Par Pacific

Second Quarter 2021 Earnings

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CORPORATE PARTICIPANTS

Ashimi Patel – *Senior Manager of Investor Relations*

William Pate – *President and Chief Executive Officer*

Will Monteleone – *Chief Financial Officer*

Joseph Israel – *President and Chief Executive Officer, Par Petroleum*

CONFERENCE CALL PARTICIPANTS

Matthew Blair – *Tudor, Pickering, Holt & Co. Securities, LLC, Research Division – Managing Director of Refining and Chemicals Research*

Jason Gabelman – *Cowen & Co. LLC, Research Division – Director and Integrated Oil, Refiners, and LNG Analyst*

Jake Gomolinski-Ekel – *Ellington Management Group, LLC*

Phil Gresh – *JP Morgan Chase & Co, Research Division – Senior Equity Research Analyst*

Neil Mehta – *Goldman Sachs Group, Inc., Research Division – VP and Integrated Oil & Refining Analyst*

Patrick Sheffield – *Beach Point Capital Management LP – Managing Director*

PRESENTATION

Operator
Good morning, and welcome to the Par Pacific Second Quarter 2021 Earnings conference call. All participants will be in listen-only mode. Should you need assistance, please signal a conference specialist by pressing the star key followed by zero. After today's presentation, there will be an opportunity to ask questions. Please note, this event is being recorded.

I'd now like to turn the conference over to Ashimi Patel, Senior Manager of Investor Relations. Please go ahead.

Ashimi Patel
Thank you, Jason. Welcome to Par Pacific's Second Quarter Earnings conference call. Joining me today are William Pate, President and Chief Executive Officer; Will Monteleone, Chief Financial Officer; and Joseph Israel, President and Chief Executive Officer of Par Petroleum.

Before we begin, note that our comments today may include forward-looking statements. Any forward-looking statements are subject to change and are not guarantees of future performance or events. They are subject to risks and uncertainties, and actual results may differ materially from these forward-looking statements. Accordingly, investors should not place undue reliance on forward-looking statements, and we disclaim any obligation to update or revise them. I refer you to our investor presentation on our website and to our filings with the SEC for non-GAAP reconciliations and additional information.

I'll now turn the call over to our President and Chief Executive Officer, Bill Pate.

William Pate
Thank you, Ashimi, and good morning to those of you on our conference call today. Our retail and logistics segments performed very well during the quarter, as our sales volumes nearly returned to pre-pandemic levels. Second quarter adjusted EBITDA was a loss of $7 million, and our adjusted net loss was $0.81 per share. These results include a $27 million non-cash mark-to-market adjustment for our prior years' RFS compliance. Excluding this impact, consolidated adjusted EBITDA was $20 million and adjusted EBITDA for our refining units approached breakeven for the quarter.

We were pleased to see the Supreme Court affirm the EPA's obligation to review small refinery exemptions on a non-continuous basis. We believe the EPA needs to quickly review outstanding SREs and address the RIN shortfall created by prior year increases in RFS obligations. The renewable fuel standard has been pushed to levels that is creating unintended consequences for the domestic refining industry. This regulation is also creating inflation and volatility in gasoline, diesel, and ultimately food prices, which hurt the consumer and hamper our domestic economic recovery.

Turning to our performance, all our business lines showed significant improvements on a quarter-over-quarter basis. Logistics profitability returned to 2019 levels, due to the dramatic upswing in Hawaii tourism, and our retail segment benefited from increasing gasoline demand, although there was some offsetting margin compression from the rise in crude oil prices during the quarter.

Conversion of our Northwest retail locations to our nomnom brand is going very well. We're launching several new initiatives with the re-brand, including a proprietary loyalty card program, dynamic pricing, a self-checkout test, and greater brand marketing investments.

Our refining operations continue to improve from pandemic lows. In Wyoming, regional cracks increased rapidly during the latter part of the second quarter, kicking off a strong summer driving season. Present

conditions are even tighter than pre-pandemic summers, and our biggest challenge is meeting strong demand.

Hawaii refining is also improving, although the progress is partially masked by the price lag related to some of our product contracts. Although Asian crack spreads are still well below historical averages, recent Chinese reforms appear to be supporting Asian cracks, despite the surge of the COVID Delta variant. The Singapore 312 market outlook for the remainder of the year is currently in excess of $6.50 per barrel. While the physical oil market is tight, our crude oil differentials have continued to be in the $2 per barrel premium range.

Washington refining was a bright spot during the pandemic, as product sales benefited from declining crude oil prices. But this year rising prices are having the opposite impact, as asphalt cracks are hampered by a significant price lag. In addition, tightening inland crude differentials and the narrow WTI-Brent spread have increased our feedstock costs. West Coast cracks are improving early in the third quarter, given increasing demand and limited supply, and feedstock costs are benefiting from improved differentials in Canadian and inland crudes.

In summary, when you exclude the noise of the mark-to-market on our prior year RINs position we showed substantial improvement over the first quarter, and we foresee continued improvement for the last half of the year, despite global cracks remaining well below historical averages. This is a testament to the actions taken during the pandemic to improve our long-term profitability. With these changes, we're now focused on reducing our debt load. With very limited capital investments planned, we expect debt reduction to accelerate as our free cash flow grows.

At this time, I will turn the call over to Joseph to discuss our operational performance.

Joseph Israel
Thank you, Bill. In the second quarter, our system continued to demonstrate safe and reliable operations, which allowed us to maintain exceptional low-cost structure in our three refineries.

Starting in Wyoming, our 321 Index in the second quarter was $30.04 per barrel, driven by strong gasoline demand in PADD 4. Our refinery team set a new quarterly record for crude charge, with approximately 18,000 barrels per day throughput. Our realized adjusted gross margin in the quarter was $10.25 per barrel, including an approximately $4.48 per barrel prior period mark-to-market expense. Our production costs were $5.71 per barrel, reflecting reliable operations and relatively high refinery throughput.

So far in the third quarter, our Wyoming 321 Index has averaged over $40 per barrel, and we are well-positioned to supply strong seasonal demand in our Rocky Mountains markets. Our third quarter throughput target is approximately 18,000 barrels per day.

In Washington, our second quarter Pacific Northwest 5221 Index was $16.05 per barrel on ANS basis, and our refinery throughput averaged approximately 39,000 barrels per day. Our realized adjusted gross margin was a negative $0.04 per barrel, including an approximately $1.69 per barrel prior period mark-to-market expense.

Other than RINs, our margin capture was also negatively impacted by the relatively narrow Cold Lake and Bakken discounts, as well as the flat price impact on asphalt netback. Our production costs set a record low, $3.28 per barrel in the quarter, driven by strong reliability following the successful first quarter turnaround execution. So far in the third quarter, our 5221 Index has improved to average more than $18.50 per barrel and our planned throughput is approximately 39,000 barrels per day.

Moving to Hawaii, our Singapore 312 Index in the second quarter was $4.38 per barrel on a Brent basis. And our realized crude differential averaged $2.01 per barrel premium to Brent. Our throughput averaged approximately 84,000 barrels per day with approximately 47% distillate yield, compared to only 41% in the second quarter of last year. This move is driven by tourism recovery in Hawaii and the increased demand for jet fuel, which has pushed Hawaii back to an import mode. Our realized adjusted gross margin was $0.34 per barrel, including an approximately $1.83 per barrel of prior period mark-to-market expense. Our production costs were $3.40 per barrel. The refinery team continues to focus on debottlenecking opportunities. And recently, we successfully completed upgrades which will allow us to run an additional 5,000 barrels per day of crude oil, with a full conversion to high-value products.

In the third quarter, we will execute our planned ten-day reformer catalyst regeneration, combined with a routine cogen maintenance. Estimated cost is approximately $1 million. So far in the third quarter, our Singapore 312 Index is up to approximately $5.50 per barrel and our estimated crude differential is approximately $1.84 per barrel premium to Brent. Our throughput target in the quarter is in the 82,000 to 85,000 barrels per day range, including the maintenance impact.

In summary, we continue to focus on safe and efficient operations. Our improved cost structure, and commercial capture continue to serve us well as we transition to a more positive profitability territory.

Now, I'll turn the call over to Will, to review our consolidated results.

Will Monteleone

Thank you, Joseph. Second quarter adjusted EBITDA and adjusted earnings were a loss of $7 million and $48 million, or $0.81 per fully diluted share. Focusing on accounting items first, refining results include a $27 million non-cash mark-to-market expense related to the 2019 and 2020 RFS compliance years. Excluding the mark-to-market RINs expense, our adjusted EBITDA and adjusted earnings per share would be $20 million and a loss of $0.35 per share. Our GAAP results also include a $7 million charge related to debt extinguishment costs.

Shifting to our segment results, Retail segment adjusted EBITDA contribution was $14 million, compared to $8 million in the first quarter of 2021. Same-store sales fuel volumes were up roughly 29%, while merchandise sales were up approximately 6% compared to the second quarter of 2020.

The logistics segment adjusted EBITDA contribution was $20 million, up $4 million from the first quarter of 2021. The improvement was driven by a full quarter of Hawaii neighbor island demand growth, as well as seasonally increased Wyoming sales.

The Refining segment reported a segment adjusted EBITDA loss of $28 million. The prior period non-cash mark-to-market RINs expense of $27 million was split; $14 million in Hawaii, $6 million in Washington, and $7 million in Wyoming. Our Hawaii operations continue to make operational strides in anticipation of distillate margin improvements.

As previously referenced, the Singapore 312 during the quarter was $4.38. However, if you look at the components, Singapore jet averaged $2.39 per barrel. To provide context, the third quarter Sing jet crack has averaged $2.91 per barrel thus far during the third quarter and the five-year average, excluding the pandemic, has been approximately $11 per barrel. Hawaii Refining results remain tightly coiled to the ongoing recovery in jet cracks.

Wyoming saw improvement throughout the quarter, with volumes and margins expanding steadily. In addition, Wyoming Refining results included a $5 million FIFO benefit in a rising price environment.

Moving to Laramie. Laramie generated adjusted EBITDAX of $15 million and net income of $0.1 million for the second quarter of 2021. During early July, Laramie completed a $160 million refinancing of its senior secured credit facilities. The new facility has a four-year maturity. As part of this transaction, Laramie hedged a substantial portion of its projected future production, which should drive accelerated debt paydown over the next 12 to 24 months. We expect Laramie's net debt to adjusted EBITDA to be below 1x at the end of 2021, with nearly $100 million in free cash flow, permitting the company to reduce its net debt load by 50% through the course of the year.

Second quarter cash generated from operations was $33 million. Excluding RINs, working capital was a small source of funds during the quarter. Capital expenditures were $6 million and accrued cash interest equaled $15 million.

One balance sheet item I wanted to provide further information on, our net liability for the 2019 and 2020 RFS compliance years totaled $151 million, based upon an average price of $1.68 per RIN unit. With respect to 2021 compliance year activity, we expect there to be approximately $40 million of cash outflows related to fixed-price commitments in the second half of 2021. In addition, we expect to continue accruing a quarterly RIN expense consistent with our past practice.

Looking forward, we expect our annual cash interest expense to decline to $50 million to $55 million, down approximately $7 million annually, and GAAP interest expense to be in the $15 million per quarter range. In addition, we expect our 2021 annual capex to be in the $35 million to $45 million range, consistent with our prior expectations.

Our quarter end liquidity totaled $243 million, made up of $174 million in cash and $69 million in availability. This reflects the $49 million cash redemption of the convertible notes and the $37 million paydown of the 12.875% notes. We also entered into a multi-year extension with J. Aron for our Hawaiian supply and offtake requirements. Our liquidity on hand remains strong and provides flexibility to consider alternatives to reduce our funding costs.

This concludes our prepared remarks. Operator, I'll turn it back to you for Q&A.

QUESTIONS AND ANSWERS

Operator
Thank you. We'll now begin the question-and-answer session. To ask a question, you may press star then one on your touchtone phone. If you are using a speakerphone, please pick up your handset before pressing the keys. To withdraw your question, please press star then two. At this time, we'll pause momentarily to assemble our roster.

Our first question comes from Neil Mehta from Goldman Sachs. Please go ahead.

Carly Davenport
Hi. Good morning to you. It's Carly on for Neil. Thanks for taking the questions this morning. Wanted to just start off on our favorite topic of RINs. Can you just walk us through your latest thoughts around where Par stands on small refinery exemptions following the Supreme Court ruling? And then just remind us how you plan to satisfy the RINs obligation payments if required in '22 and '23.

William Pate
Sure, Carly. This is Bill. I'll let Will handle the question in terms of when and how we'll satisfy any liability associated with our RINs for prior years. But with respect to the policy, our expectations, as I said in our

prepared comments, are that the EPA will act on SREs. I think they'll act relatively quickly. They've certainly laid out a timeframe, given the requirement that we effectively conclude our 2019 compliance year by early next year, that they'll have to act quickly.

We expect that we'll be granted SREs based on the hardship ruling, certainly with respect to 2019 and 2020. I think it's fair to say that these have been two of the more trying years for the refining sector. And I also think that the RINs bank is depleted, and the EPA needs to do something to address this issue. And it's starting to create issues, not just in the energy sector, but kind of throughout the economy. So, we're expecting a resolution relatively quickly and expect to receive small refinery exemptions for our refineries.

Will, you want to discuss the timing and how we would address it?

Will Monteleone
Sure. So, Carly, I think as I referenced, our net liability for the 2019 and 2020 compliance years as of 6/30 prices, which was $1.68 average, is just north of $150 million. We'd expect that, to the extent the small refinery exemptions do not go in our favor, that we would need to settle that underneath the current regulation by January.

That being said, I would point out that our expectation and current commercial plans for 2021 include ratable purchasing activity. And so, we'd expect that by the end of 2021, the RINs that we'd have on hand with respect to the '21 compliance year would ultimately be worth approximately $125 million at current prices. So, our net settlement obligation at the end of January on a cash basis would be substantially less than the $150 million with that asset on hand to support it.

Ultimately, the final settlement would need to occur in the 2023 timeframe underneath the current EPA's timelines, again which I think continue to remain subject to change based on an action.

Carly Davenport
Great. That's super helpful. Thank you. And then the follow-up is just around retail. You mentioned the re-branding in the Northwest. Could you just talk a little bit more about some of the initiatives there that you're focused on and what type of impact you think that could have on the retail contribution going forward?

William Pate
Sure. I would point out that Northwest retail is substantially smaller than Hawaii and our Hawaii retail business continues to perform very well and is a very strong franchise. In the Northwest, we've decided to adopt our nomnom brand, which we use for convenience stores in Hawaii, and we're rebranding our stores and our fuel under the nomnom brand. And that's gone very well. We started that at the end of last year. We really didn't complete the temporary signage until the middle of February.

By re-branding at that point, we're also able to shift our fuel supply and improve our economics at the pump. We are now in the process of converting to a permanent image, and that's going extremely well. And we're also, at the same time, facilitating some investments in information technology that will allow us to roll out a loyalty card, which we think will allow us to improve our customer experience. As I mentioned, we're running some self-checkout tests at some of our higher volume stores, where the activities are such that people have to wait. And then we're rolling out information technology that will allow us to engage in dynamic pricing.

I think one of the real advantages going forward will be the ability to adjust our pricing on a real-time basis in markets. It's a much more competitive market in terms of pricing than Hawaii, and I think that

technology will be extremely valuable there.

Carly Davenport
Great. Thank you.

Operator
Our next question comes from Phil Gresh from JP Morgan. Please go ahead.

William Pate
Good morning, Phil

Phil Gresh
Good morning. First question, just on Hawaii. I think in the past you've talked about being able to get to EBITDA neutrality with a $4.50 crack and a $2.00 differential. Obviously, this quarter had some transitory headwinds from some rising price effects. But, curious how you think about that now. Do you still believe that to be kind of a normalized breakeven and with trends in the third quarter north of $5.00, do you feel like you can get to that EBITDA neutrality?

William Pate
I think we can actually achieve profitability, yes. We've looked at the $4.50 and tested that against the second quarter, and I think that we would have been there but for the price lag and really market structure. If you take into account the price lag, market structure, and then the mark-to-market on RINs for the prior compliance years, and then take into account a $2.00 premium to Brent for feedstock costs, our break-even's right at that $4.50 per barrel range.

And again, as I mentioned, as Joseph noted, I think we're in the $5.50 range quarter-to-date. This morning the 312 closed at $6.27 in Singapore. And if you look at the forwards, it's over $6.50 for the remainder of the year. So, I think we're at that point where we're going to generate positive EBITDA for the refining system in Hawaii.

Joseph Israel
If I may add, the upside in Asia is very clear. The recovery in China was pretty decent, but Asia and even India are far from full potential. We need to remember that the recovery, it was not focused on the distillate side and jet fuel is lagging, and with our yield structure it will be a big upside once it catches up with jet fuel. And then we all heard about the China tax reforms that will keep exports probably lower and will support Singapore cracks in the future. So, with all the improvements made in our capture, in our cost structure in Hawaii, we are definitely expecting a bright future.

Phil Gresh
Great. Just to follow up on that, Joe, do you think that the changes in the China market are already influencing the current improvement in crack spreads, or do you think that's ahead?

Will Monteleone
Phil, this is Will. I'll jump in and provide a little bit of thought on that front. We've definitely seen in the July timeframe reduced product exports out of China, particularly in gasoline range molecules. And so again, I think that those are beginning to impact balances in the Singapore market. And then obviously the issuance of product export quotas for the second half of the year have been more limited, which again I think provides some further hard indications with respect to ongoing Chinese policy changes there that are happening.

Again, I think that the push and pull occurring in Asia right now is between that change in product flow

with the ongoing recovery. But I would say in the last three to four weeks, incremental data points have continued to validate that these policy reforms appear to be real, and they appear to be reducing exports out of the Chinese market.

Phil Gresh
Got it.

William Pate
Phil, the Chinese actually imported some gasoline in July, to give you a sense of the change.

Phil Gresh
Yes. Okay. My last question just on the opex side, your opex on refining was pretty well managed, and I'm just curious, are you seeing any rising natural gas impact to your refining business as we look at kind of 3Q and 4Q?

Will Monteleone
Really, no natural gas impact in Hawaii. And then in Washington it's modest. And the same in Wyoming. But I don't think it's a major factor for us as you would see versus a typical Gulf Coast refiner.

Phil Gresh
Right. Thank you.

Operator
The next question comes from Jason Gabelman from Cowen. Please go ahead.

Jason Gabelman
Hi. Thanks for taking my questions. I wanted to go back to you RIN exposure, if I could. I think you mentioned by the end of this year, the value of the RINs on your books would be kind of equal to your 2019 and 2020 liabilities. Is that based on those fixed commitments for buying RINs? Or does that require a future cash outflow for buying RINs? And kind of tied to that, you mentioned working capital as a small source of funds, excluding RINs. What was the impact with RINs, I guess? Thanks.

Will Monteleone
So, I think, Jason, these questions are somewhat related, for they ultimately tie back to the fixed commitment on the RIN front. You're correct in that our expectation is that our RIN assets in aggregate in the January timeframe will match the potential obligation that we have for the 2019 and 2020 settlement. And again, in order to achieve that, that requires us to satisfy the fixed commitments I referenced of $40 million, as well as to continue to buy 2021 RINs ratably, which has been our stated plan. And so, I think that's ultimately how we settle that liability.

The working capital outflow that we expect, the $40 million tied to the forward RIN commitments is, I think, the impact that you're trying to quantify.

Jason Gabelman
Okay. Yes. I also was hoping you could quantify the net working capital benefit in 2Q.

Will Monteleone
I think $40 million is the right way to think about it, and [overlapping voices] commitments that I referenced.

Jason Gabelman

Got it. Great. Thanks. And then the second question just on Laramie, it seems like a big step up in free cash flow potential this year. Are you exploring opportunities to monetize that asset?

Will Monteleone
Yes, Jason, I'd say the outlook for Laramie has definitely improved with the commodity price backdrop for both natural gas liquids and natural gas. That said, I think rapid debt paydown remains, I think, Laramie's principal focus. And I would say the acquisition and divestiture market for E&P assets remains quite depressed, given the lack of capital flowing into that space. And so, again, I think we'll continue to look at options there. And it's not a core asset for us, but at the same time I think we'll look at the ultimate A&D market values that are out there, versus our holding values and continue to think about that. But I would say today the A&D market is very challenged still.

Jason Gabelman
Great. Thanks a lot.

Operator
Again, if you have a question, please press star then one. Our next question comes from Matthew Blair from Tudor, Pickering, Holt. Please go ahead.

Matthew Blair
Hi. Good morning, Bill and Will. Hope you're doing well. Your Wyoming indicator is up $11 a barrel quarter-over-quarter. Can you talk about what's driving that? And is that something that you should be able to capture in Q3?

William Pate
Hi, Matthew. Good morning. It's Bill. Yes, I do believe that's something that we'll be able to capture in Q3. And it's really just a reflection of a very tight market with significant demand. And there's been a lot of rationalization in the area, with the shutdown of two refineries and the market is struggling to meet the demand. I'm not aware of any major outages, and I don't think that our indicator is any different than other metropolitan areas in the market. I mean, Denver's strong. Salt Lake's strong. Our little Rapid City market is strong. But you're seeing this throughout the region, given the high level of driving, which drives gasoline consumption. And also, there's a high level of jet fuel consumption, because a lot of people are flying into the region for travel.

So, really across the board, we're seeing very strong cracks in that market.

Joseph Israel
Let me add that typically when PADD 2 and PADD 5 differential to PADD 4 is high, trucking and other logistics will tend to close them. And this time because of the shortage in drivers and trucks, we see this as more sustainable.

Matthew Blair
Sounds good. And then, it looks like you're free cash flow positive in Q2. Do you think you can still be free cash flow positive for the year?

Will Monteleone
Yes, so Matt, I think part of the free cash flow benefit that you're seeing reported there is related to the working capital benefit in the quarter. Again, I think we'd expect some of that to reverse in the second half of the year, as I referenced. But I think nonetheless, our fixed charges, when you look at it, as I laid out are close to on a pro forma basis, $50 million to $55 million on the interest side. You've heard us talk about our maintenance capex levels. And then again, for the full year our capex expectations in the $35

million to $45 million range. So, when you think about covering our total fixed charges, we're in the $85 million range, and so again I think when you look at the outlook for the back half of the year with where the forward margins are, I think we're optimistic about shifting to free cash flow.

Matthew Blair
Great. And then lastly, it looks like Hawaii air traffic is down about 11% versus 2019 levels currently. In Q2, it was down 29% versus Q2 '19. Would this provide some tailwinds to your logistics segment in Q3?

Will Monteleone
I think, Matt, the key thing that drives the logistics segment is really the neighbor island activity levels. And I think if you look at that, island by island, you'll see that in certain cases we're actually tracking above 2019 levels. And I would also point out it is highly related to domestic travel activity into the neighbor islands. There is a limited amount of international activity that flows into the neighbor islands directly.

So, I think that last kind of leg of growth on the passenger arrival side is heavily weighted towards Oahu and heavily international. So, I think neither of those provide significant margins to our logistics business. So, I think they're incrementally helpful to the state and the GDP and overall activity levels, but it's not the same bang for the buck that you get on domestic arrivals into the neighbor islands.

Matthew Blair
Sounds good. Thanks.

William Pate
Thank you, Matt.

Operator
The next question comes from Patrick Sheffield from Beach Point Capital. Please go ahead.

Patrick Sheffield
Hi, guys. Thanks for taking my question. Sorry to beat the dead horse on RINs. Just tell me if this is the way we should think about it. It sounds like you guys will spend $40 million in the second half of this year buying RINs, and then at the beginning of 2022 I thought I heard you say you'd have $125 million of assets and $150 million of liability. So does that mean kind of $40 million outflow back half of this year and $25 million at the beginning of '22 if there aren't small refinery exemptions?

Will Monteleone
Yes, so, Patrick, the $40 million really relates to—think of it as the accrual we've made with respect to the first half of the year impact. And then again, we'll continue to accrue, and our EBITDA continues to reflect our RINs expense, right? In every period, right? So, just big picture, during the second quarter our current period RINs expense for 2021 activity was about $23 million. So that's embedded inside of our adjusted EBITDA results, right? So, we've already accrued for that. And we expect to continue to accrue, based on market prices and volumes at the time.

So, think of it as the $40 million in the second half of the year, and then plus some portion of the accrual that we're going to take in the second half of the year, is probably the cash impact. And then we'll ultimately settle the difference sometime in the first quarter of 2022, to the extent there's not small refinery relief branded. Liquidity is strong [overlapping voices] $240 million, so I think there's no issue.

Patrick Sheffield
Oh, yes. I'm not worried about it. I'm just trying to [indiscernible]. Because, like, it didn't hit actual cash

flow in the first half of the year, so I wasn't sure if that meant that there would actually be a cash flow hit in the second half, or if it would just be adjusted EBITDA would be $40 million less in the second half. But it's not really cash anyway.

Will Monteleone
Think of it as just solely working capital, where we've taken the accrual in the first half of the year and we're going to settle that accrual in the second half of the year. And then we're going to continue to accrue expense in our adjusted EBITDA and our results in the second half of the year. So, I think that's the best way to think about it, is just a $40 million working capital outflow in the second half of the year.

Patrick Sheffield
Got it. And then if you do—well, first, you guys are expecting confidence in the SRE. I guess, what drives that? Have you guys had conversations with regulators? Or how do you actually think about the odds of getting it?

William Pate
Well, first of all, I don't think it'd be appropriate to comment on conversations, but we're obviously engaged with our counsel and have multiple conversations regarding the SRE. And I think, most importantly, the Supreme Court having affirmed that the EPA should review SREs, we're just looking at the historical precedent and the fact that we received SREs in the past. And I think, if anything, our case for an SRE for 2019 and 2020 is as strong or stronger than our cases were in prior years.

Patrick Sheffield
Yes. That makes total sense. And if you do get it, does that mean your $151 million liability goes to zero?

William Pate
Yes, I think it's a good way to think about it is it goes to zero. I would also just point out that it's not existential. It's more a matter of, what is the liability and when we have to pay it. And based on the market values today, most of that liability we'll probably have to settle in early 2023. And I, frankly, think that the market prices are going to go down over time. So, I don't view it as being at that value today.

Patrick Sheffield
Got it. And I apologize, because I know Will's spent two hours explaining this to me before, and I still keep asking about it. But the $151 million liability also includes estimates for beyond '19 and 2020? Is that what you're saying? We're talking about January of '23 settlement?

William Pate
It's '19 and '20.

Patrick Sheffield
Okay.

Will Monteleone
It's just '19 and '20. I mean, Patrick, the other way to think about it is that there's an incremental $40 million that we have today, but it's at a fixed price, right? So there's no market risk per se on the price changing. It's just that the cash hasn't left the system yet.

Patrick Sheffield
Got it. And I don't want to open this can of worms, but then beyond 2019 and 2020 compliance, is there a framework to think about that? Or do you need to wait until the RVOs are set and—

William Pate
Yes, I think we should wait for the RVOs to set and obviously determine what SREs we want to file for going forward.

Patrick Sheffield
Okay. Thank you all. Appreciate it.

William Pate
We're assuming we're not going to get SREs, so our EBITDA reflects no SRE grants.

Patrick Sheffield
Got it. Thanks, and congrats on a good quarter.

William Pate
Thank you.

Operator
The next question comes from Jake Gomolinski-Ekel from Ellington Management. Please go ahead.

Jake Gomolinski-Ekel
Hi. Thanks for squeezing me in here. If you were to get the SRE outcome you anticipate, effectively $151 million of liabilities goes away and we just went through it—the $40 million of working cap unwind plus $25 million the next year, so call that $65 million, plus whatever you're hitting EBITDA by for the second half of the year. So, it's a relatively meaningful amount of cash. What will you use that cash for, if the SRE went your way?

Will Monteleone
I think this gets into capital allocation priorities, and again, I think this is—I think to Bill's point with respect to again, this is not an existential issue, it's just a question of timing and when we ultimately settle if we need to settle this liability. But again, I think our key focus remains paying down debt and reducing our cost of funding. Again, I think we continue to believe our Logistics and Retail franchises are strong assets and I think warrant improved cost of capital. And again, I think getting our gross level of debt down to a level that we can convince the credit market, remains, I think, probably one of our top priorities.

Jake Gomolinski-Ekel
Got it. And so, if this SRE goes away—if you get the SRE, if you get the small refinery exemption, that's already been appealed, so it's already at the EPA level. It's at this point their decision. It's not like you then have to worry about a reversal of the decision. You can just sort of immediately, effectively get minimum $60 million of incremental free cash flow in the next six months.

Will Monteleone
Yes. Again, I think the incremental $60 million you're talking about has to do with 2021, Jake. I think, in your math, because again the $40 million really relates to '21's. But again, I think the easiest way to think about this is to the extent that we're successful in the small refinery exemptions that the $150 million potential settlement liability goes away. And again, at that point in time, again, we would be in a pretty strong and balanced position with respect to even go-forward RINs, as I think you have to view 2019 and 2020 completely separately from 2021 and forward. So—

Jake Gomolinski-Ekel
Yes, sorry. I muddled two different issues. I did not ask the question clearly. If the EPA gives you the

small refinery exemption, is there any uncertainty left at that point due to some sort of appeals or it's basically it's already been appealed, they have to review it, and that's their choice. And so, if they make the decision to grant you the exemption, there's no sort of undoing of said granting of exemption.

William Pate
The decision's final at that point, Jake.

Jake Gomolinski-Ekel
Perfect. Okay. And so, the—and I was being short-term oriented. I understand that the larger liability would, as Patrick was just asking, would go away. But I'm just thinking, you're sort of assuming the $25 million in early '22, plus the working cap, plus you're hurting your EBITDA, right, meaning that for the second half of this year. So those would all be sort of immediate impacts in terms of you wouldn't have to spend that capital, or that cash anymore.

Will Monteleone
I think really it comes down to thinking about the $152 million. I think that's the key issue. And so happy to cover it more offline with you, to make sure that we're on the same page.

Jake Gomolinski-Ekel
Yes, no. I think we are. I'm just being inarticulate. That was it for me. That makes sense. And sorry, timing, I guess, on when you expect the small refinery exemption decision. I know you expressed confidence in the way it will go, but what do you think around timing of that?

William Pate
We think it'll be in the near future.

Jake Gomolinski-Ekel
And I guess the last question is around what you—presumably you're being conservative and maintaining some level of liquidity in anticipation of the decision not going your way. What do you think is the minimum amount of liquidity you need once this decision is made either way?

William Pate
Jake, again, I think the way to think about it is we won't have a significant cash funding requirement if the decision goes immediately, if the decision goes against us. Any cash funding requirement will be in the future. We do have some working capital changes to address our 2021 accrual this year, but that's unrelated to the SRE filed for prior years.

Jake Gomolinski-Ekel
Okay.

William Pate
Thank you very much.

Will Monteleone
Thanks.
CONCLUSION

Operator
There are no more questions in the queue. This concludes our question-and-answer session. I'd like to turn the conference back over to William Pate for any closing remarks.

William Pate
Thank you. I think these results this quarter illustrate the value of our diverse business lines and the improving characteristics of our refinery locations. Have a good day.

Operator
The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.