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EDITED TRANSCRIPT

MUSA - Q2 2016 Murphy USA Inc Earnings Call

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CORPORATE PARTICIPANTS

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

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

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

CONFERENCE CALL PARTICIPANTS

Ben Bienvenu *Stephens Inc. - Analyst*

Bonnie Herzog *Wells Fargo Securities, LLC - Analyst*

Chris Mandeville *Jefferies LLC - Analyst*

Ronald Bookbinder *Coker and Palmer Investment Securities, Inc. - Analyst*

Damian Witkowski *Gabelli & Company - Analyst*

Matthew Boss *JPMorgan - Analyst*

PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the second-quarter 2016 Murphy USA Incorporated 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, Chanel. Good morning, everyone. Thank you 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 then Andrew will open up the call to Q&A after some closing remarks. 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 that exist may cause actual results to differ.

For further discussion of risk factors, please see the latest Murphy USA Forms 10-K, 10-Q, 8-K and other recent SEC filings. Murphy USA takes no duties to publicly update or revise any forward-looking statements.

During today's call, we may also provide certain performance measures that do not conform to generally accepted accounting principles or GAAP. We have provided schedules to reconcile these non-GAAP measures with the reported results on a GAAP basis as part of our earnings press release, which can be found on the Investors section of our website.

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

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

Thank you, Christian. Good morning and welcome to our second-quarter 2016 conference call.

I hope you have all had time to read through the earnings press release we issued yesterday where we reported net income of $46.3 million or $1.17 per diluted share. This is up from $26.2 million and $0.59 per share in the second quarter of last year.

Earlier in the year, we shared our simple formula for driving earnings-per-share growth. Similar to the first-quarter call, I would like to start by highlighting our progress against the key elements of this formula.

First, we remain on track to achieve 5% organic unit growth in 2016. Since the beginning of the year, we have opened 17 new stores and completed seven raze and rebuilds projects in time for the summer driving season. Presently, we have 40 stores under construction, including three remaining raze and rebuild sites, and we remain on target to add between 60 and 70 new stores to our network this year.

We have already completed all 120 planned Super Cooler additions at kiosk locations this year and have accelerated installations on another 60 sites, bringing our total planned Super Cooler additions this year to 180 sites. Our 300 store refresh program is also on track.

Second, our fuel contribution this quarter illustrated the benefits of our advantaged fuel supply capabilities. Margins from our product supply and wholesale group totaled $17.4 million in the second quarter, reflecting an upward trend in product prices that created positive timing and inventory variances, reversing prior quarter variances when prices fell.

We also benefit from periods of tighter market conditions, driven by pipeline maintenance and high levels of demand. Product supply and wholesale plus RINs added an incremental $0.059 on a retail gallon equivalent basis this year compared to $0.05 a year ago. While retail margins of $0.108 per gallon exceeded the $0.09 earned last year. Taken together, fuel added an additional $20.6 million in contribution as total volume grew 2.2%.

Per site retail fuel volume was below prior year due to several factors. Structurally, we closed 10 very high performing stores during the quarter to raze and rebuild them. Seven are back up in Q3 and performing above prior results. We opened a high number of new stores in Q4 last year, which are still ramping up.

Unique to the 2015 bill class is a much higher mix of Midwest region locations under the Murphy USA brand. On average and historically, our Midwest locations performed below the chain average. So, on an average per store month basis, these factors led to a larger year-over-year decline than usual.

Going forward, we will continue to see the short-term impact of raze and rebuilds as that program continues in future year. However, we expect the new store mix to be more favorable in future years with our Murphy Express branded sites under our independent growth strategy.

On a same-store basis, we saw software volumes in April and May due to rising street prices, which made it difficult to be more aggressive economically. Prices began falling in June, and we saw positive same-store comps across all regions and continue to see a rebound from consumers in July. We expect this seasonal price pattern at that time of year and the cause and effect relationship between relative price and consumer behavior. However, we can't predict precisely when prices will peak in the quarter.

The third point is that our initiatives to improve our fuel breakeven metric continue to demonstrate significant progress that are falling to the bottom line. Merchandise margins of 15.7% expanded 110 basis points year over year, reflecting not only continued benefits from the Core-Mark supply chain contract, which we also saw in the first quarter, but also more favorable shelf rebates and allowances, along with enhanced product mix from larger stores. Total margin dollars were up 10.8% to $92.7 million in the quarter. Same-store margins were up 7%, although sales were roughly flat year over year. The same-store metrics remain slightly higher than our average per store month metrics, which reflect the same geographic mix and ramp up to new stores opened in the back half of 2015.

I would add that our store managers and staff have been dealing with a lot of changes at the store level, both with a new supplier, as well as the full scale rollout of the labor model in the second quarter, and we saw that that impacted upselling on sales at the margin.

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Turning to the cost side of the equation, our average per store direct operating expenses were down 0.9%, reflecting a 2.8% decline in labor cost as the store label model was rolled out in late Q2. Offsetting this benefit was an acceleration of maintenance costs for refresh initiatives as compared to the second quarter of last year. As a result of continued improvements on both the margin and cost side of the equation, our fuel breakeven margin has declined significantly in the second quarter to $0.0145 per gallon, down just under $0.01 per gallon from a year ago.

The fourth point is our initiatives to improve and scale efficiencies at the corporate level continue to evolve. As I mentioned last quarter, we completed the successful reorganization of our finance and accounting groups to help create a more streamlined organization. We are executing tax efficient handling of gains from asset sales utilizing like kind exchange treatment, and along with other ASaP initiatives, we are creating a leaner, more capable and scalable support structure. We are in the process of rolling out our new store accounting software to the field after upgrading the system at our home office last quarter.

We are also launching new growth initiatives at the corporate level, including the August 1 reintroduction of our proprietary Murphy USA Visa card, which offers an introductory $0.10 per gallon discount through the end of the year. This offer appeals to the consumer segment who favors immediate cents-off discount and complements other card offers we have at our stores. These four points of our value formula support our strategy to drive organic earnings growth, and we are excited about the results we achieved so far in 2016 and the momentum it creates for the full year.

The final point is we continued our capital allocation program in a ratable matter manner. During the second quarter, we bought back 244,000 shares at an average price of about $70 per share. Our study share buybacks have provided a consistent boost to earnings per share, and we expect to continue our capital allocation program in a manner that will accommodate both organic growth and shareholder returns. We ended the quarter with a strong cash balance of nearly $310 million, including $54 million of restricted cash, which will allow us to continue this two-pronged capital allocation strategy.

I will now turn it over to Mindy for a closer review of our financial results, and I will touch on some additional topics before opening the call up to Q&A.

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

Thank you, Andrew, and good morning, everyone. As Andrew mentioned, net income for the quarter was $46.3 million or $1.17 per diluted share. Total revenues were $3 billion in the quarter compared to $3.5 billion in the year ago period. The decrease in revenues was caused primarily by lower fuel prices, partially offset by an increase in store counts. Adjusted earnings before interest, taxes, depreciation and amortization, or EBITDA, was $108.6 million, up from $73.6 million from the prior year quarter, attributable largely to higher fuel and merchandise margins.

The effective tax rate for the quarter was 37.5%.

Moving to debt, as of June 30, our long-term debt totaled $648 million, reflecting increased borrowings due to the reinstated $200 million term loans that we put in place in the first quarter. The term loan carries a four-year term and a 5% per quarter amortization provision, the first payment of which was made on June 30.

Our ABL facility is capped at $450 million and is subject to a periodic borrowing base determination currently limiting us to $183 million. And at the present time, that facility remains undrawn.

Cash and cash equivalents totaled $254 million at June 30, along with $54 million of asset sale proceeds held in escrow for like kind exchange treatments. Including cash and restricted cash, net debt at quarter end is approximately $370 million. During the quarter, we repurchased 244,000 common shares for $17 million at an average price of about $70 per share under the previously announced program of up to $500 million to be completed by the end of 2017. Shares outstanding at the end of the period were approximately 39.2 million.

Capital expenditures for the quarter ended were about $70 million, which included approximately $54 million for retail growth, $10 million for maintenance capital, and the remainder for corporate expenditures. We expect full-year 2016 capital expenditures to still be in the range of our previous guidance of $250 million to $300 million.

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

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

Thanks, Mindy. The industry we operate in remains highly competitive and is subject to dynamic challenges, both within from competitors and externally from other sources, including regulations. These challenges require a great deal of focus, innovation, and execution to navigate in the short term, while staying focused on our long-term goals.

We are currently monitoring and preparing for potential impacts to our business on a number of fronts, issues such as the increase in the non-exempt overtime salary level under the Fair Labor Standards Act or the imposition of EMV at the dispensers requires detailed analysis and a thoughtful response given the mix of formats and geographies in our network. We have been actively developing our response to these and other challenges which have cost and capital implications.

However, being proactive, for example, with our store labor optimization, not only prepares us to manage day to day under new or difficult regulations to minimize cost to risk, it also generates savings, which helped to offset any cost increases that arise from such changes. This proactive approach enables us to maintain our cost leadership position and our consumer value proposition.

While we will always face similar issues in the future, I believe Murphy USA can continue to win in this dynamic environment with customers, employees and investors because we have the clarity, coherence and consistency of strategy that has served us well since the spin and will drive shareholder value as we execute our independent growth plan. We remain excited about future opportunities to innovate and push the boundaries of our business model.

Thank you and, with that, we will open it up for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Chris Mandeville, Jefferies.

Chris Mandeville - *Jefferies LLC - Analyst*

Great quarter. Andrew, if I could start just as it relates to Q3 trends that we have been observing thus far, it sounds as though the decline in fuel prices is positively affecting consumer trends. We know that Powerball, I believe, was a top five jackpot in the quarter. And so I'm just kind of curious if you could kind of comment or give a little bit of incremental color as it relates to consumer trends on in-store sales this quarter.

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

Great. So, as prices fell off -- as fuel prices fell off in June, we saw same-store comp improvements across all our regions. We continue to see that strength in July. So that is great for traffic.

Clearly, we saw in January with the $1.5 billion jackpot that had significant traffic to the stores and we had significant increase in lottery sales and other categories, and so we continue to see very, very strong performance from jackpot and the spillover effect to other categories as well.

So, on that basis, we continue to see strong traffic. As we said before, the mix of stores in 2015 had a higher concentration of Midwest stores, and so we will still be seeing some average per store month versus same-store differential in the third quarter, but we expect to see that begin to dissipate over time.

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Chris Mandeville - *Jefferies LLC - Analyst*

Okay. And then, you noted seven of your 10 raze and rebuilds are now up and running and driving better volumes. But, did those raze and rebuilds actually impact Q2 at all, or is that an effect that we will see in Q3?

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

Very limited impact in Q2 because they were down for most of the quarter. They started coming up in Q2 and ramping up, but you will see that impact in Q3.

Chris Mandeville - *Jefferies LLC - Analyst*

Great. And then, I guess, one for Mindy here very quickly. In terms of the merchant margin contribution breakdown, is there any way to kind of split that out between the likes of Core-Mark and maybe better promotion or sales mix?

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

Well, we haven't been giving what the particular Core-Mark effect is, but as you saw, our margin expanded again this quarter. What we can tell you is we would expect for the remainder of the year for our margins to normalize more in the 15.3%, 15.4% kind of range as this quarter's margin was particularly high due to some one-off rebates that we don't expect to repeat.

Chris Mandeville - *Jefferies LLC - Analyst*

Okay. So there was a few one-timers in there?

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

There were.

Chris Mandeville - *Jefferies LLC - Analyst*

Okay. And then, lastly, I guess just maybe looking long-term and keeping in mind that the last two years you had some pretty good tobacco volumes helping generate solid gross profit dollar growth on a per site basis, but, Andrew, can you help us put into context or think about what a more normalized annual merchandise margin dollar growth rate would look like longer term?

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

Yes. So one of the things with the improvement that we are seeing, we are seeing growth of new stores, the mix of stores continues to change. The Core-Mark benefit will obviously be comping next year. Super Coolers will have more one time on those. The refreshes will continue.

So, in this 7%-plus range is something that we are seeing on a pretty consistent basis. I mean, Q1 was definitely a strong number, but we have got a lot of initiatives. Some of those -- like Core-Mark, as I said, it will be comping against itself next year, and at some point you do run out of Super Coolers and refreshes and the like. But, as long as we continue to grow the mix of new stores, we continue to innovate around promotions and pricing and various other impacts, we believe that we can continue to innovate in the store as well. And even with declining categories like cigarettes, you continue to see manufacturing price increases and the like that continue to generate margin dollar growth year over year on existing stores.

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Operator

Bonnie Herzog, Wells Fargo.

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

Andrew, I do have a quick question on something you just mentioned regarding cigarette pricing. You did, it sounds like, pass on some of the manufacturer price increase in the quarter. So could you touch on that a little bit further?

And then, in terms of the uplift you might have seen in margin, was that also driven from mix? I'm just trying to get a sense of if you saw consumers uptrading to the more expensive cigarettes or premium brands.

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

Right. We continue to see that trend, Bonnie, and I don't think there was anything unique about Q2 on that front. I think the most notable thing I would point out around in cigarettes is you have got a couple of states -- Tennessee and Louisiana, in particular -- that have had sustained increases in the heat of the minimum markup or the taxes. And when you see that, you do have higher gross margins, but you do see a more precipitous falloff in volume in one or two states like that. So we continue to price each store appropriately for the market and balance the margin volume trade-off, knowing the systemic declines you would expect in cigarettes.

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

Okay. That makes sense. And then I have a little bit of a different question on your raze and rebuilds that was asked earlier. I could you remind us of your expected return on your raze and rebuilds and then the incremental sales you expect to generate from these, and then could you compare that with the average expected return from your new store builds? I guess I am trying to hear from you what is the greater priority and opportunity.

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

So, on the raze and rebuilds, these are locations where we have very small kiosks where we have significant available land underneath that to expand and the economics warrant a complete raze and rebuild as opposed to just a refresh.

We started with some of the highest volume returns that were just simply underpumped. I mean we had stores that were delivering 500,000, 600,000 gallons out of four to six pumps. And so with a larger number of dispensers, diesel at every pump, coupled with that 1200-foot small store versus the kiosk, you basically have gone in and replaced everything.

The returns on those are going to be more in the 20% to 30% unlevered after-tax range because they are just fantastic stores. And if you went out and built -- found a location that looked just like those today and built a store, you would get exceptional returns as well. Obviously, there is a finite number of those where all the conditions around the current format, the available land, the baseline economics to do reinvestment add up. We are going to do those in a ratable, and we have talked about doing approximately 20% next year.

I think the returns that we have shown in our pro formas on the analyst report, et cetera, are in that 12%-plus range on an after-tax unlevered basis. I will add, none of those returned metrics include our products -- any product supply in wholesale uplift associated with that. So, if you allocated the $0.025 to $0.03 margin that we get across our network on average to one of those stores, you would have significantly higher returns than that.

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So we know that we need to continue to add new stores, and there's opportunities and we are going to do those with our independent growth plan in markets where we can generate those high returns, but we have got to continue to reinvest in our network, and raze and rebuilds is just a part of that.

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

Okay. That's really helpful, and it makes a lot of sense. And then the last question I was hoping to touch on PS&W. I was hoping you could drill down a little bit more on a contribution in the quarter. It seemed like an anomaly given how how healthy it was and above your annual guidance. So maybe you could walk through for us the specific contributions from, say, the transfer wholesale and any timing variances, just to give us some insight on current market conditions and how that -- or they may lower on your Q3 PS&W contribution?

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

Sure. And, by the way, if you noted the $0.059 on a retail equivalent to basis compared to $0.05 last year, which was above the trend, and so, look, I think this is one of those areas in which I would ask everyone to remember to do two things.

One is, always look at it over any rolling 12-month period because you are going to have the rising and falling price environments. And so when a rising environment the way inventory transfers to cost of sales creates a positive benefit, just like it did last year and you typically see a rising environment in Q2. You typically see a falling environment in parts of Q3 and Q4 and in Q1 a rising environment. So you can't just look at a quarter. You have got to look across any 12-month period.

The second thing I would say is, after relationship between RINs and the spot prices in the market and the wholesale prices in the market need to be considered together. The spot to wholesale price differential has decreased during this period of higher RINs on a pretty significant basis where the difference in the two is sort of the net that we are looking at.

So people shouldn't get overly excited in our earnings if RINs are at $0.90 versus $0.50 because you see that impact in the trade-off because spot prices are higher, and that is something, I think, the EPA and RSS anticipated. So we haven't been -- even though we track them separately and report them separately for transparency purposes, we have consistently encouraged people to not look at those as purely additive. So you have to look at all of that in combination.

Our transfer to retail kind of absent the impact of the RIN does benefit from periods of tight market conditions, and so we saw more pipeline maintenance activity in allocation along Colonial in Q2. We saw the ARBs open more in Q2. And so that tight supply environment does positively impact our business in those proprietary barrels as well. And so that was more favorable in Q2 than in the prior year period.

And so this is one of these topics we could just keep going on. There is a lot of (multiple speakers) there. But I think the key is, look at it over any 12-month period, on a rolling basis, and look at it in its totality.

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

Got it. No, that makes sense, and I know we discussed this quite a bit so that was helpful. I appreciate it.

Operator

Matthew Boss, JPMorgan.

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Matthew Boss - *JPMorgan - Analyst*

You did a really good job of keeping store expenses in check this quarter. Can you just update us on where you stand today on your ASaP initiatives, and have you embedded any increase for wages over time into your back-half guidance and estimates?

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

I can speak to ASaP. As you know, we are currently in year two of our three-year timeline, and some of the benefits from ASaP were already embedded in the 2016 guidance and also in our corporate goals. And we are already starting to see those appear in the quarterly results, and those should be amplified as we go through the third quarter and through to the end of the year.

So we are still expecting to generate approximately $50 million of recurring benefit this year, primarily from the rollout of Core-Mark, that transition, as well as the store labor model. And then we also, on top of that, expect to reduce working capital by about $15 million throughout our chain by implementing more efficient inventory practices.

So that guidance remains consistent, and you won't see that appearing all in one place. It will be reflected in expansion of merch margin merchandise, reduction in site labor costs, as well as an expansion of our anticipated fuel margin. So it is not all in one place, but it is all embedded within our annual guidance.

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

Yes. One thing I will add, on labor rates, we have actually been able to hold total rates fairly constant in part because of mix. And so with the store labor model, we optimized the number of assistant store managers. We have lead cashier positions that we are creating. And so we are balancing that out across the roles, and that is helping on that front.

In terms of over time, if you're speaking to the specific FLSA regulation that is kicking in December, we do not expect a material change in December overtimes. And then, as we develop our plan, for 2017, at present we would expect that any increase associated with that can be offset by other improvement levers that we have available to us.

Matthew Boss - *JPMorgan - Analyst*

Great. And then how do you think about timing your share repurchase? What was the rationale for the slowdown in activity this quarter? And if RINs remains at today's elevated levels, could we expect access free cash flow to go towards share repurchase?

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

To answer your second point, I would repeat what I told -- answered Bonnie's question. If we have continued high RIN prices, we would expect to see it continue to offset the differential between the spot and rack prices in that part of the business. And so it is going to be -- there is a positive net increase for that. We have got to continue to evaluate what that is and how much of that is just invested in additional capital. That goes into adding E-85, E-15 dispensers, et cetera, to support renewable fuels.

In terms of the timing, we were clearly aggressive in the prior quarter coming out of the launch of the independent growth plan and put a major dent with the $150 million share repurchase. And so we took a more measured approach. We started the program late in May, so there were not -- there wasn't as much time in the quarter for that. But we continue to be in the market with the program and set parameters. And, clearly, if the stock has had a major run up, if you set some of the parameters, you may not be buying as many shares under certain tranches of the program.

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Matthew Boss - *JPMorgan - Analyst*

Great. Best of luck.

Operator

Ben Bienvenu, Stephens, Inc.

Ben Bienvenu - *Stephens Inc. - Analyst*

Congrats on a nice quarter. If I think about your -- you guys have talked about your new store opportunity co-locating Murphy Express stores near high-traffic Walmart areas. If I think about -- so if I think about the Little Rock market, there is a Murphy Express store that is going up, maybe a half-mile away from the nearest Walmart. It sits on a nice corner in front of Target and Home Depot. So a nice high traffic area. Is that the type of site that we should be thinking about as a potential Murphy Express site that may be in your future pipeline, or should I think of that as something beyond that type of store set opportunity?

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

For those of you on the call who don't have Ben's benefit of getting to Little Rock or Arkansas, for that matter, on a regular basis, this is going to be a 3450-square-foot store. And so, as we said before, we are building a handful more of those a year in selected markets. You typically have seen those in Arkansas, Louisiana, Colorado and a few other markets. And so we continue to do that in markets where we think that offer can be distinctive and competitive and meet consumer needs, and frankly, it keeps a foot in the door on the bigger box model.

The predominance of the Express stores you should expect to see are the 1200-square-foot models within the halo effect of this demand aggregator of price-sensitive consumers, and that will be the predominance of the mix.

Ben Bienvenu - *Stephens Inc. - Analyst*

Okay. Great. And then, if I could just ask a question on RINs. I know this is always a difficult question to answer, but RIN prices are obviously very elevated subject to whatever the mandate might look like -- the formal mandate in November. But I think it is fair to say your annual guidance range for RINs is going to look to be quite low. How do you guys think about the RIN market? Do you care to hazard a guess around what you think prices may look like going forward and how sustainable this price level is?

And then, secondarily, I think if I recall, you guys had held over some D-4 RINs that you had not sold. I was curious if you still have those in inventory or if you have sold those?

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

So, won't hazard a guess on future prices. I will go back to the discussion we had in February around the guidance where we gave guidance of $0.30 to $0.50 on the RIN, but we also gave guidance, I believe, of $0.25 to $0.45 on product supply in wholesale. And if we said if RIN prices were above that, we would expect our contribution from product supply and wholesale to be lower because there's direct offsets there and we continue to see that with elevated spot prices and the spot to rack price differential being compressed. And there are days where that spot to rack differential is negative several cents. And it encompasses 100% of the RIN value at that time.

So, again, want to be very, very clear, the guidance holistically gets you to about $0.025 to $0.03 incremental contribution from our proprietary sourcing and spot contract barrels. And we could just put that in our fuel margin instead of reporting $0.11 margins this quarter. We could have reported $0.16 margins, but we had broken that out historically. We did that at the spin. We continue to do that from a transparency standpoint,

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but there are offsets within that. And so, if we continue to see higher RIN prices, we would expect to see higher spot prices and compression in the spot to rack differential that becomes the basis of the transfer price.

Ben Bienvenu - *Stephens Inc. - Analyst*

Okay. Great. Thanks for that explanation. And then just one last one, if I could. Andrew, you mentioned the Visa cents off program for your card that you have coming in place. Should we expect a similar reaction to that program that we have seen from prior seasonal cents off programs that you would do in concert with Walmart, or is that card user base proportionally the same or smaller?

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

So we are three days into it. I will tell you that the number of card applications is -- on a daily basis is greater than what it was on a monthly basis before because it had not been a priority to promote that when we had a very attractive cents off program with the prior card that was available.

Our market research shows that more consumers that shop at our stores prefer an immediate cents off discount, and so we would expect to see those consumers gravitate towards that card and that offer, which will be great and continue to drive traffic to our store and the store behind it as well. So, basically, replacing an offer that was there, while maintaining other cards that provide different types of discounts.

So we do expect to see some uplift there, but it is really too early to tell.

Ben Bienvenu - *Stephens Inc. - Analyst*

Okay. Thanks and best of luck.

Operator

(Operator Instructions) Ronald Bookbinder, Coker Palmer.

Ronald Bookbinder - *Coker and Palmer Investment Securities, Inc. - Analyst*

Congratulations on a nice quarter. While you talked about an increase in fuel prices drives a decrease in volume, but given the positive miles environment, are you losing market share, are people less price sensitive, and how do you look at the volume versus margin in this current environment?

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

If you think about consumer behavior, there are some consumers that will always say, I am going to drive out of my way two or three miles to get an extra $0.01 or $0.02 off. And those dedicated, loyal price-sensitive customers are loyal customers, and we can kind of count on them day in and day out.

If the differential to the surrounding area in a rising price environment compresses and the reason it would compress is that the branded marketers are only selling one or two tanks of fuel a week because they are high-priced low-volume stores. And so not having their tanks replenished as often, meaning their cost of inventory in the tank is lower than someone who is turning their tanks every single day like Murphy USA or other high-volume retailer, and so being aggressive and holding a $0.10 differential, say, to the state average in a rising price environment would mean that you would be given away significant margin with little volume upside, it would be an economic to do that.

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So, as that as that differential closes, you maintain your very loyal customer, but there is a customer on the margin that says, I am going to go out of my way to buy the lowest price, but you know what, if prices get within some range, I am not going to be as price-sensitive on the margin.

The other thing we note is in very high price environments, the number of price-sensitive customers goes up, and in very low price environments, people don't go as far out of their way on the margin. So, if you break it down into the relative price sensitivity of customers, you can explain and see how in a rising price environment, you shed a little volume. The cents per gallon you would have to put on the street to keep that volume would be lost on every customer, and it would not be economic to do so.

In a falling price environment, where you are typically starting with very large margins, you can afford to put an extra $0.02 to $0.03 on the street and pick up the additional volume across the stores and the customer base. And so that is how we think about it, and we look at a month like June when we have same-store comps that are positive in every region. That kind of reinforces the view that you shed a little on the way up, you pick it up on the way down.

As it relates to total market share, we have been consistently growing total volume at the network level at or above the level of total volume growth in the markets that we are in. It is largely done by adding new stores.

And so, as we add new stores, we are taking volume away from competitors, but other advantage retailers add new stores as well, and they take some volume away from us as the high-volume retailer opens within a mile of one of our stores.

But, from a market share standpoint, we have been consistently growing market share year over year.

Ronald Bookbinder - *Coker and Palmer Investment Securities, Inc. - Analyst*

Okay. And do you see the Company or the industry moving more towards E-85, and how do you believe that would impact RINs and fuel profits?

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

So the journey toward E-85 has been very steady. It has obviously started with a small base, but it is continuing to grow. It is growing more in certain states where there are maybe additional incentives or in the corn belt in those areas. There are a number of retailers out there that, including Murphy USA -- that have been adding E-85 and E-15 to their stores, and if you look at any of our new stores, they have the flexibility to add enhanced renewable fuels, including the bio diesel at every dispenser. And so that is one of the things that we continue to look forward to.

Consumer adoption varies in different geographies, and I think that is another thing, when you talk about the value of the RIN, depending on where ethanol is priced relative to gasoline, if ethanol is higher than the price of gasoline, the way you will consistently drive volume towards E-15 and E-85 is to use that RIN value to lower the street price to create adoption. And so an E-85 where there is lower energy density needs to be priced below an E-10 on a consistent basis to drive that consumer adoption, and that is what we do.

Ronald Bookbinder - *Coker and Palmer Investment Securities, Inc. - Analyst*

Okay. And lastly, you mentioned new pricing promotional effectiveness. Could you add some color on that as to exactly what the program is, what categories it is focused on, and how many basis points of margin improvement it drives?

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

So the promotion's effectiveness really cuts across every single category, including fuels. It is just taking a much more analytical-based approach to our promotions. And so having built that capability last year, it is just a new mindset towards evaluating on the front end, what is the expected

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breakeven of the promotion, how should we think about pricing it, what is the level of vendor funding to make it attractive, what might be incremental labor be associated with that product, damages, signage costs, et cetera.

And so it is just taking a much more analytical and comprehensive view of it. And when you think about, for example, some of our candy promotions, they may drive anywhere from a 500% to 1000% uplift on units. So making sure that the pricing and the inventory availability and all that is there in place to make it an economic program versus just driving more units and volume is key.

So that has been pretty systematic, and it has been improving contribution $2 million, $3 million, $4 million a year to the bottom line. So that is kind of an example of that. Around pricing, again, it is just being more systematic with some of the talent we have been able to hire and some of the tools we have been able to develop to just measure elasticity and cross elasticity across individual items and baskets to get better overall economics from that.

And so if you look at the total year-over-year improvements we have had, a portion of that is obviously from new stores, and a portion of that is obviously from Core-Mark and other investments like Super Coolers. But a significant amount of it still remains from pricing and promotions, merchandise mix, optimization that we do. And we believe we still have more opportunities on that front.

Ronald Bookbinder - *Coker and Palmer Investment Securities, Inc. - Analyst*

Okay. Great. Good luck in the new quarter.

Operator

Damian Witkowski, Gabelli and Company.

Damian Witkowski - *Gabelli & Company - Analyst*

A few quick questions. Just going back to the market share on the fuel side, forgetting how you get to the negative [1.3] on the same-store sales basis, based on what you decided to do on pricing, do you have a sense in terms of looking at your markets under current economic conditions if the overall volume are actually positive and growing in those markets?

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

So we get data and it lags from various agencies, et cetera, that give us a really good sense of this at the state level, being able to break it down to specific store levels as pretty difficult. We do have models that help us understand relative performance across those markets. And so, for example, some of the variables we look at are population density, population growth, et cetera.

And so if you evaluate those markets using census data, if you know the population is declining and becoming less dense and other factors in rural areas are negative, you would expect to see that market declining in volume. Now, we may actually pick up volume because a couple of very weak stores end up closing on the margin, and we pick up that volume.

So we understand it the state level and the changes there, but getting it down to a local market area would be pretty difficult.

Damian Witkowski - *Gabelli & Company - Analyst*

Okay. But, on the state level, is there an answer on that, or is it positive on average, or is it also too difficult?

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

Well, we are growing market share on average across the states we are in. There are certain states that have a greater level of competitive intensity. In those states, depending on the number of stores you add, you may actually be losing share in those markets. If you are not growing in certain Midwest states at the same rate in the future and others are growing maybe with a different type of model that is less fuel dependent, they may pick up share in that market relative to you.

Damian Witkowski - *Gabelli & Company - Analyst*

That makes sense.

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

Certainly, in markets like the Southwest and Southeast that are very, very strong markets for us, we see very positive trends there across our stores and the states as a whole.

Damian Witkowski - *Gabelli & Company - Analyst*

Okay. And then, just going back to your comment on the stores in the Midwest -- the new stores that are performing below the Company average, and you say that one of the remedies is the new Express stores, and I am not sure if I followed that. Is that because they are geographically indifferent out of the Midwest, or is it because they are just down on a different corner so that it will actually help them kind of be at par even above the Company average in terms of volume?

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

It is a really good question, Damian, so there are two things that we talked about. One was the timing of the new build. We had 44 locations open in Q4. Q4 is not a great time to open stores for us. It is kind of lower volume. It is typically going into Q1 and Q2. It is a rising price environment. It is harder to be more aggressive with your introductory price. And so having in the future more control over the timing of when we can start construction on a store that we will have with our Express stores, as well as them being able to load level those throughout the year will result in a favorable comp because in the future because we will have more stores opening in Q3, which is typically a falling price environment, and so you are just going to be further along in your ramp up in the future.

So that is kind of point one. There is a timing impact there on the USA sites where you had more constraints about when you could open versus the Express model where you have a much greater degree of control.

The second point is the mix. And so when we took a portfolio approach towards the stores, you are going to have in your mix great stores, good stores, average stores, weak stores and some very weak stores. The 2015 build class had a lot more Midwest stores, which historically have underperformed. In that 44, 22 were in the Midwest. And so there are some great stores in the Midwest, and out of those, we opened some great stores.

But with our Express model, we know what are the markets and the geographies and the conditions that separate good and great performers from weak and very weak performers, and we will not be acquiring on our own in the Express independent growth model weak or very weak locations. And so the rationale that we provided this quarter about the timing and the mix should have an equal and opposite effect in future years under our independent growth strategies.

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Damian Witkowski - *Gabelli & Company - Analyst*

Okay. And then, just lastly, Andrew, if you can just help me think through the over time pay issue? Just looking at -- I mean, I assume it affects everyone, so your competitors are going to be affected just as you are. And then, considering your cost structure, would you honestly be at an advantage versus your competition?

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

So there's a couple of ways to look at it. One is, our business model is simpler than take one of the big-box store models that has 7000-square-foot stores. I ventured a guess that every manager that would fall under this regulation who is a potential exempt employee at a big-box store is making well over $47,000 a year in salary. And so I would think those exempt store managers at those bigger stores are probably less affected than we would in our simple model.

That said, the majority of our store managers are within a breath of getting to that number when you think about changes like the annual merit increase and reallocation of other benefits that we pay out in cash form that are not considered salary. So we have got levers that can get the majority of the stores very close to that.

What we have that is probably different than many of the competitors is a high number of kiosks in rural geographies where the average wage rate is 5% to 7% to 10% below the national average. And so the number established by this regulation doesn't take into account geographic pay models. And so there is a subset of our stores where there is a gap, and that is where we are evaluating what is the best approach to do that.

What I will say is our store manager turnover rate is exceptional in part because we have benefits like 401(k) and others that many other retailers do not have. And so I think we have been, as a Company, able to have good retention because of benefits. Unfortunately, some of those benefits don't count in the way this regulation is designed.

So we want to be thoughtful about how we comply, both from a cost and economics standpoint, but even more importantly, from an employee engagement and retention standpoint.

I will tell you there are other levers that we have that have nothing to do with salary or pay related to face the next wave of store labor optimization. That could more than offset any incremental costs that we have. And so there may be some incremental costs. We think it is going to be in the low single digits under any scenario, and we believe we have the ability to offset that through other levers that don't impact employee engagement and retention.

Damian Witkowski - *Gabelli & Company - Analyst*

Thanks, Andrew.

Operator

And I am showing a follow-up question from the line of Chris Mandeville, Jefferies.

Chris Mandeville - *Jefferies LLC - Analyst*

Just a quick follow-up for Mindy. Can you just let us know what was spent on the ASaP program within the quarter? I think you had kind of been at $22 million at the end of Q1.

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

I assume you want both the expense side and the capital side, so I will give you both. For the second quarter, we spent approximately $1.7 million, which was expensed, and another $1.6 million that was capitalized for a total of $3.3 million for the quarter. And that brings us program to date spending of around $26.5 million, of which $16 million we have expensed and another $10 million that we capitalized.

Chris Mandeville - *Jefferies LLC - Analyst*

Great. And then just one for Andrew. I suppose everyone has kind of heard of it already, Dollar General having acquired 41 former Walmart Express locations. That is really a small number relative to your store base. At least it looks from our vantage point, that there is only less than a dozen within a 5-mile radius of you guys. But I guess I was kind of curious about your thoughts there, what you think their intentions are. I know they had tested one out a few years back with Mansfield having run the operation there. But do you consider this just an expansion of their test, or do you think this is maybe an initiative with some staying power?

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

So my knowledge and understanding of the Walmart Express stores that were closed were that they were stores that were kind of in that 10,000-square-foot range. They were in very, very rural markets. When we do our market cluster analysis, they were in kind of our seventh and eight out of eight clusters in terms of the makeup of the markets. And they would have been kind of the markets generally we would have not gone in because of the population density growth and other parameters.

So I would -- if I had to classify them, they are very rural dollar store competitors, and I think that was the intent of the model. And so if they put -- if they acquire a few of them, they have gas in front of them, I don't think it is going to have any significant impact at all. I don't see the dollar stores getting into gasoline in a material way for just core economics focused capability reasons.

Chris Mandeville - *Jefferies LLC - Analyst*

That is what I was looking for.

Operator

Thank you and I am showing no further questions at this time. I would now like to turn the call back over to Mr. Andrew Clyde for closing remarks.

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

Great. Well, thank you for your support. We are really proud of this quarter. We are excited about the initiatives and the ongoing work our engaged team has going on, and we will look forward to speaking to you in another quarter. Thank you very much.

Operator

Ladies and gentlemen, thank you for your participating in today's conference. This concludes today's program. You may all disconnect. Everyone have a great day.

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