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# Raymond James 39th Annual Institutional Investors Conference

**Benjamin Brownlow, Analyst, Raymond James & Associates:**
It's my pleasure to introduce the CEO of Murphy USA, Andrew Clyde.

**Andrew Clyde, President and Chief Executive Officer:**
Great. Thanks, Ben, and thanks for having us here at the Raymond James Conference. We are webcasting, so we'll thank all those who are joining by webcast. And we'll be cutting that off as we end the presentation. We will have some time for Q&A here, but if you can save your questions until the end, that would be appreciated. The usual cautionary statement you're all familiar with. And then also with me today is Mindy West, our Executive Vice President and Chief Financial Officer; and Christian Pikul, our Director of Investor Relations.

We like to kick off our presentations every year with this slide. And I kind of joke with Christian. It's not because he and the Investor Relations team are lazy, but rather that it really highlights what we've been doing since our spin-off since 2013. We've been focused on a very clear coherent strategy consisting of 5 key pillars. We continue to focus on those 5 key pillars and improve upon those each and every year since the spin-off. One of the key moments in our history since the spin-off was our announcement in 2016 that we would no longer be getting locations from Walmart and that we would be pursuing third-party locations for acquisition or lease. And in doing so, we recognized that our growth profile over the coming years will be more moderated, and so we had a larger share repurchase program announced in 2016 up to $500 million, which we actually completed in 2017 of that year.

And on the right-hand side, you can see our stock performance relative to the S&P 500 Index and the 400 Midcap continuing to show solid performance over that period, albeit volatility, which is really inherent, and the fact that we are a more fuel-focused convenience retailer than some of our peers, and the stock price tends to trade largely around margin expectations quarter-to-quarter despite our view that, over the long-term, we're generating a pretty consistent $0.14 to $0.16 per gallon in our business.

A couple years ago, we decided to really describe our business to the simple formula for creating value and how we drive the EPS growth, and we've put some of the proof points up here against that for both 2016 and 2017. The first lever that we've focused on is organic growth in terms of store acquisitions. And you can see in 2017, we added 45 new stores, and we razed-and-rebuilt 21 of our older stores into the newer, larger format, and that's about 3% unit growth. At the same time, we refreshed about 300 stores out of our portfolio of around 1,450 stores, enhancing the offers in the physical facilities of those stores and also adding 244 super coolers.

So continuing to focus on organic growth in an industry that's going through a lot of consolidation we believe continues that value. The main drivers of how we grow our earnings year-over-year come through three components. Our fuel contribution, which grew 4.7% in 2017, and we did that with a little bit less volume than we've done in prior years, total volume declined 1.3%, but unit margin was up to $0.164 per gallon. Fuel breakeven is the second component, and that's the leverage we get between the merchandise margin and the operating costs, so what unit margin do you need to have a cash breakeven. And we continued to reduce that from $1.03 per gallon to $1.02 per gallon, improving on both the merchandise side and the operating cost. And as you can see there, we continued our track record of reducing operating costs per store by 2.6% on an average per-store basis.

And then on corporate costs, measuring that on a per-store basis, where it was down 10% the year before, up 3% this year, a lot of that just reflects timing differences in some of the capital programs around IT and technology in our home office. So if you take those earnings and the improvements to those and divide them by the shares outstanding, you get the improvement in earnings per share. And over the course of the last two years, you can see we've bought back almost 20% of our shares, so having a significant impact on our earnings per share.

Last year, we repurchased 3 million shares, totaling $206 million of capital; but not only completed the up to $500 million program we announced in 2016, but we've started a continuous program on a quarterly basis as we continued beyond that $500 million level. So that's how we like to think about creating value relative to our strategy. Another chart we like to show is just the competitive landscape, and this shows the three pure-tone models that we see out there in the industry: there's the hypermarket models, of which Murphy USA competes along with Walmart and their standalone stores, Costcos, the other grocery stores; the big-box C-Store companies, and you'll note most of those are privately held companies, the QuikTrips, the Sheetz, the Wawas, Casey's in that group; and then the consolidators at the bottom.

And certainly, since we spun off, a lot of companies have gone through that funnel at the bottom and have completely disappeared, The Pantry, CST amongst them. Susser sold its business to Sunoco, who, in turn, sold the Stripes business, the 7-Eleven. You see some other players there onto the right, EG, who recently acquired the 784 convenient stores from Kroger; Empire and GPM, acquiring some of the smaller chains, but they've amassed to a pretty large chain themselves, but these are either, in the case of Empire, a dealer model; or GPM, a consolidator that really leads the existing brands as they are. And they'll do the same with the recent ECR transaction. So a pretty active field. This continues to change every year, but it's been doing that for 20 years, and it'll probably keep doing that even for the next decade to come as well.

So turning to our business. Organic growth has moderated with the independent growth plan. At one point, we've thought, well, if we'd plan another deal with Walmart, there may be growth of up to 100 stores a year, but we knew we'd be getting into different markets and markets where the performance might not be the same as the performance we had in our Southwest and Southeast markets with our independent growth strategy that's moderated.

In 2017, we added 45 new stores, 21 raze-and-rebuilds. Our guidance for 2018, 30 new stores, so about 2% unit growth, but up to 25 raze-and-rebuilds. And we'll continue to see about that level for the next couple of years. One of the things that we're going to be doing more of, given that the number of great locations in front of Walmart supercenters is getting smaller and smaller, is turning to more of what we call an infill strategy, targeting the best markets, a little bit larger format that we can still build on a modular cost-efficient basis and has good returns. And we've identified our top markets in which we're doing that in. And so we'll be able to keep our focus on returns on invested capital with that model.

This is an example of the raze-and-rebuild program. really, what we're doing is we're taking, to start with, some of our highest-performing stores that sit there with a kiosk that may be 150 square feet and four to five pumps, and we're adding the larger 1,200 square foot stores anywhere from 8 to 12 dispensers and really building a new store at the end of the life of the old existing asset.

Most of these assets are 15-plus years old, and so like many great retailers, you would simply declare victory on that location or where maybe QuikTrip would go build a new location down the road. We still enjoy great traffic at that existing Walmart supercenter locations, so we're reinvesting capital now at the beginning of the life of the new asset. And it really is a new asset at that point.

You can see, using the 2016 and 2017 raze-and-rebuild class, that the fuel gallons have improved by 10%, going from 400,000 to 443,000 gallons per month; and the merchandise sales, from $160,000 to $188,000. And those are still ramping up as well because now, going from a kiosk that sell mostly cigarettes and some beverages and the coolers out front, you've got a much broader range of merchandise at these locations.

So we really do like the performance of these. They do have an impact on our return on average capital employed metric because you're basically taking a fully depreciated store, you're investing $2 million of capital into it, and you're shutting it down for four to five months. But when you're investing for the long term, this is what you want to do with your asset base.

As I said, fuel continues to differentiate Murphy USA from its peers. And so if you look at our total fuel gallon for a chain of 4.14 billion gallons, that's on a store count of 1,424 stores. And so when you translate that to the volume per store on an annual basis, we're close to 3 million gallons, three times that of Casey's, two times that of Couche-Tard and about 1.5 times that of Speedway.

So we're still performing about three times the industry average of about 80,000 gallons per store month. Despite the volatility that we see quarter-to-quarter, month-to-month, the fuel margin contribution has actually been pretty consistent and steady over time. On the left-hand side, you can see on a cents-per-gallon basis, the retail margin sort of between the rack transfer price and the Street, in blue; and then what we call our product supply and wholesale plus RINs, that's where we acquire proprietary barrels up through the rack transfer point and then offset that with RINs, you can see that's been pretty consistent over time as well in about $0.02 to $0.03.

And on the right, you can see the fuel contribution continuing to grow as we add stores as well as when we add improvement to that part of the business. This shows that on a quarterly basis, and you can see the volatility that exists quarter-to-quarter, and I can draw you to a couple of quarters of interest, in Q3 of 2015, we had $0.18 of retail margin, slightly negative contribution from product supply and wholesale; Q1 of 2017, $0.10 of retail margin, $0.00 of product supply and wholesale. But over the course of subsequent quarters, those tended to offset so that you land on that pretty consistent $0.15, $0.16 of contribution.

One other thing to note, and we'll show it on the next slide in a little bit more detail, but the red line is our fuel breakeven contribution. So that's the cash margin we need before credit cards to break even. And you can see how that's continued to improve. So by having a low cash breakeven requirement, we can sustain periods of volatility. So if you added $0.03 of credit cards on top of that and some corporate costs, there's no period of time in which our business is at risk. One other thing to note since the spin, coincidentally, we earned $0.164 in 2013, – $0.164 in 2017, but our breakeven margin requirement improved by $0.02. So we're effectively $0.02 stronger as a business since the spin. And on 4 billion gallons, that's $80 million of additional contribution.

And as I go through this, I'll highlight some of the things that we're doing. But this business isn't standing still, so on the fuel contribution side, we continue to optimize our carriers, we continue to optimize our supply contracts. We've made investments in the product terminals that we own and biodiesel blending and butane blending, et cetera, that continued to add to this contribution line every year. So we've had a real focus on continuous improvement since the spin, and we fully expect that to continue over time.

So as I noted on our fuel breakeven requirement, we've been focusing on making our business more competitive, and there's always some new competitor out there with an advantage that you've got to be able to face off. In this definition, the bottom just highlights what this is about. It's the operating expense less the payment fees and rent, minus the merchandise margins, divided by our volumes. So we'll talk about each of those components and what we've been up to.

So merchandise margin and contributions continued to expand. When we're primarily a kiosk business selling tobacco, we're probably the second or third largest tobacco retailer in the country. We recognized that due to the systemic decline in adult cigarette smokers, we needed to diversify our merchandise mix, and we do that through a lot of ways. Organically in our stores, building the larger stores helps; the raze-and-rebuilds help; the super coolers investments that we make help as well. And so you can see that nontobacco contribution on a per-month basis per store continuing to go up as we add more and more new larger stores and then improved the categories within there.

We set a merchandise unit margin record of 16.1% in 2017. Again, versus the spin, that's up 13-point – up 3% from 13.1%. A lot of opportunities to continue to improve this part of our business: the price optimization; continuing to optimize our promotions; space management; visual merchandising. And one of the things that we've been doing is continuing to enhance the quality of our team and their expertise to be able to continue to drive these improvements.

Our loyalty program is something that we've been behind on. For years, we've we kind of relied on good locations in front of Walmart supercenters. We had a seasonal discount program. But along the way, our competitors were getting further ahead with loyalty programs, then it is one of the biggest reasons why customers who buy gasoline, where they buy their groceries, choose to buy their gasoline based on the promotional programs. Now as an everyday low-price retailer, it's difficult to do high-low pricing and say, well, I'm going to raise the price to everybody and then discount it for some, and that's what a lot of the gasoline loyalty programs had been about.

So we're piloting something that is a different type of program on a different type of platform that allows us to segment our customers amongst the most loyal ones, to those that we have lower share of wallet, to those that we have no share of wallet, either on fuel and merchandise, and walk them through a journey that will allow them to buy more from us but without overpromoting to our most loyal customers. And so we'll be piloting that in 2018.

Operating costs is the other part of our breakeven equation, and that's important. And we continue to buck the industry trend, actually realizing per-store declines in our operating expenses, and these are before credit card fees on an annual basis. We just continue to stay very tight with our labor, defining standard operating procedures and do things consistently, with new leadership in the field organization, being able to execute more consistently every day when we're out there.

And so as this gap widens, we continue to improve our relative breakeven contribution. I think one of the big trends we see here is so many in the industry are investing in these large food programs at the convenience stores. And we know one thing for sure, it's going to cost a lot of capital, and you're going to have a lot of labor and spoilage and waste. But unless you have a truly differentiated offer, you may not have the top line sales and margin contribution to do that. So we're pretty comfortable knowing who we are, knowing that we're not a food retailer, and so within the model and the playing field that we've established for ourselves, we're continuing to make improvements. And we have an annual goal this year of continuing to beat inflation, and I'm pretty sure the team will do much better than that.

SG&A investments. We – when we spun off, our technology was not where it needed to be. We didn't have the full complement of people, we didn't have the right operating practices across the board, and so we've really had to invest in making those improvements, and we're still making those investments. Our SG&A continues to moderate year-over-year. And the various differences are largely a function of what may drive key programs we may be doing in that year. But we've continued to focus on our people, bringing in the right talent, having the right operating practices to do things consistently and then getting the technology in place for the future.

Capital allocation has been a high priority area for us in our business. And you can see, even before the independent growth plan, we've e already committed the $300 million of share repurchases as we are coming out the door, and we had excess cash from the sale of noncore assets. You can see in 2016 and 2017 the completion of the $500 million program. When you add all of that up, you can see that we've bought back about $829 million of shares, which is pretty close to the amount of capital we've reinvested in the business for growth, for maintenance and for other corporate IT needs. And so

we've had a pretty balanced capital allocation program. This has been an industry that is historically known for kind of overinvesting in capital and low-return projects, and we want to be really focused on having the right balance there.

We've added leverage proactively as our earnings base has continued to grow. We had a term loan that we paid off, that we reinstated, and it's now drawn back down. And that gives us flexibility to stay below the 2.5 times leverage ratio that we need to make share repurchases. We could operate under a higher leverage basis, but that allows us to – the 2.5 times allows us to make share repurchases. And in2017, we did take out a $300 million 10-year bond at very attractive rates and took advantage of good timing in the debt markets there as well.

To sum our guidance for 2018, I won't go through the details. One thing I will note is on the net income line, we did – we are a significant beneficiary of the tax reform, both from the lower rates as well as the full acceleration of the depreciation given that we're growing our business. And so that additional free cash flow goes into the pool for capital allocation as well. But our adjusted EBITDA guidance for the year was $390 million to $440 million.

And so kind of wrapping up on our value formula, what do you get with Murphy USA? Modest organic unit growth, sustained operational improvement and a mindset to continue to improve this business in what is a highly competitive industry; a very high EBITDA and leading free cash flow per store business model; a commitment to buy back our shares and a disciplined capital allocation program. And as long as we're trading at a discounted multiple, which we are from time to time, we time our share repurchases so that we're able to buy back more when our shares are discounted relative to our peers in part because of our fuel-focused model. And so this is a model that we've continued to focus on. And as you'll – you can see, we're kind of continuing to focus on this in 2018 but making improvements across the business model throughout the year.

So with that, I'll wrap up our webcast, and I think we'd probably have about seven minutes for Q&A in here before we go to our meetings.