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EDITED TRANSCRIPT

MUSA - Q4 2016 Murphy USA Inc Earnings Call

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PRESENTATION

Operator

Good day ladies and gentlemen and welcome to the Murphy USA Inc. Q4 2016 earnings conference call. At this time all participants are in a listen-only mode. Later we will conduct a question and answer session and instructions will follow at that time. (Operator instructions). As a reminder this conference call is being recorded. I would now like to introduce your host for today's conference Mr. Christian Pikul Director of Investor Relations.

Christian Pikul - *Murphy USA Inc. - Director of IR*

Thank you Crystal, 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 Donny Smith, Vice president and Controller. After some opening comments from Andrew, Mindy will provide an overview of the financial results after which we will discuss our 2017 guidance and then open up the call to Q and A.

Please keep in mind that some of the comments made during this call including the Q and 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 give than 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 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 principals or GAAP. We have provided schedules to reconcile these non-GAAP measures with the reported results on a GAAP basis as part of our press release which can be found on the investor section of our website.

With that I will turn the call over to Andrew.

Andrew Clyde - *Murphy USA Inc. - President, CEO*

Good morning and welcome to Murphy USA fourth quarter 2016 conference call. On today's call, we will discuss our fourth quarter and full year financial results and provide some details and insight around the assumption that is comprise our guidance for 2017.

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As reported in our press release yesterday afternoon, we generated income from continuing operations in the fourth quarter of $43.8 million or $1.14 per diluted share. This compares to $0.69 per diluted share a year ago. For the full year, we generated net income of $221.5 million, and this included a $56 million after tax gain on the sale of the CAM pipeline in the first quarter.

When we held this call one year ago, we noted that we would see the impact of several improvement initiatives in 2016 results and I can proudly say we delivered these benefits for our shareholders and there is more to come in 2017.

The two most impactful initiatives were a dramatic improvement in merchandise margins due partially to a new supplier contract, and also the rollout of our labor model which dramatically reduced store level operating expenses, each of which helped make our business more resilient during times of weakness and more competitive over the long term. As a result, we were still able to deliver EBITDA within our guided range, albeit at the low end of our $400 million to $400 million forecast.

While the fourth quarter had its challenges, I want to highlight some key take aways from 2016. Last year we added 67 new stores or roughly 5% unit growth, and continue to enhance our net worth through the raze-and-rebuild program, 120 super cooler installations and over 300 refresh sites. We managed an increase of 120 basis points to our merchandise margins. On $2.3 billion in sales, that equates to approximately $28 million of margin expansion versus 2015. Through store level efficiencies implemented in our labor model, we drove down operating expense before credit card fees by 4.1% on a per store basis. Notably, this reduction in cost comes at a time when the industry is experiencing significant cost pressures.

Taken together, these two initiatives provided nearly $40 million of benefits helping to offset fuel margins which were more than a penny below the midpoint of our expectations at 12.75 cents per gal. The best measure of these improvements to our business is the almost full penny per gallon reduction in our fuel break even margin metric. At $1.6 per gallon for 2016 we have improved our break even cost by more than 50% from $0.034 per gallon since the spinoff which has both strengthened the resiliency of the company and laid a solid foundation for long term earnings growth. Looking at the fuel business, while retail margins were weak, we note that we were able to provide relatively strong margins of $0.116 per gallon in an environment where gasoline prices rose about $0.80 per gallon from the low in February 2016 to the high at year end. Somewhat a mirror image of the price action in Q4 2014 when prices declined $1.10 per gallon yet produced outsized margins of nearly $0.25 per gallon at that time. This margin resiliency in a down market is attributable to the discipline and structure around regional pricing and other value added initiatives around transportation and other costs.

Two years ago on the 2014 fourth quarter call, we said that it was a matter of when, not if, crude oil and refined product prices would rebound from their sharp decline in the second half of that year. As you know, fuel prices rebounded throughout 2016 creating a challenging environment for the company in the second half of the year. As a result, both our full year retail volumes and fuel margins were below our guided ranges. However, our integrated supply business generated an additional $0.385 per gallon a margin which complements our retail strategy and serves to reduce the volatility of our results despite persistently volatile market conditions.

To further illustrate this point, I want to provide you with the combined total margins from our fuel business for the last five calendar years. In 2016, all-in margins of $0.1543 per gallon consisted of $0.1158 per gallon retail and $0.0385 per gallon contribution from the PS&W side, which includes RIN sales. 2015 our all-in margins were $0.1494 per gallon, consisting $0.125 retail and $0.024 contribution from P S&W. 2014 all-in margins were $0.1848 per gallon, consisting of $0.158 retail and $0.0268 contribution from PS&W. 2013 all-in margins of $0.1634 consisting of $0.13 retail and $0.0337 from PS&W. And in 2012, our all-in margins were $0.1445 per gallon consisting of $0.129 per gallon retail and $0.0155 contribution from PS&W.

So over these five calendar years all in margins have only moved plus or minus $0.02 per gallon and if you exclude 2014 when all prices fell off a cliff, which is what I would characterize a positive outlook for us the variance over these other years is only plus or minus $0.01 per gallon. I would also add it is important to remember the PS&W business encompasses a lot of moving parts Our reported results include our wholesale and terminal business; inventory timing adjustments reflecting the direction in overall level of gasoline prices; the internal transfer gain and loss, which reflects the underlying spot-to-rack differential and it also includes RIN sales. So you can't go back and look at a single year with or without RINs and say this is a one penny, two penny or three penny business.

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I would also add it's important to remember the PS&W business encompasses a lot of moving parts our reported results include our wholesale and terminal business, inventory timing adjustments reflecting the direction and overall level of gasoline prices, the internal transfer gain and loss, which reflects the underlying sponsor act differential and it also includes rim sales. So you can't go back and look at a single year with or without rims and say this is a one penny two penny or three penny business. On a combined basis over time, we believe our integrated model can provide approximately $0.02 to $0.03 per gallon up lift to our total fuel margins. And while I haven't gotten to the guidance section yet you will see that is how we're guiding investor to think about margin going forward.

As further evidence that spot-to-rack differentials and RIN prices are indeed negatively correlated I can share with you that when compared to 2014 we have recognized roughly $88 million in additional RIN sales which you can see in our press release. What you can't see is that over that same period our internal transfer gain and loss has declined by $100 million. The same relationship holds true versus 2015. We are showing $64 million higher RIN sales in 2016 and internally we show $46 million lower transfer to retail gain or loss. So the relationship certainly isn't 100 percent negatively correlated. But as we have explained repeatedly in the past, the two components have a clearly established relationship in an environment with lower RIN prices. We would expect an offset in the transfer to retail spot-to-rack differential that is currently a large loss buried in our fuel results business.

If you read the reports of the refineries, in the EPA discussion around the point of obligation, they all acknowledge the cost of the RIN is embedded in the spot price of gasoline and is in the refining margin. This is neither a head wind for them nor a windfall for us. The laws of economics simply don't work that way.

Now let's turn to the fourth quarter results. We have gone into a lot of detail about the fuel margin environment which has an ancillary impact on fuel volumes as we've stated in the past so let's look at merchandise sales and margins. On a average per store month basis merchandise sales were down 4.8% in the quarter and 2.2% for the year. In contrast, margins were up 1.5% in the quarter and up 5.7% for the year as shown in the earnings release table. Also of note non-tobacco margins were down slightly in the fourth quarter on a per store basis.

Beyond the tobacco category, we had suggested on our last call that we expected all-in margins to decline sequentially in the fourth quarter but reported results were a bit below our forecast due to a variety of one time factors. These include rebate timing, softer beverage sales, and write-offs of old e-cigarette inventories. We also comped a strong year in 2015 with a strong introduction of iPhone accessories, resulting in sharply higher sales and margins in general merchandise.

Despite a challenging fourth quarter, we are entering 2017 with a great deal of momentum and commitment to continue sales and margin expansion by adding more 1200 square foot stores to our network with a higher margin assortment of non-tobacco products, a restructured promotional program that will drive higher activations, accelerated super cooler installations which will optimize our facings for higher margin beverages and increase our shelf rebates, segmenting our product offering on a regional basis and piloting a loyalty program later this year. Together this approach will drive higher conversion from the fuel pump to the store improved basket size and optimize price and margin with more tailored offers and assortment.

Given the strong performance of our underlying business, we continued with our share repurchase program in Q4, taking advantage of market weakness, buying back an additional 1.7 million shares. For the full year, we repurchased $323 million worth of stock and reduced our outstanding share count by nearly 14%.

We remain committed to this balanced approach to growth and shareholder returns as we fully transition to the independent growth plan in 2017. Thanks to the improvements we have made in the underlying business and will continue to be made, we are positioning shareholders for outsized returns in a more favorable fuel environment.

Our commitment to share repurchases demonstrates our confidence around the following four points even in the face of what continues to be a challenging operating and unclear regulatory environment.

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This is distinctive strategies and the resilience of our business model our relenting efforts to improve this business through cost efficiencies and margin expansion and the outlook of our independent growth plan which provides a multi year inventory of higher return new build opportunities. And last our ability to add leverage in tandem with our earnings growth to optimize our capital structure and shareholders returns.

So with that, I will turn things over to Mindy.

Mindy West - *Murphy USA Inc. - EVP, CFO*

Thank you, Andrew and hi everyone. Revenue for the fourth quarter totaled $3.06 billion a slight increase from the $2.93 billion in the fourth quarter of 2015, and that was attributable to higher average retail prices for gasoline at $2.03 a gallon this year versus $1.92 last year. Full year 2016 revenues totaled $11.6 billion. That was down from $12.7 billion in 2015 due to lower average retail prices for gasoline of $1.93 versus $2.17.

Adjusted earnings before interest, taxes, depreciation, amortization or EBITDA was $103.2 million in the fourth quarter and $400.1 million for the full year versus 77.3 million and $342.9 million respectfully in 2015.

This improvement in EBITDA in both periods was due to lower operating and SG&A expense, higher merchandise contribution, and higher products planned wholesale contribution which more than offset weakness in fuel margins in both the fourth quarter and the full year. The effective tax rate for the quarter was 34.4% and 37.1% for the full year.

Total debt on the balance sheet at year end was $670 million broken out as follows; long term debt of $630 million consisting of $490 million of our 6% note and $140 million remaining on our $200 million term loan. We are also carrying $40 million of current liabilities under the term loan and current liabilities on the balance sheet.

Our ABL facility is capped at $450 million and is subject to periodic borrowing base redetermination currently limiting us to approximately $216 million, and at the present time that facility continues to remain undrawn. Cash and cash equivalent totaled $154 million at year end resulting in net debt of approximately $515 million.

During the quarter as Andrew mentioned we repurchased 1.7 million common shares for approximately $111 million. At an average price of about $66.50 per share under the previously announced program of up to $500 million to be completed by the end of 2017. $177 million remains under this authorization. And common shares outstanding at the end of the period were approximately $36.9 million.

So let's talk about CapEx. Capital expenditures for the quarter were $70 million which included approximately $50 million for retail growth, $10 million for maintenance capital and the remainder for other corporate expenditures. For the full year, capital expenditures totaled $264 million, $200 million of which was for retail growth, $38 million for maintenance and the remainder for other corporate.

As we move into 2017, let me lay out our CapEx plans for 2017 as a prelude to our discussion around guidance. For the full year we are expecting between $250 million and $300 million to be spent and broken out as follows, $180 million to $200 million for retail growth, $60 million to $70 million for maintenance capital which includes a large increase for an as yet undetermined amount attributable to EMV compliance. Also reflects a new super cooler initiative to accelerate the rollout on qualifying locations across our network.

The remaining funds are earmarked for other corporate investments including various IT initiatives and upgrades, terminal improvements, and completion of our home office building remodel. That concludes the financial update and now I will turn it back over to Andrew.

Andrew Clyde - *Murphy USA Inc. - President, CEO*

Thanks, Mindy. That's a great way to start the conversation for us to discuss the 2017 guidance. We'll start with fuel. Our annual fuel volumes are projected to grow between 3.5% and 7% depending on the kind of market environment we encounter this year. These ranges are a function of our forecast for new stores and average per store month volumes which we project to follow in a range of 255,000 to 265,000 gallons per store

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month. This is a wider range than the prior year due to the continued uncertainty in oil markets and the potential that another year of rising prices could have a detrimental impact on our per store volumes.

As previously mentioned, we are changing the way we are going to guide investors and the analyst with respect to our fuel business. Given all the moving parts and the inherent relationships between the product supply and retail business, as well as the interplay between RINs and the spot-to-rack differential within our product supply results we think it is much simpler and easier for investors to think about the business the way we do internally using an all-in margin. I want to stress this measure in no way intends to provide investors less visibility as our financial statements and operational tables in the press release will remain largely unchanged.

The provided range of $0.14 to $0.16 per gallon aligns with historical results and the low end reflects the potential for another year of rising oil prices and the continued lower margin environment that creates. While the upper range reflects our continued improvements to the business and the potential for a more normalized margin environment.

We acknowledge that the RIN market will remain volatile but also reiterate our fundamental belief that the economic principals and internal mechanics of the product supply business will result in anywhere from $0.02 to $0.03 per gallon over the long term. Turning to merchandise we expect to see sales up between 2.5% and 4.8% to between $2.4 billion and $2.45 billion. With continued improvements, we expect to deliver on the margin front, we expect merchandise contribution to fall in a range of 15.5% and 16.3% or between $380 million and $390 million.

On operating expense, once again we are making strong improvements on the operating front with an outlook for flat to a 2% decline in station operating expenses excluding credit card fees. This is on top of already strong performance in 2016 where we were able to reduce expenses by 4.1% and it is in sharp contrast to the rest of the industry that is facing material cost pressures. In this category, investors will see the benefit of a full year of a new labor model as well as other store level improvements.

Our guidance for selling general and administrative expense, SG&A, is $135 million to $140 million. While this is up versus our 2016 guidance of $130 million to $135 million, we note that actual SG&A expense came in at $123 million for the year.

We hired a new CIO in mid 2016 and we subsequently conducted an organization wide review over our corporate infrastructure needs and reprioritized key projects. As a result, we effectively deferred our anticipated IT spending into 2017. With additional senior hires and marketing and merchandising, operations and strategy and development, we are realigning the organization, investing in the right people to do the right jobs and better position the company to be competitive over the long term.

New store growth, we have line side between 45 and 50 new stores in 2017, along with 15 to 20 raze and rebuild projects many of which are already under way. Mindy has already addressed the capital plan that will support the growth we will see this year.

Understanding that there will be some interplay between the elements of our guidance when we run the above variables through our model, we project net income from continuing operations of $140 million to $190 million which translates to a EBITDA range of $400 million to $450 million.

Astute investors may notice that the midpoint of our guided interest expense strongly implies the potential for additional debt financing to appropriately and opportunistically utilize our balance sheet in a shareholder friendly manner. I'm so proud of the accomplishments the team has made in 2016 and we remain continually dedicated to improving every aspect of our business to compete to win over the long term.

While the fourth quarter of 2016 was challenging from a market environment perspective, we enter 2017 with a clear commitment to maximize efficiencies within our unique business model and create value at every opportunity for our shareholders. Thank you and we'll now open up the call to your questions.

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QUESTIONS AND ANSWERS

Operator

(Operator instructions). And our first question comes from Ben Bienvenu from Stevens Incorporated. Your line is open.

Ben Bienvenu - *Stephens Inc. - Analyst*

Thanks. Good morning.

Andrew Clyde - *Murphy USA Inc. - President, CEO*

Good morning, Ben.

Ben Bienvenu - *Stephens Inc. - Analyst*

So I wanted to first touch on some of the trends that you alluded to in the merchandise and gallon sales business in 4Q. Clearly a challenging operating environment but you guys also, I think, endured some of what I would characterize sort of low probability one time events most notably hurricane Matthew and to a lesser extent the Colonial pipeline explosion--Is it possible to -- just aggregate the impact that might have had on your business and even if you can hazard a guess I'd be curious to know.

Andrew Clyde - *Murphy USA Inc. - President, CEO*

Yeah, Ben, I think what you got to do especially when you get into the merch areas is break it down first between traffics, overall industry headwinds whether it's tobacco or softer beverage sales than our promotions, et cetera. And so the things you mentioned all really have an impact on traffic. And so you're slicing it up, you know, quite a bit.

So certainly with the fuel volume decline, I'd say that reflects the traffic portion of that. I would say from a promotion standpoint where we saw some softer beverage sales, some of the promotions it probably lost some fizz, if you will, and some promotions we're seeing already in 2017 where we have got some $0.15 off per gallon promotions we're seeing a much higher activation rate. So can't break it down between all the factors that drive traffic, the things that impact promotions, sort of softer declines around some categories in the decline, like tobacco, but we feel good about being able to drive traffic in a normalized environment and have better promotions and executions.

The other thing I'll say is, you know, by accelerating the super cooler installations, we originally planned 120 last year. We ended up doing 180. We're looking to do a much bigger number this year as well. Those will have a positive impact and we'll take full advantage of those promotions.

Ben Bienvenu - *Stephens Inc. - Analyst*

Okay, thank you. And then you also commented on the interplay between the wholesale and the RINs. Whether or not it's a logical remediation to RFS as it stands today there's been a lot of discussion around the change and point of obligation. And I'm curious, A. do you think that interplay still exists if there's a change in the point of obligation and, two, how do you think about positioning your assets or even participating in certain lines of business based on what the outcome could be around that front.

Andrew Clyde - *Murphy USA Inc. - President, CEO*

Right. So every party virtually out there who submitted information to the EPA has clearly noted that the RIN price is embedded in the spot price of gasoline. And, therefore, it is in the refining margin. Right? And the EPA acknowledges that and their economists, the refiners do as well. And so

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if RINs went to zero, the spot price of gasoline would fall commensurately. If the point of obligation shifted, the spot price of gasoline would go down commensurately because that cost embedded in the spot price today would go down. That's -- that's reality, Ben. And even the refiners testify to that effect.

The EPA is charged with running an effective program. So the real issue they look at are--are the -- is the compliance mechanisms going to be more difficult when you now have hundreds of additional parties responsible for compliance? Is the RIN market going to be liquid like it is today? You know, all the discussions and hype about rigged markets and various things, do not exist. There's some noise back in 2011 or 2012 around some bio diesel RINs, but the EPA has very effective controls in place today.

Their concern would be do we go from a highly liquid market where you've got motivated buyers and sellers, and as you know we sell our RINs on a very ratable basis, to an environment that has a lot less liquidity because you have a lot of -- lot more parties that have very small imbalances. That's a very serious concern for them. Right. They also see how the RFS program has implemented has encouraged investments in renewable fuels and you've seen the growth in renewable fuels. And so I think the case we made before the EPA which is in the public record and many others was pretty well received and led to the decision to not change the point of obligation.

Clearly, they're going through a comment period. There's going to be some new people involved at the top and we'll see how it plays out. In theory in economic terms, you know, it should not change our economics in any way. If it were to change, there would be some period of volatility and disruption as the spot price moves down to a new level and the new price clearing mechanisms adjust. But, Ben, there's no windfalls or headwinds on this. If we were creating a massive windfall, the assets that we have like the line space and other positions would be, valued at very high rates so people could offset that.

So our view is, the EPA has a very solid program. There's been very good evidence put forward to show why it's working effectively. The refiners are not being harmed because it's built into the spot price of gasoline and, therefore, their refining margin. If it shifted, the refining margin would go down by that amount, they wouldn't be reporting the RIN and they would be complaining that the refinery margins are 50% of what they were a year and a half ago when they were at peak levels and I think that's really the fundamental issue facing the sector.

Ben Bienvenu - *Stephens Inc. - Analyst*

Okay, thanks for that explanation. Just last one for me quickly, the buy backs, you bought back quite a bit of stock in the quarter. You're ahead of pace for the existing program in place. Just curious, your comments suggest that you have a continued commitment to buy back as does the range you provided on implied leverages as a result of the interest expense. Just curious how you're thinking about buy back, is it consistent with what you said historically.

Andrew Clyde - *Murphy USA Inc. - President, CEO*

It is and I think given the last discussion, how the market wrongly applies a valuation to a part of our business that is actually less volatile than our industry competitors, which reflects in a lower data and lower weighted average cost to capital, we seek to take advantage of, lower valuation as a result of that. We actually have a less volatile business than, , appears in the segment based on the numbers that we've shared. So as long as there's mispriced valuations, we can take advantage of that and with a lower weighted average cost to capital, generate even more exceptional returns on equity for our shareholders.

Ben Bienvenu - *Stephens Inc. - Analyst*

Great. Thank you, best of luck.

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Andrew Clyde - *Murphy USA Inc. - President, CEO*

Thank you Ben.

Operator

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

Chris Mandeville - *Jefferies LLC - Analyst*

Hey, good morning. So Andrew just kind of piggy backing on Ben's question regarding potential change and the point of obligation, I think it's fair to say that it's certainly been an overhang on the stock for quite some time now. But can you take it a step further and help us understand if the change were to take place presumably or at least the EPA were to consider changing it at the end of this month, the timeline in which implementation would actually take place just particularly given the fact that you, obviously, have some complexities on a compliance standpoint.

Andrew Clyde - *Murphy USA Inc. - President, CEO*

Yeah. I would have no idea what their timeline would be for implementing. It would involve, multiple parties, multiple changes. And the rules and has to go through an entire process. I would expect it to take many, many months before that would go into effect.

Chris Mandeville - *Jefferies LLC - Analyst*

Okay. And then---

Andrew Clyde - *Murphy USA Inc. - President, CEO*

I would think there would be a low probability based on the merits of the case.

Chris Mandeville - *Jefferies LLC - Analyst*

Got you. And then there's, obviously, been some concerns surrounding 2017 kind of getting off on the wrong foot as it relates to fuel demand. We saw Q4 having sequential decline there from the gallon growth perspective. Any ability to help us understand what you're seeing quarter-to-date and, if possible, can you help us understand the expected volume impact from those 15 to 20 raze-and-rebuilds for the first half of the year or maybe just remind us or update us for that matter on what type of uplift you've been seeing from the dozen or so that have been performed over the last two years?

Andrew Clyde - *Murphy USA Inc. - President, CEO*

Yeah. So in terms of the year starting slower from an EIA demand or weather factor et cetera you're always comping, one set of things weather related and one year versus another. And so, it's kind of hard to say. Do you have-- bluebird days that offset bad weather in a prior year so we typically don't like to project, based on that. You can see some scenarios where strengthen the economy, infrastructure spending, some of those positive changes. Actually see some improvements in demand over time. So I think it's way too early to tell, sitting here one month in how that might play out.

The things we can control like the -- you no objection the raze-and-rebuild, those are higher volume stores that have the best economics, that have the best potential for improved uplift because of the larger format store and the more pumps. Those will impact numbers in Q1 and Q2. We haven't broken that down in guidance because we don't provide the quarterly guidance. But it is baked into our annual numbers but you all should certainly

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anticipate with 20 stores out earlier in the year to see that impact on the average per store month basis affecting Q1 more than it did say Q2 and beginning of Q3 last year.

Chris Mandeville - *Jefferies LLC - Analyst*

Okay. That's good to know and then just looking at the competitive landscape, can you provide any update on what Wal-Mart's been doing from a fuel retail perspective? We saw they apparently introduced a new 2500 square foot concept, but putting that aside, how would you characterize their interest in actual engagement in fuel operations?

Andrew Clyde - *Murphy USA Inc. - President, CEO*

Yeah. It doesn't get a lot of mention publicly. I think we looked at the annual report the last three years. They're, I think fuel got used once one year, gas got used once one year and there was no mention in the last analyst day report. We've seen 60 stores, in the first pilot year followed by somewhere around 20 stores the next year. So they pop up, they've popped up in places like West Virginia and Washington state and places that were not in and not planning to go into. Certainly the new store you referenced in Crowley, Texas was right next to one of our stores like the one we mentioned in Nacogdoches a year ago. That was a high performing store. It's still a high performing store but it's just like any other competitor that moves in next door, you lose some volume from that just like we gained some volume from competitors when we move in.

I think fundamental differences if that's a stick build store versus our highly capital efficient modular store you look at the number of employees the throughputs, the offers, et cetera at the end of the day they're going to have to make their decisions based on the economics of fuel and the uplift they get to the store. We know what our economics are and feel comfortable that we can continue to build those in the proximity of, high traffic super centers.

Chris Mandeville - *Jefferies LLC - Analyst*

And just the last one for me, thinking about unit growth and timing for 2017, any ability to help us out on the cadence throughout the year?

Andrew Clyde - *Murphy USA Inc. - President, CEO*

Yes. So we've accelerated the cadence versus last year. One of the benefits of our independent growth plan is we're not subject to the blackout schedule which impacts when you must complete a store nor are we subject to additional process steps to get permitting and approval done. So we're going to effectively load level these up to 70 stores, including the raze-and-rebuilds with a much higher number of stores in the first part of the year. I think we started nine stores last year that will be open this year. And I think year-to-date, we've opened over 27 stores-- sorry we started construction on over 27 stores so that's the highest number we've ever done. That's also going to eventually lead to capital efficiencies for us and reduce our total cost to build a store because we've now load leveled the work for our partners that help us build these stores so now they have a more ratable work flow and will be able to pass those efficiencies through in terms of higher returns on investment capital.

Chris Mandeville - *Jefferies LLC - Analyst*

All very helpful. Thanks again.

Andrew Clyde - *Murphy USA Inc. - President, CEO*

Thank you.

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Operator

Our next question comes from Bonnie Herzog from Wells Fargo. Your line is open.

Bonnie Herzog - *Wells Fargo Securities, LLC - Analyst*

Hi Andrew. So I guess I was hoping you could talk about what I think seems like the broad slowdown in C-store traffic which is, obviously, driven by a number of factors but I want to zero in specifically on what role channel shifting is playing on the floor traffic. For instance, do you think online sales are in any way affecting C-stores the way other retailers are being affected either directly or indirectly?

Andrew Clyde - *Murphy USA Inc. - President, CEO*

Yeah. Bonnie, I think this is where you really got to get into the customer segmentation. I know a lot of people who would just love to have a single mountain dew and pack of chips droned to their house and dropped in their backyard and I know some people would be happy to pay $10 for that. I don't know many of our price sensitive value sensitive customers are going to be paying a premium for shipping a few convenience items to their home. And these are customers that think about how many miles can I go on a twenty dollar bill. They're going to or from a major shopping purchase or a top up shopping purchase either a Wal-Mart or in the constellation of stores that have built up around that.

We are a destination for low price, fuel low price tobacco, a destination for lottery and a number of other convenience items. And so while I think you will see that, play out over time, I don't think we're going to be disproportionately impacted by that based on who our customers are, what are their primary motivations for where and when, and -- and, you know, they go to buy, and the like.

Bonnie Herzog - *Wells Fargo Securities, LLC - Analyst*

That makes sense, and I, obviously agree with that. But I guess I've been thinking a little bit about the maybe even indirectly, Andrew, as maybe consumers more broadly are getting items online, maybe not driving, whether it's to department stores or whatever it may be, which could be negatively impacting traffic, maybe there's that component as well as the brick and mortar channel shifting possibly. Maybe there's more pressure on C-stores as there's blurring of the lines. Are you seeing any of that? I'm just trying to understand what --

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Andrew Clyde - *Murphy USA Inc. - President, CEO*

Yeah. It's going to be difficult for us to see that and attribute it to that on a store by store basis. I think the question you've got to ultimately look at is the foot traffic of the mass discounters and the grocers to actually say okay, sales may be down because there was an online purchase that took something out of the basket. But do the actual trips go down.

So I could see consumers going to a Wal-Mart and,buying there's groceries and other various items. But, they'd love to have their dog food shipped directly to their house or, a case of bottled water shipped directly to their house because it's heavy and maybe that shopper struggles with that. But did their trip go down and did their trip to and from that store also then shift their mileage and their gasoline purchase behaviors?

We think about those things, we're doing some consumer research on those things but for those things to actually play out, you're going to have to look at traffic of the mass merchants and then we can monitor the trips to and from our stores.

Bonnie Herzog - *Wells Fargo Securities, LLC - Analyst*

Okay. And then maybe a follow-up question on the consumer, and taking this a step further thinking about the Murphy consumer versus the broader C-store consumer in general sort of the health of your consumer, I'm also thinking about if there's greater pressures on the Murphy consumer, is that possibly impacting traffic into your stores?

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Andrew Clyde - *Murphy USA Inc. - President, CEO*

So I would say it's over the last several years, we've been stuck in this anemic 1.5% to 2% GDP growth mind-set. If we break out of that and, with some of the new infrastructure discussions, corporate tax rates and the like, and we actually start growing the economy, that's ultimately what's going to lift up this lower to middle class consumer that we disproportionately have. So, again it's too early to tell on that front. It's hard to see them being impacted worse than they've been hit over the last several years since the, you know, 2008, 2009 recession.

Bonnie Herzog - *Wells Fargo Securities, LLC - Analyst*

Okay. And then just maybe one final question, if I may, on tobacco that you mentioned, the soft tobacco sales but solid margins. Just trying to understand is that possibly driven by the shift from cartons maybe back to packs, just hoping you can drill down a little bit more on some of the underlying trends that you're seeing there in consumer behavior and also if you could comment on the premiumization trend or if that's softening in any way.

Andrew Clyde - *Murphy USA Inc. - President, CEO*

Yes. I think on the last call we talked about premiumization. It's less sort of buying that premium item more. It's the manufacturers discounting the premium item so it shows up as a higher mix of premium sales. Certainly our margins have been significantly enhanced by the major shift in our supply chain, partner last year we'll be getting that benefit. In January this yea we had a little bit of overlap in February last year but net-net it should still be positive on that front.

We continue to be an important player in the cigarette and tobacco area, and we're-- to leverage digital and other assets that the manufacturers have and so as we think about our loyalty programs and the way we want to interact from a digital marketing standpoint differently with our consumers we're going to be pushing a lot on that front as well.

I think the other thing just from a capability standpoint, we've added resources within the category to get sharper around our pricing and making sure that we've got the most competitive prices out there while recognizing there's more retailers in the space like the dollar stores that are selling at low prices.

So it remains a competitive and dynamic segment but we still feel very good about the segment and it's potential for margin growth over time despite the systemic unit decline that we expect to continue.

Bonnie Herzog - *Wells Fargo Securities, LLC - Analyst*

Alright, thank you.

Operator

Thank you. Our next question comes from Bob Summers from Macquarie Group. Your line is open.

Bob Summers - *Macquarie Group - Analyst*

Good morning, everyone. I just wanted to dig a little more into where you think volumes bottom out and gallons, and I guess part of what I'm asking is that, clearly sustained increases in wholesale prices creates sort of constraints for you. Maybe there's a piece that's also driven by just the overall pricing strategy change now that you're not part of a larger entity that has does certain things at times in terms of moving gas. And then in competitive component. Just trying to, again, think how and why things end up bottoming out and then end up getting better from there.

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Andrew Clyde - *Murphy USA Inc. - President, CEO*

Got it. Great question, Bob. Certainly not pleased with the, you know, 259.1000-gallon number. I would say in the price environment we experienced, if you compare that to Q4 of 2014, I think our volumes were up somewhere in that 5% plus range. So there is this nearly equal and opposite effect of gaining volume when you put more margin on the street in a $0.25 to $0.30 margin environment where prices are falling versus the affect you have in a rising price environment. So you certainly got the price environment there.

If we have a continued increase in crude oil prices which a lot of the, oil price forecasters suggest could be the case, that's a scenario where you see that bottom out at 255 because you would have another year of rising prices and you just got to remember this rising price environment, we are staying competitive with the low price player in the market. We're not becoming uncompetitive. It's just that differential between the top of the market and the bottom of the market compresses and the bottom of the market as a whole, sheds some volume. We've seen periods before, especially before we went public where an attempt to gain volume in those environments, a lot of margin was sacrificed. A lot of margin.

And if you look at the returns on this business before the spinoff, it is reflective of that type of kind of volume first mind-set. So I think we're doing it more smartly, more strategically with a better appreciation of what markets are elastic and can provide that upside versus which ones. It makes no sense to get overly aggressive because it is going to be matched immediately.

So I think those are two factors, one of which is the environment we can't control, one is how do we respond to a environment which I think we do differently than we -- when before we were a public company. I think some of the other factors we talked about, the new builds from the USA portfolio in the mid-west that had lower average volumes to start with because they were in the mid-west and these stores under performed the mid-west average those brought down the numbers the 2016, 2017 build class is stronger than that and then the 2015 build class continues to improve, although not quite up to original expectations.

We're doing more raze-and-rebuilds we're doing 20 this year versus 10 last year and we're starting them sooner. The good news is we're starting them in a softer quarter so that they're up and running fully by the spring and summer driving season. And then there's externalities like Colonial. We had two major disruptions, state of emergencies were enacted, that impact how you can change your prices. We had run-outs, although fewer than many in the industry because of our proprietary supply chain.

And last but certainly not least, is competitors. You see competitive entry continue. We recognize that we lag from a loyalty program standpoint which is why one of our objectives this year is to be piloting that later in the year. So I think all of those things combined give us some confidence around that range that we provided. I'd certainly be disappointed if we ended the year below the 259 certainly if there was a normal margin environment, price environment.

Bob Summers - *Macquarie Group - Analyst*

Okay. And then on the merchandise contribution margin rate, and I think that you've had in your answers there's bits and pieces to this but just to be more specific, I mean what are the two or three things that take us from a flat year-over-year of 15.5% to the 16.3%, what gets us that 80 basis points?

Andrew Clyde - *Murphy USA Inc. - President, CEO*

So we will have the full year of the Core-Mark relationship versus kind of 10.5 months of that. February there was some overlap on that front. Better promotions, better pricing. If you think about the new stores, we continue to have a better mix of 1200 square foot stores. And so if you add 70 new stores and they're all 1200 square foot stores with higher sales, higher margins because of better mix, you're going to continue to grow that.

Increasing the super cooler expansion program does the same. And the key thing there is you'll have fewer stock-outs when you're doing promotions, especially if you're doing better promotions, and you're going to have better facings of new items that you just didn't have room for in the old coolers. You've also got innovation from coke, Pepsi, Dr. Pepper, Snapple group, et cetera, as well as a number of other great suppliers out there.

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So they're helping us stay on top of the trends, introducing new products that we're going to get into the stores most of those products are of a higher margin as well.

So a lot of things, I guess the way I would characterize it is where 2016 was a year of some real real heavy lifting, you know, Core-Mark, store labor, 2017's going to be a lot of small muscle groups being worked out at the same time across operating expense and a variety of categories. So no one single silver bullet like we had in 2016. That is also why we've got some new leadership that has joined us and is excited about taking us to that next level and our teams are really excited about the visions within the categories and the operation and the technology to get us there.

Bob Summers - *Macquarie Group - Analyst*

Okay. And then last question, I want to dig a little into the capital structure leverage comment. And I guess to me on perspective EBITDA you're sitting at one and a half time lever which to your point is probably underutilized, are there any constraints what makes you pull the trigger and where do you think is a good point to take debt to EBITDA.

Andrew Clyde - *Murphy USA Inc. - President, CEO*

So I'll let Mindy talk about covenants and targets in terms of timing around pulling the trigger amount. We won't be able to get into that on this call but Mindy can discuss some of the covenants and constraints that we have that impact the size and tenor of what we do

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Mindy West - *Murphy USA Inc. - EVP, CFO*

Sure, Bob it's a great question. And we do have one constraint that we pay particular focus to and that's our debt to EBITDA ratio. Because we want to take a balanced approach to those CapEx and share rate purchases. It's important that we stay beneath the 2.5 times leverage ratio because when we get above it we start facing some pretty strict limitations as far as how much we can do with regards to share repurchase. So you're right. Year end we're sitting right in the 1.6 turns range. And so if you took consolidated EBITDA, that would mean that we could add an additional almost $350 million worth of debt before we start reaching that 2.5 time cap.

Operator

Thank you. And our next question comes from Ben Brownlow from Raymond James. Your line is open.

Ben Brownlow - *Raymond James & Associates - Analyst*

Good morning. Andrew you commented around same store sales. Can you specifically talk about some of the merchandise in fuel trends you saw through the quarter and you touched on the mid-west. Are you seeing improvement there and can you touch on Texas as well, please.

Andrew Clyde - *Murphy USA Inc. - President, CEO*

Sure. So I think the categories that were impacted in the quarter were beverage. It was softer sales for us, part of it was traffic. There were softer sales for the industry, one of the things you note you didn't see a price increase, major price increase from the manufacturers that usually suggest that they want to make sure they're keeping their volumes up.

As I said, some of our promotions both the nature of them and then how they've comped just hasn't been optimized and Rob and his team are doing a better job in terms of how we're going to optimize those and working with the manufacturers too have more impactful promotions that they're helping fund. So I think on the beverage side it's a variety of factors. Candy was weak, again largely due to promotion design and flatness on that front. General merchandise was as much about comping against a really impactful iPhone and phone accessories program that we launched

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the year before but the team has, additional ideas and products to roll out this year as well. So I think those are the three biggest categories that showed some impact in the quarter

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Ben Brownlow - *Raymond James & Associates - Analyst*

And did you see sort of a demand trend improvement as you worked towards year-end.

Andrew Clyde - *Murphy USA Inc. - President, CEO*

We saw those kind of throughout year-end so some of the weaker promotions were in December. So in that case, no. Geographically if you start seeing an oil price rebound, you're seeing drilling activity already picking up in Texas, one of the nice things about having a more distributed portfolio versus a highly concentrated one in, say, south Texas, we're not as adversely impacted by any demographic or employment or weather shifts that might happen from that standpoint.

Ben Brownlow - *Raymond James & Associates - Analyst*

Are you seeing any improvement in the mid-west as well?

Andrew Clyde - *Murphy USA Inc. - President, CEO*

We're seeing improvement in the mid-west stores that had opened up that had softer openings. Generally in the mid-west we continue to see competition there both in the form of, Kroger adding stores, Caseys and other adding stores in the rural markets and certainly we're not adding a lot of new stores in the mid-west. So relative to the region where we're adding new stores that are going to be higher volumes, if you looked at that region on an average per store month basis, it's going to probably face more headwinds without an associated kind of program of new builds to offset on a overall average basis.

Operator

Thank you. Our next question comes from Andrew Bird from JPMorgan. Your line is open.

Andrew Bird - *JPMorgan - Analyst*

Hi good morning thanks for taking the questions. First questions follow from Mindy thinking about sources of cash in 2017, are you expecting any positive benefits from working capital and then also what level of minimum liquidity is necessary for running the business?

Mindy West - *Murphy USA Inc. - EVP, CFO*

Great question, Andrew. We're not -- we're expecting to be more CapEx cash flow parity as we enter the year this year looking at the full year, our expectation. As for working capital, probably not a whole lot of free -- freeing up of working capital. That's all, obviously, going to depend on what prices do. And so at these lower price levels, we would not expect to be freeing up a material amount of working capital.

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Andrew Bird - *JPMorgan - Analyst*

Great, thanks. And then looking at the 20 store raze-rebuild program, it looks like, obviously, targeted mostly for the first half. Have you given thought into upsizing that program throughout the year, maybe in the second half or kind of what's the puts and takes on that as opposed to just waiting and doing another kind of 20-store program next year

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Andrew Clyde - *Murphy USA Inc. - President, CEO*

Part of it is just load leveling the work. I mean they're real synergies from load leveling the work with your partners and we'll get into those more, you know, in our analyst day when we go out and we've got all of 2016 wrapped up.

But, you know, having a balance program like that, continuing that steady growth program allows us to also maintain this nice balance between growth capital and share repurchases. I don't have exact numbers, but somewhere since the spin, we've spent about $625 million on capital and we've bought back about $625 million worth of shares. All right, and that balanced approach we think has -- has served us well and will continue to serve us -- serve us well.

Andrew Bird - *JPMorgan - Analyst*

Great, thank you.

Operator

Thank you. And this does conclude our question and answer session for today's conference. I would now like to turn the conference. I would now like to turn the conference back over to Christian Pikul for any closing remarks.

Christian Pikul - *Murphy USA Inc. - Director of IR*

Yeah. Thanks guys I know some of you are still in the queue I'm free to follow up later. I want to remind everyone we are hosting an investor day in New York City at the New York stock exchange on May 16 you will hear more about that from us in the coming weeks thanks for your time today and I'm available for follow-up this afternoon. Thanks Andrew do you have any closing comments

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Andrew Clyde - *Murphy USA Inc. - President, CEO*

No. Thank you all and look forward to following up.

Operator

Ladies and gentlemen, thank you for participating in today's conference. This does conclude the program. You may now disconnect. Everyone have a wonderful day.

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