Company Name: Murphy Usa Inc
Company Ticker: MUSA US
Date: 2017-11-02
Event Description: Q3 2017 Earnings Call

Market Cap: 2,539.42
Current PX: 72.98
YTD Change($): +11.51
YTD Change(%): +18.725

Bloomberg Estimates - EPS
Current Quarter: 1.053
Current Year: 3.773
Bloomberg Estimates - Sales
Current Quarter: 3383.167
Current Year: 13032.714

Q3 2017 Earnings Call

Company Participants

- Christian Pikul
- Andrew Clyde
- Mindy West

Other Participants

- Damian Andrew Witkowski
- Christopher Mandeville
- Carla Casella
- Daniel Imbro
- Ryan J. Domyancic

MANAGEMENT DISCUSSION SECTION

Operator

Good morning. My name is Christina and I will be your conference operator today. At this time, I would like to welcome everyone to the Murphy USA Third Quarter 2017 Earnings Conference Call. All lines have been placed on mute to prevent any background noise. After the speaker's remarks there will be a question-and-answer session. [Operator Instructions] Thank you.

Christian Pikul, Director of Investor Relations, you may begin your conference.

R. Christian Pikul

Thank you, Christina. Good morning, everyone. Thanks for 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 after some closing comments and a discussion of our 2017 guidance 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 these risk factors, please see the latest Murphy USA Forms 10-K, 10-Q, 8-K, and other relevant 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 release, which can be found on the Investors section of our website.

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With that, I will turn the call over to Andrew.

R. Andrew Clyde

Thank you, Christian. Good morning and welcome to Murphy USA's third quarter 2017 conference call. I want to start today's call by discussing hurricanes Harvey and Irma, whose impact and devastation to the citizens of Texas and Florida was also felt here in El Dorado and nationwide. Our first priority as these crises unfolded was to coordinate and ensure the safety of our employees. All members of the Murphy USA family were safe and accounted for within 24 to 48 hours. And importantly, we retained 100% of our store managers and assistant store managers, and 95% of our hourly cashiers who quickly reopened most of our locations generally within one to five days of closure.

Our culture of safety also played a role in determining when it was appropriate for employees to safely return to work and reopen stores for our customers. Many of whom also face the threat of life and property.

During Harvey, we closed approximately 80 stores in the Houston area roughly 90% of which were operational within five days of the storm's passing. All of the remaining stores returned to service within three weeks and experienced minimal damage. When Irma hit Florida with equal force both the general population and our people were better prepared to literally weather the storm as we were able to reopen 100% of our impacted stores within four days, including stores and communities without power.

Our preparation for the storms, the retention of our people and the ability to reopen quickly for our customers reflects our values as a company. We're able to provide need and assistance for our employees through onetime grants and through our need fund which employees and suppliers have generously supported. We also took special steps to work with first responders, including staging generators in anticipation of power outages and prioritizing fuel supply to source on evacuation routes in and out of the affected areas.

As you've no doubt seen in our release, the first store comps were noticeably impacted by these events. There are several points I would like to draw your attention to with respect to the impact on third quarter results.

First, the disruption and destruction of the storms themselves materially impacted our per store volumes. Second, we know consumer behavior differed most noticeably around the preparation and emergency response to the two storms. With Harvey, there was very little pre-bond and given the refinery shutdowns that took most of the month of September for supply conditions to normalize.

With Irma, especially given the evacuation orders, there was a substantial number of stores experiencing very high burn rates prior to landfall followed by a noticeable lack of demand following the storm's departure.

Third, the impact of Colonial Pipeline shipments impacting markets far down the line into Tennessee and the Carolinas throughout the month of September. These shipping delays created temporary shortages in many markets some of which we were able to mitigate through optimizing our inventory positions.

Last, demand remained subdued in the aftermath of these two storms and volumes have only recently returned to normalized seasonal levels. The merchandise side of the business was also impacted from a volumetric standpoint as a function of lower customer traffic due to the storms coinciding with the period softer C-store traffic is cited by several industry sources.

However, while the per store metrics were visibly impacted as one might expect given the magnitude of these events, the ensuing strong retail fuel margin environment coupled with our proprietary supply chain positions more than made up for the volumetric weakness in the financial results. Q3 EBITDA was $147.4 million well above prior levels of $105.3 billion generating earnings per share of $1.90 versus a dollar $1.16 in the year-ago period.

The storms were impactful on these numbers both from a volume and margin perspective. Initially, as wholesale prices move higher in response the refinery shutdowns, we suffered a number of days of very low and sometimes even negative margins. This was followed by a period of higher retail margins as refineries came back on line, pipelines shipments resumed and wholesale prices retreated. I also want to point out that the products supply in wholesale

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business including RINs generated $0.05 per gallon on a retail equivalent basis versus $0.017 in Q3 of 2016. This is up sequentially from $0.0125 per gallon in the second quarter of this year and of course higher than the zero cents per gallon we earned in the first quarter of this year.

Results were higher on a year-over-year basis due to the timing and inventory benefits associated with sharply rising prices and to a lesser extent improving on the spot-to-rack margins. So at the risk of repeating ourselves, we expect the product supply and whole wholesale business to generate between $0.02 to $0.03 per gallon over the long term. And we now expect to fall within that range this year, albeit probably closer to the lower end. We will address that more when we discuss performance against our guidance metrics later in today's call.

As we think about organic growth, we opened 12 new stores in the quarter bringing the quarter in-store count of 1,423 sites. Additionally, we opened nine new-to-industry stores since the quarter ended. Also, we completed five raze-and-rebuilds during the quarter along with one in October bringing the year-to-date total to 18 raze-and-rebuilds with more underway, some of which may land in 2018.

For our fuel contribution for the retail business, per store volumes on an average per store month basis averaged 243,000 gallons, close to a 10% decline from 268,000 gallons a year ago. We estimated that well more than half of these clients were the direct results of the disruption created by the hurricanes. Retail fuel margins were $0.155 per gallon versus $0.137 a year ago. Including the impact of product supply wholesale and RINs, all-in fuel margins were $0.205 per gallon, about $0.05 higher than a year-ago results.

If we look at our fuel breakeven, let's start with merchandise margins. Average merchandise unit margins in the quarter were 16.1%, up 10 basis points from 16.0% a year ago. Our total margin contribution on a per-store basis decreased slightly to $23,049 per store month, down from $23,593 a year ago. We look at merchandise through three lenses and the largest is of course tobacco. Tobacco sales continue to decline with the market but incremental softness in the quarter was attributable to the downtime associated with the storms and the impact on customer traffic from that; retail price compression resulting from recent M&A activity; and competitive intensity that remains persistent in the category but at a more moderate pace than we've seen in prior years.

Despite these headwinds, margin rates continue to expand in the tobacco category due to price optimization, promotional activity and our product mix. In fact we are likely to see a benefit in Q4 from the manufacturer price increase that came both earlier in the year and at a higher absolute rate than before.

When we look at beverages, our largest non-tobacco category beverage sales have seen a disproportionate impact of lower traffic in the quarter as it is typically an add-on sale with particular weakness in carbonated soft drinks. However, we are continuing to see sales and margin growth in the non-carbonated segments as we invest in larger formats and super coolers.

When we look at the Center of Store activity excluding beverages, the trend we are seeing is much more positive. Center of Store sales were up 12.8% on an average per store month basis in the third quarter driving per store margin growth of 7.6%. Center of Store activity is also correlated with our larger format builds and will continue to drive both sales and margin higher. Taking together the non-tobacco sales category, it was up 7.6%. But margins were a bit softer declining 0.9% to $9,785 on a per store month basis.

Operating expenses before credit card fees continue to show improvement, declining 5.4% year-over-year. This offsets the merchandise compression and fuel volume loss resulting in fuel breakeven margins of $0.0128 per gallon, essentially flat with year ago results.

As we mentioned in the prior quarter, we expected these OpEx comps to get a little more difficult as we start to cycle the benefits of our labor model in 2016, which largely took place in the second half. We do expect modest improvement store breakeven metric going forward.

With that I'll turn things over to Mindy, and then conclude with an update on our annual guidance.

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[008WVH-E Malynda K. West]

Thank you, Andrew, and good morning, everyone.

Revenue for the third quarter totaled $3.2 billion versus $3 billion in the year-ago period, largely attributable to the higher product prices and to a lesser extent, higher merchandise sales. Average retail prices for gasoline were $2.22 a gallon versus a $1.98 per gallon in quarter three of 2016. Adjusted earnings before interest taxes, depreciation and amortization or EBITDA, as previously mentioned, was $147.4 million versus $105.3 million a year ago. The effective tax rate for the quarter was 37.5%, largely in line with the year-ago rate of 36.6%.

Total debt on the balance sheet as of September 30, was $884 million broken out as follows: long-term debt of $865 million consisting of $492 million carrying value of our 6% notes to 2023. $295 million carrying value of our 5.625% notes due 2027 and $78 million remaining on our $200 million term loan. We are also carrying $20 million of expected amortization under that term loan and current liabilities on the balance sheet. Using these figures on the back of strong quarter three results, our leverage ratio now approximates 2.1 times, which is down from 2.3 times at the end of the second quarter.

Our ABL facility remains in place with a $450 million cap and is subject to periodic borrowing based determinations currently limiting us to approximately $295 million at quarter end. And at the present time that facility is undrawn.

Cash and cash equivalents totaled $169 million resulting in debt of approximately $715 million.

During the quarter we repurchased $1.26 million common shares or approximately $86 million at an average price of $68 per share under the previously announced program of up to $500 million to be completed by the end of 2017. Approximately $25 million remains under this authorization. After completing the existing repurchase program the company may elect to repurchase additional shares utilizing existing available cash balances if we believe that prices are favorable.

Common shares outstanding at the end of the period were $35.1 million. Capital expenditures for the quarter were $74 million, which included approximately $54 million for retail growth, $9 million for maintenance capital and the remaining for other corporate expenditures.

Year-to-date capital expenditures were $212 million and Andrew will address how we are tracking versus our guidance next. And for CapEx we do expect to remain within our initial guidance range of $250 million to $300 million.

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

R. Andrew Clyde

Thanks, Mindy. It's a great segue to discuss our annual 2017 guidance that we announced in February of this year, which we subsequently revised in April following weak Q1 results and prior to our $300 million bond offering.

So, we'll start with fuel. Our annual fuel volumes are projected to fall below both are guided range of 4.3 billion to 4.5 billion gallons as well as full year 2016 volumes of 4.195 billion gallons. With the impact from the storms, we are forecasting 4.15 billion gallons in total for the year. On an average per store month basis retail fuel gallons will fall short of our guidance range of 255,000 to 265,000 gallons. We are currently forecasting full year volumes to average around 245,000 gallons or an approximate 5% decrease from the 259,000 gallons in 2016.

If you do the math in your models that suggest Q4 volumes between 240,000 and 245,000 gallons per month, which includes the subdued retail demand in October from certain storm-impacted areas in Florida and Texas, our two biggest markets. And in the month of October, volumes were down approximately 5% on a year-over-year basis.

On a brighter note, retail fuel margins are expected to come in at or above the high end of our original guidance of $0.14 to $0.16 per gallon which includes the impact of RINs and our product supplying wholesale business. We are forecasting full year average retail margins of about $0.14 coupled with about a $0.02 contribution from product supply

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and wholesale including RINs which will get us pretty close to $0.16 cents on an all-in basis. Notably, these results will exceed our revised guidance of $0.125 to $0.15 we issued in April following a very difficult first quarter for the industry. And despite the run up in crude prices in late October, October margins will be several cents per gallon higher than a year ago.

In merchandise, we guided total merchandise sales of $2.4 billion to $2.5 billion and we will likely fall short of our target in this case. We are on track for a figure closer to $2.37 billion due partially to the impact from the storms and also attributable to lower customer traffic. On merge contribution in conjunction with softer sales, we are also likely to come in at or just below the low end of our merchandise contribution margin guidance of $380 million to $390 million which still approximates a 4% improvement over full year 2016 results of $364 million.

The retail station operating expense excluding credit card fees, we provided guidance of staying flat to 2% savings. And we are close to track and land closer to the 2% benefit side of that range. We are continuing to see the impact from the year-over-year benefits of the labor model coupled with continued store level improvements in other areas as well as adjusting labor hours for lower traffic.

For G&A, our guidance on a selling, general, and administrative expense was $135 million to $140 million. We are likely to end the year at or below the low end of that range including the $2.1 million charge incurred in the first quarter. While we are likely to underspend on G&A this year, we do expect an increase in 2018 as we continue executing technology-related investments to improve the long-term productivity of our business. So, this is more of a timing issue of some initiatives are pushed into 2018.

On new store growth, we provided a range of 45 to 50 new stores and 15 to 20 raze and rebuilds, and we remain on track for both of those targets. On CapEx, we provided a range of $250 million to $300 million and we will likely end the year slightly above the midpoint of $275 million but within the guided range.

Net income, we provided an initial guidance range of $140 million to $190 million, which was revised lower in April to $90 million to $160 million. However, we're now forecasting $145 million to $155 million, which is back within the initial guided range.

For adjusted EBITDA, initial guidance was $400 million to $450 million, which was subsequently revised lower to $340 million to $410 million in April. As the year plays out, we expect to gravitate towards the low end of the original guidance, while remaining closer to the high end of adjusted guidance or about $400 million in line with 2016 results.

All in all, 2017 has been a challenging year given exceptionally weak Q1 market conditions and the hurricane-related disruptions we experienced during Q3. The impact of which is still resonating into Q4. Nevertheless, while the underlying per-store metrics are showing some pressure, our advantaged business model remains competitively positioned to capture profits in a variety of market conditions.

As we plan for 2018, our continued focus is on improving the core business while allocating capital in a responsible manner towards the highest-return projects including new stores, raise-and-rebuild, technology-related vestments and share repurchases that maximizes value for our long-term shareholders.

In summary, we will maintain strategic clarity around our priorities and operational mindset around improvements while continuing to allocate capital in a highly disciplined manner. I'd like to thank all of our Murphy USA family for their support during this quarter and the challenges they faced and the resilience they showed in difficult circumstances. And I thank all of you on this call for your interest in Murphy USA, and we'll open up the call to Q&A.

Q&A

Operator

[Operator Instructions] Your first question comes from Bonnie Herzog from Wells Fargo. Your line is open.

<Q>: Hi. Good morning. It's actually [ph] Adam (22:00) on for Bonnie. How are you?

<A>: Good, [ph] Adam (22:01).

<Q>: Good. Just a quick question related to the traffic. I think the big focus this quarter was obviously the huge gallon decline. I know you touched on a bit in your prepared remarks would it being about half of the contribution which would imply that still a mid-single digit decline in volume and which seems to have carried through until October where I believe you said, it's about 5% decline in volume. So, I would classify that as generally running a point or two below what I would say is your run-rate. So, I was hoping if you could just comment on A, if that's true and B, what are the factors that are contributed to that? And then also, do you think that there's anything that can bring you back whether it's Q4 or Q1 next year to maybe closer to a low single digit decline where you've been trending recently? Thank you.

<A>: A good question and I think clearly, we've anticipated the question around traffics and trying to tease out in a quarter where you've got a lot of moving parts. What's sort of the systemic trend versus what storm impact that I'll tell you right now, I can't give you a level of precision on that. What I will do is draw you back to the last call where we talked about a number of impacts to volume and traffic that we were seeing. We talked about competitive intensity from new players. We talked about behaviors after the M&A activity were stronger brands or we're pricing differently than the weaker brands they acquired and how they were pricing prior to their acquisition. We talked about loyalty and its continued importance to a certain segment of customers. It was also talked about how the industry has priced in Q1 and even in the storms in terms of when there are periods of expanded margins how aggressive people are pricing.

And so, I think underlying any seasonal store market structure impact, you do have those ongoing trends and you continue to see those out there. I think as we think about the second part of your question which is, what – how are we thinking about this going forward? I'd really put it under three categories. The first one is, we know we have to capture demand from under-served segments. We've talked about loyalty before and how important that is to customers who buy gasoline from grocery stores, or mass merchants and how we have not had a loyalty program so it's an important segment.

We will be launching the pilot of a highly distinctive unique loyalty program in Q1 of 2018. And we think that's going to be an important contributor towards capturing that segment of under-served customers. And during Q4, we got some insights into just how our customers might respond to something like that to a digital loyalty program on a much smaller scale for tobacco where we got close to a million customers signing up in a single month. And it tells you something about the value orientation of our customers and the fact that they seek out loyalty programs as much as others.

And so, while many retailers pat themselves on the back for gaining 1 million to 2 million customers in a year, we were highly encouraged by what we were able to do in a very short period of time. There's also some segments like the fleet customer where we know with our everyday low price and that discount, it's a competitive offer. We do not have a go-to-market model that's effective for that. We've got an incredible sales force out there. Their focus has been on the Walk for Excellence and the improvements Rene talked about at our Analyst Day improving our stores and we expected to be able to divert some of their attention towards that important segment and get incremental sales.

And there's also some things we can do around niche products to optimize share of those segments in certain markets. So the first point out is just capturing under-served segments and we see a lot of opportunities there. The second is around this optimizing our competitive positioning and we've talked about the impact of competition.

What we are seeing year over year over year though is a deceleration of the new builds that competitors and one can simply look to Walmart's Analyst Day and the 2019 projections they laid out for Supercenters and neighborhood markets. And while clearly, adding fuel in front of so many neighborhood markets in prior years had an impact on us and others. This is a rapid deceleration of that, when you look at about 25 stores in 2019. The M&A trends we talked about in prior years have largely had their impact in those markets.

It's certainly not over. QuickTrip announced out hundreds of new stores in Austin and San Antonio. We think our model in front of the supercenters in those traffic areas is always going to be impacted by those additions, just like when we go into a market others are impacted but it will be much less impacted than the former CST and Strike brands

in those markets. And those who have acquired during the process of acquiring those brands.

The other thing we looked at very carefully store-by-store is when you have these falling price environment as where can we go put a price on the street and get volume. And where is that, just immediately matched and you just erode the market and you just chase it down. And I think that some of competitive activity over time has made some of those opportunities fewer. And so faced with immediate matching and some of the shifts that you see, you see us and others just less aggressive in taking prices down as aggressively in those periods.

And frankly with our new fuels pricing system up and running in every one of our stores, we've got better data and tools and insights to optimize our pricing. I'll give you an example, I was in Memphis on Monday, we had a store that was doing over 400,000 gallons and lanes 15 and 16 making $0.075. And when you strip out the credit card fees associated with that, you've got a low variable margin. We've optimized that store around 300,000 gallons still well above our industry average and well over four times the industry average. And it's earning $0.13 cents per gallon in line. That's a 31% improvement in gross margin dollars.

So there are some things we're doing there that will both improve our volume performance but may also reduce our volume performance at some stores. Now I think the third thing we're going to really focus on in 2018 is just increasing our uptime around operational excellence. We talked about the supply outages in Q3 on a wide-scale basis, but how do we minimize those day-to-day in smaller regional situations? How do we minimize store outages, carrier cross drops where they dropped the wrong product in the tank, products spec issues, maintenance. And our support center incident management has been something on the radar screen to improve for over a year. And we started an initiative to address. That that will lead to better up time at our stores, and we're also looking at our credit card and network outages and the impact that has.

So [ph] Adam (30:25) that was not just for you, but for everyone who I know had some questions about the volume, the underlying trends and what we can do about those. And we'll have a better perspective on what that means for 2018 guidance in our February call, but I hope that addresses that important question.

<Q>: Yes, thank you very much.

Operator

Your next question comes from Damian Witkowski from Gabelli & Company. Your line is open.

<Q - Damian Andrew Witkowski>: Hey. Good morning. Just a follow-up on the competition for fuel volumes. A, If you think about Wal-Mart and what they're doing, are they actually pricing where they are opening gas stations in front of neighborhood stores? Are they actually pricing below you? And when you talk about competition, increased competition, obviously you had some M&A in your biggest state, but are they also just closing the gap between you and them? Or are they actually pricing now below you and do you expect it to continue and same goes for the remaining space and competition there?

<A>: So I would say we seek to be the lowest or match the low in our markets with the exception of some of the specialty cost club operations that have unique membership requirements. So if somebody who has a big box or a grocery store or another type of offer in front of us, we will be at or below their price. So I think that answers the first competitive dynamic. On the on the second one, I mean if you think about you know brands like The Pantry before that you know high debt, high breakeven requirements, high fixed charges, they were clearly pricing for [indiscernible] (32:22) margin with a stronger ownership and financial structure. They're going to optimize that price volume differential.

So those stores that we are competing with are not going to be below us and in rare cases are they going to be priced with us. But the top of the market to bottom of market gap will have closed somewhat as a result of that. And so you've got to look at your absolute price relative to the other low competitors but you also have to look at the differential to the top of the market. When you look overall across all of our markets, we continue to price actually slightly more aggressive to the low in our markets. And the differentials to the state across a wide period of time are actually the

same or higher.

It's just that you have more of the lower priced competitors in that market so they have actually become more convenient to go to in those markets.

You also see some high-low pricing from some of the major brands with the loyalty programs, where some of them raised their prices significantly to those customers who do not have their loyalty program then to get cents off per gallon either through their program or maybe some affiliated grocery store program.

So I think, Damian, at the end of the day, what you're just seeing is just a continued saturation of more new competitors who price low and then some of the weaker brands being taken out. That said, depending on what those weaker brands are as those new competitors come into those markets like the Texas example I gave you, those M&A decisions will look different in hindsight now that those stores will be differentially impacted significantly more than the volume impact in our store in part because of the significant merchandise impact it'll have to those competitors. That will then put pressure on their breakeven requirements and cause them to think about whether they can afford to price down or they need to price up as they lose volume in some cases, even more differentially than we will.

<Q>: And then when you talk about increased competition in cigarettes, is that similar drivers, is it the better operators sort of looking at that category and...

<A>: It is. And it's the various programs the manufacturer offers and who are on those programs. But we've also seen sort of a deceleration of the number of new competitors that have come into the markets versus prior years on that. I mean, a lot of these markets are now saturated with dollar stores, saturated we see stores where you see the new entries coming in.

Many of the competitors are not able to participate in some of the loyalty and digital loyalty programs that the manufacturers offer. And so that give us and some other larger scale competitors who can invest in that technology an advantage. So I think what you're going to see across the sector is a continuation of kind of winners and losers haves and have nots. And that's why we continue to make investments in technology and in our existing stores and highly disciplined capital allocation around new stores. Given the fact this is going to continue to be an industry where we're going to see a persistent competition.

<Q>: And then lastly just Andrew you called out see as these just weaken the third quarter. Any reason why you think that is, and is that continuing into the fourth quarter here?

<A - R. Andrew Clyde>: I think it's just the overall trend, Bonnie and her team certainly write a lot about that in their piece as well. Certainly as we noted it was an add-on category. And when you saw traffic down as a whole, you lose that add-on sales. I can tell you we sold a lot more bottled water than carbonated soft drinks as people were preparing for the storm, so Q3 was unique there.

What continues to be impressive is the innovation and partnerships that the major carbonated soft drink companies have in terms of introducing new products and categories on our larger stores and our super coolers are able to take advantage of. And so, whether it's fuel or tobacco or carbonated soft drinks, they're headwinds in those categories. It's how you manage around those and how your business model is able to take advantage of the opportunities to manage around those.

<Q - Damian Andrew Witkowski>: Thanks.

Operator

Your next question comes from Chris Mandeville from Jefferies. Your line is open.

<Q - Christopher Mandeville>: Hey, good morning. Thanks for taking my question. Andrew, with respect to product supply and wholesale at the guide of being near to $0.02% for the full year. Can you talk about that a little bit just the dynamics there as it relates to today? I'm trying to understand that as – at least from what we've seen thus far, the arbs

do seem to be quite open quarter to-date or while we finally started seeing them allocate line space on the Colonial and – so, just trying to understand why we should ultimately fall out on the low end there and maybe versus – potentially the mid to high end?

<A - R. Andrew Clyde>: Yeah, well, I think the biggest reason to fall into the low end is the $0.00 contribution in Q1. That's just really, really hard to make up. And so, we've had other Q quarters like Q3 where we made $0.05. But it's really hard to offset a $0.00 quarter. If you go back to Q1, we kind of talk about you know the three core dynamics that kind of impact that number. The first is around the market structure and it's a positive or favorable or negative for our kind of transfer to retail to spot spot-to-rack number. And let's just assume spot-to-rack is going to be negative as long as you have positive RINs of greater than $0.20, $0.30.

We were oversupplied for an extended period and the arbs are close. Line space on Colonial was trading at a negative crack spreads were positive. And so, you have all these very, very, very favorable conditions for people to get product to the rack and discount that product at the rack. And we said clearly, if we just bought all our product at the OPIS lower OPIS low to at the rack, we would have made more money in Q1.

In Q3, we would have been out of product everywhere in the south, southeast, right, through that model. So over the long run, our proprietary supply chain is going to be advantaged. We saw with the tightness in the marketplace in Q3, those conditions improved. We saw 20% of the U.S. refinery capacity largely concentrated in the Gulf Coast go offline. We saw exports halt coming out of the country as the country actually showed its resilience.

But we continue to be in a refinery long, inventory long unconstrained environment. So, I think you're going to continue to see some pressure on the spot-to-rack business. And that's where our team is looking at, our mix, how we contract, how we optimize around that to take advantage of it.

But knowing that having ratable, secure, low-cost supply over time is distinctive an advantage to our business. And as I said in Q3 last year and Q3 this year, we would have been in a world of hurt, had we not employed that model for a business of our scale. Otherwise, we would have been allocated and shut off.

The other thing in Q1 that we saw was a lot of speculation around the regulatory outcome of rents. I didn't say speculation in rents aside speculation in the regulatory outcome which led to rent prices being depressed.

I think we have regulatory clarity on that now. RIN prices are back at equilibrium and there's some equilibrium between the spot-to-rack in RIN prices as that rent is embedded in the refinery spot price, and you clearly see that in the very high crack spreads that refiners are earning today. And so, we expect that to stay more in equilibrium, now that we have some resolution on those matters.

And the third part is just how you're in a rising or falling price environment and what does that do on your timing and inventory variances and how is that offset your retail position. And so, that's just going to kind of fluctuate with time. So, nine months kind of year-to-date were $0.022 per gallon but that compares to $0.035 last year. So, we think we're going to be above $0.02 this year. But a lot can happen in a very short period of time on the products supply side. So, we'll see where we shake out. But we think this is a business overall, that's going to continue to earn that $0.14, $0.15, $0.16 per gallon on an all-in basis.

<Q>: Right. Yeah. I appreciate that. But just maybe in summation here, so, with the 2.2 quarter-to-date or year-to-date, excuse me. Are we just simply assuming that market conditions for PS&W are maybe less favorable in Q4 versus Q3? And is that really just you being conservative or what you're observing so far in October, November?

<A>: I think transfer to retail certainly started more favorable, but as the supply conditions resolve themselves, inventory gets built back up. You'll see that moderate. Rent has certainly have come back to equilibrium. There is probably some extra buying that drove prices up as people had to cover positions who were perhaps short anticipating a different outcome.

I think the big wild card though is going to be around pricing. So, as you saw crude prices run up at the end of October, typically you would see prices didn't fall off at the latter part of the year, and I think that could swing things enough to say going closer to $2.2 or $2.5. I do think the retail margin is going to be higher than kind of that $0.13 normalized

margin that we've talked about for the year and in some way that offset some of that as well. And so, to the extent we're buying a little bit more at rack and rack prices are subdued, we're picking up that benefit in our retail margin the way those barrels get priced in.

So, I would just encourage everybody to think about the 14 to 16, and the fact that we think we're going to come in solidly around the 16 if not a hair higher.

<Q>: Great. Great. And then the last one for me. I appreciate the color on the hurricane impact, the gallons and expectations going into Q4. But, just looking at the merged guide I think you said it was $2.37 billion or somewhere along those lines for the full year. If that was the correct number that I had heard, it seems to imply again for Q4, assuming maybe similar tobacco revenue trends on a per metric base or a per store basis that the non-tobacco trends are going to then decelerate sequentially. Is that accurate?

And if so, why?

<A - Andrew Ramsay Burd>: Yeah. So – I mean we're actually seeing in Q4 on the tobacco side kind of a deceleration in the kind of the decline versus Q3 when the traffic from the storm, the digital loyalty, the competitive side of that. And so, I wouldn't attribute it to that and to Q4 per se. It's just generally kind of that overall subdued traffic in part kind of on the fuel side of that flowing through.

I think in 2018 on the merchandise store, there's still a lot that Rob and his team are working on in terms of the center store optimization, pricing sharper on the tobacco side, the impact of the loyalty program, our ability to participate in some newly announced longer period programs next year. So, I'm not bearish on a category and I'm certainly not expecting anything accelerating versus what we've seen on that front. Just some of that is just the continued traffic impact as we move from September and October that's reflected in that guidance.

<Q>: All right. Thanks, Andrew.

Operator

Your next question comes from Carla Casella from JPMorgan. Your line is open

<Q - Carla Casella>: Hi. One question on one of the items on the guidance you talked about. You've guided to minus 2% station operating expense. Does that – do you look your station operating expense on a per average store basis or is that just overall total?

<A>: That's on a per-store basis.

<Q - Carla Casella>: Okay. And so, then how much of that is driven more by the mix of the size format store versus just overall cost containment?

<A>: The improvement, if you think about it, the newer stores are all bigger, so they have a higher cost. So if you looked at it on a kiosk basis, those are getting smaller and smaller in the mix. So these are real operational savings. And if you will, sort of the headwind is the fact that you're building bigger stores that incur higher cost, right. So the actual improvement on a same-store basis is actually greater than that.

<Q - Carla Casella>: That's great. Okay. That's helpful. And then did you give us an idea of that store build for the future. I know you gave the rest of this year, did you – the messages you gave 2018 or beyond what's a good run rate number for new build and raze-and-rebuild?

<A>: We have. And if you look in sort of our kind of Analyst Day, we've talked about ranges in the kind of 50 to 70 range. We said in some years, it may be more new builds over the years it may be more raze-and-rebuild. And so we're going to be really thoughtful around that from a market standpoint and capital discipline standpoint where we're putting new stores and certainly the same on the raze-and-rebuild.

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Certainly, the challenge with the raze-and-rebuild is you take it out of commission for four months, right. And then you take a store that has very little book value left on it that you write off and you add $2 million in new capital to it. So we love the outcome from the sales, the fuel volume, the better offer and all of that. We're also mindful of the impact on you know total returns on capital at the portfolio level when you do those. So we'll be providing that guidance in February in terms of the specifics on that mix.

<Q - Carla Casella>: Okay great. Thank you.

Operator

[Operator Instructions] Your last question comes from Benjamin Bienvenu from Stephens Inc. Your line is open.

<Q - Daniel Imbro>: Yes good morning. This is Daniel Imbro on for Ben. Thanks for taking our questions.

<A - R. Andrew Clyde>: Okay.

<Q - Daniel Imbro>: So you guys showed a nice merchandise margin leverage in the quarter despite difficult comparison. Andrew, I think you called out some of where those improvements are coming from. But how should we think about that trajectory going forward kind of through the end of this year and to out years?

<A - R. Andrew Clyde>: Yeah. So if I look at where some of the margin rate comes from, clearly we continue to see improvement on the tobacco side because you're seeing the manufacturer increases. The team has done a great job around the optimize promotions of some of the more promoted categories like [ph] Candy (50:27). We're able to improve sales. But we're also able to grow our margin dollar significantly through better programs there. Some of our areas like dispense beverages, we're managing better and better and have a bigger portion of our mix. And then just the center of store having higher margins [audio gap] (50:52-51:00) still a lot more optimization that can take place in our business to expand our unit margins.

We're always going to have this larger base of tobacco, so you're never going to be able to compare us to a retailer that does 20% to 30% in tobacco sales. It's going to be hard to get that kind of one-time impact we got from the Core-Mark shift a year ago, but there's a lot of incremental improvements we can continue to make across the categories.

<Q>: Okay. Thank you. Helpful color. Turning your attention to unit growth. End of the quarter the [indiscernible] (51:41) pipeline is sort of under construction. How long should we think about that until they come online? And are these more planned is into existing markets or are you planning new markets or kind of what's the mix there?

<A>: Yeah. So, these are mostly existing markets that we're in. The stores that we talked about in construction, you expect most of those to get delivered this year. We had a few delays and setbacks in permitting and construction starts, power connections, et cetera, due to the storms, but we wouldn't expect those to be material. There are a couple of stores that we pushed off from 2017 to 2018 just due to the fact that we can start them before a certain point in time.

But I think as we go forward, you're going to continue to see concentration in our existing markets where we can build up scale with loyalty that continues to be even more important, continue to go with the high traffic areas, but that doesn't necessarily have to be right in front of the Wal-Mart, but that's always been a good proxy for a high traffic area. But, we have success away from that, but typically with a little bit larger format. So, I would expect to continue to see – as we've talked about modest growth in our core markets in high traffic areas with a format that generates attractive levered returns and staying within our capability instead.

<Q>: Okay. Great and then last one for me, kind of continuing on the growth topic, how the raze and rebuilds this year performed relative to your expectations? And maybe what are some of the learnings you've learned from those so far this year that you can utilize going forward as you continue to do this to your store-based? Thanks.

<A>: Yes. So, they've absolutely met or exceeded expectations. I mean you got to remember these were 112- to 150-square-foot kiosks. I mean we really didn't start doing the [ph] 208 (53:48) larger kiosk until 2007. Many of these had four pumps, maybe one diesel dispenser. And so – I mean, the volume performs exceeds the prior volume

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performance. All of these were a high performing stores. I think there was only one out of the entire mix where the volume came down, but that's because there was a large new format store that was built very close by. And it would have impacted that store whether we did the raze and rebuild or not.

The categories like tobacco that are high frequency where customers have their store. They go to – they tend to go somewhere else for that three- to four-month period. So, you've got to earn them back. And certainly in non-state minimum states we're able to get them back. But it's a little bit harder in state-minimum states where you can't be as differentiated in your pricing. But the customers love it, we get great feedback from them, and overall, we've been very pleased with that. As I said you're writing off some remaining book value as I said you're writing off some remaining book value and you're adding $2 million of capital on top of that. But it's the right thing to do for a business that's in testing in the long term versus trying to fight, increase competition with the weak asset that you have on the ground. So continuing to do those at a modest pace continues to be part of our overall plan. And there's a good pipeline of those remaining.

Operator

Your next question comes from Ryan Domyancic from William Blair. Your line is open.

<Q - Ryan J. Domyancic>: Hey good morning thanks for taking my question. So Hypermarket a competitor recently announced that they're exploring strategic alternatives for their C-store business. I think they have a decent sized footprint in one of your largest states Florida. So, I mean, offhand, do you know what the overlap you have with that competitor is and then depending on what happens to those assets in whose hands they go into if the asset is sold. Would it be easier to compete against those assets under a new competitor going forward? Thanks.

<A>: Yes it's all public data. So, we know precisely how they overlap and you guys can look at that as well. A high percentage of the stores are in Pennsylvania, where there's zero overlap and that's not a market from a market attractiveness standpoint are pursuing and similarly there are some on the West Coast. A lot of their markets, a lot of their Florida stores are actually in the panhandle along the Alabama border where we have some unique proprietary supply assets. I would say other than the ones in California that do about a 177,000 gallons per month I think the ones and the rest of the markets the average is closer to around 130,000. And so, I would largely say these are you know kind of undifferentiated convenience stores with a kind of undifferentiated food offer that are consistent with what others have been selling. And I think it makes a lot of sense to go try to get a really, really high multiple from someone, if they will pay you for that in the market.

Unlike some of the networks that have been acquired that have had financial challenges, these have not. And so I would not expect to see a whole lot of difference in terms of how they're operated from a pricing or branding standpoint in fuel or tobacco or other categories in someone else's hands, so naturally the synergies that people will go after.

But it's a little bit different than the dynamic I described with Damian's question around someone who's pricing high for cash margins versus getting that in check. I think these stores are probably pricing optimally in fuel and tobacco and other things to start with.

<Q - Ryan J. Domyancic>: Great. Thank you very much for the color.

Operator

There are no further questions at this time. I turn the call back over to the presenters.

Unverified Participant

Right. Well, listen I appreciate your call and questions today your participation. There are a lot of questions around sort of the underlying volume of the transactions et cetera. And we highlighted a number of things that we're working on,

around attracting new customer segments and continuing to optimize our business. What I would like to end with though is just kind of a reinforcement of the Murphy USA model. There's a number of retailers out there that are focused on top line categories like food and there are a lot of attention played to that without regards to cost, there's a lot of retailers out there that are talking about adding lots and lots of new units. And in a market that's very competitive without maybe the same regard for returns. What is Murphy USA model? This is a free cash flow generating machine that is very focused on allocating capital between unlevered, high return, ROIC stores and share repurchases and the capital discipline there.

And our focus is on continuing to drive EPS performance in the 15% to 20% range year over year to sustain the return on equity that we've generated since the spend. And as we demonstrated in this quarter and will continue to demonstrate that mindset and our business model is well positioned to address the headwind challenges that this industry faces as well as a one-off headwinds that happened in any quarter like Q3.

And we'll look forward to sharing more when providing our guidance for 2018 on our February call. But thank you for your time today.

Operator

This concludes today's conference call. You may now disconnect.

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