

Murphy USA Inc. NYSE:MUSA

FQ3 2022 Earnings Call Transcripts

Thursday, October 27, 2022 3:00 PM GMT
S&P Global Market Intelligence Estimates

	-FQ3 2022-			-FQ4 2022-	-FY 2022-	-FY 2023-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	7.01	9.30	▲ 32.67	4.03	24.34	17.13
Revenue (mm)	6003.92	6194.70	▲ 3.18	5647.00	23536.14	23266.83

Currency: USD

Consensus as of Oct-24-2022 6:35 PM GMT

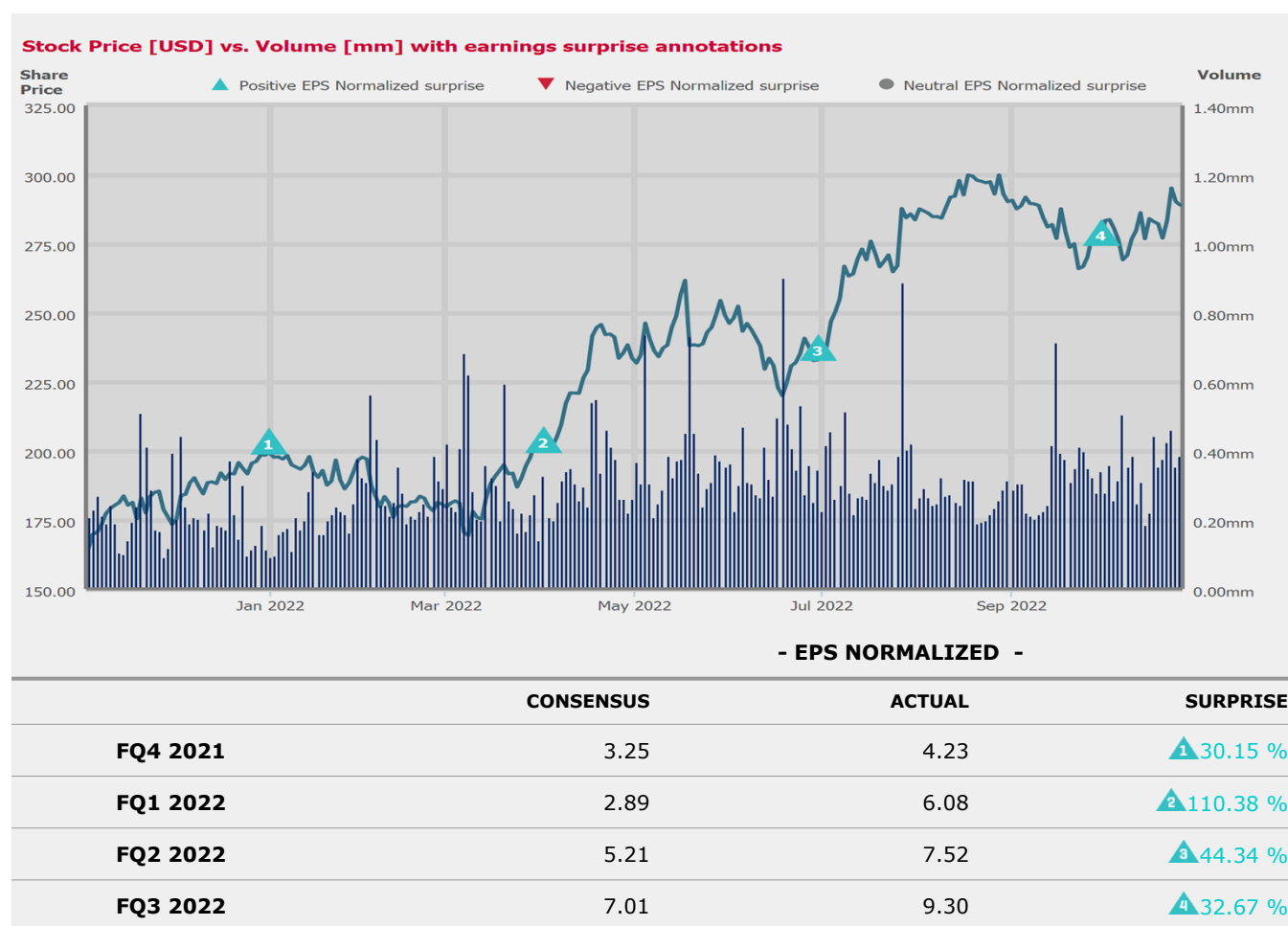


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Call Participants

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Robert Frederick Dickerson

Jefferies LLC, Research Division

Presentation

Operator

Good morning. My name is Emma, and I will be your conference operator today. At this time, I would like to welcome everyone to the Murphy USA Third Quarter Earnings Conference Call. [Operator Instructions]

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

Christian Pikul

Vice President of Investor Relations & FP&A

Great. Thank you, Emma. Good morning, everyone. With me, as usual, 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 we'll open up the call to Q&A. Please keep in mind that some of the comments made during this call, including the Q&A portion, will be considered forward-looking statements as defined in the Private Securities Litigation Reform Act of 1995. As such, no assurances can be given that these events will occur or projections will be attained. A variety of factors exist that may cause actual results to differ.

For further discussion of risk factors, please see the latest Murphy USA Forms 10-K, 10-Q, 8-K and other recent SEC filings. Murphy USA takes no duty to publicly update or revise any forward-looking statements. During today's call, we may also provide certain performance measures that do not conform to generally accepted accounting principles or GAAP. We have provided schedules to reconcile these non-GAAP measures with the reported results on a GAAP basis as part of our earnings press release, which can be found on the investors section of our website.

With that, I'll turn the call over to Andrew.

R. Andrew Clyde

President, CEO & Director

Thank you, Christian. Good morning, and welcome to everyone joining us today. Third quarter results clearly demonstrate that the earnings power of our business has been and we expect will continue to be sustained throughout a variety of different macro and economic environments and business conditions.

Looking back over the past 3 years, we performed well during the onset of the COVID-19 pandemic. Successfully navigated supply chain challenges during the early period of the recovery and widened our advantage in the most recent period of higher cost and inflationary wage pressures.

We have prospered during periods of sharp rising product prices that threatened broader consumer spending. And in the most recent quarter, delivered strong financial results as prices fell and interest rates rose.

If our advantaged business can thrive across these varied macroeconomic environments, each characterized by unique challenges and opportunities. We remain confident in our ability to perform if the economy worsens or if we embark upon a period of economic recovery. Our distinct model and enduring strategy have served our shareholders well, and we see no reason to believe the future will be any different in Murphy USA.

Affordability matters and we are clearly seeing the benefits of our everyday low price strategy in our third quarter results. On a same-store basis, Q3 gallons were up 9%. Tobacco margins were up nearly 6% and non-tobacco margins were up nearly 9%. Powerful proof points that our low price offer is resonating across categories, resulting in volume growth and market share gains.

The QuickChek offer also continues to resonate with customers as it delivers high-quality food and convenience items at value prices. We continue to invest in our customer value proposition at QuickChek

and grow in the markets where it has already earned a loyal customer base and valuable brand recognition.

This strong in-store performance amidst a challenging and uncertain economic backdrop further solidifies our view that for most consumers, a trip to Murphy USA represents a largely non-discretionary occasion, a trend that we are seeing continued into the fourth quarter.

Our affordable offer continues to be underpinned by the low-cost DNA of our organization and our efficient operating model. While higher costs have impacted both our business and other industry operators, we continue to be advantaged from a labor perspective. The operating expense comparisons are beginning to moderate as we start to lap some of the targeted wage adjustments and other inflationary impacts over the last 12 months.

OpEx at the store level was up 6.4% for the quarter, including roughly \$4 million of special incentives to our store associates. We cannot be more pleased with the impact of this appreciation program, which increased the engagement of our associates and allow them to do what they do best, serve customers, drive merchandise sales, and recruit like-minded new associates.

As we exited the summer, store-level engagement has maintained at a high level. And while staffing remains a challenge for the industry, we have seen a positive impact on recruiting in applicant flow in recent months.

Alongside these short-term investments in our affordable offer and operating model, we continue to prioritize disciplined capital allocation as we think about long-term investments.

Our organic growth program continues to be the single most impactful driver of long-term sustainable growth in EBITDA and earnings per share.

I'm pleased to report that we are on track to deliver between 40 and 45 new stores in 2022 and expect a similar level of activity in 2023.

Importantly, all of our new stores are exceeding internal expectations and are incrementally positive to the network averages as evidenced by the stronger APSM versus same-store sales figures in the fuel and non-tobacco categories.

In addition, we are on track to complete 33 raze-and-rebuilds, which replace high-performing kiosks with a larger 1,400 square foot store that features a broader assortment of higher-margin merchandise, better grab-and-go food offer and a more favorable customer experience.

In addition to organic growth, share repurchase remains a key element of our broader capital allocation strategy and underpins our value creation pledge to investors. Given recent performance in our view of the sustainability of this performance, we believe our stock offers a compelling value based on both current and long-term earnings outlook.

We continue to believe share repurchase represents the most impactful use of free cash flow for long-term investors beyond capital allocated to organic growth. As such, we continue to be active in share repurchase, buying back nearly 800,000 shares during the third quarter for \$212 million at an average price of \$276 per share. This amount represents significant progress against the 5-year \$1 billion program, our board approved in December of 2021, and we are currently on track to complete that program well ahead of schedule.

Finally, I would note that while debate and uncertainty continue to exist with respect to the new baseline for long-term fuel margins, the excess cash generated and used to buy back shares over the past 3 years represents real and enduring value to long-term investors with more than 25% of outstanding shares being repurchased over that period.

Investors who have held throughout this period has not only enjoyed significant price appreciation but can expect to enjoy a greater percentage of future earnings and shareholder distributions without having allocated more capital to the Murphy USA investment.

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

Malynda K. West

Executive VP of Fuels, CFO & Treasurer

Thank you, Andrew, and good morning, everyone. Revenue for the third quarter was \$6.2 billion compared to \$4.6 billion in the year ago period. Average retail gasoline prices were \$3.67 per gallon versus \$2.89 per gallon in the third quarter of 2021. Third quarter EBITDA was \$367 million versus \$212.5 million in the year ago period. Net income for the quarter was \$219.5 million versus \$104 million in 2021, resulting in reported earnings per share of \$9.28 versus \$3.98 in the year ago period. And the effective tax rate in the third quarter was 24.5%.

The business continues to generate significant free cash flow, and that is reflected in our cash position. Cash balances did decline slightly to \$193 million from \$240 million in the second quarter or a total net decrease of approximately \$47 million despite capital expenditures of roughly \$78 million and roughly \$220 million of shareholder distributions, including the \$212 million of share repurchases Andrew mentioned in the third quarter.

Total debt on the balance sheet as of September the 30, 2022, remained at approximately \$1.8 billion, of which approximately \$15 million is captured in current liabilities, representing the 1% per annum amortization of our term loan, and the remainder of reduction in long-term lease obligations. Our \$350 million revolving credit facility had a 0 outstanding balance at quarter end and is still currently undrawn. These figures result in gross adjusted leverage that we report to our lenders of approximately 1.5x.

And with that, I will turn it back over to Andrew.

R. Andrew Clyde

President, CEO & Director

Thanks, Mindy. Before taking any questions, I would note that third quarter average per store month volumes not only exceeded 2019 levels but are the strongest since the third quarter of 2016. October performance continues this trend of taking share and growing volumes, which were up high single digits year-over-year. Current margins approximate \$0.30 per gallon, up from about \$0.20 per gallon to start the month.

It's important to note we see recent margins reactive to and reflective of typical volatility related to the up and down swings in product prices. So while some may be tempted to label third quarter retail margins as an outlier, this level may simply be reflective of what the industry can expect in future periods of falling prices and indicative of a higher equilibrium industry structure that reflects the higher cost of doing business for the marginal convenience store retailer.

With that, operator, let's open up the call questions.

Question and Answer

Operator

Thank you. [Operator Instructions] Your first question today comes from the line of Ben Bienvenu with Stephens.

Benjamin Shelton Bienvenu
Stephens Inc., Research Division

I want to ask about the volume growth in the fuel side of the business because it's substantially higher than what we're seeing in the industry. And maybe now that we've seen prices go up and then come back down, I'm curious, one, what's your sense of kind of -- to the extent you have the visibility repeat rate on new customers that you attracted that have maybe stuck around at a slightly lower price environment versus the peak we saw this summer? And then also, who do you think you're taking that market share from?

R. Andrew Clyde
President, CEO & Director

So I think -- Mandy did a great job last quarter kind of explaining what we're seeing in terms of the price environment. We made significant investment over the last 2 to 3 years really refining our pricing playbooks and our capabilities around this.

And what was really helpful is during the rising price period as we saw prices run off faster, we were able to maintain our differential hold on to and gain volume in that rising price period. So when prices fell, we were able to widen our differentials appropriately.

And certainly, the volatility that we've continued to see since the Ukrainian invasion has really caused a great deal of uncertainty in the marketplace. Prices are, on average going up \$0.10, up or down \$0.10, and that just creates uncertainty as to whether tomorrow's prices are going to run back up or not. So it's just been a very favorable environment for us.

The stickiness comes from 2 things. One, lower income consumers are facing challenges. And for our Murphy USA customers, we know this is a non-discretionary purchase. So in a high price environment, they stay with us. And we gained new customers as more and more consumers are impacted by the inflationary trends. So I think as long as we're seeing higher prices, they're going to remain sticky.

I think the second thing is because of the discipline of our pricing, they trust the brand that it will be the lowest price in the marketplace. And then you compound that with the loyalty program that we've established and enhance, there's a great deal of stickiness that comes with that. So I think that bodes well for the future outlook as well.

Benjamin Shelton Bienvenu
Stephens Inc., Research Division

Okay. That makes sense. Yes. And that's a good point. I guess, it's not just the price of fuel is high as the price of everything is high. So that value been from the consumer doesn't go away if fuel prices necessarily roll over a little bit. You kind of insinuated this in your comments, Andrew, about kind of the margins we've seen year-to-date. I mean, is that your paradigm for what you think your new fuel margin looks like on a go-forward basis? Do you think there's some elevated level of fuel margin earnings in your year-to-date performance that will go away as we go forward? Maybe if we could just revisit this topic as I'm sure we'll continue to going forward.

R. Andrew Clyde
President, CEO & Director

Sure. You could go back over any period of time and see a rising price environment like we saw for the first half of the year. And whether you look at our margins relative to those periods, the OPIS data

average industry margins during those periods, and then compare that to the rise in breakeven margin requirements as you've done in some of your analysis Ben, it correlates pretty well, right? And so what we're seeing in the third quarter is just the typical effect of a falling price environment where the supply costs fall faster than the retail margin.

But I'd suggest just doing the same analysis and look at similar periods of steeply falling prices, you could argue that this price fall off was somewhat unprecedented, but we can go back in time in 2014, 2008 and see similar periods there. And just look at the differentials between the margins earned then and the margins earned now. And so it really is that structural difference that's going to be more enduring.

I missed the second half of your question a while ago as to who we're taking share from. I think it is the marginal retailers broadly who continue to find themselves being forced to price up to maintain their break-even. If you look at the OPIS data, that survey of 25,000 to 30,000 retailers that suggests we're down 15% to 18% versus 2019, my guess is, and it's just a guess is that largely represents kind of the average to bottom half of the industry, not the top quartile, high-volume low-priced retailers.

And so I suspect Murphy USA along with similarly competitive peers are the ones taking the share from the bottom half of the market. And then it just creates that vicious cycle where as they lose a little bit more volume, incur a little bit higher cost, lose a little bit more traffic associated with that lost volume, the breakeven inches up. And it may only be \$0.01 or \$0.02 from these levels, but that certainly supports maintaining current levels and indeed, growing that over time.

Operator

Your next question comes from the line of Anthony Bonadio with Wells Fargo.

Anthony Bonadio

Wells Fargo Securities, LLC, Research Division

So I wanted to ask about RINs quickly. Number of RINs you're selling now looks more or less in line with what you were doing before the pandemic, but prices have obviously risen considerably and remain elevated. Can you just talk about just a little more about the underlying drivers there and how sustainable you think that is? And then I know you've guided to that [indiscernible] to \$0.03 per gallon contribution from PS&W RINs over the long run. But is there any reason to think that shouldn't be higher if current price levels persist?

Malynda K. West

Executive VP of Fuels, CFO & Treasurer

Yes, I'll take that question, Anthony. Yeah, RIN values continue to remain elevated, but we continue to sell ratably month-to-month. And so that continues to be a fluctuating piece of our business.

And also, the way we explain it, we account for that in the other income category, and there's an offsetting impact in the spot to rack price that runs through the rest of our PS&W, which is why we say over time regardless of what RIN values do, we expect to make \$0.02 to \$0.03 a gallon.

The fact that it can fluctuate quarter-to-quarter is based primarily on the direction of price movements. And so in a quarter like we saw this one where prices are continuing, or falling, that's more of a disadvantaged environment for our product supply and wholesale just because of the way we account for the timing impact of the barrels.

So in those periods, you will see a decline in PS&W and instances in which prices are running up, you're going to see something over \$0.02 to \$0.03. But on balance, we still expect that PS&W should be able to earn \$0.02 to \$0.03, maybe a little bit more as we continue to optimize and leverage our scale. But on balance, we think that that's where it should land over the sweep of time.

R. Andrew Clyde

President, CEO & Director

One thing I'd add, Anthony, to that is when we see environments in the past, it was often reflective of a longer refinery supply-demand balance, and so you saw more discounting at the rack, and that put pressure on that net number.

The tighter the refinery complex supply-demand balances, the less discounting you're going to see at the rack. And so that is something that can benefit us in the short term. But over long term, as Mandy said, the market gets back into equilibrium. So that's one of the other things to just look at is how tight is the supply-demand balance. And it's probably a little bit tighter than it was a couple of years ago, given the challenges with our energy policy.

Anthony Bonadio

Wells Fargo Securities, LLC, Research Division

Got it. Got it. That's all, it's really helpful. And then secondly, I just wanted to ask about the merchandise gross margins. Can you just talk a little bit more about what drove the 40 bps of expansion in the quarter? And then taking a step back, that 20% number looks like a record for you guys. Is that a better way to think about the earnings power of this part of the business going forward now that you've got the acquisition lap and we're starting to see more stable consumer behavior?

R. Andrew Clyde

President, CEO & Director

It is. So the big upside during the quarter was the non-tobacco merchandise that's attached to the fuel transactions, right? And so that's your higher-margin packaged beverage, center of the store, your grab-and-go items dispensed beverage, and the like that is associated with some but certainly not all of the fuel trips. So with fuel gallons being up naturally those attached to fuel categories performed really well.

And I think as long as we continue to sustain higher fuel volumes, et cetera, those attached categories will remain. And so that 20% kind of resets now with the QuickChek higher-margin business being added to the mix.

Anthony Bonadio

Wells Fargo Securities, LLC, Research Division

Got it. Thanks so much guys and good luck.

Operator

Your next question comes from the line of Rob Dickerson with Jefferies.

Robert Frederick Dickerson

Jefferies LLC, Research Division

Great. So just kind of a basic question. I know we all kind of look at the OPIS data. There's obviously some volatility in the quarter. It seemed like kind of margins had come down a little bit as we got into October, and I realize you stated that's kind of a more general kind of marginal look and maybe it's not for all the -- it doesn't speak specifically to your performance, obviously. But when we kind of look at that correlation that does seem to be pretty strong, I mean, you still did kind of decently better than what that correlation would have suggested over time, even if you go back, I don't know, 7 years. So would you say that there was any kind of near-term dislocation kind of that you saw as you got through the quarter relative to kind of historical average? And is that something that should continue just because of competitive advantage?

R. Andrew Clyde

President, CEO & Director

Yes, Rob, I wish I could help you there. I mean we don't spend a lot of time doing correlations to OPIS data because we're looking at our results every day and know what they are, and the cash that goes into the bank. So trying to model it related to some third-party estimate just doesn't serve significant purpose for us.

I would say the basic fundamentals of the business haven't changed, right? When prices run up, the big difference that we've seen is given the pressure on cost and volumes and merchandise sales, we're not seeing as much margin compression as we did.

And as prices fall, given the volatility that we're seeing in the daily price movements, there's probably greater uncertainty as what's going to happen 24, 48, 72 hours. And so you see a little bit of the different dynamic there. And so that's how we look and explain the market to ourselves. And if that creates a weaker correlation, or a better correlation, or explanation of the difference to the OPIS, I just can't speak to that.

Robert Frederick Dickerson

Jefferies LLC, Research Division

All right. Fair enough. Let me ask, I guess, a different way. So right now, if gas, let's just say going forward, price of gas comes down, right, sounds like profitability in theory assuming there's some decelerated rate on price relative to cost that margin could actually go up from here? Or if the price of gas stays high, you should also be able to retain kind of an advantaged margin going forward in the near term because you're taking share on volume. So kind of a lot in there, but that's all I have.

R. Andrew Clyde

President, CEO & Director

Yes. Look, I mean, this is just a real simple business. If prices rise, margins aren't going to be as high, as prices fall, margins are going to be greater. When prices on an absolute basis are higher, consumers are more price sensitive. And when you're in an inflationary environment like we're in, and they're having to cut purchase elsewhere, they're going to look for more value from everyday low-price retailers like Murphy USA and other similarly competitive low-price brands.

If prices get back below \$2 a gallon, consumers are flush, they're not going to be as price sensitive. So at current levels, I expect that we will continue to gain whole share these price levels, and then we'll just get back to the normal up and down movement of typical volatility in the associated margin environments that we've seen historically.

I think what the big difference is some of the lags and compression may continue to look different than in the past and more similar if volatility continues to hold up.

Operator

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

John Macalister Royall

JPMorgan Chase & Co, Research Division

Can you talk about the underlying trend of OpEx inflation, how that's running when you strip out things like the onetime bonuses and credit card fees. If I did the math right, I think you were relatively flat to 2Q on station OpEx when you strip out the bonuses. So have you seen a slowing of inflation or even that you're actually starting to move sideways at this point?

R. Andrew Clyde

President, CEO & Director

Yes. So we're probably in that 4% to 5% range if you strip out the appreciation bonus. We're certainly lapping some of the salary and hourly increases that we made a year ago as we complete our plan for 2023. We do continue to see that moderating, not only sideways, but a little bit further down, closer to that 4% range.

There are certain costs that maybe we had long-term contracts that we haven't seen as much cost pressure on that will be picked up next year. So we're certainly not looking at 6%, 7%, 8%, 9% cost going forward, but probably more in that 4-plus percent type range. So I don't know if that sideways or down, but that's kind of a near-term view of what we're seeing.

John Macalister Royall*JPMorgan Chase & Co, Research Division*

Great. Thank you, Andrew. And then so just a question on the buyback. I think it was a couple of years ago that you guys had put out some long-term targets. And at the time, I think you were talking about doing \$1 million shares annually. This year, you're pacing pretty steadily, \$700,000, \$800,000 per quarter. So how do you think about the buyback today with, obviously, much better cash flows persisting. Is this kind of a \$2.5 million to \$3 million annually, should we think about that as kind of the go-forward rate number?

R. Andrew Clyde*President, CEO & Director*

Yes. So look, the long run view that we present kind of every year what that raise the bar chart is essentially just posing the question. What do you have to believe to continue to generate compounded annual growth of our share price of 15% to 20%? And the 3 drivers, right, EBITDA growth, shares outstanding, and the multiple given to the business.

And so we've often kind of said, look, if you just achieve the EBITDA associated with improving the business, adding new stores, et cetera, it gets you to a certain sustainable level given a stated fuel margin. Buy back \$1 million shares, get a half a turn or not on the multiple. That allows us to achieve our shareholder return objectives.

And then we've been very clear, organic growth is our first priority and free cash flow. Above and beyond that is going to get assigned to share repurchase. And so I think we've just been doing pretty much what we've pledged investors is that additional free cash flow will be returned to shareholders via share repurchases.

So if we continue to see elevated fuel margins that generate free cash flow above our first growth priority, we will continue to do that. And so we can't predict the future in terms of what the margins will absolutely be but we can provide a commitment of how we will return that excess free cash flow to shareholders.

John Macalister Royall*JPMorgan Chase & Co, Research Division*

Okay. Understood. So it sounds like the \$1 million per year is maybe more like a 4. Okay, thanks very much. Appreciate it.

Operator

Your next question comes from the line of Carla Casella with JPMorgan.

Carla Casella*JPMorgan Chase & Co, Research Division*

How we think of it in the question. We've heard of several of our consumer food companies talk about how the -- there was some strength in -- or an impact of 3Q of the greater consumer mobility. And I'm wondering if you have parsed out or can parse out how much of your Q3 strength might have been from greater consumer mobility versus other consumers just trading down into more value alternatives.

R. Andrew Clyde*President, CEO & Director*

And when you say mobility, are you speaking to back to work?

Carla Casella*JPMorgan Chase & Co, Research Division*

Oh, no, I think more consumer traveling. They've actually commented that during the summer, people were out traveling, so anything that was typically done at home, they sell less out. But then they're starting as people have gone -- as schools have reopened, they're seeing kind of a return to normalcy.

So I'm wondering if you guys saw that same kind of pickup in the mobility travel during the summer, you're seeing as similar slowdown in travel as the schools have reopened.

R. Andrew Clyde

President, CEO & Director

Carla, we can't isolate our traffic at our stores based on consumer travel versus their normal purchases. We know in front of our Walmart Stores, 50% of people are going to or from a trip to Walmart. We know people are trading down into our stores because we are the lowest price, best value out there. But we can't isolate exactly if it's higher summer travel or not. We're seeing the typical seasonality.

But underpinning all of this is probably a trade down effect, which is greater, which is reflected in the volume growth relative to the industry decline. So I would say that's the biggest factor driving the performance is the greater price sensitivity that consumers have around these non-discretionary purchases. And whether there's some discretionary travel in there, and we're getting more than our fair share of that is probably just a reflection of being a value brand.

Carla Casella

JPMorgan Chase & Co, Research Division

Okay. Great. And then just one follow-up on the cost of your raze-and-rebuild on new construction, any change in overall like cost to build, and how we should be thinking about that as we model it in?

R. Andrew Clyde

President, CEO & Director

Yes. We have noticed that there's about a \$400,000 \$500,000 increase in the total cost to build. I mean, concrete is a great example of where costs are up significantly. The good news is when we then look at returns on capital with very, very conservative margin assumptions, we're achieving the same returns or higher as before.

And then as we're seeing new stores come online, they're achieving or exceeding those volume expectations, the consumer traffic at even higher margins. So we are seeing a cost increase that is flowing through, but returns continue to look very attractive even with just very conservative margin enhancements in our capital projections.

Operator

Your next question comes from the line of Bobby Griffin with Raymond James.

Bobby Griffin

I guess, Andrew, first, we've talked about in the past kind of the flywheel effect on the tobacco business as you guys have gained share, others go away from low price, the manufacturer support you more and it kind of drives that flywheel. It seems the non-cigarette business still here picking up that there could be potential, the same things that start taking place going forward there. So just curious, like in your conversations with suppliers and stuff, is there opportunities for more support from them going forward into 2023, given your strength in non-tobacco versus what is likely the rest of the industry not growing nearly as much?

R. Andrew Clyde

President, CEO & Director

Yes. Look, I think there are 2 things that consumer packaged goods manufacturers look for. And I think they see both of them in Murphy USA. One is growing the business, right? And if you think about all these non-tobacco categories attached to fuel, they are growing disproportionately through Murphy USA. And with the traffic down in other brands, you can imagine that others are not seeing the same type of growth and are seeing declines. So that's one thing.

The second is there's just been this bigger movement among some of the C-stores chains towards private label products. And it makes sense for those that have their own commissary those that have their own

supply chain distribution, those that may have a tighter concentration of stores from a network standpoint. But that model doesn't necessarily work well for Murphy USA, especially given, one, our smaller formats. And two, consumers come to us because they trust us that we're going to have the lowest and best prices and value on the best national and regional brands they trust.

And so if you're growing the brand and you're committed to the brands, I think there is the potential, Bobby, for that same flywheel effect where on the margin, manufacturers are going to look at you and say, you're committed. And to the extent the contracts allow, we can provide more support in the various ways they do it. So I think it's a good question, and that's how, certainly, we think about it in the great partnerships we have with these brands.

Bobby Griffin

Appreciate that. And very helpful. And then I guess, secondly, just on the fuel side of the business, like when we look at kind of the daily wholesale prices, you've talked about it a lot, there's just been a high level of volatility in the market. So I guess maybe 2 parts. One, what do you view this, obviously, geopolitical events, but what else could be driving that, and it looks like it could be sticky going forward? And then two, like structurally, that puts you guys, it seems like in a pretty advantaged spot. If that was to go back to normal, would that be something we should account for that? It would give peers back some of the -- that could compete better with you? Or do you think it's just something that it would not reverse hurt the business as much?

R. Andrew Clyde

President, CEO & Director

Sorry, on that second part of the question, it's reverting back to a lower level of volatility?

Bobby Griffin

Yes. Like if we go back to a lower level volatility in the wholesale market and maybe even the PS&W supply market is not as tight, does that correspond with taking away like a pretty sizable advantage that you guys have had here recently because we've talked about how higher volatility really probably puts MUSA even in a more advantaged place versus peers given the optimization you've done on the fuel side and the fact that the smaller players are worried about changing price if it's going to run up the next day. Just kind of curious as what happens in the end market if we go back to something normal even though we haven't seen normal quite yet?

R. Andrew Clyde

President, CEO & Director

Yes. So I think I understand. So look, I think at the end of the day, there's kind of 3 things that you look at. Our price is going up or down, our price is high or low, where customers are more sensitive or not. And then we're seeing higher or lower levels of volatility. And so if we saw a much lower level of volatility in a much greater certainty around price movements, I would expect some of that kind of risk premium where people are waiting maybe 2 or 3 extra days to see what prices are going to do. Some of that advantage could actually go away.

What are some of the things that drive it, right? Geopolitical unrest, global supply-demand balances, right? And you think just around OPEC and the changes that we've seen going all the way back to pre-COVID, the month before to what we've seen more recently with production, cuts versus increases, the refinery complex in the U.S., right, with refineries being taken out of service. Refineries then start running at higher levels of utilization. So they have unplanned outages.

And then when they take their refineries down for planned outages, just given all the challenges, we continue to see unplanned outages come on the other side of those turnarounds. So I don't have a crystal ball with respect to how Geopolitics and the global supply-demand balance for crude is going to play out, but certainly, those challenges are not something that we're in a position as a country to see get resolved anytime quickly.

The logistics bottlenecks that we've seen in the past can continue to create that local volatility. So there are many sources of volatility. And I suspect most of -- all of them are going to be at play for the near to medium term.

Bobby Griffin

Perfect. That's exactly what I was looking for, Andrew. I appreciate the details and best of luck to you in the fourth quarter.

R. Andrew Clyde

President, CEO & Director

Thank you.

Operator

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

Bonnie Lee Herzog

Goldman Sachs Group, Inc., Research Division

Hi, Andrew. I wanted to circle back on something about the small and marginal operators. Just wanted to ask about them in the context of their breakeven margins. You talked about this a bit, but clearly, you and other large operators are benefiting from the structural change we're seeing in this industry as these small operators breakeven, margins have gone up considerably given the disproportional cost pressures they've been facing. So how are you thinking about this as inflation peaks and maybe some of these cost pressures start to ease for these operators. Isn't there a scenario where small operators breakeven margins start to come down as cost pressures ease, which might result in some pressure to margins for yourself and your peers, just how do you think through that?

R. Andrew Clyde

President, CEO & Director

Yes. So if inflation peaks, that means their annual rate of cost increases is going to stop increasing. But I don't think you're suggesting we're going to see massive deflation where their cost actually come down. So they're going to be stuck with a higher cost structure than they had 5 years ago. That's not going to change.

They've made fundamental decisions about how they think about traffic-driving categories, whether it's fuel or tobacco and you don't even have to get into the marginal retailers. You get into some of the more established second quartile chains that aren't on everyday low-price tobacco contracts, don't have the scale to invest in differentiated loyalty platforms, have accepted, they can continue to raise prices and lose volume but maintain a level of profitability.

You don't invest in your stores, so your sustaining maintenance either goes up or if you don't invest in it, it erodes the perception of quality at that store and it goes down. So I don't think that inflation moderating at 4% and even going back to the long-run goals of 2%, 2.5% are going to change their cost structure. I think this is a structural step change that we've seen, and there have been structural step changes in the past.

I think in the shorter time period as we come out of an inflationary in environment, if we continue to see high prices and I suspect we're going to have prices closer to \$3 or higher than prices below \$2, consumers are going to remain pressured, and they're going to continue to seek out value. So I think that's going to disproportionately benefit the low-price retailers versus the higher-priced retailers.

I think the other thing is if you think about the structural change that's taken place, the annual increase to their breakeven is going to be much smaller than this kind of step level change that we've seen. And so the ability for retailer to pass through an extra \$0.01 or \$0.02 or \$0.03 per year when you see prices running up or falling by \$1 a gallon is not something that they're going to hesitate to do because it's going

to be barely noticed by consumers in the spectrum of large price changes. So anyway, so we feel pretty confident about that.

The problem also is that anyone who has ever on everyday low price that got off of it, just finds it extremely expensive and painful to go try to capture that volume because they have to give up so much margin to get down to price points to get that volume back. And those that have maintained that everyday low price position are going to fight to keep it. So I think we're just in a new equilibrium. We've seen a step change in the cost structure for the industry. The increases are going to be much more modest going forward. But I don't think with lower inflation, we're going to see deflation or anything that significantly brings a breakeven lower.

Bonnie Lee Herzog

Goldman Sachs Group, Inc., Research Division

Not even on the margin. I mean, that was helpful. And to your point, yes, I'm not expecting it to go all the way back pre-COVID because I agree. It seems like there's certainly a permanent change, which will help to support. But even slight easing of their breakeven margin should or could change of the dynamic potentially, just in terms of like as you highlighted, the behaviors, right, [indiscernible]

R. Andrew Clyde

President, CEO & Director

Yes. So the formula is real simple. The merchandise contribution is going to have to go up faster than future cost increases even at a lower rate of inflation increase. And then you got to divide that by the volume. So are they going to gain back their gallons? Are they going to gain back their tobacco share? Are they going to gain back their attached to fuel merchandise transactions? Those are the things you have to believe.

Bonnie Lee Herzog

Goldman Sachs Group, Inc., Research Division

Okay. That was super helpful. And then just my final question for you, if I may. It's on your guidance, you didn't really touch on it or update it this quarter, but there's only 2 months left in the year. So curious to hear how you feel about some of your ranges. For instance, your merchandise contribution guidance for the year looks like it might be conservative unless you're expecting, I guess, a meaningful slowdown in Q4? Just any color on some of your ranges would be helpful.

R. Andrew Clyde

President, CEO & Director

Yes. I would say is that around fuel, we're close to the higher end of the range that you can project out. Absolutely on merchandise will probably be above the high end on cost. We're probably closer towards the low end of our adjusted range. SG&A probably close to being in the middle, and CapEx probably just a little bit below the low end of that range as some projects get pushed to the next year.

Bonnie Lee Herzog

Goldman Sachs Group, Inc., Research Division

Thanks again.

R. Andrew Clyde

President, CEO & Director

Thank you.

Operator

This concludes today's Q&A. I will now turn the call back to Andrew Clyde.

R. Andrew Clyde

President, CEO & Director

Great. Well, thanks everyone for joining in. I think as we said in the prepared remarks, third quarter represented a different environment than the ones we've seen in the past. But I think the pattern that we certainly recognize is, is that our advantaged business model, and the capabilities, and the team surrounding it are well prepared to drive this business forward regardless of the macro environment that we find themselves in. We can't predict what that environment will be, but we are confident in the resilience of the business, the agility of our decision-making on the both steps we've taken in the past and will continue to take in the future to move this business forward for all our stakeholders. Thank you, and look forward to any follow-up questions.

Operator

This concludes today's conference.

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