarter call, while we are disappointed in our ability to put new stores into service, an ongoing issue for many retailers across the country, as Mindy mentioned, in 2024, we were able to complement new store growth by redirecting capital into other revenue-generating areas of the business.

In addition to adding between 30 to 35 new stores this year, we are accelerating our raise-and-rebuild activity, targeting between 35 and 40 locations. Further, we are planning on remodeling approximately 50 2,800 square foot stores to install queuing lanes, improving and consolidating our food and beverage offer in the store for easier customer access, adding additional cooler facings and creating a better customer experience through better lining and cleaner layouts, all of which will help to drive in-store sales, particularly in the food and beverage categories.

As a reminder to our investors, raise-and-rebuilds and remodel projects are not store count-additive, but they are EBITDA-additive at rates of return equal to or better than our new store program, which runs between 12% and 15% after tax.

Moving on to fuel volume. For the past 2 years, per-store volumes have remained within the 242,000 to 245,000 gallons per month range. And in a normal environment, we expect new stores and raise-and-rebuild activity to offset flat to slightly declining legacy stores, resulting in flat to slightly higher per-store volumes in 2024. This translates to guidance up or down about 1% versus 2023 or a range of 240,000 to 245,000 gallons per month.

Looking inside the store. In 2024, we expect to increase our trajectory of merchandise contribution growth. From 2014 to 2019, total annualized contribution growth for merchandise averaged about 6% and improved to 7% since 2020. In 2024, through a variety of investments in store performance, format expansion, enhanced center store promotional activity, continued innovation and new menu offers at QuickChek, we expect total contribution dollars to range between \$860 million and \$880 million or about 8% growth at that midpoint.

Turning to OpEx. While the inflationary factors that drove 2022 operating expense have moderated in 2023, labor and service cost inflation have proven sticky and remain in our structural base. Additionally, as we increase our average format size through 2,800 square foot stores coupled with raise-and-rebuild activity, we would expect not only higher fuel merchandise contribution but higher operating expenses as well. In fact, just from that growth activity alone, costs would increase about 1% a year. So as a result, we expect about 5% to 7% increases in per-store operating expenses, and this excludes credit card fees and rents and translates to \$35,000 to \$35,500 on a per-store month basis.

For corporate costs, G&A expense was \$241 million, within our guided range of \$235 million to \$245 million, reflecting our investments in people and technology. These capability-building activities come with significant upfront investments, which will continue into 2024, but they are critical to making the company more competitive in the marketplace and leveraging our advantaged model over the next decade. These investments are as important to us as new store investments and come with much higher returns once these benefits scale across the network, which using Murphy Drive Rewards as an example, can take a few years to reach maximum impact but result in an extremely strong uplift across the network.

With this in mind, we are funding this future growth with investment dollars today and expect G&A expense to increase about 8% at the midpoint to fall within a range of \$255 million to \$265 million, which is roughly half the growth rate in 2023, adjusted for a \$25 million charitable donation made in 2022.

In closing, as is our custom, we will provide a range of fuel margins representative of our view of the industry around which investors can forecast the earnings power of the business subject to their own beliefs and expectations. For reference, the \$0.26 to \$0.30 range we guided to last year proved to be conservative given all-in actual margins of \$0.314. Nevertheless, maintaining our view that a \$0.02 swing around the midpoint is representative of the historical annual margin volatility of the business prior to 2020, we believe 2023 performance lays the groundwork for a sustainable range of \$0.30 to \$0.34 per gallon in 2024 and subject to upward bias beyond 2024.

Given that the first half 2023 all-in margins approximated \$0.29 per gallon with little-to-no volatility in prices or competitive behavior and second half all-in margins approximated \$0.335 per gallon with relatively low volatility, we believe using these 2 periods to characterize the lower end of the range is an appropriate benchmark for future expectations.

If you recall, in 2022, we calculated the dramatic price decline in the third quarter, a once in every 5- to 6-year event. That's about a \$0.03 to \$0.04 per gallon impact on fuel full year margins, which helps to find the high end of the range. Therefore, to achieve the high end of the range of \$0.34 per gallon, one would have to assume a higher level of price volatility than last year and/or the potential for an extended fall in prices that would create opportunity for the industry and Murphy USA to experience elevated margins.

Using the midpoint of the official guidance metrics discussed, bracketed by \$0.30 to \$0.34 all-in fuel margins, we would expect these outcomes to generate approximately \$1 billion to \$1.2 billion of adjusted EBITDA.

As we like to say, we don't have a crystal ball, but we do believe we have accurately characterized for the past 4 years how the market would respond to the shocks we have seen over that period. But just as important is our perspective around how consumers behave during these shocks and how they respond to the Murphy USA value proposition. While past performance is not necessarily indicative of future results, last year's performance in a relatively unremarkable setting gives us confidence that higher margins are not only structural and sustainable, but also that the same market and competitive forces resulting in persistently higher than expected margins will continue to influence the economics of the marginal player and result in upward pressure over time.

Let me close with a few comments on preliminary January performance. Per-store fuel volumes approximated 99% of prior year levels, impacted by severe winter weather across the southern states and in the Atlantic states, which impacted QuickChek traffic. However, retail-only margins are quite a bit higher than last January, averaging around \$0.22 per gallon versus \$0.19 per gallon in January of 2023 and we're seeing them trend a bit higher in early February.

We are seeing continued momentum in the tobacco category, growing market share across all segments and driving a 6% increase in tobacco contribution dollars in January. While nontobacco categories not attached to fuel were impacted by more customer traffic attributable to weather, food and beverage contribution dollars are showing signs of strength as price increases taken periodically throughout 2023 are showing up in the 2024 margins. Of course, January is only one month, but we are certainly off to a great start with a lot of internal excitement around improvements we are making as we continue to drive the earnings potential of the business higher. Looking ahead into 2024 and beyond, investors should learn to expect more of the same for Murphy USA in the future. I'll now turn the call back to the operator to open us up for some questions. Operator?

Question and Answer

Operator

[Operator Instructions] Your first question comes from the line of Bobby Griffin from Raymond James.

Robert Kenneth Griffin

Raymond James & Associates, Inc., Research Division

First off, just more of a high-level question on kind of your guys' position as the low-cost operator and mixed with kind of how you're growing the business towards the larger-format stores. So as these larger-format stores become a bigger portion of, call it, the overall mix of your stores, understanding they -- obviously, you're going to have more OpEx than your original formats. But is there still ways to maintain kind of the low-cost discipline from a growth perspective of operating expenses as well as on the SG&A side, too, to keep that competitive positioning within the industry?

R. Andrew Clyde

President, CEO & Director

Absolutely. Bobby, one of the things that we always look closely at is what's the fuel margin requirement from those stores, what's the coverage ratio, et cetera. And then, look, the reality is, if you see deals that cross our desk, et cetera, from time to time, and you look at formats that have experimented maybe with food and beverage in a different way where they got maybe higher revenue and margins, but they drove up their cost significantly, and frankly, even some of the bigger-box chains that have come out onto the market that didn't have the distinctive food and beverage capabilities of QuickChek or the density of the consumer base that translates into the velocity, you know what we found?

We actually found that those other formats, including the other bigger ones, actually require more fuel to cover the breakeven requirement than less. And what that means is that 2,800 square foot store is really at the sweet spot, right? We haven't tried to jump the chasm or 2 chasms all the way to where a distinctive QuickChek offer would be. But we're able to innovate within that box, and it just makes us more and more competitive because we are adding more revenue and margin and contribution from the things we're adding with less labor and so our breakeven just gets lower.

And so from a slightly higher OpEx at the store, the thing we really look at is how much is that net expanding and we continue to expand that, especially relative to a lot of other players in the industry. I hope that addressed your question.

Robert Kenneth Griffin

Raymond James & Associates, Inc., Research Division

Yes. That's very helpful. And I guess, secondly for me and then I'll turn it over. Just you talked a little bit about this in your prepared remarks, but it's a meaningful step-up in the contribution of the gross profit from the merchandise side of the business versus some -- versus, I guess, 2023 trends and kind of seeing these larger stores flow in. Can you maybe just unpack the visibility into that? And is there some concrete examples? Or just kind of anything to help us understand kind of, okay, here's the building blocks work and the visibility is solid? Or is it a little bit more of we're still going to have to kind of see how things flow in to kind of get our hands wrapped around that, I think, at the midpoint of \$67 million year-over-year contribution from merchandise?

R. Andrew Clyde

President, CEO & Director

Yes. So look, as Mindy highlighted, I mean, tobacco sales continue to lead. We continue to take share there. The price, the value, the offer that we're providing just becomes more and more relevant as customers seek out affordability.

We're growing premium tobacco products, but the discounted ones have a higher penny profit, and we're growing those as well. The new noncombustible products have a higher margin, and we're best positioned to lead in that trend towards the lower-risk products. So on a 2-year stack basis, tobacco sales are incredible for us relative to the industry.

[indiscernible] is a great one. We're on a 2-year stack. We're up 12% in sales. Food and beverage is up 6.4%. Unpacking that a little bit further, if we're generating \$113 million of contribution from food and beverage in 2023, Murphy is generating now \$10 million of that, and it's up almost 90%, meaning we turned around a category that was not adding anything to the business. And so from a total enterprise standpoint, we generated about \$10 million of contribution in food and beverage for Murphy, leveraging the insights, the capabilities, et cetera, since the spin.

So across the categories, we just continue to see innovation growth. I can talk more about the digital transformation efforts and what we're seeing there as well, but that's probably our highest-returning investment that we're making across the business right now, and it's going to be highly impactful on the merchandise side.

Robert Kenneth Griffin

Raymond James & Associates, Inc., Research Division

I appreciate the details, and best of luck here in the first quarter.

R. Andrew Clyde

President, CEO & Director

Thank you.

Operator

Your next question comes from the line of Bonnie Herzog from Goldman Sachs.

Bonnie Lee Herzog

Goldman Sachs Group, Inc., Research Division

I had a high-level question on your business, Andrew. Based on your -- for modeling purposes only, your expectation for fuel margins and EBITDA, I guess it implies to me that you're increasingly more reliant or maybe dependent on strong fuel margins at the midpoint of those. So I guess I was just hoping to get a little bit more color on that. And then maybe in the context of that, what are your expectations for, I guess, total inside store EBITDA growth?

R. Andrew Clyde

President, CEO & Director

Yes. So when you -- sorry, just for clarity, when you say we're more reliant on the fuel margin, what do you exactly mean by that so that I can answer your question specifically?

Bonnie Lee Herzog

Goldman Sachs Group, Inc., Research Division

I look at your total fuel contribution, what you're guiding, the cents per gallon and then the range that -- for modeling purposes, at the midpoint to EBITDA and I sort of compare that with last year, increasingly more of the EBITDA seems to be coming from fuel -- total fuel contribution versus inside the store. So I'm just trying to understand the sustainability of that. Or is there something going on with the inside merch contribution to some extent?

R. Andrew Clyde

President, CEO & Director

Yes. Okay. Got it. So what would be really interesting is if we just held the business constant, and we projected what the EBITDA would be at \$0.16 margins back in 2019, half of that. We didn't drive the industry margins to be \$0.32. The marginal retailer did, right? And we took that advantage. We put a lot of it on The Street to grow share and sustain volumes, which is why our volumes are up, as Mindy talked about, versus the industry.

So what I would encourage you and investors to do is say, hey, input \$0.16 per gallon in there back to 2019, and then look at the incredible growth on the merchandise side of the business since then and its contributions towards EBITDA. I think that's the best way to look at it.

Is the EBITDA growth more reliant on fuel? I guess, right? Because the margins just keep going up. We don't want them to go down, but that's certainly not slowing down the increase that we're seeing on total merchandise contribution. In our remarks, we noted the total contributions grown from a 6% CAGR to a 7% CAGR, now an 8% CAGR. And a big chunk of that is because of the higher fuel margins and us taking a portion of that and investing it to drive traffic that comes into the store and then, frankly, using some of that contribution to make other investments like our digital investments that are all about in the early stages driving merchandise.

So we're not relying on in the sense that we need it like the others with a zero breakeven. But versus 2019, if you model the business at \$0.16, I think you'd say, wow, the merchandise side of the business has done incredibly well.

Bonnie Lee Herzog

Goldman Sachs Group, Inc., Research Division

Okay. That's super helpful. And then just my second question would be on your fuel volume guidance. You touched on this a bit, but your guidance implies volumes will decline at the midpoint this year versus last. So just trying to understand that, especially in the context of you being the low-cost provider. And typically, Andrew, I think share gainer. Is it sort of just your expectation for the industry? Or is there anything changing in terms of your strategy of balancing volumes with what you were just mentioning, profitability or whatever?

R. Andrew Clyde
President, CEO & Director

Our expectation is our fuel volumes will be up slightly. The raise-and-rebuilds and the new store activity will more than offset the flat to slightly declining legacy stores. So our expectation is they will be up slightly, and we will continue the same pricing strategies that position us as the bottom of market, everyday low-price retailer.

Operator

Your next question comes from the line of John Royall from JPMorgan.

John Macalister Royall
JPMorgan Chase & Co, Research Division

So my first question is on the capital allocation side. How should we think about share buybacks in '24 given you've got some growth in earnings at the midpoint of the illustrative range, but CapEx is growing a fair amount? And maybe relatedly, you reduced your absolute net debt in '23, built a little bit of cash. How do you feel about the balance sheet today? And do you want to live within cash flows in terms of your capital allocation priorities? Or could you lever up a little bit and return some more capital this year?

R. Andrew Clyde
President, CEO & Director

Yes. So look, when we present our kind of 3- to 5-year outlook in our raise the bar chart, we always show, look, here's where we expect EBITDA to grow through growth initiatives, slight changes in fuel margin. And then we kind of set an expectation of buying back about 1 million shares a year. It's exactly what we did last year without really impacting the balance sheet.

And so we're going to take advantage of the free cash flow. If we have additional free cash flow in years like 2022, we'll use that to buy back more. And if we fall short because of the margin environment or capital growth opportunities present themselves, we won't hesitate to tap the balance sheet to make that commitment.

I don't know if -- Mindy, if you want to add any other thoughts around the balance sheet.

Malynda K. West
Executive VP of Fuels, CFO & Treasurer

No. I mean, I think we're fine with the leverage levels that we have, that we have plenty of access to liquidity and additional capital if we need it. So we plan to make good on our commitment to buy 1 million shares a year. But we think that our existing operating cash flows can more than fund our even ambitious CapEx budget and still leave an increment leftover. So it largely depends on what is the share price as to would we need to borrow anything in order to meet our commitment. But certainly comfortable that we have the capacity to do that.

John Macalister Royall
JPMorgan Chase & Co, Research Division

Great. That's helpful. And then maybe if you could talk a little bit about the tick-down in unit merchandise margins from 3Q to 4Q? Is that just mix from the tobacco business being strong and the nontobacco business being down? And if so, what are your expectations that you have baked into the '24 guide with that 8% growth? Does any of that come from margin growth?

R. Andrew Clyde
President, CEO & Director

Yes. So I don't have the specifics around the individual components here. There's always going to be this challenge when you're growing tobacco faster than your competitors, you've got a unit margin reduction. As we said before, we don't take unit margin to the

bank. We take contribution margin dollars to the bank. And so that's usually the biggest driver there. There could be some mix within some of the other center-of-the-store categories, promotional activity, et cetera.

As we think about 2024, we expect to see really a lot more of the same. But we're going to get the full year benefit of the price increases at QuickChek on food and beverage, where we were very intentional last year in terms of holding price to demonstrate value to our customers. And if any of you also look at the earnings reports from the major QSR chains, they're now recognizing that they probably may have taken a little bit too much price and they're talking about value. And for us, value never goes out of style and we need to deliver that every day. So I do think we'll see some improvement this year on that front.

One of the things that I haven't talked about is the investment in G&A in terms of the impact from the digital transformation efforts. The G&A spend from that is in the neighborhood of \$40 million across the initiative, and some of it's being capitalized. But just in terms of the pilots that we've already run, we're seeing a 20-plus percent return on that investment on an annualized basis. And those pilots have all exceeded what we estimated on paper.

When you take the initiatives that we've completed and analyzed that are now going into pilot, we expect a return on that to be north of 40%. And a significant amount of that is going into the merchandise contribution, right? So it might be getting that additional upsell at QuickChek that's more than doubled. It's that incremental contribution from the production planning. It's that share of wallet from the personalization on the Murphy side.

We've segmented our stores and identified where we can take price and where we want to be a little bit more aggressive across the entire center of the store that's generating benefits beyond expectation. So there's just a whole host of things within those initiatives that we're going to see and we're not only start to pay early dividends in 2024, but provide the foundation to sustain that type of growth into the future. And there's elements of the program like the updated QuickChek Rewards, et cetera, that will be coming in the near future as well.

Operator

Your next question comes from the line of Ben Bienvenu from Stephens.

Benjamin Shelton Bienvenu
Stephens Inc., Research Division

So my first question is on the fuel side of the equation. I think, Andrew and Mindy, there's been this notion historically that in order to get margin, you have to give up gallons. And so this combination and the guidance of gallons on a APSM basis, minus 1% to plus 1% to flat to slightly up at the midpoint while also having very strong margins is potentially kind of in contention with one another.

But I wonder as breakeven requirements for the industry have gone higher and yours have gone lower, what are you seeing with your retail fuel price differential that potentially allows you to be more competitive and take market share as you have? And is that something that you see continuing as you move forward?

R. Andrew Clyde
President, CEO & Director

Yes. So Ben, look, what I would say is when you think about our volume and our margin, you really got to break those 2 apart and then break each of those volume and margin components into pieces. So if we have flat macro demand, plus or minus 1%, that's kind of the first indication of how our stores are going to do. We're going to have a massive recession or we have something like COVID or we're going to have economic growth or prosperity or something that drives that up. That's going to be the first indication of what we're able to do.

And then secondly, where do we price? And we're going to price every day low price. And so I think you're right as our differential to the competition is going to be the biggest determinant of that. And with the higher structural margins that we've seen, we've been able to put an extra \$0.01 or so on The Street. We kept it on The Street in '23, and that allows us to certainly offset any competitive pressures from new builds because other good competitors are building new stores like we are.

And in that environment, you would think, okay, well, flat volumes, flat margins. But margins are going up largely because of the structural regions we've been talking about, right? The marginal player doesn't have the scale to invest in the things that we're doing, doesn't have the extra penny to put on The Street. Their trade-off at the top of the market, they take a \$0.01 in profit, lose 4% volume. They're almost kind of neutral to that. And by the way, go ahead and put it up \$0.02 if you have to, to offset some of the other traffic losses.

So it's really that factor that allows us to get both volume and margin. And then after that, it would just be structurally what is going on in the price environment, right? 2022 was a much more volatile environment, and we benefited both volume and margin in that scenario. 2023 was a fairly benign environment. It didn't hurt us volumetrically, and we actually still did even better than we expected on the margin side, but I would attribute that largely to the marginal player in that structural dynamic.

And so there's nothing to read into strategy, like one of the earlier questions, about us changing our price/volume equation. We will be everyday low price. We will take our advantage and put it on The Street for the benefit of our consumers who need us now more than ever. And that helps begin this virtuous cycle or flywheel that flows through to traffic inside the store, the benefits we have there, the free cash flow to invest in growth and new capabilities and then, of course, get back to our shareholders. So I hope that answers your question, but we are not doing anything that would signal, hey, we're doing anything different from a price/volume equation strategy.

Benjamin Shelton Bienvenu
Stephens Inc., Research Division

Yes. That makes a lot of sense. It's very helpful. Shifting gears to the tobacco side of the business. How analogous is what's happening there to what's -- is it to what's happening in the fuel business? Because I look at that business, the industry volumes have declined materially. You've seen APSM sales and contribution expand meaningfully. Merchandise margins on tobacco, up almost 150 basis points over the last 3 years while taking market share.

Is that a similar market structure such that the breakeven within the tobacco business are being driven higher? Or that's a component that's -- it's all the circular reference? Is that something that you see persisting in share gains continuing in that side of the business?

R. Andrew Clyde
President, CEO & Director

It is. And Ben, for kicks, I thought about doing sort of the fuel breakeven calculation but putting fuel in the numerator and tobacco in the denominator to kind of get the same-type equation. And it's exactly the same. It's a commodity that has the same type of elasticity.

And so if you go back to Q1 of 2019, our bulk cigarettes, carton was 45%. It peaked almost at 60%, but it's still up 10 percentage points, right? So people are buying more in bulk from us at our stores. We've applied the same strategy to smokeless and also the way we think about, say, cigars in terms of how we promote and price those.

And if you look at the discount on a per-pack, per-roll, per-stick basis, those have increased also as we've been able to take promotional funds as well as profit from other parts of the business to invest in that to grow that share. And so while cigarette share has grown, smokeless share and cigar share has grown even more significantly as a result of applying those same types of price/volume trade-offs in that category. And similarly, we see a lot of the marginal competitors behaving the same way in that category as they do in the fuel category, very analogous categories.

Operator

[Operator Instructions] Your next question comes from Anthony Bonadio from Wells Fargo.

Anthony Bonadio
Wells Fargo Securities, LLC, Research Division

So I just wanted to dig in a little bit on unit growth or NTI growth. You ultimately came in near the low end of negatively revised guidance in '23. So can you just walk us through just at a high level some of the hurdles there as the year progressed versus your original expectations? And then just, I guess, what's giving you confidence in 2024 to accelerate that unit growth?

R. Andrew Clyde
President, CEO & Director

Yes. So look, on the unit growth, we've expressed our disappointment there. I mean it's just been a variety of issues. Some of it's permitting, some of it is labor issues with general contractors. We've had stores where we've expected utilities to hook up and you wait a month or longer for the utilities to show up. I mean it's very frustrating, to say the least. And when I talk to industry peers and as well as other retail small-box retail peers, they're experiencing the same thing.

Our confidence lies in the fact that we're just building up the pipeline faster. And so you have to start more projects on a risk-adjusted basis to be able to finish more projects within the calendar year. So it's just a simple exercise of loading up more into the queue, knowing the average QuickChek store has gone from taking 4 years to 5 years; Murphy store from contract completion, 2 years to 3 years.

And one of the things we talked about as well is we've improved our time by about 6 months with our general contractors by providing a set of incentives, you think carrots and sticks. The challenge now is we've lost all of that 6 months plus some because there's not an incentive for them to invest in over time, expediting, et cetera, because there will be something else outside of their control that would impact their ability to deliver on time or ahead of time, and therefore, earn an incentive bonus that would more than make up for the overtime or the expediting cost. And so I'd like to think some of that will return to normal, but we're not counting on it. So we're just loading up the queue and staffing up for that more than we had in the past.

Anthony Bonadio

Wells Fargo Securities, LLC, Research Division

Okay. Got it. And then just on PS&W and RINs, I know you guys have kind of talked about that like \$0.025 to \$0.03 per gallon range over the long term as we model that. But this is now the third straight year, I guess, that you guys have come in ahead of that. Should we be thinking about that any differently now in the model?

Malynda K. West

Executive VP of Fuels, CFO & Treasurer

I don't think so, Anthony. The direction and magnitude of the price swings primarily dictate what the fluctuation is from quarter-to-quarter. And if you remember second quarter, where we commented that it was completely unremarkable from a macro basis, we turned in right in the center of that range of \$0.25.

So I would say going forward, while we're still going to have quarterly fluctuations, I would model something \$0.02 to \$0.03, maybe \$0.03 and a little higher given the capability investments that we've made in that part of the business and the way that we leverage our scale. But I would not predict that we're going to earn outsized product supply and wholesale margins unless you see an environment of rising prices consistently, which would then dictate that we're going to make some money in the way that we account from our inventory barrels.

But at the same time, retail margins from the other side would likely be squeezed in that environment too as a partial offset. But no change to how we're telling you to model. It's just really a function of the direction and magnitude of the price increases or decreases.

Operator

There are no further questions at this time. Andrew Clyde, I turn the call back to you.

R. Andrew Clyde

President, CEO & Director

Great. Well, thank you, everyone, for listening in. As I said, we're really excited about the 2023 results the team delivered. But we've got even more excitement about what lies ahead, and we hope more of the same is good for all our Murphy USA investors. Thank you.

Operator

Thank you. This does conclude today's conference call. You may now disconnect.

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